

- 1) The risk structure of interest rates is
 - A) the structure of how interest rates move over time.
 - B) the relationship among interest rates on bonds with different maturities.
 - C) the relationship among the term to maturity of different bonds.
 - D) the relationship among interest rates of different bonds with the same maturity.

- 2) The risk that interest payments will not be made, or that the face value of a bond is not repaid when a bond matures is
 - A) interest rate risk.
 - B) inflation risk.
 - C) default risk.
 - D) moral hazard.
 - E) exchange rate risk.

- 3) U.S. government bonds have no default risk because
 - A) they are backed with gold reserves.
 - B) the federal government can increase taxes or even just print money to pay its obligations.
 - C) they are backed by the full faith and credit of the federal government.
 - D) all of the above.
 - E) of only A and B of the above.

- 4) The spread between the interest rates on bonds with default risk and default-free bonds is called the
 - A) junk margin.
 - B) bond margin.
 - C) risk premium.
 - D) default premium.

- 5) If the probability of a bond default increases because corporations begin to suffer large losses, then the default risk on corporate bonds will _____ and the expected return on these bonds will _____.
 - A) increase; increase
 - B) decrease; increase
 - C) increase; decrease
 - D) decrease; decrease

- 6) If the possibility of a default increases because corporations begin to suffer losses, then the default risk on corporate bonds will _____, and the bonds' returns will become _____ uncertain, meaning that the expected return on these bonds will decrease.
 - A) increase; more
 - B) decrease; more
 - C) decrease; less
 - D) increase; less

- 7) The theory of asset demand predicts that as the possibility of a default on a corporate bond increases, the expected return on the bond _____ while its relative riskiness _____.
 - A) rises; falls
 - B) falls; rises
 - C) rises; rises
 - D) falls; falls

- 15) A reduction in the riskiness of corporate bonds will _____ the price of corporate bonds and _____ the price of Treasury bonds.
- A) increase; increase
 - B) increase; reduce
 - C) reduce; increase
 - D) reduce; not affect
 - E) reduce; reduce
- 16) An increase in the riskiness of corporate bonds will _____ the yield on corporate bonds and _____ the yield on Treasury securities.
- A) reduce; reduce
 - B) increase; reduce
 - C) increase; not affect
 - D) reduce; increase
 - E) increase; increase
- 17) Bonds with relatively low risk of default are called _____ securities and have a rating of Baa (or BBB) and above; bonds with ratings below Baa (or BBB) have a higher default risk and are called _____.
- A) high quality; lower grade
 - B) high quality; junk bonds
 - C) investment grade; junk bonds
 - D) investment grade; lower grade
- 18) A risk premium is sometimes called a _____.
- A) default premium.
 - B) junk premium.
 - C) rating premium.
 - D) liquidity premium.
- 19) Corporate bonds are not as liquid as government bonds because _____.
- A) the corporate bond rating must be calculated each time they are traded.
 - B) corporate bonds are not callable.
 - C) fewer corporate bonds for any one corporation are traded, making them more costly to sell.
 - D) of all of the above.
 - E) of only A and B of the above.
- 20) When the default risk in corporate bonds increases, other things equal, the demand curve for corporate bonds shifts to the _____ and the demand curve for Treasury bonds shifts to the _____.
- A) right; right
 - B) left; left
 - C) right; left
 - D) left; right
- 21) As default risk increases, the expected return on corporate bonds _____, and the return becomes _____ uncertain.
- A) increases; more
 - B) decreases; more
 - C) decreases; less
 - D) increases; less

22) Which of the following statements are true?

- A) An increase in default risk on corporate bonds lowers the demand for these bonds, but increases the demand for default-free bonds.
- B) A corporate bond's return becomes more uncertain as default risk increases.
- C) The expected return on corporate bonds decreases as default risk increases.
- D) As their relative riskiness increases, the expected return on corporate bonds decreases relative to the expected return on default-free bonds.
- E) All of the above are true statements.

23) Which of the following statements are true?

- A) A corporate bond's return becomes less uncertain as default risk increases.
- B) A decrease in default risk on corporate bonds lowers the demand for these bonds, but increases the demand for default-free bonds.
- C) As their relative riskiness increases, the expected return on corporate bonds increases relative to the expected return on default-free bonds.
- D) The expected return on corporate bonds decreases as default risk increases.

24) Which of the following statements are true?

- A) A decrease in default risk on corporate bonds lowers the demand for these bonds, but increases the demand for default-free bonds.
- B) A corporate bond's return becomes more uncertain as default risk increases.
- C) As their relative riskiness increases, the expected return on corporate bonds increases relative to the expected return on default-free bonds.
- D) The expected return on corporate bonds increases as default risk increases.

25) Which of the following statements are true?

