

Personal Finance, 6e (Madura)
Chapter 5 Banking and Interest Rates

5.1 Types of Financial Institutions

1) Bank fees for use of an automated teller machine (ATM) do not need to be considered when choosing a bank since fees are set by the federal government and are the same for all banks.

Answer: FALSE

Diff: 1

Question Status: Revised

2) Bank ATM charges may be substantial if you make many transactions monthly and use out-of-network machines.

Answer: TRUE

Diff: 1

Question Status: Previous edition

3) Depository institutions are financial institutions that accept deposits (that are insured up to a maximum level) from individuals or firms and provide loans.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) An example of a depository financial institution is an insurance company.

Answer: FALSE

Diff: 2

Question Status: Previous edition

5) Deposits in commercial banks that are members of the FDIC, are insured up to a maximum of \$50,000 per account.

Answer: FALSE

Diff: 1

Question Status: Revised

6) Savings institutions differ from commercial banks in that they tend to focus less on providing commercial loans.

Answer: TRUE

Diff: 2

Question Status: Previous edition

7) Credit unions are nonprofit depository institutions that serve members who have a common affiliation (such as the same employer or same community).

Answer: TRUE

Diff: 2

Question Status: Previous edition

8) Introductory high interest rates paid by financial institutions for new accounts are usually a good deal and you should therefore take advantage of them without question.

Answer: FALSE

Diff: 1

Question Status: Previous edition

9) Nondepository institutions are financial institutions that provide various financial services, but their deposits are not federally insured.

Answer: TRUE

Diff: 2

Question Status: Previous edition

10) Finance companies are more selective in choosing the borrowers they serve, and therefore they usually charge lower interest rates than banks or credit unions.

Answer: FALSE

Diff: 1

Question Status: Revised

11) Securities firms primarily sell insurance to protect individuals from adverse events.

Answer: FALSE

Diff: 1

Question Status: Previous edition

12) A mutual fund is a means by which investors with only a small amount of money can invest in a portfolio of securities.

Answer: TRUE

Diff: 1

Question Status: Previous edition

13) Financial institutions loan funds at _____ they pay depositors.

A) a lower interest rate than

B) a higher interest rate than

C) a rate equal to what

D) a cost plus 3% of what

Answer: B

Diff: 2

Question Status: Revised

14) Which of the following is **not** a depository institution?

A) First National Bank of Chicago

B) Butterfield and Edwards Brokerage Company

C) American 1 Federal Credit Union

D) New England Savings Bank

Answer: B

Diff: 2

Question Status: Revised

15) Financial institutions that accept deposits (that are insured up to a maximum level) from individuals and provide loans are called

- A) finance companies.
- B) depository institutions.
- C) investment companies.
- D) nondepository institutions.

Answer: B

Diff: 1

Question Status: Previous edition

16) Which of the following is **not** a depository institution?

- A) Commercial bank
- B) Securities firm
- C) Savings institution
- D) Credit union

Answer: B

Diff: 1

Question Status: Previous edition

17) Deposits at commercial banks are insured up to _____ per depositor by the Federal Deposit Insurance Corporation (FDIC).

- A) \$100,000
- B) \$75,000
- C) \$250,000
- D) \$150,000

Answer: C

Diff: 1

Question Status: Previous edition

18) Deposits at commercial banks are insured by a government-owned insurance agency called the

- A) Federal Deposit Insurance Corporation.
- B) National Credit Union Share Insurance Fund.
- C) Federal Deposit Interest Company.
- D) Insurance Regulatory and Development Authority.

Answer: A

Diff: 1

Question Status: Revised

19) Which of the following financial institutions would be used the most by business customers wishing to borrow money?

- A) Commercial banks
- B) Savings institutions
- C) Credit unions
- D) All are used equally by business customers.

Answer: A

Diff: 2

Question Status: Previous edition

20) To join a credit union, you need to

- A) have a steady job.
- B) be a member of a group with a common bond.
- C) have established good credit.
- D) be sponsored by an existing member of that credit union.

Answer: B

Diff: 1

Question Status: Previous edition

21) Savings institutions accept deposits and provide mortgage and personal loans to individuals. Another name for these financial institutions is

- A) trust institutions.
- B) economy institutions.
- C) insured institutions.
- D) thrift institutions.

