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ECO 2115
Introduction to Money and Banking
Final Examination
December 17, 2011
2 PM to 5 PM

Answer all questions on the Scantron sheet
Pocket non-programmable calculators permitted

RULES

1. Answer all questions on the Scantron sheet using a pencil.
2. Non-programmable calculators permitted.
3. You cannot use a mobile device as your calculator.
4. You have 3 hours to complete the exam.
5. Look at the blackboard from time to time for possible corrections.
6. Turn off your mobile phones.
7. This exam contains 125 questions and 21 pages.

1. A consol is:
    a. Another name for a zero-coupon bond
    b. A bond with a maturity date exceeding 10 years
    c. A bond that makes periodic interest payments forever but never matures
    d. A form of a bond that is issued quite often by the U.S. Treasury

2. Which of the following best expresses the formula for determining the price of a Canadian Treasury bill that matures n periods from now per $100 of face value when the interest rate is i?
    a. $\$100/(1 + i)^n$
    b. $\$100(1 + i)$
    c. $\$100/(1 + i)$
    d. $1 + \$100/(1 + i)^n$

3. Once you buy a coupon bond, which of the following can change?
    a. Coupon rate
    b. Coupon payment
    c. Face value
    d. Yield to maturity

4. A 10-year Government of Canada bond as a face value of $1,000, price of $1,200, and a 7.5% coupon rate. Based on this information, we know:
    a. The present value is greater than its price
    b. The current yield is equal to 8.33%
    c. The coupon payment on this bond is equal to $75 annually
    d. The coupon payment on this bond is equal to $90 annually

5. If the annual interest rate is 5% (.05), the price of a one-year Treasury bill per $100 of face value would be:
    a. $95.00
    b. $97.50
    c. $95.24
    d. $96.10

6. If the annual interest rate is 5% (.05), the price of a six-month Treasury bill would be:
    a. $97.50
    b. $97.59
    c. $95.25
    d. $95.00

7. The relationship between the price and the interest rate for a zero coupon bond is best described as:
    a. Volatile:
    b. Fluctuating
    c. Inverse
    d. Non-existent

8. If a consol is offering an annual coupon of $50 and the annual interest rate is 6%, the price of the consol is:
    a. $47.17
    b. $813.00
    c. $833.33
    d. $8333.33

9. Which of the following statements is most accurate?
    a. Yield to maturity is equal to the coupon rate if the bond is held to maturity
    b. Yield to maturity is the same as the coupon rate
    c. Yield to maturity will exceed the coupon rate if the bond is purchased for face value
    d. **Yield to maturity is the same as the coupon rate if the bond is purchased for face value and held to maturity**

10. When the price of a bond is below the face value, the yield to maturity:
    a. Is below the coupon rate
    b. **Will be above the coupon rate**
    c. Will equal the current yield
    d. Will equal the coupon rate

11. A $1000 face value bond purchased for $965.00, with an annual coupon of $60, and 20 years to maturity has:
    a. **A current yield equal to 6.22%**
    b. A current yield equal to 6.00%
    c. A coupon rate equal to 6.22%
    d. A yield to maturity and current yield equal to 6.00%

12. In calculating the current yield for a bond:
    a. The coupon payment is ignored
    b. **The present value of the capital gain/loss is ignored**
    c. The present value of the final payment is the only important consideration
    d. The present value of the coupon payments is the only important consideration

13. Which of the following is not a reason why the yield to maturity can differ from the current yield?
    a. Because the yield to maturity considers the capital gain/loss
    b. Because the current yield focuses only on the coupon payment and the purchase price
    c. Because most bonds are not purchased for face value
    d. Because the current yield moves in the opposite direction from price

14. A $1,000 face value bond, with an annual coupon of $40, one year to maturity and a purchase price of $980 has:
    a. A current yield that equals 4.00%
    b. A coupon rate that equals 4.08%
    c. A current yield that equals 4.08% and a yield to maturity that equals 6.12%
    d. A current yield that equals 4.08% and a yield to maturity that equals 4.0%

15. A 30-year Government of Canada bond as a face value of $1,000, price of $1,200 with a $50 coupon payment. Assume the price of this bond decreases to $1,100 over the next year. The one-year holding period return is equal to:
    a. -9.17%
    b. -8.33%
    c. **-4.17%**
    d. -3.79%