- A) The expected return on corporate bonds decreases as default risk decreases.
- B) As their relative riskiness increases, the expected return on corporate bonds decreases relative to the expected return on default-free bonds.
- C) An increase in default risk on corporate bonds decreases the demand for default-free bonds.
- D) A corporate bond's return becomes more uncertain as default risk decreases.

26) Which of the following statements are true?

- A) An increase in default risk on corporate bonds lowers the demand for these bonds, but increases the demand for default-free bonds.
- B) The expected return on corporate bonds decreases as default risk increases.
- C) A corporate bond's return becomes less uncertain as default risk increases.
- D) Only A and B of the above are true statements.
- E) Only A and C of the above are true statements.

- 27) Which of the following statements are true?
- A) A bond with default risk will always have a positive risk premium, and an increase in its default risk will raise the risk premium.
 - B) A corporate bond's return becomes less uncertain as default risk increases.
 - C) The expected return on corporate bonds decreases as default risk decreases.
 - D) Only A and B of the above are true statements.
- 28) Which of the following statements are true?
- A) Bonds with low ratings have been dubbed junk bonds.
 - B) Two major investment advisory firms, Moody's Investor Service and Standard and Poor's Corporation, provide default risk information by rating the quality of corporate and municipal bonds.
 - C) The expected return on corporate bonds decreases as default risk increases.
 - D) All of the above are true statements.
 - E) Only A and B of the above are true statements.
- 29) Which of the following long-term bonds currently has the lowest interest rate?
- A) Municipal bonds
 - B) Corporate Baa bonds
 - C) U.S. Treasury bonds
 - D) Corporate Aaa bonds
- 30) Which of the following long-term bonds has the highest interest rate?
- A) Corporate Baa bonds
 - B) Municipal bonds
 - C) Corporate Aaa bonds
 - D) U.S. Treasury bonds
- 31) Which of the following long-term bonds currently has the lowest interest rate?
- A) Corporate Baa bonds
 - B) Corporate Aa bonds
 - C) Corporate Aaa bonds
 - D) U.S. Treasury bonds
- 32) Which of the following long-term bonds has the highest interest rate?
- A) U.S. Treasury bonds
 - B) Corporate Aa bonds
 - C) Corporate Aaa bonds
 - D) Corporate Baa bonds
- 33) Which of the following short-term securities has the lowest interest rate?
- A) Negotiable certificates of deposit
 - B) Banker's acceptances
 - C) Commercial paper
 - D) U.S. Treasury bills
- 34) Of the following long-term bonds, the one with the highest interest rate is
- A) U.S. Treasury bonds.
 - B) municipal bonds.
 - C) corporate Baa bonds.
 - D) corporate Caa bonds.

- 35) The bankruptcy of the Enron Corporation
- A) increased the perceived riskiness of municipal bonds.
 - B) increased the Baa–Aaa spread.
 - C) reduced the Baa–Aaa spread.
 - D) increased the perceived riskiness of Treasury securities.
 - E) did not affect the corporate bond market.
- 36) During a "flight to quality"
- A) the change in the spread between Aaa and Baa bonds cannot be predicted.
 - B) junk bonds become more attractive to investors.
 - C) the spread between Aaa and Baa bonds increases.
 - D) the spread between Aaa and Baa bonds is not affected.
 - E) the spread between Aaa and Baa bonds decreases.
- 37) The spread between interest rates on low quality corporate bonds and U.S. government bonds
- A) narrowed moderately during the Great Depression.
 - B) did not change during the Great Depression.
 - C) narrowed significantly during the Great Depression.
 - D) widened significantly during the Great Depression.
- 38) Which of the following statements are true?
- A) The demand for a bond declines when it becomes less liquid, increasing the interest rate spread between it and relatively more liquid bonds.
 - B) The differences in bond interest rates reflect differences in both default risk and liquidity.
 - C) A liquid asset is one that can be quickly and cheaply converted into cash.
 - D) All of the above are true statements.
 - E) Only A and B are true statements.
- 39) Which of the following statements are true?
- A) A risk premium is sometimes mistakenly called a "liquidity premium."
 - B) The demand for a bond declines when it becomes less liquid, increasing the interest rate spread between it and relatively more liquid bonds.
 - C) The differences in bond interest rates reflect differences in both default risk and liquidity.
 - D) Only A and B are true statements.
 - E) Only B and C are true statements.
- 40) When the Treasury bond market becomes more liquid, other things equal, the demand curve for corporate bonds shifts to the _____ and the demand curve for Treasury bonds shifts to the _____.
- A) right; right
 - B) left; left
 - C) left; right
 - D) right; left

