Financial Markets and Institutions 12th edition Madura Test Bank

SKU: 9781337099745-TEST-BANK

Chapter 02: Determination of Interest Rates

1. The level of installment debt as a percentage of disposable income is generally ____ during recessionary periods.
   a. higher
   b. lower
   c. zero
   d. negative

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Knowledge

2. At any given point in time, households would demand a ____ quantity of loanable funds at ____ rates of interest.
   a. greater; higher
   b. greater; lower
   c. smaller; lower
   d. none of the above

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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3. Businesses demand loanable funds to
   a. finance installment debt.
   b. subsidize other companies.
   c. invest in fixed and short-term assets.
   d. none of the above

ANSWER: c
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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4. The required return to implement a given business project will be ____ if interest rates are lower. This implies that businesses will demand a ____ quantity of loanable funds when interest rates are lower.
   a. greater; lower
   b. lower; greater
   c. lower; lower
   d. greater; greater

ANSWER: b
DIFFICULTY: Easy

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KEYWORDS: Bloom's: Comprehension

5. If interest rates are ____, ____ projects will have positive NPVs.
   a. higher; more
   b. lower; more
   c. lower; no
   d. none of the above

ANSWER: b
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6. The demand for funds resulting from business investment in short-term assets is ____ related to the number of projects implemented, and is therefore ____ related to the interest rate.
   a. inversely; positively
   b. positively; inversely
   c. inversely; inversely
   d. positively; positively

ANSWER: b
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

7. If economic conditions become less favorable, then:
   a. expected cash flows on various projects will increase.
   b. more proposed projects will have expected returns greater than the hurdle rate.
   c. there would be additional acceptable business projects.
   d. there would be a decreased demand by business for loanable funds.

ANSWER: d
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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8. As a result of more favorable economic conditions, there is a(n) ____ demand for loanable funds, causing an ____ shift in the demand curve.
   a. decreased; inward
   b. decreased; outward

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c. increased; outward
d. increased; inward

ANSWER: c
DIFFICULTY: Easy
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9. The federal government's demand for loanable funds is ____. If the budget deficit is expected to increase, the federal government's demand for loanable funds would ____.

a. interest-elastic; decrease
b. interest-elastic; increase
c. interest-inelastic; increase
d. interest-inelastic; decrease

ANSWER: c
DIFFICULTY: Moderate
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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10. Other things being equal, foreign governments and corporations would demand ____ U.S. funds if their local interest rates were lower than U.S. rates. Therefore, for a given set of foreign interest rates, foreign demand for U.S. funds is ____ related to U.S. interest rates.

a. less; inversely
b. more; positively
c. less; positively
d. more; inversely

ANSWER: a
DIFFICULTY: Moderate
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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11. For a given set of foreign interest rates, the quantity of U.S. loanable funds demanded by foreign governments or firms will be ____ U.S. interest rates.

a. positively related to
b. inversely related to
c. unrelated to
d. none of the above

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01

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12. The quantity of loanable funds supplied is normally
    a. highly interest-elastic.
    b. more interest-elastic than the demand for loanable funds.
    c. less interest-elastic than the demand for loanable funds.
    d. equally as interest-elastic as the demand for loanable funds.
    e. A and B

ANSWER: c
DIFFICULTY: Moderate
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13. The ____ sector is the largest supplier of loanable funds.
    a. household
    b. government
    c. business
    d. none of the above

ANSWER: a
DIFFICULTY: Easy
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14. If a strong economy allows for a large ____ in households' income, the supply curve will shift ____.
    a. decrease; outward
    b. increase; inward
    c. increase; outward
    d. none of the above

ANSWER: c
DIFFICULTY: Moderate
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15. The equilibrium interest rate
    a. equates the aggregate demand for funds with the aggregate supply of loanable funds.
    b. equates the elasticity of the aggregate demand and supply for loanable funds.

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c. decreases as the aggregate supply of loanable funds decreases.
d. increases as the aggregate demand for loanable funds decreases.

ANSWER: a
DIFFICULTY: Easy
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16. The equilibrium interest rate should
a. fall when the aggregate supply of funds exceeds the aggregate demand for funds.
b. rise when the aggregate supply of funds exceeds the aggregate demand for funds.
c. fall when the aggregate demand for funds exceeds the aggregate supply of funds.
d. rise when the aggregate demand for funds equals the aggregate supply of funds.
e. B and C

ANSWER: a
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

17. Which of the following is likely to cause a decrease in the equilibrium U.S. interest rate, other things being equal?
a. a decrease in saving by foreign savers
b. an increase in inflation
c. pessimistic economic projections that cause businesses to reduce expansion plans
d. a decrease in saving by U.S. households

ANSWER: c
DIFFICULTY: Moderate
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18. The Fisher effect states that the
a. nominal interest rate equals the expected inflation rate plus the real rate of interest.
b. nominal interest rate equals the real rate of interest minus the expected inflation rate.
c. real rate of interest equals the nominal interest rate plus the expected inflation rate.
d. expected inflation rate equals the nominal interest rate plus the real rate of interest.