16. The holding period return on a bond:
    a. Can never be more than the yield to maturity
    b. Will equal the yield to maturity if the bond is purchased for face value and sold at a lower price
    c. Will be less than the yield to maturity if the bond is sold for more than face value
    d. Will be less than the yield to maturity if the bond is sold for less than

17. The bond demand curve slopes downward because:
    a. At lower prices the reward for holding the bond increases
    b. As bond prices fall so do yields
    c. As bond prices fall bonds are less attractive
    d. As bond prices rise yields increase

18. If the quantity of bonds supplied exceeds the quantity of bonds demanded, bond prices:
    a. Would rise and yields would fall
    b. **Would fall and yields would rise**
    c. Would rise but yields will remain constant
    d. Would fall and yields would fall

19. If the Canadian government's borrowing needs increase, all other factors constant:
    a. The demand for bonds will decrease
    b. The price of bonds will increase
    c. **The supply of bonds will increase**
    d. The yields on bonds will decrease

20. As general business conditions deteriorate, all other factors constant:
    a. The demand for bonds will increase
    b. The supply of bonds will decrease
    c. Bond prices will decrease
    d. Bond yields will increase

21. When expected inflation increases, for any given nominal interest rate:
    a. The cost of borrowing increases and the desire to borrow decreases
    b. The real interest rate increases
    c. The bond supply curve shifts to the left
    d. The cost of borrowing decreases and the desire to borrow increases

22. Suppose that the return on assets other than bonds falls. In the bond market this will result in:
    a. A movement down the bond demand curve
    b. A shift to the left of the bond demand curve
    c. An increase in the price of bonds
    d. A shift to the left of the bond supply curve

23. In a recent IMF report, Canada's debt to GDP ratio will rise from 64.2% in 2007 to 68.9% by 2014. During the same period, the U.S. debt to GDP ratio will rise from 61.9% to 108.2%. Given this information, everything else constant, we should expect:
    a. Bond prices in both countries to rise
    b. U.S. bond prices to rise relative to Canadian bond prices
    c. U.S. yields to fall relative to Canadian yields
    d. **U.S. yields to rise relative to Canadian yields**

24. Fly-By-Night Inc. issues $100 face value, zero-coupon, one-year bonds. The current return on one-year, zero-coupon Canadian treasury bills is 3.5%. If the Fly-By-Night bonds are selling for $92.00, what is the risk premium for these bonds?

a. 8.7%
b. 1.5%
c. 5.2%
d. 8.0%

25. Which of the following is true of interest-rate risk?

a. It is the risk that the coupon rate for a bond will change, affecting current bondholders' coupon payments
b. It refers to the probability that a borrower will default on debt obligations
c. It is the risk that the face value of a bond will change before maturity
d. **Individuals owning long-term bonds are exposed to greater interest-rate risk**

26. Interest-rate risk would not matter to which of the following bondholders?

a. A holder of a Canadian government bond
b. A holder of a Canadian government bond indexed for inflation
c. A holder of a Canadian government bond who plans on selling it in one year
d. A holder of a Canadian government bond that plans on holding it until it matures

27. The two best known bond rating services are:

a. The Bank of Canada and Moody's Investment Services
b. The Bank of Canada and the Fitch Ratings
c. Standard & Poor's and the Financial Post
d. Standard & Poor's and DBRS

28. The lowest rating for an investment grade bond assigned by DBRS is:

a. D
b. CCC
c. BBB
d. ABA

29. Commercial paper refers to:

a. The financial publications read by the CEOs of public corporations
b. Any debt security with a maturity exceeding one year
c. Short-term collateralized securities issued only by corporations
d. Unsecured short-term debt issued by corporations and governments

30. If a bond's rating improves it should cause:

a. The bond's price and yield to increase, all other factors constant
b. The bond's price and yield to decrease, all other factors constant
c. The bond's price to increase and its yield to decrease, all other factors constant
d. The bond's price to decrease and its yield to increase, all other factors constant

31. Bonds issued by the Government of Canada are referred to as benchmark bonds because:
- **a.** They are always purchased for a premium
- **b.** **They are the closest thing to a risk-free bond**
- **c.** All bonds from national governments are labelled as benchmark bonds
- **d.** All bonds from the Canadian government have the same rate of interest