- 41) A decrease in the liquidity of corporate bonds, other things being equal, shifts the demand curve for corporate bonds to the _____ and the demand curve for Treasury bonds shifts to the _____.
- A) right; right B) right; left C) left; right D) left; left
- 42) The risk premium on corporate bonds becomes smaller if
- A) the liquidity of corporate bonds increases. B) the liquidity of corporate bonds decreases.
C) the riskiness of corporate bonds increases. D) both A and C occur.
- 43) The risk premium on corporate bonds rises when
- A) the Treasury bond market becomes less liquid.
B) a flurry of major corporate bankruptcies occurs.
C) brokerage commissions fall in the corporate bond market.
D) any of the above occurs.
- 44) A decrease in the risk premium on corporate bonds results from
- A) an increase in Treasury bond liquidity.
B) a flurry of major corporate bankruptcies.
C) a decline in corporate bond brokerage commissions.
D) all of the above.
E) both A and B of the above.
- 45) A decrease in marginal tax rates would likely have the effect of _____ the demand for municipal bonds, and _____ the demand for U.S. government bonds.
- A) decreasing; increasing B) increasing; increasing
C) decreasing; decreasing D) increasing; decreasing
- 46) Which of the following statements are true?
- A) Interest rates on municipal bonds will be lower than comparable bonds without the tax exemption.
B) Because coupon payments on municipal bonds are exempt from federal income tax, the expected after-tax return on them will be higher for individuals in higher income tax brackets.
C) An increase in tax rates will increase the demand for municipal bonds, lowering their interest rates.
D) All of the above are true statements.
E) Only A and B are true statements.

47) Which of the following statements are true?

- A) Because coupon payments on municipal bonds are exempt from federal income tax, the expected after-tax return on them will be higher for individuals in higher income tax brackets.
- B) Interest rates on municipal bonds will be higher than comparable bonds without the tax exemption.
- C) An increase in tax rates will increase the demand for Treasury bonds, lowering their interest rates.
- D) Only A and B are true statements.

48) Which of the following statements are true?

- A) An increase in tax rates will increase the demand for Treasury bonds, lowering their interest rates.
- B) Interest rates on municipal bonds will be higher than comparable bonds without the tax exemption.
- C) Because the tax-exempt status of municipal bonds was of little benefit to bond holders when tax rates were low, they had higher interest rates than U.S. government bonds before World War II.
- D) Only A and B are true statements.

49) The interest rate on municipal bonds falls relative to the interest rate on Treasury securities when

- A) income tax rates are raised.
- B) there is a major default in the municipal bond market.
- C) corporate bonds become riskier.
- D) municipal bonds become less widely traded.
- E) none of the above occur.

50) The interest rate on municipal bonds rises relative to the interest rate on Treasury securities when

- A) municipal bonds become more widely traded.
- B) income tax rates are lowered.
- C) income tax rates are raised.
- D) there is a major default in the corporate bond market.
- E) corporate bonds become riskier.

51) If income tax rates were lowered, then

- A) the interest rate on municipal bonds would fall.
- B) the prices of municipal bonds would fall.
- C) the interest rate on Treasury bonds would rise.
- D) both A and B would occur.

52) If income tax rates were lowered, then

- A) the interest rate on municipal bonds would rise.
- B) the interest rate on Treasury bonds would fall.
- C) the interest rate on municipal bonds would fall.
- D) both A and B would occur.
- E) both B and C would occur.

- 53) If income tax rates were lowered, then
- A) the prices of municipal bonds would fall.
 - B) the prices of Treasury bonds would rise.
 - C) the interest rate on Treasury bonds would rise.
 - D) both A and B would occur.
- 54) Municipal bonds have default risk, yet their interest rates are lower than the rates on default-free Treasury bonds. This suggests that
- A) the benefit from the tax-exempt status of municipal bonds exceeds their default risk.
 - B) the benefit from the tax-exempt status of municipal bonds is less than their default risk.
 - C) the benefit from the tax-exempt status of municipal bonds equals their default risk.
 - D) Treasury bonds are not default-free.
 - E) both C and D above are correct.
- 55) If the tax-exempt status of municipal bonds were eliminated, then
- A) the interest rates on municipal, Treasury, and corporate bonds would all decrease.
 - B) the interest rate on municipal bonds would exceed the rate on Treasury bonds.
 - C) the interest rate on municipal bonds would equal the rate on Treasury bonds.
 - D) the interest rates on municipal, Treasury, and corporate bonds would all increase.
 - E) the interest rates on municipal bonds would still be less than the interest rate on Treasury bonds.
- 56) The differences among the various bond ratings reflect
- A) the bonds' relative liquidity.
 - B) the bonds' relative default risks.
 - C) the bond's relative tax treatment.
 - D) all of the above.
 - E) only A and B of the above.
- 57) The risk structure of interest rates is explained by differences in
- A) the bonds' relative liquidity.
 - B) the bonds' relative default risks.
 - C) the bond's relative tax treatment.
 - D) all of the above.
 - E) only A and B of the above.
- 58) The relationship among interest rates on bonds with identical default risk, but of different maturities is called the
- A) bond demand curve.
 - B) yield curve.
 - C) liquidity structure of interest rates.
 - D) time-risk structure of interest rates.

