Multiple Choice Questions (1-10: 10x1=10 points; 11-55: 45 x 2=90 points)

1. The principal amount of a bond is the amount:
   A) originally lent.
   B) of interest agreed upon when the bond was originally issued.
   C) paid to the bondholders on a regular basis.
   D) of interest the bondholder is entitled to when the bond matures.
   E) the bondholder receives even if the borrower defaults on the loan.

2. The coupon rate is the:
   A) amount originally lent.
   B) regular payment of interest to a bondholder.
   C) interest rate promised when a bond is issued.
   D) maximum interest rate that can be paid on a bond.
   E) the growth rate of interest payments on a bond.

3. If the principal amount of a bond is $2,000,000, the coupon rate is 6%, and the inflation rate is 4%, then the annual coupon payment made to the holder of the bond is _____.
   A) $12,000    B) $40,000    C) $80,000    D) $120,000    E) $200,000

4. James pays $10,000 for a newly issued two-year government bond with a $10,000 face value and a 6 percent coupon rate. One year later, after receiving the first coupon payment, James sells the bond. If the current one-year interest rate on government bonds is 7 percent, then the price he receives is:
   A) $10,000.
   B) $700.
   C) greater than $10,000.
   D) less than $10,000.
   E) either greater or less than $10,000, but not equal to $10,000.

5. A three-year bond with a principal amount of $5,000, a 4% coupon rate paid annually, one year from maturity will sell for what price (rounded to the nearest dollar) in the bond market if interest rates are 5%?
   A) $4,762    B) $4,952    C) $5,000    D) $5,200    E) $5,460

6. One year before maturity the price of a bond with a principal amount of $1,000 and a coupon rate of 5% paid annually rose to $1,019. The one year interest rate:
   A) rose to 6.0%.    B) remained at 5%.    C) fell to 3%.    D) fell to 2%.    E) fell to 1%.

7. A dividend is a(n):
   A) interest payment made to shareholders.
   B) interest payment made to bondholders.
   C) regular payment made to stockholders for each share they own.
   D) regular payment made to bondholders for each dollar they lent.
   E) coupon payment made on each share of stock.

8. You originally required a risk premium of 6 percent in addition to the rate of return on safe assets before you would purchase shares of Techno Company stock. If you and other investors increase the risk premium you require to 8 percent, the price of Techno Company stock will:
   A) increase.    B) decrease.    C) not change.
   D) equal the new risk premium plus the rate of return on safe assets.
   E) equal the old risk premium plus the new risk premium.
9. You expect a share of EconNews.Com to sell for $65 a year from now and to pay a $2 dividend per share in one year. What should you pay (rounded to the nearest dollar) for the stock today if you require an 8% return?
   A) $60  B) $62  C) $67  D) $70  E) $72

10. You expect a share of RiskyEcon.Com to sell for $56 a year from now and to pay a dividend of $1 per share annually. If the current interest rates on government bonds is 5%, but you demand a risk premium of 5% to hold a share of this risky stock, what is the most you should pay for this stock today (rounded to the nearest dollar)?
   A) $52  B) $54  C) $56  D) $57  E) $63

11. Money is:
   A) the same as income.
   B) all financial assets.
   C) any asset used to make purchases.
   D) the sum of assets minus debts.
   E) the market value of all final goods and services produced in a country in a year.

12. Assets of the commercial banking system include:
   A) reserves and loans.
   B) deposits.
   C) reserves and deposits.
   D) loans and deposits.
   E) travelers' checks.

13. Liabilities of the commercial banking system include:
   A) reserves and loans.
   B) deposits.
   C) reserves and deposits.
   D) loans and deposits.
   E) reserves.

14. Bank reserves are:
   A) currency and customer checking deposits.
   B) currency, customer checking and savings deposits.
   C) any asset used to purchase goods and services.
   D) financial assets obtained from savers and lent to borrowers.
   E) cash and similar assets held to meet depositor withdrawals or payments.

15. 100% reserve banking refers to a situation in which banks' reserves equal 100% of their:
   A) loans.
   B) deposits.
   C) profits.
   D) income.
   E) money.