32. The default-risk premium:
- **a.** Is negative for a Government of Canada bond
- **b.** **Is also known as the risk spread**
- **c.** Must always be greater than 0 (zero)
- **d.** Is assigned by a bond-rating agency

33. The risk structure of interest rates says:
- **a.** The interest rates on a variety of bonds will move independently of each other
- **b.** **Lower rated bonds will have higher yields**
- **c.** Government of Canada bond yields always change by more than other bonds
- **d.** Interest rates only compensate for risk in structured amounts

34. A borrower who has to pay an interest rate of 8% rather than 6% due to risk spread will:
- **a.** Pay $20 more in interest annually for every $100 borrowed
- **b.** **Pay 33.3% higher interest in dollar terms**
- **c.** Pay 2% in net interest
- **d.** Pay less interest in total over the life of the loan

35. According to the Expectations Theory of the term structure, if interest rates are expected to be 2%, 2%, 4%, and 5% over the next four years, what is the yield on a three-year bond today?
- **a.** **2.7%**
- **b.** 4%
- **c.** 4.3%
- **d.** 8%

36. The risk spread on bonds fluctuates mainly because:
- a. Taxes tend to increase over time
- b. Bond rating agencies are often inconsistent
- **c.** **New information about a borrower's financial condition becomes available**
- d. People change their attitudes towards risk quickly

37. The Government of Canada yield curve:
- a. **Shows the relationship among bonds with the same risk characteristics but different maturities**
- b. Assumes maturities are constant, and reflects the difference in risk
- c. Always has a positive slope
- d. Always has a negative slope

38. During a recession you would expect the difference between the commercial paper rate and the yield on Canadian T-bills of the same maturity to:
   a. Be the same since their maturities are the same
   b. **Increase reflecting the possibility of higher default risk for commercial paper**
   c. Decrease
   d. Fluctuate on a daily basis

39. The term structure of interest rates:
   a. Always results in an upward sloping yield curve
   b. **Represents the variation in yields for securities differing in maturities**
   c. Usually results in a flat yield curve
   d. Usually results in a downward sloping yield curve

40. When the yield curve is upward sloping, people are expecting:
   a. An economic slowdown
   b. The Canadian government may default on its obligations
   c. The Bank of Canada is going to ease monetary policy
   d. Long-term yields to be higher than short-term yields

41. The yield on a 30-year Government of Canada bond is 6.5%; the yield on a 2-year Government of Canada bond is 4.0%. This data:
   a. Indicate the yield curve is downward sloping
   b. Indicate the yield curve is flat since the risk premium needs to be added for longer maturities
   c. Indicate the yield curve is upward sloping
   d. Indicate that people expect inflation to decrease in the future

42. Assume the Expectations Hypothesis regarding the term structure of interest rates is correct. Then, if the current two-year interest rate is 5% and the current one-year rate is 6%, then investors expect:
   a. The future one-year rate to be 4%
   b. The future one-year rate to be 5%
   c. The future one-year rate to be 6%
   d. The future one-year rate to be 1%

43. Suppose that 1-year AAA bills are yielding 1.5% and that 2-year AAA bills are yielding 2.3%. According to the Expectations Hypothesis, how much will a $100 1-year AAA bill be selling for one year from today?
   a. $96.34
   b. $96.99
   c. $97.75
   d. $98.52

44.
An increase in the term spread between the 3-month and 10-year benchmarks is a predictor for:
   a. An increase in default risk in the long run
   b. A decrease in inflation rates
   c. An increase in inflation rates
   d. A slowdown in GDP growth

45. Under the Expectations Hypothesis, bonds of different maturities are assumed to be perfect substitutes because:
- **a.** The risk premium is assumed to be negative
- **b.** **Market forces would always have long-term interest rates equal the average of the current and expected short-term rate**
- **c.** Expectations of future interest rates are uncertain and therefore cannot be included in the analysis
- **d.** Bond markets are very liquid

46. Voting rights in a corporation are held by:
- **a.** The board of directors
- **b.** The preferred shareholders
- **c.** The corporate bondholders
- **d.** **The common shareholders**

47. If a public corporation goes bankrupt and does not have enough assets to pay off all creditors:
- **a.** The shareholders are personally liable for the balance
- **b.** The fact that stockholders are residual claimants means they may have to pay in additional capital to cover the obligations
- **c.** The shareholders receive any dividends due before the other creditors are paid
- **d.** **The shareholders cannot lose more than their investment**

