Test Bank for Money Banking and the Financial System 4th Edition by Hubbard

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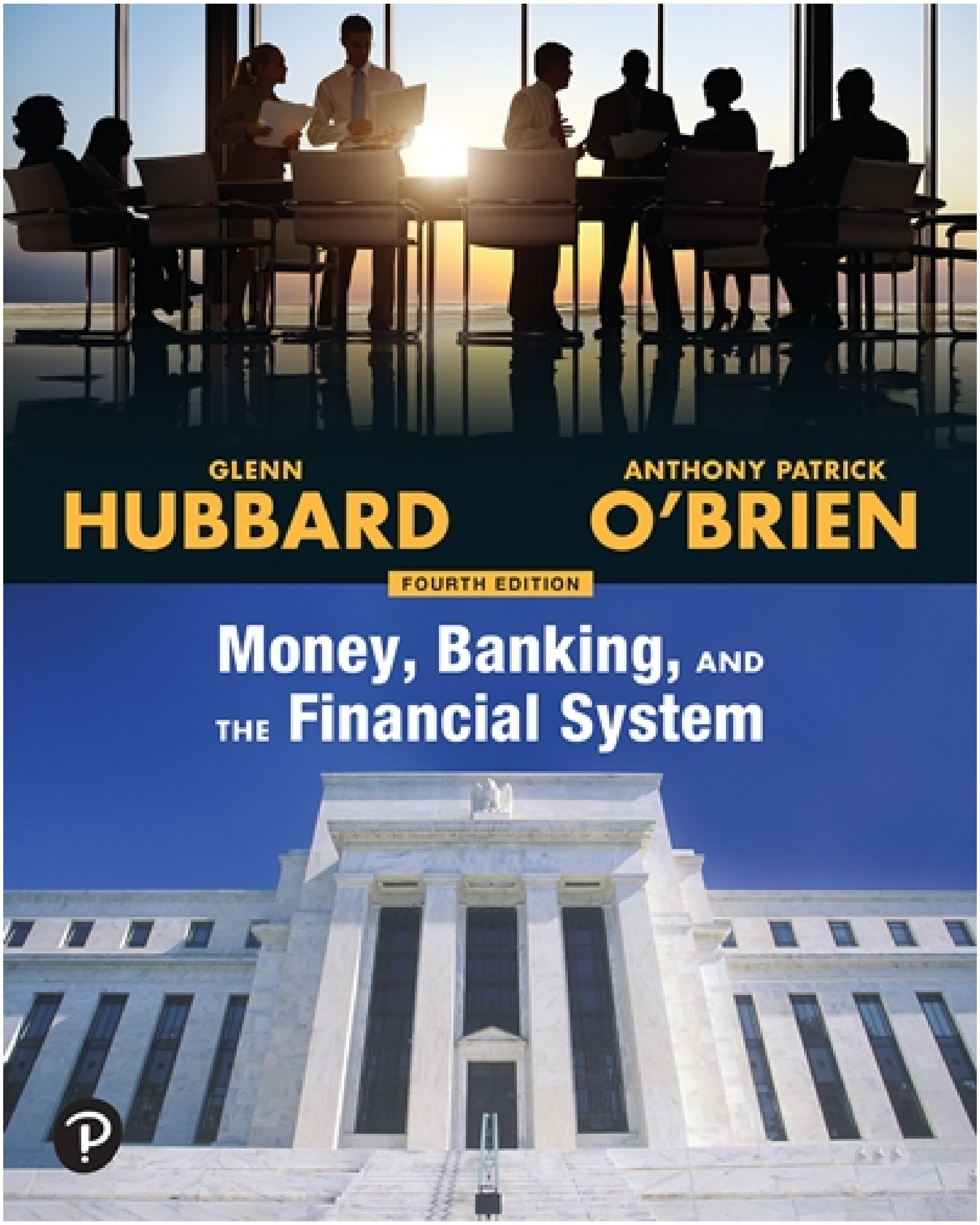

Test Bank

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MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) The financial system is primarily a means by which
A) money is put into circulation.
B) business firms distribute their goods.
C) funds are transferred from savers to borrowers.
D) the government puts into operation its plans for the economy.
Answer: C

2) Which of the following is NOT a financial asset?
A) a bond issued by Google
B) Wells Fargo Bank
C) a certificate of deposit
D) a home mortgage loan
Answer: B