Answer: D

Diff: 1

Question Status: Revised

22) Which of the following characteristics is common to both commercial banks and credit unions?

- A) Lower fees
- B) Lower credit card rates
- C) Insurance up to \$250,000
- D) Nonprofit

Answer: C

Diff: 1

Question Status: Previous edition

23) Which of the following is a nonprofit depository institution that provides services only to members who have a common affiliation?

- A) Commercial bank
- B) Savings institution
- C) Credit union
- D) Finance company

Answer: C

Diff: 1

Question Status: Revised

24) Which of the following financial institutions specializes in making personal loans to people who are perceived to have a higher risk of default?

- A) Finance companies
- B) Commercial banks
- C) Savings institutions
- D) Credit unions

Answer: A

Diff: 1

Question Status: Previous edition

25) If you were taking out a personal loan, the highest rate would probably be charged by a

- A) commercial bank.
- B) finance company.
- C) member of your family.
- D) credit union.

Answer: B

Diff: 1

Question Status: Previous edition

26) _____ are nondepository institutions that facilitate the purchase or sale of securities by firms or individuals by providing investment banking services and brokerage services.

- A) Finance companies
- B) Securities firms
- C) Insurance companies
- D) Investment companies

Answer: B

Diff: 2

Question Status: Previous edition

27) _____ are nondepository institutions that provide insurance to protect individuals or firms against possible adverse events.

- A) Finance companies
- B) Securities firms
- C) Insurance companies
- D) Investment companies

Answer: C

Diff: 1

Question Status: Previous edition

28) _____ are nondepository institutions that sell shares to individuals and use the proceeds to invest in securities to create mutual funds.

- A) Investment companies
- B) Finance companies
- C) Securities firms
- D) Insurance companies

Answer: A

Diff: 1

Question Status: Previous edition

29) A financial conglomerate offers a diverse set of services that include which of the following?

- A) Credit cards
- B) Personal loans
- C) Brokerage subsidiary
- D) All of the above.

Answer: D

Diff: 2

Question Status: Previous edition

30) Which of the following is classified as a nondepository institution?

- A) Credit union
- B) Insurance company
- C) Commercial bank
- D) Savings institution

Answer: B

Diff: 1

Question Status: Revised

31) If you have \$10,000 that you do not currently need for expenses and you wish to put it somewhere so that it will earn a return, which of the following financial institutions would you **not** choose?

- A) Savings institution
- B) Finance company
- C) Securities firm
- D) Investment company

Answer: B

Diff: 1

Question Status: Previous edition

32) You have \$3,000 that you may need any day to replace the furnace in your house. Which of the following would be the best place to put the \$3,000?

- A) A one-year CD earning 4%
- B) A common stock mutual fund earning 9%
- C) A savings account earning 2%
- D) Shares of stock in a high-tech company that could double in 6 months

Answer: C

Diff: 1

Question Status: Revised

33) Your great aunt Mary passed away and left you an inheritance of \$5,000. Since you don't have a need for the money in the near future, which of the following would be the best place to put the \$5,000?

- A) A savings account earning 1% interest
- B) A checking account
- C) A five-year CD paying 4.38% annually
- D) High-risk stock in a producer of natural gas that is predicted to triple in the next year

Answer: C

Diff: 1

Question Status: Revised

34) Which of the following is not a service provided by a commercial bank?

- A) Checking and savings accounts
- B) FDIC insurance on all deposits with no maximum limit
- C) Personal loans
- D) Mortgage loans

Answer: B

Diff: 1

Question Status: Revised

35) Financial institutions offering traditional checking and savings accounts as well as providing loans to both individuals and firms are called _____.

Answer: depository institutions

Diff: 1

Question Status: Previous edition

36) A nondepository institution facilitating transactions in stocks or bonds is a(n) _____.

Answer: securities firm

Diff: 1

Question Status: Previous edition

37) Organizations that offer a diverse set of financial services to individuals and firms are _____.

Answer: financial conglomerates

Diff: 1

Question Status: Previous edition

38) During the financial crisis that began in 2008, what was the key aspect in banks that made savers comfortable that their money was safe?