48. What do bondholders and shareholders have in common?
- **a.** **Both are claimants**
- b. Both have voting rights
- c. Both are shareholders in the company
- d. Both receive fixed payments on their securities each year

49. The S&P/TSX composite index is:
- a. An index made up of the stock prices of the 100 largest corporations in Canada
- b. An index that measures the value of purchasing 100 shares in each of the corporations that make up the index
- c. **The value-weighted average of the largest 220 firms listed on the TSX**
- d. The broadest measure of stock market performance in North America

50. The Nasdaq Composite Index:
- a. Is made up of over 50,000 firms traded on the Over-the-Counter market
- b. Is a price-weighted index
- c. **Is made up of mainly newer firms, and heavily influenced by technology and internet companies**
- d. Is the most broadly based index in use

51. People differ on the method by which stock should be valued. Some people are chartists, others behaviouralists. The basic difference between these groups is:
- a. Chartists rely on astrological charts to predict stock values, behaviouralists rely on psychology
- b. Behaviouralists are finance based, chartists study charts of investor psychology
- c. **Chartists study charts of stock prices; behaviouralists focus on investor psychology and behavior**
- d. Chartists and behaviouralists are the same in their approach; essentially there aren't any differences

52. The dividends that shareholders receive:
   a. Are fixed by contract and paid annually
   b. **Are distributions from profits**
   c. Are paid before all other obligations of the company are met
   d. Are always equal to the average amount of interest paid to a bond holder, adjusting for the value of the holdings

53. You start with a portfolio valued at $500. Over the next twelve months it loses 40%; the following year it has a gain of 30%. At the end of two years your portfolio is worth:
   a. **$390**
   b. $450
   c. $300
   d. $410

54. The dividend-discount model of stock valuation:
   a. **Is an application of the net present value formula**
   b. Takes the net present value of expected dividends and add it to the future sale price of the stock
   c. Takes the net present value of the expected future price of the stock and adds the annual dividend
   d. Takes the annual dividend, adds it to the expected future selling price and divides by the number of years to get the current price

55. A stock has an annual dividend of $10.00 and it is expected not to grow. It is believed the stock will sell for $100 one year from now, and an investor has a discount (interest) rate of 6% (0.06). The dividend discount model predicts the stock's current price should be:
   a. $94.67
   b. $116.00
   c. **$103.77**
   d. $106.60

56. A stock currently does not pay an annual dividend. An investor expects this policy to remain in force. She believes, however, the stock of this company will sell for $110.00 per share four years from now. If she has an interest (discount) rate of 7% (0.07), the dividend discount model predicts the current price of this stock should be:
   a. You cannot apply the model to this example since it requires a dividend be offered
   b. $82.00
   c. $83.92
   d. $86.35

57. A company currently pays an annual dividend of $6.50 per share. It expects the growth rate of the dividend will be 2.5% (0.025) annually. If the interest (discount) rate is 5% (0.05) what does the dividend-discount model predict the current price of the stock should be?
   a. It doesn't, you need an expected future price to use the model
   b. $257.50
   c. $130.00
   d. $266.50

58. The basic dividend-discount model is a bit of an oversimplification for valuing stocks because:
   a. It ignores expected dividend growth.
   b. It ignores the value of future dividends.
   c. **It ignores the risk involved in holding stocks**.
   d. It cannot handle stocks that do not pay dividends.

59. The theory of efficient markets assumes that:
   a. Prices of bonds, but not stocks, reflect all available information.
   b. The prices of all financial instruments reflect all available information.
   c. Stock prices are relatively rigid because it takes a while for information to efficiently move through the market.
   d. The best approach to determining stock prices is to follow the chartists.

60. Which of the following is not a violation of the efficient markets hypothesis?
   a. Returns on equities tend to be higher in January than any other month.
   b. Small cap stocks tend to outperform large cap stocks.
   c. **Stocks that over perform tend to subsequently underperform**.
   d. Stocks like Colgate-Palmolive and Kraft outperform during recessions.

61. Professor Jeremy Siegel, of the University of Pennsylvania, conducted research that showed that:
   a. **Over the long run, stocks are less risky than bonds**.
   b. Over the long run, bonds are less risky than stocks.
   c. Over the long run, bonds frequently outperform stocks.
   d. Investors should only own stocks for short periods of time to maximize returns.

