Faculty of Commerce- English Section

Department of Economics

E216: Money and Banking

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Tutorial on Chapter 4: *Understanding Interest Rates*

Economics of Money, Banking, and Fin. Markets, 11e (Mishkin)

Question 1: Choose the correct answer:

1. The concept of ________ is based on the common-sense notion that a dollar paid to you in the future is less valuable to you than a dollar today.
   A) present value
   B) future value
   C) interest
   D) deflation
2. An increase in the time to the promised future payment ________ the present value of the payment.
   A) decreases
   B) increases
   C) has no effect on
   D) is irrelevant to
3. With an interest rate of 6 percent, the present value of $100 paid next year is approximately
   A) $106.
   B) $100.
   C) $94.
   D) $92.
4. What is the present value of $500.00 to be paid in two years if the interest rate is 5 percent?
   A) $453.51
   B) $500.00
   C) $476.25
   D) $550.00
5. If a security pays $55 in one year and $133 in three years, its present value is $150 if the interest rate is
   A) 5 percent.
   B) 10 percent.
   C) 12.5 percent.
   D) 15 percent.
6. To claim that a lottery winner who is to receive $1 million per year for twenty years has won $20 million ignores the process of
   A) face value.
   B) par value.
   C) deflation.
   D) discounting the future.
7. A credit market instrument that provides the borrower with an amount of funds that must be repaid at the maturity date along with an interest payment is known as a
   A) simple loan.

B) fixed-payment loan.
C) coupon bond.
D) discount bond.

8. A credit market instrument that requires the borrower to make the same payment every period until the maturity date is known as a
A) simple loan.
B) fixed-payment loan.
C) coupon bond.
D) discount bond.

9. A credit market instrument that pays the owner a fixed coupon payment every year until the maturity date and then repays the face value is called a
A) simple loan.
B) fixed-payment loan.
C) coupon bond.
D) discount bond.

10. A ________ pays the owner a fixed coupon payment every year until the maturity date, when the ________ value is repaid.
A) coupon bond; discount
B) discount bond; discount
C) coupon bond; face
D) discount bond; face

11. The ________ is the final amount that will be paid to the holder of a coupon bond.
A) discount value
B) coupon value
C) face value
D) present value

12. 1If a $1000 face value coupon bond has a coupon rate of 3.75 percent, then the coupon payment every year is
A) $37.50.
B) $3.75.
C) $375.00.
D) $13.75

13. If a $5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is
A) $650.
B) $1,300.
C) $130.
D) $13.

14. A bond that is bought at a price below its face value and the face value is repaid at a maturity date is called a
A) simple loan.
B) fixed-payment loan.
C) coupon bond.
D) discount bond.

15. The interest rate that equates the present value of payments received from a debt instrument with its value today is the
A) simple interest rate.
B) current yield.
C) yield to maturity.
D) real interest rate.

16. If the amount payable in two years is $2420 for a simple loan at 10 percent interest, the loan amount is
A) $1000. B) $1210 C) $2000. D) $2200.

17. In which of the following situations would you prefer to be the lender?
    A) The interest rate is 9 percent and the expected inflation rate is 7 percent.
    B) The interest rate is 4 percent and the expected inflation rate is 1 percent.
    C) The interest rate is 13 percent and the expected inflation rate is 15 percent.
    D) The interest rate is 25 percent and the expected inflation rate is 50 percent.
18. In which of the following situations would you prefer to be the borrower?
    A) The interest rate is 9 percent and the expected inflation rate is 7 percent.
    B) The interest rate is 4 percent and the expected inflation rate is 1 percent.
    C) The interest rate is 13 percent and the expected inflation rate is 15 percent.
    D) The interest rate is 25 percent and the expected inflation rate is 50 percent.

Question 2: answer the following questions:

1. If you decided to get a $10000 loan from the bank and the interest rate is 5%. What is the yearly payment to the bank to pay off the loan in 2 years?
2. If the interest rate is 5%, what is the present value of a security that pays you $1, 050 next year and $1,102.50 two years from now