



Independent Study | in Idaho

ECON 343
Money and Banking

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Course Guide

Independent
Study | in Idaho

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Econ 343 Money and Banking

University of Idaho
3 Semester-Hour Credits

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University of Idaho

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Econ 343: Money and Banking

3 Semester-Hour Credits: UI

Welcome!

Whether you are a new or returning student, welcome to the Independent Study in Idaho (ISI) program. Below, you will find information pertinent to your course including the course description, course materials, course objectives, as well as information about assignments, exams, and grading. If you have any questions or concerns, please contact the ISI office for clarification before beginning your course.

Policies and Procedures

Refer to the ISI website at www.uidaho.edu/isi and select *Students* for the most current policies and procedures, including information on setting up accounts, student confidentiality, exams, proctors, transcripts, course exchanges, refunds, academic integrity, library resources, and disability support and other services.

Course Description

Influence of money and banking on economic activity; influence of monetary policies to achieve society's economic goals. Prerequisite: Econ 201 (Principles of Economics) and Econ 202 (Principles of Economics), or Econ 272 (Foundations of Economic Analysis).

Required: Internet access

14 graded lessons, 1 optional assignment, 4 self-study practice exams, 4 proctored exams

Students may submit up to 5 assignments per week. Before taking exams, students MUST wait for grades and feedback on assignments, which may take up to three weeks after date of receipt by the instructor.

ALL assignments and exams must be submitted to receive a final grade for the course.

Course Materials

Required Course Materials

- Mishkin, Frederic S. *The Economics of Money, Banking, and Financial Markets*. 8th ed. Boston: Addison-Wesley, 2007. ISBN: 9780321415059
- **Readings:** Federal Reserve articles: available online on the BbLearn version of this course.

Course Delivery

This course is available online. An electronic course guide is accessible through BbLearn at no additional cost. Refer to your *Registration Confirmation Email* for instructions on how to access BbLearn.

Course Introduction

Welcome to the world of economics. This course examines an important branch of economics called *Money and Banking*, which includes the study of financial institutions, the financial markets, the role of money in the economy, and the impact of monetary policy. The focus of this branch of economics is on the role that money plays in the lives of individual decision makers, on government policy, and on the economy as a whole.

Like economics, law is a way of thinking...a method of analysis:

You will teach yourselves *the law*...I will train your mind. You come in here with a skull full of mush...and if you survive this class...you will leave here thinking *like lawyers*.

—Professor Charles Kingsfield of *The Paper Chase* on the first day of class

The banking industry in the United States has undergone massive changes since the 1970s. Not since the Great Depression have so many institutional reforms been enacted. The Depository Institutions Deregulation and Monetary Control Act of 1980 began a process of **deregulation** of banking, arguably the most heavily regulated industry in the United States. Deregulation provided a series of challenges to the banking industry that shook it to its core. The first challenge was the savings and loan crisis (1980–1992), which led to the near collapse of the entire savings and loan industry and cost the taxpayers about \$150 billion. Other 1980s crises included the 1980–1982 recession; the Third World debt crisis (where financial institutions of the industrialized world loaned many poor nations nearly a trillion dollars, for which many nearly defaulted); the 1987 stock market crash; the sharp rise of the U.S. national debt; and the melt-down of the junk bond market in the late 1980s.

The savings and loan crisis led to the passage of two important pieces of legislation: Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). These bills provided the money and the legislative muscle to end the savings and loan crisis and enacted many important new restrictions and regulations on financial institutions.

The 1990s continued the revolution in banking that began in the 1980s. The rise of new technologies and new financial innovations like **derivatives**, the process of **globalization**, and the rise of the Internet have further challenged banking authorities and changed the landscape of banking. The industry is rapidly consolidating, changing from numerous unit banks to branch banking, largely from the passage of the Riegle-Neal Interstate and Branching Efficiency Act of 1994.

The differences between financial institutions such as commercial banks, credit unions, and savings banks, are rapidly disappearing; you may not be able to tell the difference between them in twenty years. Many new financial services such as online banking, interstate banking and branching, ATMs, derivatives, and many others, unheard of twenty years ago, now exist. The 1990s was a period of transition for the banking industry that was both exciting and scary. The “wall” between investment and commercial banking came down in 1999 with the passage of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999. This may lead to “one-stop” shopping for financial services in the future.

The new century began with the challenges posed by the collapse of the “Dot-Com” boom and the recession of 2001. The terrorist attack on 9/11/01 continues to pose challenges to the U.S. and the global community. The Enron scandal and other accounting related investor fraud led to the passage of the Sarbanes-Oxley Act (Public Company Accounting Reform and Investor Protection Act) of 2002.

The future of banking and financial services looks bright. Federal banking regulators have managed the various crises aggressively and efficiently (although not without controversy). The nexus of changes in technology, changes in institutions and laws, and globalization are fundamentally changing banking. We may even have “brickless” banks, conducting banking via the Internet from home. These firms would be entirely “online” much like Amazon.com, only offering financial services and banking.