62. Management fees for mutual funds are:
   a. **Different across funds and can significantly impact the return to an investor.**
   b. Fixed by regulation.
   c. Fixed by regulation but can vary by the size of the fund.
   d. Usually a percentage of the return achieved by fund managers.

63. Which of the following could cause a stock market bubble?
   a. Changes in the real interest rate
   b. Changes in the risk premium
   c. **Investor euphoria**
   d. Changes in dividends

64. A Canadian traveling to Europe will find it easier to make purchases now because:
   a. Most countries in Europe accept Canadian dollars
   b. Most of the countries of Europe have adopted the British pounds as the standard currency
   c. **Many of the countries in Europe now use the same currency, the euro**
   d. All of the countries in Europe now use the same currency, the euro

65. If in Dec 2008 one U.S. dollar exchanged for 1.15 C$ and in late 2009 one U.S. dollar exchanged for 1.04 C$, then:
   a. The U.S.$ appreciated relative to the dollar
   b. **The dollar appreciated relative to the U.S.$**
   c. Canadian goods became more expensive to Americans
   d. Canadian goods became more expensive to Canadians

66. Which of the following statements is most correct?
- a. If the Cdn $ depreciates relative to the yen, then it is likely also depreciating relative to the euro
- b. If the Cdn $ is appreciating relative to the euro, the euro is likely depreciating relative to the yen
- c. If the Cdn $ is depreciating relative to the euro it is likely depreciating relative to all currencies
- **d. If the Cdn $ is appreciating relative to the yen, the yen is depreciating relative to the Cdn $**

67. The real exchange rate is defined as:
- **a.** The nominal exchange rate plus the rate of inflation
- **b.** The spot exchange rate
- **c. The rate at which one can exchange the goods and services from one country for the goods and services from another country**
- **d.** The exchange rate that would exist if nominal rates were not fixed by governments

68. If the current exchange rate is 1€/1C$ and bagels cost 1€ in France and 1C$ in Canada and the current exchange rate for bagels is 0.74 European bagel/1 Cdn bagel and if the bagels are identical:
- **a.** The nominal exchange rate is 0.74€/C$
- **b.** This is a good example of the Theory of Purchasing Power of Parity working as it should
- **c.** The real exchange rate equals the nominal exchange rate
- **d. The real exchange rate is 0.74 French bagel/1 Cdn bagel**

69. If a Japanese Toyota sells for 2,500,000 yen and the nominal exchange rate is 110 yen/$, then the dollar price of the Japanese automobile is:
- **a.** 22,727 yen
- **b.** $20,000
- **c.** $25,000
- **d. $22,727**

70. Depreciation of the real exchange rate:
- a. Makes Canadian exports more expensive to foreigners
- **b. Makes Canadian exports less expensive to foreigners**
- c. Means a basket of Canadian goods would exchange for more foreign goods
- d. Means an appreciation of the nominal exchange rate

71. The law of one price:
- **a. Is based on arbitrage**
- **b.** Applies only to real goods and not financial assets
- **c.** Can explain short-run exchange rates but not long-run exchange rates
- **d.** Is a mathematical concept that is not useful in explaining exchange rates

72. Considering the law of one price, evidence shows:
- **a.** The law works most of the time
- **b.** This is the closet thing to a perfect law in economics
- **c. That the law fails most of the time**
- d. The law only works in the very short run

73. The theory of purchasing power parity implies the real exchange rate between

two countries is:
   a. Flexible
   b. Less than one
   c. Greater than one
   d. **Equal to one**

74. Purchasing power parity says that:
   a. Differences in inflation rates between countries should have no impact on the exchange rate between those countries
   b. **Differences in inflation rates between countries will create changes in exchange rates**
   c. The changes in exchange rates move independently from inflation
   d. For inflation to change the exchange rate, the rate of inflation has to be the same between countries

75. If Great Britain experiences higher rates of inflation than Canada over a long period of time, we should expect the British (pound) per Cdn $ (dollar) exchange rate to:
   a. **Increase**
   b. Hold constant, there isn't any link between inflation and exchange rates
   c. Decrease
   d. Hold constant since exchange rates are fixed