59) Yield curves can be

- A) downward sloping.
- B) steeply upward sloping.
- C) moderately upward sloping.
- D) all of the above.
- E) only A and B of the above.

60) Typically, yield curves are

- A) mound shaped.
- B) gently downward sloping.
- C) gently upward sloping.
- D) flat.
- E) bowl shaped.

61) When yield curves are steeply upward sloping,

- A) long-term interest rates are above short-term interest rates.
- B) medium-term interest rates are above both short-term and long-term interest rates.
- C) short-term interest rates are above long-term interest rates.
- D) medium-term interest rates are below both short-term and long-term interest rates.
- E) short-term interest rates are about the same as long-term interest rates.

62) When yield curves are downward sloping,

- A) short-term interest rates are about the same as long-term interest rates.
- B) medium-term interest rates are above both short-term and long-term interest rates.
- C) medium-term interest rates are below both short-term and long-term interest rates.
- D) long-term interest rates are above short-term interest rates.
- E) short-term interest rates are above long-term interest rates.

63) When yield curves are flat,

- A) medium-term interest rates are below both short-term and long-term interest rates.
- B) long-term interest rates are above short-term interest rates.
- C) short-term interest rates are about the same as long-term interest rates.
- D) medium-term interest rates are above both short-term and long-term interest rates.
- E) short-term interest rates are above long-term interest rates.

- 64) According to the expectations theory of the term structure
- A) buyers of bonds do not prefer bonds of one maturity over another.
 - B) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
 - C) interest rates on bonds of different maturities move together over time.
 - D) all of the above.
 - E) only A and B of the above.
- 65) According to the expectations theory of the term structure
- A) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
 - B) interest rates on bonds of different maturities move together over time.
 - C) buyers of bonds prefer short-term to long-term bonds.
 - D) all of the above.
 - E) only A and B of the above.
- 66) According to the expectations theory of the term structure
- A) when the yield curve is downward sloping, short-term interest rates are expected to decline in the future.
 - B) when the yield curve is steeply upward sloping, short-term interest rates are expected to rise in the future.
 - C) buyers of bonds do not prefer bonds of one maturity over another.
 - D) all of the above.
 - E) only A and B of the above.
- 67) According to the expectations theory of the term structure
- A) when the yield curve is steeply upward sloping, short-term interest rates are expected to rise in the future.
 - B) when the yield curve is downward sloping, short-term interest rates are expected to decline in the future.
 - C) investors have strong preferences for short-term relative to long-term bonds, explaining why yield curves typically slope upward.
 - D) all of the above.
 - E) only A and B of the above.
- 68) According to the expectations theory of the term structure
- A) when the yield curve is downward sloping, short-term interest rates are expected to decline in the future.
 - B) yield curves should be as equally likely to slope downward as slope upward.
 - C) when the yield curve is steeply upward sloping, short-term interest rates are expected to rise in the future.
 - D) all of the above.
 - E) only A and B of the above.

- 69) According to the expectations theory of the term structure
- A) buyers of bonds do not prefer bonds of one maturity over another.
 - B) yield curves should be as equally likely to slope downward as slope upward.
 - C) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
 - D) all of the above.
 - E) only A and B of the above.
- 70) According to the expectations theory of the term structure
- A) interest rates on bonds of different maturities do not move together over time.
 - B) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
 - C) buyers of bonds do prefer short-term to long-term bonds.
 - D) all of the above.
- 71) According to the expectations theory of the term structure
- A) interest rates on bonds of different maturities move together over time.
 - B) the interest rate on long-term bonds will exceed the average of short-term interest rates that people expect to occur over the life of the long-term bonds, because of their preference for short-term securities.
 - C) buyers of bonds prefer short-term to long-term bonds.
 - D) all of the above.
 - E) only A and B of the above.
- 72) If the expected path of one-year interest rates over the next five years is 4 percent, 5 percent, 7 percent, 8 percent, and 6 percent, then the expectations theory predicts that today's interest rate on the five-year bond is
- A) 5 percent. B) 8 percent. C) 7 percent. D) 4 percent. E) 6 percent.
- 73) If the expected path of 1-year interest rates over the next four years is 5 percent, 4 percent, 2 percent, and 1 percent, then the expectations theory predicts that today's interest rate on the four-year bond is
- A) 1 percent. B) 2 percent. C) 5 percent. D) 4 percent. E) 3 percent.
- 74) Over the next three years, the expected path of 1-year interest rates is 4, 1, and 1 percent. The expectations theory of the term structure predicts that the current interest rate on 3-year bond is
- A) 5 percent. B) 1 percent. C) 3 percent. D) 2 percent. E) 4 percent.