3) If you buy a bond issued by Intel, the bond is a(n)
A) asset to both you and Intel.
B) liability to both you and Intel.
C) liability to Intel and an asset to you.
D) liability to you and an asset to Intel.
Answer: C

4) Which of the following forms the largest share of household holdings of financial assets?
A) bonds
B) equity in unincorporated businesses
C) pension entitlements
D) corporate stocks
Answer: C

5) From 1978 to 2019, the percentage of wealth held by households decreased for all of the following categories of assets EXCEPT
A) equity in unincorporated businesses.
B) corporate stocks.
C) bonds.
D) deposits.
Answer: B

6) Which of the following is NOT a key financial service provided by the financial system?
A) liquidity
B) profitability
C) information
D) risk sharing
Answer: B

7) Economists define risk as
A) the difference between the interest rate borrowers pay and the interest rate lenders receive.
B) the ease with which an asset can be exchanged for other assets or for goods and services.
C) the difference between the return on common stock and the return on corporate bonds.
D) the chance that the value of financial assets will change from what you expect.
Answer: D

8) Economists define liquidity as
A) the fraction the asset makes up of an investor's portfolio.
B) the difference between the total demand for an asset and the total supply of the asset.
C) the difference between the return on the asset and the return on a long-term U.S. Treasury bond.
D) the ease with which an asset can be exchanged for money.
Answer: D

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9) Which of the following assets is the most liquid?
A) washing machine
B) money market mutual fund
C) U.S. Treasury bond
D) computer

Answer: B

10) By providing and communicating information, the financial system
A) eliminates the risk in investing in the stock market.
B) reduces the difference between the return on three-month U.S. Treasury bills and the return on thirty-year U.S. Treasury bonds.
C) guarantees investors a reasonable return on their money.
D) relieves individual savers from the necessity of searching out individual borrowers.

Answer: D

11) Financial securities that represent partial ownership of a corporation are known as
A) stocks.
B) bonds.
C) coupons.
D) dividends.

Answer: A

12) Securitization is the process of
A) issuing stocks to finance capital spending.
B) reducing risk by decreasing corporate debt loads.
C) issuing bonds to finance purchases of equipment and structures.
D) converting loans into securities.

Answer: D

13) If a bank grants you a mortgage, the mortgage is
A) a liability to you as well as a liability to the bank.
B) a liability to you, but an asset to the bank.
C) an asset to you, but a liability to the bank.
D) an asset to you as well as an asset to the bank.

Answer: B

14) Financial markets
A) channel funds directly from lenders to borrowers.
B) act as go-betweens by holding a portfolio of assets and issuing claims based on that portfolio to savers.
C) generally provide lenders with lower returns than do financial intermediaries.
D) channel funds indirectly between borrowers and lenders.

Answer: A

15) If you purchase a Treasury bond, the Treasury bond is
A) a liability to you as well as a liability to the U.S. government.
B) an asset to you as well as an asset to the U.S. government.
C) a liability to you, but an asset to the U.S. government.
D) an asset to you, but a liability to the U.S. government.

Answer: D

16) Funds flow from lenders to borrowers
A) indirectly through financial markets.
B) primarily through government agencies.
C) directly through financial intermediaries.
D) indirectly through financial intermediaries.

Answer: D

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17) Which of the following is NOT a financial intermediary?
A) Allstate Insurance Company
B) Bank of America
C) NASDAQ
D) Vanguard Total Stock Market Index Fund

Answer: C

18) Which of the following is NOT a financial intermediary?
A) bank
B) mutual fund
C) insurance company
D) stock exchange

Answer: D

19) The main role of financial intermediaries is to
A) provide advice to consumers on how they should handle their finances.
B) help ensure that there is enough money in circulation.
C) borrow funds from savers and lend them to borrowers.
D) provide funds to the federal government to cover the budget deficit.

Answer: C

20) Financial intermediaries
A) include the New York and American Stock exchanges.
B) directly issue claims on individual borrowers to savers.
C) are owned and operated by the federal government.
D) include banks and other depository institutions.

Answer: D

21) A "primary market" is a market
A) in which newly issued claims are sold by savers to borrowers.
B) for government securities.
C) for debt by large or "primary" corporations.
D) in which newly issued claims are sold to buyers by borrowers.

Answer: D

22) A bank lending depositors' money to a local business and a pension fund investing contributions in shares of a company are similar financial activities in that
A) both involve funds being channeled from savers to borrowers through financial intermediaries.
B) both involve in an increase in the overall level of risk in the financial system.
C) both involve a reduction in the overall level of liquidity in the financial system.
D) both involve the use of financial markets.