76. When a currency is described as undervalued, this implies:
   a. **It is undervalued relative to what the describer believes purchasing power parity to be**
   b. It is undervalued relative to the exchange rate set by the nation's central bank
   c. The exchange rate is greater than one
   d. The exchange rate is lower than one year previous

77. Short-run movements in nominal exchange rates are primarily due to:
   a. Changing prices of goods and services in the countries involved
   b. **Changing rates of return on domestic and foreign assets**
   c. Inflation differentials
   d. Changes in exports

78. Considering the dollar-euro market, as a dollar will purchase fewer euros, holding other factors constant:
   a. **This is represented by a downward movement along the supply of dollars curve**
   b. This would be represented by a leftward shift in the demand for dollars curve
   c. This would be represented by a leftward shift of the supply of dollars curve
   d. This is represented by a downward movement along the demand for dollars curve

79. Considering the dollar-euro market, as a dollar purchases a fewer number of euros, we should see:
   a. The quantity of dollars demanded decrease
   b. The quantity of dollars supplied increase
   c. **An increase in the purchase of Canadian assets by Europeans**
   d. A decrease in Canadian exports to Europe

80. If Canadians develop a greater appreciation for Mexican-made goods, we should observe the following change in the dollar-peso market:
   a. **The supply curve of dollars shifts right**
   b. The demand curve for dollars shifts left
   c. The supply curve of dollars shifts left
   d. The demand curve for dollars shifts right

81. A decrease in Canadians' preference for foreign goods will lead to the following in the foreign exchange market:
   a. An increase in the demand for dollars
   b. **A decrease in the supply of dollars**
   c. A depreciation of the dollar relative to foreign currencies
   d. A movement down the demand curve for dollars

82. An increase in the real interest rate on Canadian bonds, everything else equal, will have the following impact on the foreign exchange market:
   a. The demand for dollars will decrease
   b. The supply of dollars will increase
   c. The dollar will depreciate relative to foreign currencies
   d. The demand for dollars will increase

83. Ignoring risk differences, if we observe Canadian investors purchasing foreign bonds when the Canadian interest rate is above the foreign interest rate, we could assume that:
   a. Canadian investors lack good information
   b. These investors expect the dollar to appreciate over the life of their investment
   c. These investors expect the dollar to depreciate over the life of their investment
   d. These investors expect that Canadian inflation will increase

84. 'Microfinance' refers to:
   a. Extreme monitoring to prevent moral hazard
   b. Loans with very little or no collateral
   c. Loans to individuals, 'macrofinance' is loans to firms
   d. Non-profit lending with very small loans

85. Financial institutions, acting as financial intermediaries, perform all of the following, except:
   a. Provide ways to diversify risk
   b. Pooling resources of small savers
   c. Increase transactions costs
   d. Provide safekeeping and accounting services

86. The fact that a financial intermediary can hire a lawyer to write one contract that works for many customers is an example of:
   a. Economies of scale
   b. The law of diminishing marginal returns
   c. The law of increasing opportunity cost
   d. The law of demand

87. Mutual funds offer investors:
    a. A greater return for greater risk than what an investor can earn on his own
    b. A lower return for more risk than what the investor could earn on his own
    c. A lower return for less risk than what the investor could earn on his own
    d. **A way for individuals to eliminate the idiosyncratic risk associated with any single investment**

88. Asymmetric information poses two important obstacles to the smooth flow of funds from savers to investors. They are:
    a. **Adverse selection, which arises before the transaction occurs, and moral hazard, which occurs after the transaction**
    b. Moral hazard, which arises before the transaction occurs, and adverse selection, which occurs after the transaction
    c. Adverse selection and moral hazard, both of which occur after the transaction
    d. Adverse selection and moral hazard, both of which occur before the transaction

89. Which of the following is a problem of moral hazard?
    a. A lender cannot distinguish good risk from bad risk borrowers
    b. **An individual who purchases auto insurance begins to leave his or her keys in the car while running into a store**
    c. Life insurance companies offer an average premium to smokers and non-smokers so they do not have to have two different premiums
    d. An auto insurance company charges higher premiums to younger drivers than what they charge to older drivers

90. The interest rates charged on most credit cards is:
    a. **High due to the problem of adverse selection**
    b. High because Visa and MasterCard have a virtual monopoly on this business
    c. High due to diseconomies of scale that exist in this market
    d. Lower than they should be given the problem of adverse selection