- A) Congress was watching over the banks
- B) The Federal Reserve did not let any banks fail
- C) Deposits were insured up to \$250,000 by FDIC
- D) Bailouts protected the savers

Answer: C

Diff: 2

Question Status: New

39) Lucky Louie has \$10,000 that he wants to invest for 3 years but wants to take no risk on the investment. His best course of action would be to

- A) invest in a 3 year Treasury note.
- B) invest in a blue chip stock portfolio.
- C) put his money in a 3 year CD at his bank.
- D) Both A and C are correct.

Answer: D

Diff: 3

Question Status: New

Use the following two columns of items to answer the matching questions below:

- A) financial institutions that accept deposits and provide loans
- B) a nondepository institution that sells shares to individuals and uses the proceeds to invest in securities and create a mutual fund
- C) a nondepository institution that provides insurance to protect against adverse events
- D) a nondepository institution that specializes in providing personal loans
- E) nondepository institutions that facilitate the purchase and sale of securities by firm or individuals
- F) financial institutions that offer a diverse set of services

40) depository institutions
Diff: 1
Question Status: Revised

41) securities firm
Diff: 1
Question Status: New

42) insurance company
Diff: 1
Question Status: Revised

43) financial conglomerates
Diff: 1
Question Status: New

44) investment company
Diff: 1
Question Status: Revised

45) finance company
Diff: 1
Question Status: New

Answers: 40) A 41) E 42) C 43) F 44) B 45) D

46) List four types of financial institutions that you have made use of or might deal with in the future.

Answer: Finance companies, securities firms, insurance companies, investment companies, banks, and credit unions.

Diff: 1

Question Status: Revised

5.2 Banking Services Offered

1) To prevent an overdraft or "bounced check," it is always a good idea to record each check written in your check register and reconcile your account balance when you receive your monthly bank statement.

Answer: TRUE

Diff: 1

Question Status: Revised

2) You can be assured that if your ATM query shows you have a certain balance in your checking account, that figure is more accurate than the amount in your check register.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) Debit cards allow you to pay for a purchase later when the bill arrives.

Answer: FALSE

Diff: 2

Question Status: Previous edition

4) A debit card differs from a credit card in that it does not provide credit; instead, it deducts the purchase from your checking account immediately.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) Banks do not charge fees for safety deposit boxes.

Answer: FALSE

Diff: 2

Question Status: Previous edition

6) ATM cards are declining in use because they are expensive and the machines are becoming more difficult to locate.

Answer: FALSE

Diff: 1

Question Status: Previous edition

7) Cashier's checks, money orders, and traveler's checks are secured check alternatives to a personal check and therefore are more risk-free for the payee.

Answer: TRUE

Diff: 1

Question Status: Previous edition

8) A(n) _____ card allows you to pay for a purchase at a later time when the bill arrives.

A) credit

B) debit

C) expense

D) ATM

Answer: A

Diff: 1

Question Status: Previous edition

9) A(n) _____ card allows you to pay for a purchase directly from your checking account without writing a check.

A) credit

B) debit

C) expense

D) travel

Answer: B

Diff: 1

Question Status: Previous edition

10) Which of the following is **not** a service that a depository institution might offer?

A) Checking services

B) Credit counseling

C) Online services

D) The use of a debit card

Answer: B

Diff: 1

Question Status: Revised

11) The Act that allows banks to transmit electronic images of checks, thus allowing funds to be transferred immediately is known as

A) Check 2004.

B) the Electronic Check Act of 2004.

C) the Fraud Detecting Act.

D) Check 21.

Answer: D

Diff: 1

Question Status: Revised

12) Which of the following is **not** a reason that your checking account balance might change from one month to another?

- A) Deposits to your account
- B) Cleared checks
- C) Purchasing new shoes with a credit card
- D) Bank fees

Answer: C

Diff: 1

Question Status: Previous edition

13) Your checkbook balance at the end of May is \$1,041.52. When you receive May's bank statement, you discover the following additional items: Bank fees, \$27.00; Interest earned, \$16.35. Your adjusted checkbook balance after considering these items is

- A) \$1030.87.
- B) \$1052.17.
- C) \$950.04.
- D) \$997.65.

Answer: A

Explanation: A)

Checkbook balance	\$1,041
Add: Interest	\$163
Deduct: Bank fees	<u>\$271</u>
Adjusted Balance	\$933

Diff: 1

Question Status: Revised

14) Which of the following is **not** an advantage of using ATM cards?

