

# Financial Markets and Institutions

## Question Bank (for Final Exam)

### Multiple Choice Questions

**Q1.** If a country's imports exceed its exports, the country experiences

- a) Current account deficit
- b) Foreign trade deficit
- c) Current account surplus
- d) Foreign trade surplus

**A1. (b)**

**Q2.** Main economic goals are

- 1) Sustainable economic growth
  - 2) Price-level stability
  - 3) Full employment
  - 4) Equitable distribution of income
  - 5) Balanced trade
  - 6) Financial stability
- a) 1-2-3-4      b) 1-2-4-5      c) 1-3-4-5      d) All of above      e) Non of above

**A2. (d)**

**Q3.** Which of the following is false?

A stable financial system

- a) manages financial risks
- b) maintains employment levels close to the economy's natural rate
- c) allocates resources inefficiently
- d) eliminates relative price movements of real or financial assets

**A3. (c)**

**Q4.** Which of the following statements is NOT true?

During financial instability periods;

- a) asset prices deviate excessively from their real values
- b) payments may not arrive on time
- c) problems in the form of "bank run" may occur in the banking system
- d) banks are willing to finance profitable projects

**A4. (d)**

**Q5.** The benefit of the next best alternative sacrificed or the second highest-valued alternative that we give up to get something is called

- a) Financial benefit
- b) Opportunity cost
- c) Income
- d) Revenue

**A5. (b)**

**Q6.** Main macroeconomic policies are

- 1) Monetary policy
  - 2) Fiscal policy
  - 3) Trade policy
  - 4) Exchange rate policy
- a) only 1-2      b) only 2-3      c) only 1-3-4      d) 1-2-3-4

**A6. (d)**

**Q7.** Which of the following is NOT one of the main features of the primary market?

- a) New issue of securities
- b) Maturity is short-term; less than 1 year
- c) Exchange of funds for financial claim
- d) Funds for borrower and an IOU for lender
- e) A security can be sold only once

**A7. (b)** Short term is one of the futures of money market.

**Q8.** Which of the following is NOT one of the main features of the primary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) No new funds for Issuer

**A8. (d)**

**Q9.** Which of the following is NOT one of the main features of the primary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) Provides Liquidity for Seller

**A9. (d)**

**Q10.** Which of the following is NOT one of the main features of the primary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) Trading Previously Issued Securities

**A10. (d)**

**Q11.** Which of the following is one of the main features of the secondary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) No New Funds for Issuer

**A11. (d)**

**Q12.** Which of the following is one of the main features of the secondary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) Provides Liquidity for Seller

**A12. (d)**

**Q13.** Which of the following is one of the main features of the secondary market?

- a) New issue of securities
- b) Exchange of funds for financial claim
- c) Funds for borrower and an IOU for lender
- d) Trading Previously Issued Securities

**A13. (d)**

**Q14.** Which of the following is NOT one of the main features of the capital market?

- a) Maturity is long-term; more than 1 year in general.
- b) Instruments; debt and equity
- c) Less liquid
- d) Higher returns
- e) Low risky

**A14. (e)**



**Q23.** Which of the following is NOT one of the main features of the organized market?

- a) Securities Listed
- b) Visible Marketplace
- c) Members Trade
- d) All Securities Traded off the Exchanges

**A23. (d)**

**Q24.** Which of the following is one of the main features of the organized market?

- a) Securities Listed
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A24. (a)**

**Q25.** Which of the following is one of the main features of the organized market?

- a) Visible Marketplace
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A25. (a)**

**Q26.** Which of the following is one of the main features of the organized market?

- a) Members Trade
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A26. (a)**

**Q27.** Which of the following is NOT one of the main features of the Over-the-Counter Markets?

- a) Members Trade
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A27. (a)**

**Q28.** Which of the following is NOT one of the main features of the Over-the-Counter Markets?

- a) Visible Marketplace
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A28. (a)**

**Q29.** Which of the following is NOT one of the main features of the Over-the-Counter Markets?

- a) Securities Listed
- b) Wired Network of Dealers
- c) No Central and Physical Location
- d) All Securities Traded off the Exchanges

**A29. (a)**

**Q30.** Which of the following is NOT one of the main features of the Debt Markets?

- a) Investor receives interest
- b) Capital gain/loss when sold
- c) Maturity date can be short term, intermediate term, or long term.
- d) An example as a security is common stock.