91. Which of the following statements is true?
    a. Unsecured loans generally involve very high interest rates as a result of the free-rider problem
    b. **Unsecured loans generally involve very high interest rates as a result of adverse selection**
    c. Unsecured loans are no longer made; all loans now must have some form of collateral
    d. Unsecured loans are only made to individuals with very high net worth because it is the only way to limit the risk

92. Often a bank will require a loan officer to make personal visits on customers with loans outstanding. This is encouraged because:
    a. The bank worries about another bank trying to steal their customers
    b. The bank wants to make sure the business is busy
    c. **This is an effective monitoring technique and should reduce moral hazard**
    d. The bank has excess funds available and hopes to make another loan to the business

93. Considering the balance sheet for all chartered banks in Canada, the largest category of liabilities is:
- **a.** Borrowing from other banks in Canada
- **b.** **Personal savings deposits**
- **c.** Chequable deposits
- **d.** Government of Canada deposits

94. A bank's liquid assets include:
- **a.** Personal deposits
- **b.** Currency in the bank but not currency in the ATM machines
- **c.** **The bank's deposits at the Bank of Canada**
- **d.** Residential mortgages and mortgage-backed securities

95. Chartered banks differ from credit unions in the following way:
- **a.** **Credit unions focus on consumer loans while chartered banks primarily make loans to businesses as well as consumers**
- **b.** Credit unions make loans and accept deposits while chartered banks just make loans
- **c.** Chartered banks cannot make auto loans to individuals, just to businesses while credit unions can do both
- **d.** Credit unions do not have to hold reserves while chartered banks do

96. Which of the following statements best completes this sentence: "On a bank's balance sheet..."?
- **a.** Liabilities show the uses of funds and assets show the sources of funds
- **b.** Assets show the sources of funds and the net worth shows the uses of funds
- **c.** **Net worth shows the sources of funds and liabilities show the uses of funds**
- **d.** Liabilities show the sources of funds and assets show the uses of funds

97. Which of the following is not a bank liability?
- **a.** **Commercial loans**
- **b.** Demand deposits
- **c.** Non-transaction deposits
- **d.** Bank of Canada borrowings

98. A bank's loan loss reserves are:
- **a.** The amount of loans that have defaulted in the past twelve months
- **b.** The same as equity capital
- **c.** **An amount the bank sets aside to cover potential losses from defaulted loans**
- **d.** A liability of the bank since it is a source of funds

99. A bank's Return on Equity (ROE) is calculated by:
- **a.** **Dividing the bank's net profit after taxes by the bank's capital**
- **b.** Dividing the banks liabilities by the bank's capital
- **c.** Taking the bank's assets plus the net profit after taxes and dividing this sum by the bank's capital
- **d.** Dividing the bank's net profit after taxes by the sum of the bank's assets and its liabilities

100. A bank's off-balance-sheet activities usually:
- **a.** Increase both its assets and liabilities while reducing net income
- **b.** **Increase its net income but do not change its assets or liabilities**
- **c.** Increases a bank's liabilities but not its assets
- **d.** Increases a bank's assets but not its liabilities

101. The fact that a bank's assets tend to be long-term while its liabilities are short-term creates:
- **a.** **Interest-rate risk**
- **b.** Credit risk
- **c.** Lower risk for the bank, this is why they follow this strategy
- **d.** Trading risk

102. In its role as the bankers' bank, a central bank performs each of the following, except:
- **a.** Providing loans during times of financial distress
- **b.** **Providing deposit insurance**
- **c.** Overseeing commercial banks and the financial system
- **d.** Managing the payments system

103. The primary objective of most central banks in industrialized economies is:
- **a.** High securities prices
- **b.** Low unemployment
- **c.** **Price stability**
- **d.** A strong domestic currency

104. The correlation between high rates of inflation and economic growth is:
- **a.** Direct; one brings about the other
- **b.** **Inverse; high inflation usually means low economic growth**
- **c.** There is no correlation between these measures
- **d.** Is direct at low rates of economic growth and inverse at high rates

105. Central banks are in a position to control risk in the economy because they:
- **a.** Control the unemployment rate
- **b.** Control the economy's real growth rate
- **c.** **Control short-term interest rates**
- **d.** Can change taxes