- A) It is an easy and convenient way to withdraw funds.
- B) Your total banking expenses will be lower.
- C) You have access to your account any time of the day.
- D) You can bank at remote locations all over the world.

Answer: B

Diff: 1

Question Status: Revised

15) Which of the following is **not** a disadvantage of using ATM cards?

- A) Forgetting to record the transaction
- B) Fees from your bank and other banks for using out-of-network machines
- C) Increased fees if you make too many transactions per period
- D) Difficulty of withdrawing funds

Answer: D

Diff: 1

Question Status: Previous edition

16) A _____ is a check that is written on behalf of a person to a specific payee and will be charged against a financial institution's account.

- A) cashier's check
- B) money order
- C) traveler's check
- D) personal check

Answer: A

Diff: 1

Question Status: Previous edition

17) You are purchasing a new car and are making a down payment of \$6,500. To be assured of payment, the dealership would request that you provide a

- A) personal check.
- B) money order.
- C) cashier's check.
- D) traveler's check.

Answer: C

Diff: 2

Question Status: Revised

18) A _____ is a check that is written on behalf of a person for a fixed amount that is paid in advance.

- A) cashier's check
- B) money order
- C) traveler's check
- D) personal check

Answer: B

Diff: 2

Question Status: Revised

19) A _____ is a check that is written on behalf of an individual and will be charged against a large well-known financial institution or credit card sponsor's account.

- A) cashier's check
- B) money order
- C) traveler's check
- D) personal check

Answer: C

Diff: 1

Question Status: Previous edition

20) If you wish to make purchases that are charged against your checking account without writing a check you need to have a(n) _____.

Answer: debit card

Diff: 1

Question Status: Previous edition

Use the following two columns of items to answer the matching questions below:

- A) automatically deducts an amount from a checking account
- B) extends the payment time through credit

21) debit card

Diff: 1

Question Status: Revised

22) credit card

Diff: 1

Question Status: Revised

Answers: 21) A 22) B

23) The opening balance in your checking account was \$1000. During the month you had the following activity: wrote two checks for \$45.00 and \$75.00 but only the first one cleared; had two debit card transactions for \$50 and \$35.20; received a bank charge for the account of \$6, deposited a check you received from a friend for \$100 but it did not clear by month end. What is your month end account balance?

A) \$1052.13

B) \$875.45

C) \$863.80

D) \$888.80

Answer: C

Diff: 2

Question Status: New

24) to speed the process of paying your bills and save money on stamps, you could

A) agree with the service provider to pay quarterly.

B) use your bank's online banking capability.

C) pay with money orders.

D) use your bank's wire transfer capability.

Answer: B

Diff: 1

Question Status: New

5.3 Selecting a Financial Institution

1) Convenience, deposit rates and insurance, and fees are primary considerations in choosing a financial institution for your needs.

Answer: TRUE

Diff: 1

Question Status: Revised

2) Since rates and fees differ only slightly between all national banks, there is little need to consider these when choosing your financial institution.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) Because of potential security concerns, it is unlikely that you will find a financial institution that offers mobile applications.

Answer: FALSE

Diff: 2

Question Status: Revised

4) Because they have lower expenses, Web-based financial institutions tend to pay higher interest rates on deposits than institutions with physical branches.

Answer: TRUE

Diff: 2

Question Status: Previous edition

5) Which of the following should **not** affect your choice of a financial institution?

A) Convenience

B) Whether it is state or federally chartered

C) Deposit rates and insurance

D) Fees

Answer: B

Diff: 1

Question Status: Previous edition

6) Which of the following is **not** a fee that financial institutions may charge?

A) Checking account service charge

B) ATM usage fee

C) Depository insurance

D) Safety deposit box rental

Answer: C

Diff: 1

Question Status: Revised

7) _____ is a movement that began in September 2011 to protest against large banks that are believed to receive excessive support from the government.

- A) The 15-M
- B) March on Washington
- C) Anti-corruption
- D) Occupy Wall Street

Answer: D

Diff: 1

Question Status: Previous edition

8) Lorenzo is considering two banks for his checking account. Suny Bank requires a minimum deposit of \$100 and charges a monthly fee of \$8, plus 5 cents a check. Merchants Bank also requires a minimum deposit of \$100, it charges a per check fee of 15 cents but no monthly fee. How many checks would Lorenzo need to write each month to make Suny Bank cheaper to use than Merchants?