16. Banks hold reserves:
   A) to earn interest.
   B) to increase profits.
   C) to escape the double coincidence of wants.
   D) to meet depositor withdrawals and payments.
   E) only because the government requires them to hold reserves.

17. The reserve/deposit ratio equals:
   A) 10% of bank reserves.
   B) 10% of bank deposits.
   C) 100% of bank reserves.
   D) bank reserves divided by bank deposits.
   E) bank deposits divided by bank reserves.

18. Commercial banks create new money:
   A) by printing currency.
   B) by issuing checks.
   C) through multiple rounds of lending and borrowing.
   D) when they buy government bonds from the Federal Reserve.
   E) when they increase their desired reserve/deposit ratio.

19. In Econland all $5,000,000 in currency is held by banks as reserves. The public does not hold any currency. If the banks' desired reserve/deposit ratio is 10%, the money supply in Econland equals:
   A) $4,545,545  B) $5,000,000  C) $5,500,000  D) $50,000,000  E) $55,000,000
20. If the actual reserve/deposit ratio equals 15% and the desired reserve/deposit ratio for this bank is 10%, the bank should:
   A) do nothing because this is a profitable situation.
   B) stop making loans.
   C) send the extra reserves to the central bank.
   D) request that customers withdraw deposits from the bank.
   E) make more loans in order to earn interest.

21. Typically the money supply increase by a multiple of the increase in bank reserves created by the central bank because of:
   A) the power of compound interest.
   B) small differences make a large difference.
   C) fractional reserve banking.
   D) 100-percent reserve banking.
   E) the central bank requires multiple expansion.

22. When an individual deposits currency into a checking account:
   A) bank reserves increase which allows banks to lend more and, ultimately, increases the money supply.
   B) bank reserves decrease which reduces the amount banks can lend thereby reducing the growth of the money supply.
   C) bank reserves are unchanged.
   D) bank reserves decrease which increases the amount banks can lend, thereby increasing the growth of the money supply.
   E) bank reserves increase which reduces the amount banks can lend, thereby reducing the growth of the money supply.

23. After the Federal Reserve increases reserves in the banking system through open-market purchases, banks create new deposits through multiple rounds of lending and accepting deposits until the:
   A) Federal Reserve requires them to stop.
   B) deposit insurance limit is reached.
   C) actual reserve/deposit ratio is greater than the desired reserve/deposit ratio.
   D) actual reserve/deposit ratio is equal to the desired reserve/deposit ratio.
   E) actual reserve/deposit ratio is less than the desired reserve/deposit ratio.

24. In Macroland there is $10,000,000 in currency. The public holds half of the currency and banks hold the rest as reserves. If banks' desired reserve/deposit ratio is 10%, deposits in Macroland equal ______ and the money supply equals ______.
   A) 50,000,000; 60,000,000  D) 100,000,000; 100,000,000
   B) 55,000,000; 55,000,000  E) 100,000,000; 110,000,000
   C) 50,000,000; 55,000,000

25. If the public switches from doing most of its shopping with currency to using checks instead and the Fed takes no action, the money supply will:
   A) increase.
   B) decrease.
   C) not change.
   D) either increase or decrease.
   E) equal the quantity of currency that is still in use.

26. If the desired reserve/deposit ratio equals .10, then every dollar of currency in bank vaults supports ______ of the money supply, while every dollar of currency held by the public contributes ________ to the money supply.
   A) $1; $1  B) $0.10; $1  C) $1; $0.10  D) $10; $1  E) $10; $0.10
27. If bank reserves are 200, the public holds 400 in currency, and the desired reserve/deposit ratio is .25, the deposits are ____ and the money supply is _____.
A) 200; 600  B) 400; 800  C) 600; 1,000  D) 800; 1,200  E) 2,400; 2,800

28. The central bank of the United States is:
A) Bank of America.  D) the Federal Reserve System.
C) Bank One.

29. In an open-market purchase the Federal Reserve ____ government bonds and the supply of bank reserves _____.
A) buys; increases  D) sells; increases
B) buys; decreases  E) sells; decreases
C) buys; does not change