Answer: A

23) The leading federal regulatory body for financial markets in the United States is the
A) Securities and Exchange Commission.
B) Investors Protection Agency.
C) Federal Bureau of Investigation.
D) Federal Financial Market Bureau.

Answer: A

24) Economists define money as
A) bonds issued by large corporations.
B) anything that people are willing to accept in payment for goods and services or to pay off debts.
C) deposits in commercial banks.
D) cash in circulation.

Answer: B

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25) The Federal Reserve System
A) is responsible for conducting fiscal policy for the United States.
B) is headed by the Secretary of the Treasury.
C) is in charge of managing the New York Stock Exchange.
D) is the central bank of the United States.

Answer: D

26) Monetary policy refers to the government's
A) management of the money supply and interest rates to achieve macroeconomic objectives.
B) decisions on how much money to collect in taxes.
C) plans for retiring the national debt.
D) decisions on how much money to spend.

Answer: A

27) Diversification refers to the
A) difficulty of converting investments in common stocks into investments in bonds.
B) splitting of wealth into many assets.
C) difference between the liquidity of an asset and its risk.
D) difficulty of selling common stocks in a weak market.

Answer: B

28) The purpose of diversification is to
A) reduce risk.
B) increase the liquidity of a financial portfolio.
C) reduce tax liability.
D) reduce the brokerage fees involved in managing a financial portfolio.

Answer: A

29) The financial system provides risk sharing by allowing
A) savers to hold many assets.
B) borrowers to convert liabilities into assets.
C) borrowers to obtain funds either directly or indirectly.
D) savers to earn interest tax-free.

Answer: A

30) Liquidity
A) is the best available measure of the riskiness of an asset.
B) is the ease with which an asset can be exchanged for money.
C) was declining for many financial assets during the 1990s.
D) is a characteristic of money, and of no other asset.

Answer: B

31) Which of the following assets is the least liquid?
A) money market mutual fund
B) treasury bond
C) house
D) stock

Answer: C

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32) Increased liquidity in recent decades has reduced interest rates on which of the following assets (holding constant all other things that affect interest rates)?
A) U.S. government bonds
B) business loans
C) bonds issued by large corporations
D) bonds issued by state governments

Answer: B

33) The financial system performs the role of communicating information by
A) incorporating all available information into the prices of financial assets.
B) constantly increasing the liquidity of most assets.
C) providing to investors for a nominal charge all government reports available about a particular company.
D) constantly reducing the riskiness of most assets.

Answer: A

34) The distinguishing feature of a well-functioning financial market is the
A) incorporation of available information into asset prices.
B) continual reduction in the riskiness of most assets.
C) continual increase in the liquidity of most assets.
D) increased ease of converting common stocks into bonds.

Answer: A

35) In the United States, monetary policy is carried out by
A) Congress.
B) Congress and the President acting together.
C) the President.
D) the Federal Reserve System.

Answer: D

36) In the United States, the lender of last resort is
A) the Federal Deposit Insurance Corporation.
B) Fannie Mae.
C) the Federal Reserve.
D) the Securities and Exchange Commission.

Answer: C

37) A decline in bank lending has the most significant effect on
A) small businesses.
B) large businesses.
C) the federal government.
D) state governments.

Answer: A

38) As it became clear that the COVID-19 pandemic would cause a significant recession in the United States, all of the following took place EXCEPT
A) cities and school districts found it easier to use financial markets to borrow money.
B) the Federal Reserve took steps to stabilize the financial system.
C) many investors stopped buying financial assets.
D) employment started to decline.

Answer: A

39) The Consumer Financial Protection Bureau estimates that about ________ people in the United States lack credit scores.
A) 800,000
B) 17 million
C) 45 million
D) 160 million

Answer: C

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40) The funds for loans from peer–to–peer lenders come from three key sources. Which of the following is NOT one of those key sources?
A) financial firms
B) other businesses
C) individuals
D) government

Answer: D

41) The interest rate on loans made by peer–to–peer lenders tends to be
A) higher than the interest rate on bonds and lower than the interest rate on credit cards.
B) lower than the interest rate on bonds and lower than the interest rate on credit cards.
C) lower than the interest rate on bonds and higher than the interest rate on credit cards.
D) higher than the interest rate on bonds and higher than the interest rate on credit cards.