- 75) According to the segmented markets theory of the term structure
- A) buyers of bonds do not prefer bonds of one maturity over another.
 - B) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds.
 - C) interest rates on bonds of different maturities do not move together over time.
 - D) all of the above.
- 76) According to the segmented markets theory of the term structure
- A) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope upward.
 - B) bonds of one maturity are not substitutes for bonds of other maturities, therefore, interest rates on bonds of different maturities do not move together over time.
 - C) the interest rate for each maturity bond is determined by supply and demand for that maturity bond.
 - D) all of the above.
 - E) none of the above.
- 77) According to the segmented markets theory of the term structure
- A) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope downward.
 - B) bonds of one maturity are close substitutes for bonds of other maturities, therefore, interest rates on bonds of different maturities move together over time.
 - C) the interest rate for each maturity bond is determined by supply and demand for that maturity bond.
 - D) all of the above.
- 78) According to the segmented markets theory of the term structure
- A) the interest rate for each maturity bond is determined by supply and demand for that maturity bond.
 - B) bonds of one maturity are not substitutes for bonds of other maturities, therefore, interest rates on bonds of different maturities do not move together over time.
 - C) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope downward.
 - D) only A and B of the above.
- 79) According to the segmented markets theory of the term structure
- A) the interest rate for each maturity bond is determined by supply and demand for that maturity bond.
 - B) investors' strong preferences for short-term relative to long-term bonds explains why yield curves typically slope upward.
 - C) bonds of one maturity are close substitutes for bonds of other maturities, therefore, interest rates on bonds of different maturities move together over time.
 - D) all of the above.
 - E) only A and B of the above.

- 80) The liquidity premium theory of the term structure
- A) suggests that markets for bonds of different maturities are completely separate because people have preferred habitats.
 - B) indicates that today's long-term interest rate equals the average of short-term interest rates that people expect to occur over the life of the long-term bond.
 - C) assumes that bonds of different maturities are perfect substitutes.
 - D) does none of the above.
- 81) According to the liquidity premium theory of the term structure
- A) buyers of bonds may prefer bonds of one maturity over another, yet interest rates on bonds of different maturities move together over time.
 - B) even with a positive term premium, if future short-term interest rates are expected to fall significantly, then the yield curve will be downward sloping.
 - C) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds plus a term premium.
 - D) all of the above.
 - E) only A and B of the above.
- 82) According to the liquidity premium theory of the term structure
- A) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds plus a term premium.
 - B) because of the positive term premium, the yield curve will not be observed to be downward sloping.
 - C) because buyers of bonds may prefer bonds of one maturity over another, interest rates on bonds of different maturities do not move together over time.
 - D) all of the above.
 - E) only A and B of the above.
- 83) If 1-year interest rates for the next three years are expected to be 4, 2, and 3 percent, and the 3-year term premium is 1 percent, then the 3-year bond rate will be
- A) 1 percent. B) 2 percent. C) 3 percent. D) 4 percent. E) 5 percent.
- 84) If 1-year interest rates for the next four years are expected to be 4, 2, 3, and 3 percent, and the 4-year term premium is 1 percent, then the 4-year bond rate will be
- A) 1 percent. B) 2 percent. C) 3 percent. D) 4 percent. E) 5 percent.
- 85) If 1-year interest rates for the next five years are expected to be 4, 2, 5, 4, and 5 percent, and the 5-year term premium is 1 percent, then the 5-year bond rate will be
- A) 1 percent. B) 2 percent. C) 3 percent. D) 4 percent. E) 5 percent.
- 86) If 1-year interest rates for the next two years are expected to be 4 and 2 percent, and the 2-year term premium is 1 percent, then the 2-year bond rate will be
- A) 1 percent. B) 2 percent. C) 3 percent. D) 4 percent. E) 5 percent.