30. In Macroland, currency held by the public is 2000 econs, bank reserves are 300 econs, and the desired reserve/deposit ratio is 10%. If the Central Bank prints an additional 200 econs and uses this new currency to buy government bonds from the public, the money supply in Macroland will increase from ____ econs to _____ econs assuming that the public does not wish to change the amount of currency it holds.
A) 2,000; 2,200  B) 2,300; 2,500  C) 3,000; 5,000  D) 5,000; 7,000  E) 5,300; 7,500

31. In Macroland, currency held by the public is 2000 econs, bank reserves are 300 econs, and the desired reserve/deposit ratio is 10%. If the Central Bank sells government bonds to the public in exchange for 200 econs that are then destroyed, the money supply in Macroland will decrease from ____ econs to _____ econs assuming that the public does not wish to change the amount of currency it holds.
A) 2,000; 1,800  B) 2,300; 2,100  C) 3,000; 1,000  D) 5,000; 3,000  E) 6,000; 2,000

32. In Macroland, currency held by the public is 2000 econs, bank reserves are 600 econs, and the desired reserve/deposit ratio is 15%. If the Central Bank sells government bonds to the public in exchange for 300 econs that are then destroyed, the money supply in Macroland will decrease from ____ econs to _____ econs assuming that the public does not wish to change the amount of currency it holds.
A) 2,000; 1,700  B) 2,600; 2,300  C) 2,990; 2,645  D) 6,000; 4,000  E) 7,000; 6,000

33. The money supply in Macroland is currently 2,500, bank reserves are 200, currency held by public is 500, and banks' desired reserve/deposit ratio is 0.10. Assuming the values of the currency held by the public and the desired reserve/deposit ratio do not change, if the Central Bank of Macroland wishes to increase the money supply to 3,000, then it should conduct an open-market ____ government bonds to/from the public.
A) purchase of 50  B) purchase of 250  C) purchase of 500  D) sale of 50  E) sale of 500

34. A banking panic is an episode in which:
A) depositors, spurred by news or rumors of possible bankruptcy of one bank, rush to withdraw deposits from the banking system.
B) commercial banks, fearing Federal Reserve sanctions, unwillingly participate in open-market operations.
C) commercial banks, concerned about high interest rates, rush to borrow at the Federal Reserve discount rate.
D) depositors, afraid of increasing interest rates, attempt to engage in discount-window borrowing at the Federal Reserve.
E) the Federal Reserve, concerned about unusually rapid increases in the money supply, refuses to make loans to commercial banks through discount window lending.

35. During the Great Depression in the United States between 1929 and 1933, banks' reserve/deposit ratio ____ and the amount of currency held by the public _____. while the money supply _____.
A) increased; increased; increased  D) decreased; decreased; increased
36. In the Keynesian model an expansionary gap will develop if there is:
   A) an increase in average labor productivity.  D) too little spending.
   B) a decrease in average labor productivity.  E) stabilization policy.
   C) too much spending.

37. The key assumption of the basic Keynesian model is that in the short run firms ______.
   A) meet demand at preset prices  D) operate just as they do in the long run
   B) adjust prices to bring sales in line with capacity  E) produce potential output
   C) change prices frequently

38. Firms do not change prices frequently because:
   A) there are legal prohibitions against doing so.
   B) it is easier to change the quantity of capital used in production.
   C) it is costly to do so.
   D) customers will refuse to patronize firms that change prices frequently.
   E) managers are lazy.

39. Planned aggregate expenditure is total:
   A) value added in the economy.
   B) planned spending on final goods and services.
   C) profits in the economy.
   D) revenue from the sale of goods and services.
   E) income of households, businesses, governments, and foreigners.

40. If firms sell less than expected, actual investment increases because _____, which is counted as
    investment.
    A) the unsold goods are added to inventory
    B) the government buys the unsold goods
    C) the unsold goods are distributed to poor households
    D) the unsold goods are given to foreigners as part of foreign aid
    E) households buy the unsold goods at bargain prices

41. Dave’s Mirror Company expects to sell $1,000,000 worth of mirror and to produce $1,250,000
    worth of mirrors in the coming year. The company purchases $300,000 of new equipment during the year.
    Sales for the year turn out to be $900,000. Actual investment by Dave’s Mirror Company equals _____ and
    planned investment equals ______.  
    A) $250,000; $150,000  D) $650,000; $550,000
    B) $300,000; $200,000  E) $900,000; $800,000
    C) $550,000; $450,000