Answer: A

42) Peer–to–peer lenders make a profit by
A) paying a lower interest rate to depositors than they charge to borrowers.
B) charging borrowers quarterly interest rates, but paying the providers of funds on an annual basis.
C) charging borrowers a one–time fee and charging those who provide funds a fee for collecting payments from borrowers.
D) securitizing their loans and selling them to large financial institutions.

Answer: C

43) The process by which investment banks guarantee a certain price to a firm issuing stocks or bonds is known as
A) peer–to–peer lending.
B) underwriting.
C) proprietary trading.
D) securitization.

Answer: B

44) Until very recently, investment banks rarely engaged in which of the following?
A) underwriting
B) lending to households
C) proprietary trading
D) securitization

Answer: B

45) All of the following represent returns to savers EXCEPT
A) dividends on stocks.
B) coupon payments on bonds.
C) fees on loans.
D) interest payments on loans.

Answer: C

46) The role of the financial system is to
A) ensure that investment banks remain profitable.
B) protect commercial banks from government regulation.
C) channel funds from households and other savers to businesses.
D) provide loans from the Federal Reserve to households and businesses.

Answer: C

47) Ordinary (non–securitized) loans cannot be resold after they have been granted by a bank or another lender. Therefore, these loans are
A) financial securities but not financial assets.
B) neither financial assets nor financial securities.
C) both financial assets and financial securities.
D) financial assets but not financial securities.

Answer: D

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48) Because securitized loans are loans that have been bundled with other loans and sold to investors, they are
A) financial securities but not financial assets.
B) neither financial assets nor financial securities.
C) financial assets but not financial securities.
D) both financial assets and financial securities.

Answer: D

49) All of the following are true regarding securitized loans EXCEPT
A) they provide risk sharing.
B) they cannot be resold.
C) they provide information.
D) they provide liquidity.

Answer: B

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

50) Briefly discuss three reasons why firms may borrow funds from a bank.

Answer: Many firms rely on bank loans to meet their short–term needs for credit, such as funds to pay for inventories or to meet their payrolls. Many firms rely on bank loans to bridge the gap between the time they must pay for inventories or meet their payrolls and when they receive revenues from the sales of goods and services. Some firms also rely on bank loans to meet their long–term credit needs, such as funds they require to physically expand the firm.

51) Briefly explain the process of securitizing mortgages.

Answer: The mortgage lender sells the loan to a government–sponsored enterprise or financial firm that bundles the mortgage with mortgages from other lenders, providing the basis for a mortgage–backed security.

52) How are interest payments on mortgages distributed to investors who own mortgage–backed securities?

Answer: The banks that grants, or *originates*, the original mortgages will still collect the interest paid by the borrowers and send those interest payments on to the government agency or financial firm to distribute to the investors who have bought the mortgage–backed security.

53) Briefly explain the difference in how banks and peer–to–peer lenders make profits on loans.

Answer: Banks have traditionally earned profits on loans by paying a lower interest rate to depositors than they charge to borrowers. Peer–to–peer lenders make profits by charging borrowers a one–time fee and charging the people providing funds a fee for collecting the payments from borrowers.

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

54) Which president said, "We have now passed the worst ... and we shall rapidly recover"?
A) Donald Trump during the COVID-19 pandemic
B) George W. Bush near the start of the Great Recession
C) Herbert Hoover near the start of the Great Depression
D) Franklin Delano Roosevelt near the start of the Great Depression

Answer: C

55) What made the recession of 2007–2009 different than any other recession since the Great Depression?
A) It was accompanied by a financial crisis.
B) The impact was primarily limited to the financial sector.
C) The Fed failed to reduce interest rates.
D) The government did not implement a fiscal stimulus.

Answer: A

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56) Fannie Mae and Freddie Mac both
A) help regulate the banking system.
B) reduce access to funds for mortgages by purchasing existing mortgages.
C) directly lend funds to people seeking mortgages.
D) sell bonds to investors and use the funds to purchase mortgages.

Answer: D

57) The Coronavirus Aid, Relief and Economic Security (CARES) Act provided all of the following EXCEPT
A) direct payments to educational institutions to compensate for lower tax revenues.
B) supplemental unemployment insurance payments.
C) loans and grants to businesses under the Paycheck Protection Plan (PPP).
D) direct payments to households.

