Faculty of Commerce, Benha University

Economics of Money & Banking

Level 2

Course Code:

Economics E216

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Tutorial 5

1) The spread between the interest rates on bonds with default risk and default-free bonds is called the

   A. risk premium. B. Junk margin.
   C. Bond margin. D. default premium.

2) The theory of asset demand predicts that as the possibility of a default on a corporate bond decreases, the expected return on the bond _____ while its relative riskiness _____.

   (A) rises; rises (B) rises; falls
   (C) falls; rises (D) falls; falls

3) The risk structure of interest rates is explained by differences in

   (A) the bonds' relative default risks. (B) the bonds' relative liquidity.
   (c) the bond's relative tax treatment. (D) all of the above

4) The term structure of interest rates is _____

   (A) the relationship among interest rates on bonds with different maturities.
   (B) the structure of how interest rates move over time.
   (C) the relationship among the term to maturity of different bonds.
   (D) the relationship among interest rates of different bonds with the same maturity.

5) When yield curves are steeply upward sloping,

   (A) long-term interest rates are above short-term interest rates.
   (B) short-term interest rates are above long-term interest rates.
   (C) short-term interest rates are about the same as long-term interest rates.
   (D) medium-term interest rates are above both short-term and long-term interest rates.

6) According to the expectations theory of the term structure

   (A) when the yield curve is steeply upward sloping, short-term interest rates are expected to rise in the future.
   (B) when the yield curve is downward sloping, short-term interest rates are expected to decline in the future.

(C) investors have strong preferences for short-term relative to long-term bonds, explaining why yield curves typically slope upward.
(D) only (a) and (b) of the above.

7) According to the expectations theory of the term structure
(A) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
(B) interest rates on bonds of different maturities are not expected to move together over time since buyers of bonds prefer short-term to long-term bonds.
(C) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope upward.
(D) only (a) and (b) of the above.

8) According to the expectations theory of the term structure
(A) the interest rate on long-term bonds will exceed the average of short-term interest rates that people expect to occur over the life of the long-term bonds, because of their preference for short-term securities.
(B) interest rates on bonds of different maturities move together over time.
(C) buyers of bonds prefer short-term to long-term bonds.
(D) all of the above

9) According to the segmented markets theory of the term structure
(A) bonds of one maturity are close substitutes for bonds of other maturities, therefore, interest rates on bonds of different maturities move together over time.
(B) the interest rate for each maturity bond is determined by supply and demand for that maturity bond.
(C) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope downward.
(D) all of the above.

10) Which of the following theories of the term structure is (are) able to explain the fact that interest rates on bonds of different maturities tend to move together over time?
(A) The expectations theory
(B) The segmented markets theory
(C) The liquidity premium theory
(D) Both (a) and (b) of the above
(E) Both (a) and (c) of the above

11) The _____ of the term structure of interest rates states that the interest rate on a long-term bond will equal the average of short-term interest rates that individuals expect to occur over the life of the long-term bond, and investors have no preference for short-term bonds relative to long-term bonds.
(A) segmented markets theory
(B) expectations theory
(C) liquidity premium theory
(D) separable markets theory

12) Markets in which funds are transferred from those who have excess funds available to those who have a shortage of available funds are called
A) commodity markets.
B) funds markets.
C) derivative exchange markets.
D) financial markets.

13) Which of the following can be described as involving indirect finance?
(A) A bank buys a U.S. Treasury bill from one of its depositors.
(B) A corporation buys a short-term security issued by another corporation.
(C) A pension fund manager buys a short-term corporate security the primary market.
(D) Both (b) and (c) of the above.

14) Which of the following can be described as involving indirect finance?
(A) A corporation takes out loans from a bank.
(B) People buy shares in a mutual fund.
(C) A corporation buys a short-term corporate security in a secondary market.
(D) All of the above. (e) Only (a) and (b) of the above.

15) The process of indirect finance using financial intermediaries is called
(A) direct lending. (B) financial intermediation. (C) disintermediation. (D) financial liquidation.

16) Economies of scale enable financial institutions to
(A) reduce transactions costs.
(B) avoid the asymmetric information problem.
(c) eliminate the need to diversify.
(D) reduce moral hazard.
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17) An example of economies of scale in the provision of financial services is
(A) investing in a diversified collection of assets.
(B) providing depositors with a variety of savings certificates.
(C) spreading the cost of borrowed funds over many customers.
(D) spreading the cost of writing a standardized contract over many borrowers. Answer: D

18) The process where financial intermediaries create and sell low-risk assets and use the proceeds to purchase riskier assets is considered as asset transformation and also known as
(A) risk sharing. (B) risk aversion. (C) risk neutrality. (D) risk shedding.

19) Reducing risk through the purchase of assets whose returns do not always move together is
(A) disintermediation. (B) intermediation. (C) intervention. (d) diversification.

20) The presence of transaction costs in financial markets explains, in part, why
(A) financial intermediaries and indirect finance play such an important role in financial markets.
(B) equity and bond financing play such an important role in financial markets.
(C) corporations get more funds through equity financing than they get from financial intermediaries.
(D) direct financing is more important than indirect financing as a source of funds.

21) Typically, borrowers have superior information relative to lenders about the potential returns and risks associated with an investment project. The difference in information is called __________, and it creates the __________ problem.
(A) adverse selection; moral hazard
(B) asymmetric information; risk sharing
(c) asymmetric information; adverse selection
(D) adverse selection; risk sharing

22) The problem created by asymmetric information before the transaction occurs is called _____, while the problem created after the transaction occurs is called _____.
(A) adverse selection; moral hazard.
(B) moral hazard; adverse selection
(c) costly state verification; free-riding
(D) free-riding; costly state verification

23) A professional baseball player may be contractually restricted from skiing. The team owner includes this clause in the player's contract to protect against
(A) fraud. (B) moral hazard. (C) adverse selection. (D) regulatory circumvention.

24) Intermediaries who link buyers and sellers by buying and selling securities at stated prices are called
A) investment bankers. B) traders. C) brokers. D) dealers.

25) The presence of transaction costs in financial markets explains, in part, why
A) financial intermediaries and indirect finance play such an important role in financial markets.
B) equity and bond financing play such an important role in financial markets.
C) corporations get more funds through equity financing than they get from financial intermediaries.
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