- A) over 50
- B) over 60
- C) over 70
- D) over 80

Answer: D

Explanation: $D) 8 \text{ monthly charge} / 10 \text{ cent per check differential} = 80 \text{ checks break even}$

Diff: 1

Question Status: Revised

9) Describe four factors you should consider when choosing a financial institution.

Answer: Several answers are acceptable here such as a debit card, no service fee, ATM card, credit card, location, free checks, interest rate offered, and interest rate charged on loans.

Diff: 1

Question Status: Previous edition

10) Lucky Louie's bank requires a minimum balance at all times of \$1500 in order to provide free checking services. The bank pays .5% per annum interest on the minimum balance. If you do not maintain the balance, account service fees are \$4 per month. Assuming Lucky can earn 2.5% on his money not sitting at the bank, what is his net benefit to maintaining the minimum balance?

- A) Not a benefit; he should invest his money elsewhere at 2.5%
- B) \$18 per year benefit
- C) \$48 per year benefit
- D) Breakeven

Answer: B

Diff: 2

Question Status: New

5.4 Interest Rates on Deposits and Loans

1) Certificates of deposit (CDs) with shorter maturity dates tend to pay higher interest rates than those with longer maturity dates.

Answer: FALSE

Diff: 1

Question Status: Previous edition

2) A certificate of deposit guarantees or locks in an interest rate for a specified time and rate.

Answer: TRUE

Diff: 1

Question Status: Previous edition

3) A risk-free rate is a return on an investment that is guaranteed for a specified period.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) A risk premium is the amount of interest you might receive over and above the risk-free return insured by the federal government.

Answer: TRUE

Diff: 1

Question Status: Revised

5) Investments with a higher risk of default pay higher rates of interest than those that are less risky.

Answer: TRUE

Diff: 1

Question Status: Revised

6) It is illegal for a federally insured financial institution to charge those with poor credit records higher interest rates than those with good credit.

Answer: FALSE

Diff: 1

Question Status: Revised

7) The one-year loan rate for individuals is usually about the same as the one-year CD rate.

Answer: FALSE

Diff: 2

Question Status: Previous edition

8) Wanda Clark expects interest rates to decline in the next few months. To maximize her earnings, she should put her savings in a

- A) two-year certificate of deposit.
- B) six-month certificate of deposit.
- C) cashier's check.
- D) savings account.

Answer: A

Diff: 2

Question Status: Revised

9) Which of the following is **not** true regarding certificates of deposit (CDs)?

- A) The longer the term, the higher the interest rate paid.
- B) All banks offer the same rates on CDs.
- C) Early withdrawals of money are subject to a penalty.
- D) The investment of large amounts will pay higher interest than lower amounts.

Answer: B

Diff: 2

Question Status: Previous edition

10) The _____ is the return on an investment that is guaranteed for a specified period.

- A) risk-free rate
- B) risk premium
- C) specific return
- D) fair market return

Answer: A

Diff: 1

Question Status: Previous edition

11) When you invest in a CD that has a maturity of one year, you are guaranteed the interest rate offered on that CD. Your return would be

- A) a risk premium.
- B) money in the bank.
- C) a risk-free return.
- D) liquid assets.

Answer: C

Diff: 2

Question Status: Revised

12) The _____ is an additional return beyond the risk-free rate that can be earned from a deposit guaranteed by the government.

- A) risk-free rate
- B) risk premium
- C) specific return
- D) nominal return

Answer: B

Diff: 1

Question Status: Previous edition

13) Your commercial bank is offering a one-year CD with an interest rate of 7%. A financial company offers an interest rate of 10% on its one-year certificate (not a CD). The risk premium offered by the financial company is

- A) 7%.
- B) 3%.
- C) 4%.
- D) 1.5%.

Answer: B

Diff: 1

Question Status: Revised

14) The interest rate is composed of the _____ and the _____.

- A) risk-free rate; risk discount
- B) risk-free rate; risk premium
- C) risk-free rate; default risk premium
- D) None of the above.

Answer: B

Diff: 2

Question Status: Previous edition

15) In saving or investing, the _____ the risk, the _____ the potential return.