**A30. (d)**

**Q31.** Which of the following is NOT one of the main features of the Equity Markets?

- a) Investor receives *dividends* (periodical payments) if declared
- b) Capital gain/loss when sold
- c) No maturity date (can be considered long term)
- d) An example as securities are bond and mortgage

**A31. (d)**

**Q32.** Which of the following is NOT one of the main features of the Equity Markets?

- a) Investor receives *dividends* (periodical payments) if declared
- b) Capital gain/loss when sold
- c) Maturity date can be short term, intermediate term, or long term.
- d) An example as a security is common stock.

**A32. (c)**

**Q33.** Which of the following is NOT one of the main features of the Debt Markets?

- a) Investors receive interest
- b) Capital gain/loss when sold
- c) No maturity date (can be considered long term)
- d) An example as securities are bond and mortgage

**A33. (c)**

**Q34.** Which of the following is NOT one of the main trends in financial institutions?

- a) Rapid growth of mutual funds and pension funds
- b) Increased consolidation of financial institutions via mergers
- c) Decreased competition between financial institutions
- d) Growth of financial conglomerates

**A34. (c)**

**Q35.** Which of the following is NOT one of the main trends in financial institutions?

- a) Rapid growth of mutual funds and pension funds
- b) Decreased consolidation of financial institutions via mergers
- c) Increased competition between financial institutions
- d) Growth of financial conglomerates

**A35. (b)**

**Q36.** Which of the following is false?

Increased international funds flow;

- a) Reduced disclosure of information
- b) Reduced transaction costs
- c) Reduced foreign regulation on capital flows
- d) Increased privatization

**A36. (a)**

**Q37.** Which of the following is false?

Increased international funds flow;

- a) Increased disclosure of information
- b) Increased transaction costs
- c) Reduced foreign regulation on capital flows
- d) Increased privatization

**A37. (b)**

**Q38.** Which of the following is false?

Increased international funds flow;

- a) Increased disclosure of information
- b) Reduced transaction costs
- c) Increased foreign regulation on capital flows
- d) Increased privatization

**A38. (c)**

**Q39.** Which of the following is false?

Increased international funds flow;

- a) Increased disclosure of information
- b) Reduced transaction costs
- c) Reduced foreign regulation on capital flows
- d) Reduced privatization

**A39. (d)**

**Q40.** Which of the following is NOT one of the main features of Investment Banks?

- a) Help companies to go public
- b) Help in mergers and acquisition
- c) Broker for institutional clients
- d) Accept deposits

**A40. (d)**

**Q41.** Which of the following is NOT one of the main features of Investment Banks?

- a) Help companies to go public
- b) Help in mergers and acquisition
- c) Broker for institutional clients
- d) Originate and fund mortgage loans

**A41. (d)**

**Q42.** A market is .....if it reflect all available information.

- a) efficient
- b) inefficient
- c) financial
- d) non-financial

**A42. a**

**43) Which of economic sector is the main demander for loanable funds**

- a) Household Sector
- b) Business Sector**
- c) Government Sector
- d) Foreign Sectors

**44) Which of the following statements is false?**

- a) There is a positive relationship between the interest rate and the quantity of loanable funds demanded**
- b) Households demand loanable funds to finance housing, automobiles, household items
- c) Purchases of housing, automobiles, household items purchase result in installment debt.
- d) Installment debt increases with the level of income.

**45) Which of the following statements is false?**

- a) A government budget deficit increases the demand for loanable funds.
- b) A government budget surplus increases the supply of loanable funds.
- c) Government demand for funds is interest-elastic**
- d) Government expenditure and tax policies are independent of interest rates

**46) Supply of loanable funds increases when;**

- a) Disposable income increases
- b) Expected future income decreases
- c) Wealth decreases
- d) Default risk rises**

**47) Which of the following statements is false?**

- a) Businesses choose projects by calculating the project's net future value**
- b) One of the most important demanders for loanable funds is business sector
- c) Businesses demand loanable funds to invest in assets
- d) Quantity of funds demanded depends on how many projects to be implemented

**48) Which of economic sector is the main supplier for loanable funds**

- a) Business Sector
- b) Household Sector**
- c) Government Sector
- d) Foreign Sectors

**49) Which of the following statements is false?**

**A government budget deficit;**

- a) Increases the demand for loanable funds.
- b) Increases the real interest rates.
- c) Increases private investment**
- d) Increases households saving

**50) Which of the following statements is false?**

- a) A rise in the the real interest rate decreases the quantity of loanable funds demanded.
- b) A decrease in the the real interest rate increases the quantity of loanable funds demanded.
- c) A rise in the the real interest rate increases the quantity of loanable funds supplied.
- d) A decrease in the the real interest rate increases the quantity of loanable funds supplied.**

51) Which of the following statements is false?