- 87) If the yield curve is flat for short maturities and then slopes downward for longer maturities, the liquidity premium theory (assuming a mild preference for shorter-term bonds) indicates that the market is predicting.
- A) a decline in short-term interest rates in the near future and an even steeper decline further out in the future.
 - B) a decline in short-term interest rates in the near future and a rise further out in the future.
 - C) a rise in short-term interest rates in the near future and a decline further out in the future.
 - D) constant short-term interest rates in the near future and a decline further out in the future.
- 88) If the yield curve slope is flat, the liquidity premium theory (assuming a mild preference for shorter-term bonds) indicates that the market is predicting
- A) a mild rise in short-term interest rates in the near future and a mild decline further out in the future.
 - B) constant short-term interest rates in the near future and a mild decline further out in the future.
 - C) a mild decline in short-term interest rates in the near future and a continuing mild decline further out in the future.
 - D) constant short-term interest rates in the near future and further out in the future.
- 89) If the yield curve has a mild upward slope, the liquidity premium theory (assuming a mild preference for shorter-term bonds) indicates that the market is predicting
- A) a decline in short-term interest rates in the near future and a rise further out in the future.
 - B) a rise in short-term interest rates in the near future and a decline further out in the future.
 - C) constant short-term interest rates in the near future and further out in the future.
 - D) a decline in short-term interest rates in the near future and an even steeper decline further out in the future.
- 90) According to the liquidity premium theory of the term structure
- A) when short-term interest rates are expected to decline significantly in the future, the yield curve is likely to be downward sloping,
 - B) when short-term interest rates are expected to rise in the future, the yield curve will be upward sloping.
 - C) when short-term interest rates are expected to decline moderately in the future, the yield curve is likely to be flat.
 - D) all of the above.
 - E) only A and B of the above.
- 91) According to the liquidity premium theory
- A) a steeply rising yield curve indicates that short-term interest rates are expected to remain unchanged in the future.
 - B) a flat yield curve indicates that short-term interest rates are expected to rise moderately in the future.
 - C) a moderately rising yield curve indicates that short-term interest rates are not expected to change much in the future.
 - D) only A and B of the above are true.

- 92) According to the liquidity premium theory of the term structure
- A) when short-term interest rates are expected to rise in the future, the yield curve will be upward sloping.
 - B) when short-term interest rates are expected to decline significantly in the future, the yield curve is likely to be downward sloping.
 - C) when short-term interest rates are expected to remain unchanged in the future, the yield curve is likely to be flat.
 - D) all of the above.
 - E) only A and B of the above.
- 93) According to the liquidity premium theory of the term structure
- A) when short-term interest rates are expected to decline moderately in the future, the yield curve is likely to be flat.
 - B) when short-term interest rates are expected to remain unchanged in the future, the yield curve is likely to be slightly upward sloping.
 - C) when short-term interest rates are expected to rise in the future, the yield curve will be steeply upward sloping.
 - D) all of the above.
 - E) only A and B of the above.
- 94) According to the liquidity premium theory of the term structure, a steeply upward sloping yield curve indicates that
- A) short-term interest rates are expected to rise in the future.
 - B) short-term interest rates are expected to remain unchanged in the future.
 - C) short-term interest rates are expected to decline moderately in the future.
 - D) short-term interest rates are expected to decline sharply in the future.
- 95) According to the liquidity premium theory of the term structure, a slightly upward sloping yield curve indicates that
- A) short-term interest rates are expected to rise in the future.
 - B) short-term interest rates are expected to remain unchanged in the future.
 - C) short-term interest rates are expected to decline moderately in the future.
 - D) short-term interest rates are expected to decline sharply in the future.
- 96) According to the liquidity premium theory of the term structure, a flat yield curve indicates that
- A) short-term interest rates are expected to rise in the future.
 - B) short-term interest rates are expected to remain unchanged in the future.
 - C) short-term interest rates are expected to decline moderately in the future.
 - D) short-term interest rates are expected to decline sharply in the future.

- 97) According to the liquidity premium theory of the term structure, a downward sloping yield curve indicates that
- A) short-term interest rates are expected to rise in the future.
 - B) short-term interest rates are expected to remain unchanged in the future.
 - C) short-term interest rates are expected to decline moderately in the future.
 - D) short-term interest rates are expected to decline sharply in the future.
- 98) According to the liquidity premium theory
- A) a steeply rising yield curve indicates that short-term interest rates are expected to rise in the future.
 - B) a flat yield curve indicates that short-term interest rates are expected to fall moderately in the future.
 - C) a moderately rising yield curve indicates that short-term interest rates are not expected to change much in the future.
 - D) all of the above are true.
 - E) only A and B of the true.
- 99) According to the liquidity premium theory
- A) a downward sloping yield curve indicates that short-term interest rates are expected to fall sharply in the future.
 - B) a flat yield curve indicates that short-term interest rates are expected to rise moderately in the near future, then fall moderately in the distant future.
 - C) a moderately rising yield curve indicates that short-term interest rates are expected rise moderately in the future.
 - D) a steeply rising yield curve indicates that short-term interest rates are expected to remain unchanged in the future.
- 100) According to the liquidity premium theory of the term structure
- A) bonds of different maturities are substitutes, but investors can prefer one bond maturity over another.
 - B) if yield curves are downward sloping, then short-term interest rates are expected to fall by so much that, even when the positive term premium is added, long-term rates fall below short-term rates.
 - C) yield curves should never slope downward.
 - D) both A and B of the above are true.
 - E) both A and C of the above are true.
- 101) Which of the following theories of the term structure is (are) able to explain the fact that interest rates on bonds of different maturities tend to move together over time?
- A) The expectations theory
 - B) The segmented markets theory
 - C) The liquidity premium theory
 - D) Both A and B of the above
 - E) Both A and C of the above