ANSWER: a
DIFFICULTY: Easy
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19. If the real interest rate was negative for a period of time, then
    a. inflation is expected to exceed the nominal interest rate in the future.
    b. inflation is expected to be less than the nominal interest rate in the future.
    c. actual inflation was less than the nominal interest rate.
    d. actual inflation was greater than the nominal interest rate.

ANSWER: d
DIFFICULTY: Easy
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20. If inflation is expected to decrease, then
    a. savers will provide less funds at the existing equilibrium interest rate.
    b. the equilibrium interest rate will increase.
    c. the equilibrium interest rate will decrease.
    d. borrowers will demand more funds at the existing equilibrium interest rate.

ANSWER: c
DIFFICULTY: Easy
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21. If inflation turns out to be lower than expected
    a. savers benefit.
    b. borrowers benefit while savers are not affected.
    c. savers and borrowers are equally affected.
    d. savers are adversely affected but borrowers benefit.

ANSWER: a
DIFFICULTY: Easy
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22. If the economy weakens, there is ____ pressure on interest rates. If the Federal Reserve increases the money supply there is ____ pressure on interest rates (assume that inflationary expectations are not affected).
    a. upward; upward
    b. upward; downward
    c. downward; upward
    d. downward; downward

ANSWER: d

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KEYWORDS: Bloom's: Knowledge

23. What is the basis of the relationship between the Fisher effect and the loanable funds theory?
a. the saver's desire to maintain the existing real rate of interest
b. the borrower's desire to achieve a positive real rate of interest
c. the saver's desire to achieve a negative real rate of interest
d. B and C

ANSWER: a
DIFFICULTY: Moderate
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24. Assume that foreign investors who have invested in U.S. securities decide to decrease their holdings of U.S. securities and to instead increase their holdings of securities in their own countries. This should cause the supply of loanable funds in the United States to_____ and should place ____ pressure on U.S. interest rates.
a. decrease; upward
b. decrease; downward
c. increase; downward
d. increase; upward

ANSWER: a
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Application

25. Assume that foreign investors who have invested in U.S. securities decide to increase their holdings of U.S. securities. This should cause the supply of loanable funds in the United States to ____ and should place ____ pressure on U.S. interest rates.
a. decrease; upward
b. decrease; downward
c. increase; downward
d. increase; upward

ANSWER: c
DIFFICULTY: Moderate
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26. If the federal government needs to borrow additional funds, this borrowing reflects a(n) ____ in the supply of loanable funds and a(n) ____ in the demand for loanable funds.

a. increase; no change
b. decrease; no change
c. no change; increase
d. no change; decrease

ANSWER: c
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Knowledge

27. If the federal government reduces its budget deficit, this causes a(n) ____ in the supply of loanable funds and a(n) ____ in the demand for loanable funds.

a. increase; no change
b. decrease; no change
c. no change; increase
d. no change; decrease

ANSWER: d
DIFFICULTY: Moderate
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28. When there are expectations of higher inflation in the future, we would typically expect the supply of loanable funds to ____ and the demand for loanable funds to ____.

a. increase; decrease
b. increase; increase
c. decrease; increase
d. decrease; decrease

ANSWER: c
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.02
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KEYWORDS: Bloom's: Comprehension

29. If the real interest rate is expected to become negative, then the purchasing power of savings would be ____, as the inflation rate is expected to be ____ the existing nominal interest rate.

a. decreasing; less than
b. decreasing; greater than
c. increasing; greater than

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d. increasing; less than

ANSWER: b
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Application

30. If economic expansion is expected to decrease, the demand for loanable funds should ____ and interest rates should ____.

a. increase; increase
b. increase; decrease
c. decrease; decrease
d. decrease; increase

ANSWER: c
DIFFICULTY: Moderate
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31. The federal government's spending policies are generally thought to be _____ interest rates, but municipal governments' spending is somewhat _____ interest rates.

a. independent of; sensitive to
b. sensitive to; independent of
c. inversely rated to; positively related to
d. positively related to; inversely related to

ANSWER: a
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.02
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KEYWORDS: Bloom's: Knowledge

32. The federal government's _____ determines the budget deficit and therefore determines the government's demand for loanable funds.