- a) The loanable funds market is global is a national market.
- b) Lenders want to earn the highest possible real interest rate they will search it by looking everywhere in the world.
- c) Borrowers want to pay the lowest possible real interest rate and they will search it by looking everywhere in the world.
- d) Because lenders are free to search the highest real interest rate and borrowers are free to search the lowest real interest rate; the loanable funds market a single, integrated and global market.

52) Which of the following statements is false?

- a) Economic Growth: increased growth  $\Rightarrow$  increased demand for funds  $\Rightarrow$  interest rates increase
- b) Increased foreign supply of loanable funds: security prices increase  $\Rightarrow$  interest rates increase
- c) Expected Inflation: security prices fall  $\Rightarrow$  interest rates increase
- d) Government budgets deficit: increase borrowing  $\Rightarrow$  security prices fall  $\Rightarrow$  interest rates increase

53) Which of the following statements is false?

- a) Financial capital is mobile.
- b) Financial capital moves to the best advantage of lenders and borrowers
- c) Funds flow out of the country in which the real interest rate is highest
- d) Funds flow into the country in which the real interest rate is highest

54) Which of the following is not the reason that the expected profit rises?

- a) Advances in technology creates profitable new products
- b) A growing population brings increased demand for goods and services
- c) A business cycle expansion
- d) A recession

55) Which of the following statements is false?

A government budget surplus;

- a) Increases the supply of loanable funds.
- b) Decreases the real interest rates.
- c) Decreases households saving
- d) Decreases private investment

56) Which of the following statements is false?

- a) The liquidity of a security affects the yield/price of the securities.
- b) A liquid investment is easily converted to cash at minimum transactions cost.
- c) Investors pay more (lower yield) for liquid investment.
- d) The lower the liquidity of an asset  $\Rightarrow$  the lower the return it is expected to yield.

56) Which of the following statements is false?

- a) The liquidity of a security affects the yield/price of the securities.
- b) A liquid investment is easily converted to cash at minimum transactions cost.
- c) Investors pay less (lower yield) for liquid investment.
- d) The lower the liquidity of an asset  $\Rightarrow$  the higher the return it is expected to yield.

**57) Which of the following statements is false?**

**Treasury Bills are**

- a) one of the safest money market instruments
- b) issued by Governments
- c) high-risk instruments
- d) returns are not attractive

**58) Which of the following statements is false?**

**Treasury Bills are**

- a) one of the safest money market instruments
- b) issued by Governments
- c) zero-risk instruments
- d) returns are attractive

**59) Which of the following statements is false?**

**Treasury Bills are**

- a) one of the safest money market instruments
- b) issued by private companies
- c) zero-risk instruments
- d) returns are not attractive

**60) Which of the following statements is false?**

- a) Bonds are used by companies/governments to raise money and finance a variety of projects and activities.
- b) Owners of bonds are debt holders, or creditors, of the issuer.
- c) Bonds are distinctly different from the money market securities in that they employ *a long-term rather than a short-term perspective*.
- d) The values of bonds can change substantially over time.
- e) Bond markets facilitate the flow of long-term debt from surplus units to deficit units.

**61) Which of the following statements is false?**

- a) Bonds are used by companies/governments to raise money and finance a variety of projects and activities.
- b) Bonds are distinctly different from the money market securities in that they employ *a short-term rather than a long-term perspective*.
- c) The values of bonds can change substantially over time.
- d) Bond markets facilitate the flow of long-term debt from surplus units to deficit units.

**62) Which of the following statements is false?**

- a) Bonds are used by companies/governments to raise money and finance a variety of projects and activities.
- b) Bonds are distinctly different from the money market securities in that they employ *a long-term rather than a short-term perspective*.
- c) The values of bonds can not change substantially over time.
- d) Bond markets facilitate the flow of long-term debt from surplus units to deficit units.

**63) Which of the following statements is false?**

- a) Bonds are used by companies/governments to raise money and finance a variety of projects and activities.
- b) Bonds are distinctly different from the money market securities in that they employ *a long-term rather than a short-term perspective*.
- c) The values of bonds can change substantially over time.
- d) Bond markets facilitate the flow of short-term debt from surplus units to deficit units.

## Fill in the Blank Questions

**Q1.** .....is crucial for economic growth, as most transaction in the real economy are made through the financial system.