106. Most economists agree that a well-designed central bank would:
- **a.** **Be independent of political pressure**
- **b.** Make its policy actions difficult to interpret
- **c.** Be accountable only to other banks
- **d.** Be run by one key policy maker

107. The Bank of Canada's policy regarding announcing its policy decisions has:

- **a.** Always been to announce it immediately; that was part of the original Bank of Canada Act of 1934
- **b. Only recently gone to immediate announcement; until 1996 these policy decisions were secret**
- **c.** Been to release the decisions immediately since its early failure at preventing the high inflation rates of the 1970's
- **d.** Changed so that now the Bank of Canada does not release its decisions publicly

108. The Bank of Canada was created in:

- **a.** 1867
- **b. 1934**
- **c.** 1945
- d. 1967

109. The Bank of Canada's current target for the inflation rate is:

- a. 2%
- b. **2%** plus or minus 1%
- c. 0%
- d. Less than 4%

110. The first part of the Bank of Canada's monetary policy framework is inflation targeting, the second part is:

- a. Interest rate targeting
- b. Positive economic growth
- c. Unemployment targeting
- **d. Flexible exchange rate**

111. A central bank's balance sheet would categorize each of the following as liabilities, except:

- **a.** Currency
- **b. Loans**
- **c.** The government's account
- **d.** Accounts of the commercial banks

112. The quantity of securities held by the Bank of Canada is controlled through:

- **a.** The Minister of Finance
- **b.** The Bank's annual budget
- **c. Open market operations**
- **d.** The purchases made by the chartered banks

113. For the Bank of Canada, the largest liability on its balance sheet is:

- **a.** Chartered bank reserves
- **b. Currency**
- **c.** Governments' accounts
- **d.** Government securities

114. The monetary base is the sum of:
- **a.** Deposits of financial institutions and M2++
- **b.** M1+ and deposits of financial institutions
- **c.** Currency in the hands of the public, deposits of financial institutions and M1+
- **d.** **Currency in the hands of the public and deposits of financial institutions**

115. When chartered banks hold no reserves, the monetary base is the same as:
- **a.** Foreign exchange reserves
- **b.** **Currency in circulation**
- **c.** M1+
- **d.** M2++

116. When the Bank of Canada makes an advance to a chartered bank, the impact on the Banking System's balance sheet is:
- **a.** An increase in liabilities with no change in assets
- **b.** An increase in assets and a decrease in liabilities
- **c.** A decrease in assets and an increase in liabilities
- **d.** **The same as that of an open market purchase**

117. Harry gets $1000 in currency from his grandfather when he graduates from college. He deposits these funds into his chequing account. What is the impact on the monetary base of Harry's deposit?
- **a.** **The monetary base did not change**
- **b.** The monetary base increased by $1000
- **c.** The monetary base decreased by $1000
- **d.** The monetary base increases by more than a $1000

118. The Bank of Canada pays interest on reserve deposits at a rate equal to:
- **a.** **The bank rate minus 50 basis points**
- **b.** The target rate plus 25 basis points
- **c.** The target rate
- **d.** The target rate minus 50 basis points

119. If the overnight rate were below the target rate, the response from the Bank of Canada would likely be to:
- **a.** Raise the bank rate
- **b.** Raise the deposit rate
- **c.** Purchase government securities
- **d.** **Sell government securities**

120. The tools of monetary policy include:
- **a.** **The target overnight rate**
- **b.** The excess reserve rate
- **c.** The currency-to-deposit ratio
- **d.** Both the excess reserve rate and the target overnight rate

121. According to a very recent news release from the Bank of Canada, the Bank has decided to maintain the target for the overnight rate at _____.

a. 1.00%
b. 1.25%
c. 1.50%
d. 1.75%
e. 2.00%

122. (True = A or False = **B**) China's central bank is currently focused on tackling inflation instead of maintaining growth.

123. (**True = A** or **False = B**) Most bonds today are traded electronically.

124. In the short video on bond valuation from the Veblen website, which tool is the presenter using to show how to calculate the value of a bond?

a. MS Word
b. By hand
c. MS Excel
d. An animated PowerPoint presentation.

125. After-hours trading of stocks is considered _____ riskier than regular hour trading?

a. More
b. Less
c. Equally
d. Irrelevant since this type of trading is illegal.