- A) higher; higher
- B) lower; lower
- C) higher; lower
- D) Both A and B are correct

Answer: D

Diff: 2

Question Status: Previous edition

16) The relationship between risk and return

- A) is positive.
- B) is negative.
- C) is inverse.
- D) has no correlation.

Answer: A

Diff: 1

Question Status: Previous edition

17) Juan has \$1,000 that he would like to invest in a CD. His bank offers two alternatives, a one-year CD paying 6% or a two-year CD paying 9% per annum. Juan has been reading that interest rates are rising, and, based on his research, he estimates that by year-end the rate on one-year CDs will increase to 10%. What alternative would give Juan the most interest and what would the total interest be?

- A) Two one-year CDs returning \$120 interest
- B) Two one-year CDs returning \$160 interest
- C) One two-year CD returning \$180 interest
- D) One two-year CD returning \$1,900 interest

Answer: C

Explanation: C) Two one-year CDs at 6 and 10% would return \$160, while the two-year CD would return \$180, therefore, this is the best choice.

Diff: 1

Question Status: Revised

18) Jack has \$1,000 that he wishes to invest for the next two years. One-year CDs are currently paying 8% while two-year CDs are paying 12% per annum. Economists are predicting that interest rates will rise by the end of the year. What is the minimum amount interest rates would have to increase to in order for the one-year CD to be better than the two-year CD?

- A) 16%
- B) 14%
- C) 12%
- D) 10 %

Answer: A

Explanation: A) Total dollar return over the two years at 12% is \$240; one year return at 8% is \$80, therefore interest rates would have to increase to 16% or better to make up the difference.

Diff: 1

Question Status: Revised

19) The _____ is the return that is guaranteed on an investment for a specified period of time.

Answer: risk-free rate

Diff: 1

Question Status: Previous edition

Use the following two columns of items to answer the matching questions below:

- A) a return on an investment that is guaranteed for a specified period
- B) an additional return beyond the risk-free rate

20) risk-free rate

Diff: 1

Question Status: Revised

21) risk premium

Diff: 1

Question Status: Revised

Answers: 20) A 21) B

22) The relationship between risk and return is positive because

- A) the longer the term of the investment, the more exposed it is to negative inflation effects.
- B) investors need to be compensated with additional return on investment to bear additional risk.
- C) not every investment has risk, so there is really no distinct relationship.
- D) Both A and B are correct.

Answer: B

Diff: 2

Question Status: New

23) When borrowing money from a bank for a home mortgage, 30 year interest rates are generally

- A) the same as 15 year and 20 year rates.
- B) between .5% and 1% lower than 15 year rates.
- C) between .5% and 1% higher than 15 year rates.
- D) The term of the mortgage has no bearing on rates; only the borrower's credit rating matters.

Answer: C

Diff: 2

Question Status: New

5.5 Why Interest Rates Change

1) Interest rate changes are affected by the relationship of the total supply of funds provided by all investors and the total demand for funds by all borrowers.

Answer: TRUE

Diff: 2

Question Status: Previous edition

2) The monetary policy of the Federal Reserve System (the Fed) has very little to do with the changes in interest rates a consumer will experience.

Answer: FALSE

Diff: 2

Question Status: Revised

3) The risk-free rate on borrowed funds is determined by

- A) the Federal Reserve.
- B) Congress.
- C) supply and demand.
- D) the banking system.

Answer: C

Diff: 2

Question Status: Revised

4) The term structure of interest rates is the relationship between the maturities of _____ debt securities and the annualized yields offered on those securities.

- A) risk-free
- B) risk premium
- C) specific return
- D) nominal return

Answer: A

Diff: 3

Question Status: Previous edition

5) The term structure of interest rates is measured by a(n) _____, which shows the interest rate offered at each maturity level.

- A) economist
- B) yield curve
- C) pie chart
- D) index

Answer: B

Diff: 2

Question Status: Previous edition

6) The term structure is often based on rates of return or yields offered by _____ which are _____ issued by the U.S. Treasury with different maturities.

- A) Treasury securities; mutual fund securities
- B) Treasury securities; equity securities
- C) Treasury securities; debt securities
- D) None of the above.

Answer: C

Diff: 3

Question Status: Previous edition

7) The yield curve is typically _____, meaning that the annualized interest is higher for debt securities with longer terms to maturity.