a. monetary policy
b. fiscal policy
c. congressional policy
d. economic policy

ANSWER: b
DIFFICULTY: Easy
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33. Canada and the United States are major trading partners. If Canada experiences a major increase in economic growth, that could place ____ pressure on Canadian interest rates and ____ pressure on U.S. interest rates.

a. upward; upward
b. upward; downward
c. downward; downward
d. downward; upward

ANSWER: a
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Application

34. If investors shift funds from stocks into bank deposits, this ____ the supply of loanable funds and places ____ pressure on interest rates.

a. increases; upward
b. increases; downward
c. decreases; downward
d. decreases; upward

ANSWER: b
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Comprehension

35. When Japanese interest rates rise, and if exchange rate expectations remain unchanged, the most likely effect is that the supply of loanable funds provided by Japanese investors to the United States will ____, and U.S. interest rates will ____.

a. increase; increase
b. increase; decrease
c. decrease; decrease
d. decrease; increase

ANSWER: d
DIFFICULTY: Moderate
LEARNING OBJECTIVES: FMAI.MADU.15.02.02
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KEYWORDS: Bloom's: Application

36. Which of the following will probably not result in an increase in the business demand for loanable funds?

a. an increase in positive net present value (NPV) projects
b. a reduction in interest rates on business loans
c. a recession

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d. none of the above

ANSWER: c
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Knowledge

37. If the aggregate demand for loanable funds increases without a corresponding ____ in aggregate supply, there will be a ____ of loanable funds.

a. increase; surplus
b. increase; shortage
c. decrease; surplus
d. decrease; shortage

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Knowledge

38. A ____ federal government deficit increases the quantity of loanable funds demanded at any prevailing interest rate, causing an ____ shift in the demand schedule.

a. higher; inward
b. higher; outward
c. lower; outward
d. none of the above

ANSWER: b
DIFFICULTY: Moderate
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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39. Which of the following is not true regarding foreign interest rates?

a. The large flow of funds between countries causes interest rates in any given country to become more susceptible to interest rate movements in other countries.
b. The expectations of a strong dollar should cause a flow of funds to the United States.
c. An increase in a foreign country's interest rates will encourage investors in that country to invest their funds in other countries.
d. All of the above are true regarding foreign interest rates.

ANSWER: c
DIFFICULTY: Easy
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40. Which of the following is least likely to affect household demand for loanable funds?
    a. a decrease in tax rates
    b. an increase in interest rates
    c. a reduction in positive net present value (NPV) projects available
    d. All of the above are equally likely to affect household demand for loanable funds.

ANSWER: c
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Knowledge

41. Which of the following statements is incorrect?
    a. The Fed's monetary policy is intended to influence U.S. economic conditions.
    b. The Fed's monetary policy affects the supply of loanable funds, which affects interest rates.
    c. By influencing interest rates, the Fed is able to influence the amount of money that corporations and households are willing to borrow and spend.
    d. All of the statements above are true.

ANSWER: d
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Knowledge

42. The ____ suggests that the market interest rate is determined by factors that control the supply of and demand for loanable funds.
    a. Fisher effect
    b. loanable funds theory
    c. real interest rate
    d. none of the above

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Knowledge

43. When forecasting future interest rates, if the net demand for funds (ND) is _____, there will be an _____ adjustment in interest rates.
    a. negative; upward
    b. negative; downward
    c. positive; upward

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d. positive; downward

ANSWER: c
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Knowledge

44. Other things being equal, a ____ quantity of U.S. funds would be demanded by foreign governments and corporations if their domestic interest rates were ____ relative to U.S. rates.

a. smaller; high
b. larger; high
c. larger; low
d. none of the above

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Application

45. The federal government demand for funds is said to be interest-inelastic, or ____ to interest rates.

a. sensitive
b. insensitive
c. relatively sensitive as compared to other sectors
d. none of the above

ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.01
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KEYWORDS: Bloom's: Knowledge

46. In computing the net present value of a proposed project, the required rate of return to implement the project will be _____ if interest rates are _____.

a. lower; higher
b. lower; lower
c. higher; lower
d. higher; unchanged

ANSWER: b
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

47. The expected impact of an increased expansion by businesses is an ____ shift in the demand schedule and ____ in the supply schedule.

a. inward; an inward shift
b. inward; an outward shift
c. outward; an inward shift
d. outward; no obvious change

ANSWER: d
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

48. Which of the following is a valid representation of the Fisher effect?

a. $i = E(\text{INF}) + i_R$
b. $i_R = E(\text{INF}) + i$
c. $E(\text{INF}) = i + i_R$
d. none of the above