- 102) Which of the following theories of the term structure are able to explain the fact that yield curves usually slope upward?
- A) The expectations theory
 - B) The segmented markets theory
 - C) The liquidity premium theory
 - D) Both B and C of the above
 - E) Both A and C of the above
- 103) The ____ of the term structure of interest rates states that the interest rate on a long-term bond will equal the average of short-term interest rates that individuals expect to occur over the life of the long-term bond, and investors have no preference for short-term bonds relative to long-term bonds.
- A) liquidity premium theory
 - B) segmented markets theory
 - C) expectations theory
 - D) separable markets theory
- 104) When the yield curve is upward sloping,
- A) the liquidity premium theory suggests that short-term interest rates are expected to fall.
 - B) the expectations theory suggests that short-term interest rates are expected to fall.
 - C) the segmented markets theory suggests that short-term interest rates are expected to fall.
 - D) the expectations theory suggests that short-term interest rates are expected to rise.
- 105) When the yield curve slopes down,
- A) the expectations theory suggests that short-term interest rates are expected to rise.
 - B) the liquidity premium theory suggests that short-term interest rates are expected to rise.
 - C) the segmented markets theory suggests that short-term interest rates are expected to rise.
 - D) the expectations theory suggests that short-term interest rates are expected to fall.
- 106) In actual practice, short-term interest rates and long-term interest rates move together; this is the major shortcoming of the
- A) separable markets theory.
 - B) liquidity premium theory.
 - C) expectations theory.
 - D) segmented markets theory.
- 107) Since yield curves are usually upward sloping, the ____ indicates that, on average, people tend to prefer holding short-term bonds to long-term bonds.
- A) segmented markets theory
 - B) expectations theory
 - C) liquidity premium theory
 - D) both A and B of the above
 - E) both A and C of the above

108) It cannot explain the empirical fact that interest rates on bonds of different maturities tend to move together.

- A) Expectations theory
- B) Segmented markets theory
- C) Liquidity premium theory
- D) Both A and B of the above
- E) Both A and C of the above

109) A particularly attractive feature of the _____ is that it tells you what the market is predicting about future short-term interest rates by just looking at the slope of the yield curve.

- A) liquidity premium theory
- B) segmented markets theory
- C) expectations theory
- D) both A and B of the above

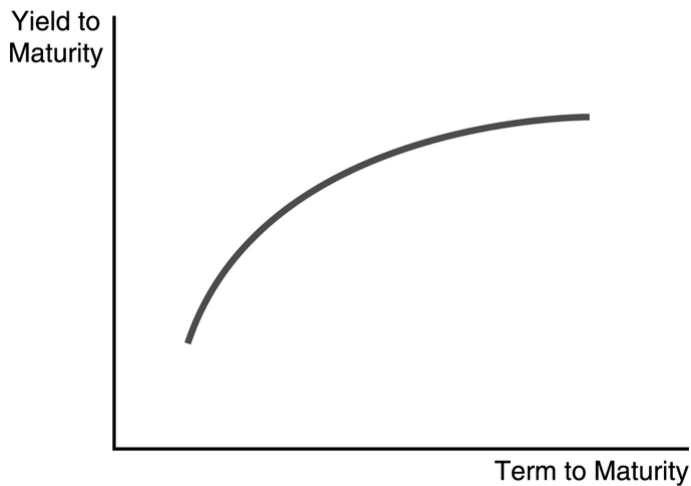


Figure 6-1

110) The steeply upward sloping yield curve in Figure 6-1 indicates that

- A) short-term interest rates are expected to remain unchanged in the future.
- B) short-term interest rates are expected to fall sharply in the future.
- C) short-term interest rates are expected to rise in the future.
- D) short-term interest rates are expected to fall moderately in the future.