**A1.** Financial Stability

**Q2.** A major financial instability can lead to bank runs, hyperinflation, and .....

**A2.** a stock market crash

**Q3.** .....are markets in which funds are transferred from people who have an excess of available funds to people who have a shortage.

**A3.** Financial markets

**Q4.** .....are markets in which financial assets (securities/instruments) are purchased or sold.

**A4.** Financial markets.

**Q5.** .....is referred to as a marketplace in which financial tools like commodities and securities are purchased and received in exchange of cash.

**A5.** Cash market

**Q6.** .....is a commerce marketplace where the futures contracts are purchased and sold.

**A6.** Futures market.

**Q7.** .....policy involves the management of interest rates and the quantity of money.

**A7.** Monetary

**Q8.** .....policy affects interest rates, inflation, and business cycles, all of which have a major impact on financial markets and institutions.

**A8.** Monetary

**Q9.** The government agency responsible for conducting monetary policy is the .....

**A9.** central bank.

**Q10.** The .....develops monetary policy and helps government in implementing them.

**A10.** central bank

**Q11.** Primary role of the ..... Markets is to transfer funds from one country to another.

**A11.** Foreign exchange

**Q12.** ..... companies assist individuals and businesses in managing contingencies and risks.

**A12.** Insurance

**Q13.** ..... banking offer the services like retail and conventional banks but virtually.

**A13.** Internet

**Q14.** The value of an asset is the ..... value of cash flows discounted at the market required rate of return.

**A14.** present/current

**Q15)** Interest rate risk is a major risk impacting financial .....

**Q16)** There is an .....relationship between security prices and interest rates.

**Q17)** There is a positive relationship between the quantity of loanable funds supplied and .....rates, *ceteris paribus*.

**Q18)** .....value *is* the amount of money in the future that an amount of money *today* will yield, given prevailing interest rates.

**Q19)** .....value *is* the amount of money *today* that would be needed to produce, at current IRs, a given future amount of money.

**Q20)** The quantity of loanable funds demanded depends on the real interest rate and .....

**Q21)** If a country's net exports are .....; the rest of the world supplies funds to that country and the quantity of loanable funds in that country is greater than national saving.

**Q22)** If a country's net exports are .....; the country is a net supplier of funds to the rest of the world and the quantity of loanable funds in that country is less than national saving.

**Q23)** .....the risk that a lender takes on in the chance that a borrower will be unable to make the required payments on their debt obligation.

**A:** Default risk

**Q24)** ..... markets enable financial market participants to maintain liquidity.

**A:** Money

**Q25)** ..... is a market that banks and non-deposit financial institutions settle contracts with each other and with central bank, involving temporary liquidity surpluses and deficits.

**A:** Interbank market

**Q26)** .....is a market that absorbing the issues and enabling borrowers to raise new funds.

**A:** Primary market

**Q27)** .....is a market that for different short-term securities, which redistributes the ownership, ensures liquidity, and as a result, increases the supply of lending and reduces its price.

**A:** Secondary market

**Q28)** .....is a market that for financial contracts whose values are derived from the underlying money market instruments.

**A:** Derivatives market

**Q29)** A .....is a debt investment in which an investor loans money to an entity (corporate/governmental) which borrows the funds for a defined period of time at a variable or fixed interest rate.

**A:** bond

**Q30)** Categories of bonds are .....bonds and treasury bonds.

**A:** corporate

**Q31)** Categories of bonds are corporate bonds and ..... bonds.

**A:** treasury

**Q32)** ..... is the date on which the bond will mature and the bond issuer will pay the bond holder the face value of the bond.

**A:** Maturity date

**Q33)** The fact that bond prices and yields move in .....directions is often confusing to new investors.

**A:** opposite

## True-False Questions

**Q1.** The essential economic and business function of financial markets is channeling funds from lenders/savers to borrowers/investors.

**A1.** True

**Q2.** Capital market is less risky as deal in short term liquid asset.

**A2.** False

**Q3.** Returns in money market are high as risk is higher.

**A3.** False

**Q4.** A major financial instability can lead to a stock market crash, hyperinflation, and .....

**A4.** bank runs

**Q5.** A major financial instability can lead to bank runs, a stock market crash, and .....

**A5.** hyperinflation

**Q6.** Capital market is more risky as deal in long term liquid asset.

**A6.** True

**Q7.** Returns in capital market are high as risk is higher.

**A7.** True

**Q8.** Capital market is less risky as deal in long term liquid asset.

**A8.** False

**Q9.** Returns in money market are low as risk is higher.

**A9.** False

**Q10.** Capital market is more risky as deal in short term liquid asset.

**A10.** False

**Q11.** Returns in money market are high as risk is lower.

**A11.** False

Q12) The firms undertake investment projects if the future value of the project exceeds the cost.

