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Economics 252 – Financial Markets

Spring 2011

Lecture 7: Theory of Debt, Its Proper Role, Leverage Cycles

February 11, 2011

Multiple Choice Questions

Question 8.1

Which of the following are causes for interest rates, according to Eugen von Boehm-Bawerk?
(More than one answer may apply.)

(a) Roundaboutness.
(b) Technical progress.
(c) The supply and the demand for savings in the economy.
(d) Time preference.

Question 8.2

Consider a Robinson Crusoe economy, as in the Irving Fisher theory of interest rates. If a second Robinson Crusoe is introduced into this economy, who is more patient than the first Robinson Crusoe, what happen to the interest rate?

(a) The interest rate doubles, because there are now two people in the economy.
(b) The interest rate increases.
(c) The interest rate remains the same.
(d) The interest rate decreases.

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Question 8.3

Which two contracts can be used to replicate the payoff of a conventional bond (or corporate bond), as introduced in this lecture?

(a) An annuity with constant, semi-annual payments, whose last payment occurs at the maturity of the conventional bond, and a discount bond that pays at the maturity date of the conventional bond.
(b) A discount bond that pays at the maturity date of the conventional bond and a discount bond that pays a year after the maturity date of the conventional bond.
(c) Two annuities with constant, semi-annual payments, whose last payments occur at the maturity of the conventional bond.
(d) A consol with constant, semi-annual payments and a discount bond that pays at the maturity date of the conventional bond.

Question 8.4

The creation of which U.S. institution did Elizabeth Warren influence decisively?

(a) The *Harvard Magazine*.
(b) The Financial Stability Oversight Council.
(c) The Consumer Financial Protection Bureau.
(d) An agency promoting honeymoon loans.

Question 8.5

Suppose that today you are given a 12-month spot rate as well as an 18-month spot rate. Which forward rate can you compute from these two rates?

(a) The forward rate between 18 months and 24 months from today.
(b) The forward rate between today and 18 months from today.
(c) The forward rate between 24 months and 36 months from today.
(d) The forward rate between 12 months and 18 months from today.

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Correct Answers

8.1: (a), (b), and (d)
8.2: (d)
8.3: (a)
8.4: (c)
8.5: (d)