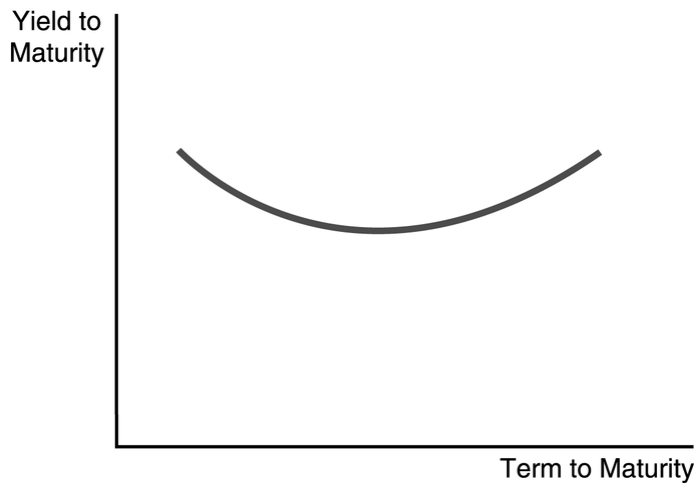


Figure 6-2

- 111) The U-shaped yield curve in Figure 6-2 indicates that short-term interest rates are expected to ____.
- A) rise in the near-term and fall later on
 - B) fall moderately in the near-term and rise later on
 - C) remain unchanged in the near-term and rise later on
 - D) fall sharply in the near-term and rise later on
- 112) The U-shaped yield curve in Figure 6-2 indicates that
- A) inflation is expected to remain constant in the near-term and rise later on.
 - B) inflation is expected to rise moderately in the near-term and fall later on.
 - C) inflation is expected to fall sharply in the near-term and rise later on.
 - D) inflation is expected to remain constant in the near-term and fall later on.

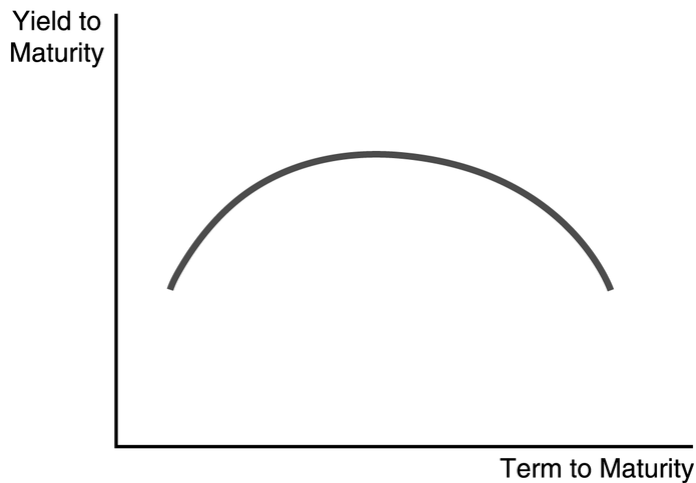


Figure 6-3

- 113) The inverted U-shaped yield curve in Figure 6-3 indicates that
- A) short-term interest rates are expected to fall moderately in the near-term and rise later on.
 - B) short-term interest rates are expected to fall sharply in the near-term and rise later on.
 - C) short-term interest rates are expected to rise in the near-term and fall later on.
 - D) short-term interest rates are expected to remain unchanged in the near-term and fall later on.
- 114) The inverted U-shaped yield curve in Figure 6-3 indicates that
- A) inflation is expected to fall moderately in the near-term and rise later on.
 - B) inflation is expected to remain unchanged in the near-term and rise later on.
 - C) inflation is expected to rise moderately in the near-term and fall later on.
 - D) inflation is expected to remain constant in the near-term and fall later on.
- 115) An inverted yield curve predicts that
- A) short-term interest rates will remain unchanged in the future.
 - B) short-term interest rates are expected to rise in the future.
 - C) short-term interest rates will fall in the future.
 - D) short-term interest rates will rise and then fall in the future.
 - E) short-term interest rates will fall and then rise in the future.
- 116) When short-term interest rates are expected to fall in the future, the yield curve will
- A) be an inverted U shape.
 - B) have a W shape.
 - C) slope up.
 - D) be inverted.
 - E) be flat.

Answer Key
Testname: CH6

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

Answer Key
Testname: CH6

- 52) D
- 53) D
- 54) A
- 55) B
- 56) B
- 57) D
- 58) B
- 59) D
- 60) C
- 61) A
- 62) E
- 63) C
- 64) D
- 65) E
- 66) D
- 67) E
- 68) D
- 69) D
- 70) B
- 71) A
- 72) E
- 73) E
- 74) D
- 75) C
- 76) D
- 77) C
- 78) D
- 79) E
- 80) D
- 81) D
- 82) A
- 83) D
- 84) D
- 85) E
- 86) D
- 87) A
- 88) C
- 89) C
- 90) D
- 91) C
- 92) E
- 93) D
- 94) A
- 95) B
- 96) C
- 97) D
- 98) D
- 99) A
- 100) D
- 101) E
- 102) D

Answer Key
Testname: CH6

- 103) C
- 104) D
- 105) D
- 106) D
- 107) E
- 108) B
- 109) A
- 110) C
- 111) D
- 112) C
- 113) C
- 114) C
- 115) C
- 116) D