Answer: A

58) Which of the following best describes a "bubble"?
A) an unsustainable increase in the price of a class of assets
B) when the price of an asset reaches a new high
C) rapid increases in inflation
D) when bond prices rise more quickly than stock prices

Answer: A

59) All of the following were significant changes in the mortgage market in the 2000s EXCEPT
A) mortgage-backed securities became more popular with investors.
B) borrowers tended to increase the amount of their down payments.
C) investment banks became significant participants in the secondary mortgage market.
D) lenders loosened lending standards.

Answer: B

60) In response to the COVID-19 pandemic, the Fed initiated the Main Street Lending Program to make loans to
A) charities and non-profit organizations.
B) large corporations.
C) small businesses.
D) medium-size firms.

Answer: D

61) The Troubled Asset Relief Program (TARP) allowed
A) the Fed to provide funds to commercial banks in return for stock.
B) the Treasury to inject funds into commercial banks in return for stock in the banks.
C) the Treasury to insure bank deposits at major U.S. banks.
D) the Fed to make loans to banks as the lender of last resort.

Answer: B

62) Which firm did the Treasury allow to fail during the financial crisis?
A) Bear Stearns
B) J.P. Morgan
C) Lehman Brothers
D) American International Group (AIG)

Answer: C

63) Alt-A borrowers were those who
A) chose adjustable-rate mortgages instead of fixed-rate mortgages.
B) used mortgages to purchase apartments.
C) borrowed using "interest-only" mortgages.
D) did not provide documentation of their income when applying for a mortgage.

Answer: D

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64) The financial crisis of 2007–2009 worsened after the failure of which firm?
A) American International Group (AIG)
B) General Motors
C) Lehman Brothers
D) Bear Stearns

Answer: C

65) All of the following occurred at the beginning of the financial crisis of 2007–2009 EXCEPT
A) many borrowers defaulted on their mortgages.
B) banks began to ease lending requirements to all borrowers.
C) commercial and investment banks suffered heavy losses due to their holdings of mortgage–backed securities.
D) the value of mortgage–backed securities declined sharply.

Answer: B

66) Borrowers with flawed credit histories are referred to as ________ borrowers.
A) securitized
B) subprime
C) adjustable–rate
D) alt–A

Answer: B

67) Which of the following was the largest fiscal policy action in U.S. history?
A) the Paycheck Protection Plan (PPP)
B) the Affordable Care Act (ACA)
C) the Coronavirus Aid, Relief and Economic Security (CARES) Act
D) the Troubled Asset Relief Program (TARP)

Answer: C

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

68) Why did some economists and policymakers criticize the Fed and Treasury for arranging the sale of Bear Stearns to JP Morgan Chase in 2008?

Answer: The main concern was with the *moral hazard problem*, which is the possibility that managers of financial firms such as Bear Stearns might make riskier investments if they believe that the federal government will save them from bankruptcy.

69) What are the four main provisions of the Coronavirus Aid, Relief and Economic Security (CARES) act?

Answer:
1. Direct payments to households
2. Supplemental unemployment insurance payments
3. Funds to state governments to offset some of their costs from fighting the epidemic
4. Loans and grants to businesses under the Paycheck Protection Plan (PPP)

70) How did securitization and the bursting of the housing bubble contribute to the Financial Crisis of 2007–2009?

Answer: Many investment banks and other investors purchased mortgage–backed securities because they paid higher interest rates than securities of comparable default risk. When the housing bubble burst, the value of the mortgage–backed securities declined significantly, resulting in massive losses for those who owned them, including many investment banks.

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1) C
2) B
3) C
4) C
5) B
6) B
7) D
8) D
9) B
10) D
11) A
12) D
13) B
14) A
15) D
16) D
17) C
18) D
19) C
20) D
21) D
22) A
23) A
24) B
25) D
26) A
27) B
28) A
29) A
30) B
31) C
32) B
33) A
34) A
35) D
36) C
37) A
38) A
39) C
40) D
41) A
42) C
43) B
44) B
45) C
46) C
47) D
48) D
49) B

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50) Many firms rely on bank loans to meet their short–term needs for credit, such as funds to pay for inventories or to meet their payrolls. Many firms rely on bank loans to bridge the gap between the time they must pay for inventories or meet their payrolls and when they receive revenues from the sales of goods and services. Some firms also rely on bank loans to meet their long–term credit
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54) C
55) A
56) D
57) A
58) A
59) B
60) D
61) B
62) C
63) D
64) C
65) B
66) B
67) C
68) The main concern was with the *moral hazard problem*, which is the possibility that managers of financial firms such as Bear Stearns might make riskier investments if they believe that the federal government will save them from bankruptcy.
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