ANSWER: a
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Knowledge

49. The real interest rate can be forecasted by subtracting the ___ from the ____ for that period.

a. nominal interest rate; expected inflation rate
b. prime rate; nominal interest rate
c. expected inflation rate; nominal interest rate
d. prime rate; expected inflation rate

ANSWER: c
DIFFICULTY: Easy
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50. According to the Fisher effect, expectations of higher inflation cause savers to require a ____ on savings.

a. higher nominal interest rate
b. higher real interest rate
c. lower nominal interest rate
d. lower real interest rate

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ANSWER: a
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Knowledge

51. The federal government's demand for funds is _____, and municipal governments' demand for funds is somewhat _____.

a. interest-inelastic; interest-inelastic
b. interest-elastic; interest-elastic
c. interest-inelastic; interest-elastic
d. interest-elastic; interest-inelastic

ANSWER: c
DIFFICULTY: Moderate
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KEYWORDS: Bloom's: Knowledge

52. The substantial decline in interest rates during the credit crisis is attributed to which of the following changes in the market for loanable funds?

a. an increase in both the supply of and the demand for loanable funds
b. a decrease in both the supply of and the demand for loanable funds
c. a decrease in the supply of loanable funds and an increase in the demand for loanable funds
d. an increase in the supply of loanable funds and a decrease in the demand for loanable funds

ANSWER: d
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

53. The crowding-out effect occurs when:

a. foreign investors crowd out U.S. investors in the market for loanable funds.
b. the federal government's demand for loanable funds due to a higher budget deficit crowds out the private demand in the market for loanable funds.
c. institutional investors crowd out individual investors in the market for loanable funds.
d. firms and municipal governments crowd out households in the market for loanable funds.

ANSWER: b
DIFFICULTY: Easy
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54. According to the loanable funds theory, market interest rates are determined by the factors that control the supply of and demand for loanable funds.

a. True

b. False

ANSWER: a
DIFFICULTY: Easy
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KEYWORDS: Bloom's: Comprehension

55. The supply of loanable funds in the United States is partly determined by the monetary policy implemented by the Federal Reserve System.

a. True

b. False

ANSWER: a
DIFFICULTY: Easy
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56. At any point in time, households and businesses demand a greater quantity of loanable funds at lower rates of interest.

a. True

b. False

ANSWER: a
DIFFICULTY: Easy
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57. The business demand for funds resulting from short-term investments is inversely related to the number of projects implemented and inversely related to the interest rate.

a. True

b. False

ANSWER: b
DIFFICULTY: Moderate
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58. Other things being equal, a smaller quantity of U.S. funds would be demanded by foreign governments and corporations if their domestic interest rates were high relative to U.S. rates.

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a. True
b. False

ANSWER: b
DIFFICULTY: Easy
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59. If foreign interest rates fall, foreign firms and governments would likely reduce their demand for U.S. funds.
a. True
b. False

ANSWER: a
DIFFICULTY: Easy
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60. Since the aggregate demand for loanable funds is the sum of the quantities demanded by the separate sectors, and since most of these sectors are likely to demand a larger quantity of funds at lower interest rates (other things being equal), the aggregate demand for loanable funds is positively related to interest rates at any point in time.
a. True
b. False

ANSWER: b
DIFFICULTY: Moderate
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61. In general, suppliers of loanable funds are willing to supply more funds if the interest rate is higher.
a. True
b. False

ANSWER: a
DIFFICULTY: Easy
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62. If the aggregate demand for loanable funds increases without a corresponding increase in aggregate supply, there will be a surplus of loanable funds.
a. True
b. False

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ANSWER: b
DIFFICULTY: Easy
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63. The relationship between interest rates and expected inflation is often referred to as the loanable funds theory.
a. True
b. False
ANSWER: b
DIFFICULTY: Easy
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64. According to the Fisher effect, if the real interest rate is zero, the nominal interest rate must be equal to the expected inflation rate.
a. True
b. False
ANSWER: a
DIFFICULTY: Easy
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65. To forecast interest rates using the Fisher effect, the real interest rate for an upcoming period can be forecasted by subtracting the expected inflation rate over that period from the nominal interest rate quoted for that period.
a. True
b. False
ANSWER: a
DIFFICULTY: Moderate
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66. According to the Fisher effect, when the inflation rate is lower than anticipated, the real interest rate is relatively low.
a. True
b. False
ANSWER: b
DIFFICULTY: Easy
LEARNING OBJECTIVES: FMAI.MADU.15.02.02

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67. Forecasters should consider future plans for corporate expansion and the future state of the economy when forecasting business demand for loanable funds.

a. True
b. False

ANSWER: a
DIFFICULTY: Easy
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