Q13) Projects with a positive net present value are accepted because the present value of their benefits outweighs their costs.

Q14) If interest rates decrease, more projects will have a positive net present value businesses will need a greater amount of financing

Q15) If interest rates decrease, more projects will have a positive net present value businesses will demand more loanable funds

Q16) If economic conditions become more favorable demand for loanable funds increases.

Q17) If economic conditions become more favorable expected cash flows will increase

Q18) When planned expenditures exceed revenues from taxes, the government demands loanable funds.

Q19) Default risk premium = risky security yield – treasury security yield of same maturity (T)

Q20) Liquidity is ability to exchange an asset for cash. (T)

Q21) An upward-sloping yield curve indicates that securities with longer maturities offer lower annual yields. (F)

Q22) Money markets are used to facilitate the transfer of short-term funds from individuals, corporations, or governments with excess funds to those with deficient funds. (T)

Q23) Capital markets are used to facilitate the transfer of short-term funds from individuals, corporations, or governments with excess funds to those with deficient funds. (F)

Q24) Money market securities are debt securities with a maturity of **one year or less**. (T)

Q25) Capital market securities are debt securities with a maturity of **one year or less**. (F)

Q26) Bond prices and yields are like a seesaw: when bond yields go up, prices go down, and when bond yields go down, prices go up. (T)

Q27) Bond prices and yields are like a seesaw: when bond yields go up, prices go up, and when bond yields go down, prices go down. (F)

## Short Answer Questions

**Q1.** Define the term of “finance”.

**Q2.** What are the types of finance?

**Q3.** Define the term of “financial system”.

**Q4.** Define the term of “financial market”.

**Q5.** Define the term of “security/financial asset”.

**Q6.** What are the main components of financial system?

**Q7.** Describe the term of “financial stability”.

**Q8.** What is meant by valuation of securities?

Answer-8: The process of estimating the worth of a security. This is done by looking at the cash flows that will be generated by the security and discounting them back to the present using an appropriate rate.

**Q9.** Why do we need to calculate valuation of securities?

Answer-9: to ensure that we are paying a fair price for the investment. It also allows us to determine the rate of return that we would need to receive to break even on our investment.

**Q10.** What are the main factors influence on security yields and prices?

Answer:

- 1) Default risk (Credit Risk)
- 2) Liquidity
- 3) Tax status
- 4) Term to maturity
- 5) Special contract provisions such as embedded options

**Q11.** What are the more popular money market securities?

Answer:

- 1) Treasury Bills
- 2) Commercial Papers
- 3) Certificates of Deposit
- 4) Repurchase Agreements

**Q12.** What are the bond investment strategies?

Answer:

- a) Matching Strategy
- b) Laddered Strategy
- c) Barbell Strategy
- d) Interest Rate Strategy

## Essay Questions

- Q1.** Explain the role and functions of financial markets in detail.
- Q2.** What are the types of finance? Explain personal finance in detail.
- Q3.** What are the types of finance? Explain corporate finance in detail.
- Q4.** What are the types of finance? Explain public finance in detail.
- Q5.** What are the types of finance? Explain investment management in detail.
- Q6.** What are the types of finance? Explain risk management in detail.
- Q7.** What are the types of finance? Explain quantitative finance in detail.
- Q8.** Explain financial stability and financial instability comparatively in detail.
- Q9.** Explain Primary Market and Secondary Market comparatively in detail
- Q10.** Explain Money Market and Capital Market comparatively in detail
- Q11.** Explain Organized Market and Over-the-Counter Market comparatively in detail
- Q12.** Explain Cash Market and Futures Market comparatively in detail
- Q13.** Explain Debt Market and Equity Market comparatively in detail
- Q14.** Explain the role and functions of general financial institutions in detail.
- Q14.** Explain the role and functions of non-depository financial institutions in detail.
- Q14.** What are the role and functions of central banks in financial markets? Explain in detail.
- Q15.** Explain the influence of improvements in information technology on financial markets.
- Q16.** Explain the importance of interest rates changes in real and financial markets.
- Q17.** Explain the role/purpose of money markets in an economy.
- Q18.** What are the money markets segments, explain briefly.
- Q19.** Explain treasury bonds in detail.
- Q20.** Explain treasury bills in detail.
- Q21.** What are the bond investment strategies, explain in detail?