42. When housing prices increase, household wealth _____ and consumption ______.
    A) increases; increases  D) decreases; increases
    B) increases; decreases  E) decreases; decreases
    C) increases; does not change

43. In Econland autonomous consumption equals 200, the marginal propensity to consume equals 0.9, net
    taxes are fixed at 100, planned investment is fixed at 200, government purchases are fixed at 300, and net
    exports are fixed at 50. Induced expenditure equals:
    A) .1Y  B) 660 + .1Y  C) .9Y  D) 660 + .9Y  E) 6660

44. In Macroland autonomous consumption equals 100, the marginal propensity to consume equals .75, net
    taxes are fixed at 40, planned investment is fixed at 50, government purchases are fixed at 150, and net
    exports are fixed at 20. Short-run equilibrium output in this economy equals:
    A) 387  B) 1000  C) 1150  D) 1160  E) 1280
45. An economic recession in Japan ______ the demand for exports from East Asian countries resulting in a reduction in autonomous expenditures in these East Asian countries and a(n) ______ output gap in the East Asian countries.

A) reduces; expansionary  
B) increases; expansionary  
C) reduces; recessionary  
D) increases; recessionary  
E) reduces; autonomous

Use the following to answer questions 46-49:

46. Based on the Keynesian cross diagram, short-run equilibrium output equals:
   A) 3000  
   B) 3250  
   C) 4000  
   D) 4750  
   E) 5000

47. Based on the Keynesian cross diagram, at short-run equilibrium output autonomous expenditure equals _____ and induced expenditure equals _____.
   A) 1000, 3000  
   B) 1000, 4000  
   C) 3000, 4000  
   D) 1000, 3250  
   E) 3000, 3250

48. Based on the Keynesian cross diagram, if output equals 5,000 planned aggregate expenditure is _____ output and firms will ____ production.
   A) greater than; increase  
   B) greater than; decrease  
   C) equal to; not change  
   D) less than; increase  
   E) less than; decrease

49. Based on the Keynesian cross diagram, at short-run equilibrium output,
   A) there is a recessionary gap.  
   B) there is an expansionary gap.  
   C) output equals potential output.  
   D) firms will be producing more than they can sell.  
   E) firms will be producing less than they can sell.

50. If planned aggregate expenditure (PAE) in an economy equals 1,000 + .9Y and potential output (Y*) equals 9,000, then this economy has:
   A) an expansionary gap.  
   B) a recessionary gap.  
   C) no output gap.  
   D) no autonomous expenditure.  
   E) no induced expenditure.

51. In the short-run Keynesian model, to close a recessionary gap of $5 billion dollars government purchases must be:
   A) increased by $5 billion.  
   D) increased by less than $5 billion.
B) decreased by $5 billion.  E) decreased by less than $5 billion.
C) increased by more than $5 billion.

52. If short-run equilibrium output equals 10,000, the income-expenditure multiplier equals 5, potential output (Y*) equals 11,000, then government purchases must _______ to eliminate any output gap.
   A) increase by 20  D) decrease by 200
   B) increase by 200  E) decrease by 250
   C) increase by 250

53. In the short-run Keynesian model where the marginal propensity to consume is 0.5, to offset an expansionary gap resulting from a $1 billion increase in autonomous consumption, taxes must be:
   A) increased by $1 billion.  D) decreased by $2 billion.
   B) decreased by $1 billion.  E) increased by $.5 billion.
   C) increased by $2 billion.

54. If short-run equilibrium output equals 10,000, the income-expenditure multiplier equals 10, the MPC equals .9, and potential output (Y*) equals 9,000, then transfer payments must be decreased by _______ (rounded to the nearest whole number) to eliminate any output gap.
   A) 10  B) 100  C) 1111  D) 11  E) 111

55. If short-run equilibrium output equals 10,000, the income-expenditure multiplier equals 5, the MPC equals .8, and potential output (Y*) equals 9,000, then taxes must be increased by _______ to eliminate any output gap.
   A) 20  B) 200  C) 225  D) 250  E) 1000