- A) upward sloping
- B) horizontal
- C) downward sloping
- D) vertical

Answer: A

Diff: 3

Question Status: Previous edition

8) Information such as _____ can be easily found on a variety of Web sites.

- A) loan rates
- B) stock quotes and company information
- C) yields of Treasury securities
- D) All of the above.

Answer: D

Diff: 1

Question Status: Previous edition

9) When interest rates rise, individuals who make deposits will earn a _____ rate of interest, while individuals who need to borrow funds will have to pay a _____ rate.

- A) higher; lower
- B) lower; higher
- C) higher; higher
- D) lower; lower

Answer: C

Diff: 3

Question Status: Previous edition

10) An increase in borrowing by the U.S. government will result in all of the following **except**

- A) upward pressure on interest rates.
- B) reduction in government regulation.
- C) an increase in the demand for funds.
- D) an increase in the issuance of Treasury securities.

Answer: B

Diff: 1

Question Status: Revised

11) When the Federal Reserve wishes to _____ interest rates, it _____ the amount of funds at commercial banks.

- A) increase; increases
- B) reduce; reduces
- C) reduce; increases
- D) Both A and B are correct.

Answer: C

Diff: 2

Question Status: Previous edition

12) When the Federal Reserve buys or sells Treasury securities to affect the money supply, it uses

- A) open market operations.
- B) reserves at commercial banks.
- C) discount rate adjustments.
- D) federal funds adjustments.

Answer: A

Diff: 2

Question Status: Revised

13) If the government borrows funds to finance a military build-up in the Middle East, this will cause a

- A) shift in the demand for funds.
- B) shift in the supply of funds.
- C) shift in monetary policy.
- D) shift in open-market operations.

Answer: A

Diff: 3

Question Status: Previous edition

14) Interest rates could change due to all of the following **except**

- A) United Nations resolution to change the U.S. Treasury rate.
- B) shift in savings by investors.
- C) shift in monetary policy of the Fed.
- D) shift in business demand for funds.

Answer: A

Diff: 1

Question Status: Revised

15) Which of the following is true with regard to rising interest rates?

- A) Use short-term loans to take advantage of low interest rates.
- B) Select long-term savings options to lock in current interest rates.
- C) Use long-term loans to take advantage of current low rates.
- D) The term of the loan option is not affected by rising interest rates.

Answer: C

Diff: 1

Question Status: Revised

16) The risk-free rate on borrowed funds is determined by the _____ and _____ of funds.

Answer: supply; demand

Explanation: *Appendix

Diff: 1

Question Status: Previous edition

17) Discuss interest rates in general in the United States and the effects of rising and falling interest rates. Does the Federal Reserve take an active role in setting interest rates?

Answer: Falling interest rates or lower interest rates stimulate purchases and new home building. Rising interest rates have the opposite effect. The Federal Reserve is active and regularly increases or decreases interest rates depending on the state of the economy.

Diff: 1

Question Status: Revised

18) The term structure of interest rates states that

A) terms of the loan have major effects on the interest rate.

B) the long term interest rate is the geometric mean of the series of short term rates covering the same period.

C) the long term rate would be higher than the individual short term rates in a rising interest rate environment.

D) Both B and C are correct.

Answer: D

Diff: 3

Question Status: New

19) When the Fed loosens monetary policy, interest rates will _____ and money supply will go _____.

A) up; stay the same

B) down; stay the same

C) go down; go up

D) go up; go down

Answer: C

Diff: 2

Question Status: New

5.6 How Banking Services Fit Within Your Financial Plan

1) Describe how interest rates affect your personal budget, income statement, and balance sheet. What account groups do they affect? Give two specific examples.

Answer: This is a subjective answer. Interest rates affect the income and expense groups. On the income side, interest earned on an account varies. The interest rate affects the ability to purchase a home or car, or obtain a student loan.

Diff: 1

Question Status: Revised

2) If you are anticipating a rising interest rate environment, your planning and analysis of your loan and investment portfolio should focus on

- A) minimizing fixed rate investments and moving variable rate debt to fixed rate.
- B) investing in more fixed rate securities and moving variable rate debt to fixed rate.
- C) investing in preferred stock since the dividend rate is above the CD and bond interest rates.
- D) investing in CD's since they are insured by FDIC and minimizing borrowing.

Answer: A

Diff: 3

Question Status: New