

ECO 301: Money and Banking

Name: (20 points) _____

Instructor: Dr. James Murray.

Spring 2010

Exam 1

Directions: Work in groups of up to four people and answer the following questions. All papers will be collected, but only one member's paper will be randomly selected and graded and all members of the group will receive the same grade.

By signing below, you agree that the following work represents the efforts of everyone in the group, and you are willing to accept as your own grade for the group project the grade earned from this representation of your group's work. Every member must agree to these terms to earn a non-zero grade for this assignment.

_____ Signature Group Member 1	_____ Print Name	_____ Date
_____ Signature Group Member 2	_____ Print Name	_____ Date
_____ Signature Group Member 3	_____ Print Name	_____ Date
_____ Signature Group Member 4	_____ Print Name	_____ Date

- (b) (10 points) Suppose the bond is held for only one year then re-sold on the secondary market. Suppose you expect interest rates next year to be 5%. What is your expected capital gain?
3. (10 points) Suppose as the economy rebounds from the recession there is an increase in current disposable income and in expected future disposable income. *Describe and illustrate* the impact on the corporate bond market. What should happen to interest rates on corporate bonds and the quantity of corporate bonds in equilibrium?
4. Suppose the Federal Reserve conducts an open market purchase of Treasury bonds.
- (a) (10 points) *Describe and illustrate* the impact on the market for money. What happens to the quantity of money and interest rate in the short run?

- (b) (10 points) *Describe and illustrate* the impact on the market for bonds. What happens to the quantity of bonds and interest rate in the short run?
- (c) (10 points) Suppose bonds and money are substitute assets to store wealth. Suppose fiscal policy actions cause individuals to doubt the Federal government's ability to repay its loans. *Describe and illustrate* the impact on the market for money *and* bonds.
5. (10 points) Suppose people expect interest rates to rise, but also the degree of uncertainty regarding future interest rates increases. Draw and describe the shape the yield curve will take. If it is possible the yield curve can take more than one shape, draw and describe each scenario.