Course Objectives

The objectives of this course are to:

1. introduce the student to economic thinking and analysis;
2. acquaint the student with economic and financial concepts, terminology, and logic;
3. familiarize the student with the tools needed for examining important economic variables such as real output, inflation, unemployment, and interest rates;
4. introduce to the student the basics of the U.S. financial system, types of financial institutions, methods of financial intermediation, the evolution of the structure of the U.S. financial system, U.S. central bank,

- money creation, and money types;
5. facilitate critical thinking by exploring the analytical tools derived from economic theory and its applications;
 6. introduce to the student the various policy tools available to decision-makers for influencing the money supply, interest rates, availability of credit, productivity growth, inflation, and unemployment;
 7. introduce to the student the basic workings of the macro-economy through the exploration of basic macro models;
 8. explore some of the basic macroeconomic disagreements among economists and the policy implications from those disagreements;
 9. familiarize the student with the growing global economy and how the economic future of the nations of the world are intertwined; and
 10. illustrate the importance and relevance of the financial markets, the U.S. monetary system, the global economy, and economics in general to the student's life and future career.

Lessons

Each lesson may include the following components:

- lesson objectives
- reading assignment
- important terms
- lecture
- written assignment
- Web-links: References to Web sites are provided at the beginning of each lesson for your interest, but their review is *not* a course requirement. I encourage you to become familiar with sites such as these, which deal directly or indirectly with economics.
- *For Your Interest*: These are topics of interest that appear at the beginning of lessons 1 and 14. Again, they are for your interest but will not appear as questions on the exams.

Your decision to undertake this course places you in a special category of student. I have found, on average, that independent-study students who complete the course are more motivated and achieve more than students on campus. The reason is the self-motivation and discipline needed to complete an independent-study course.

Study Hints

Each student develops individual study habits that are often unique. Thus, there is no one "best way" to approach this material. What is important is that you learn the important concepts in the course. Nonetheless, I will suggest a possible approach that you may find helpful.

- First of all, read the textbook and other assigned readings as a first pass through the material. Choose a quiet setting. You should read the chapter(s) in your text first before reviewing the lectures. They will be helpful in preparing for the exams.
- Next, read the lesson in this course guide and consider how this information fits in with the textbook material. Lectures: Material labeled "lecture" is included in each of the lessons. Most of these are chapter reviews in staccato format. However, some lectures include new material.
- Follow this step by referring to the commentary in the course guide listing the key topic areas. Review the key objectives of each lesson.
- Do the assignments. These will help you understand the important issues in each chapter. The lessons typically have from 3 to 7 essay/graphing questions and 10 to 20 multiple-choice questions.
- Note the importance of graphing. Economic models are often presented in graph form. You will need to be able to graph and explain many of these economic models. Be sure to practice making these graphs. It takes work to get them down cold!

- Remember to:
 - Complete all assigned readings.
 - Set a schedule allowing for completion of the course one month prior to your desired deadline. (An *Assignment Submission Log* is provided for this purpose.)
 - Keep a copy of each lesson!
 - Complete the entire lesson assignment (partial or incomplete assignments will have the appropriate points deducted).
- Web pages and URL links in the World Wide Web are subject to change. If you cannot access a link that has been listed in this course guide, use your favorite search engine (such as Google) to locate the site. To seek assistance or provide any updated information, contact your instructor.
- Do not hesitate to contact your instructor if you have any questions.

Readings/Articles

You are assigned a reading/article for each lesson. Most are publications from the Federal Reserve System. Some of these are journal quality. You need to be able to summarize each article for the respective exams and write a solid paragraph about each. If you have any questions about these articles or what you need to know and understand, please contact your instructor. NOTE: The articles are available online through the Blackboard version of this course, in a printable format, or you may purchase them in a print format through the UI Bookstore.

Optional Extra Credit Paper

An extra credit paper may add a maximum of 40 points to your course total. Therefore, a good paper will add 25 or more points to your course total, an average paper 25 points or so, and a below average paper fewer than 15 points.

The extra credit paper option is not for everyone. It requires an investment in time and research effort. Nonetheless, it offers potential rewards in terms of grade and knowledge enhancement. Furthermore, it allows Independent Study in Idaho students the same option as offered to on-campus students.

The topic is *Financial Innovation: Past, Present, and Future*. This is a broad topic. You can write the paper on new financial instruments, new technologies, or specific pieces of legislation. You should narrow the topic to some aspect of financial innovation that has occurred in the past, is occurring in the present, or will occur in the future.

The paper should be a minimum of eight pages in length, word-processed, double-spaced, with citations and bibliography in either APA or MLA format. You may choose which format you would like to use— but be consistent. Contact your instructor if you have any questions.

Exams

- There are four graded exams that are structured much like the practice exams. (See *Practice Exams* below.)
- You must wait for grades and comments on lessons prior to taking each subsequent exam.
- For your instructor's exam guidelines, refer to the letter sent to you upon registration and the *Exam Information* sections in this course guide.

Practice Exams

A practice exam is provided at the end of each block of material to help you prepare for the exam that will be graded. The practice exams will assist you in identifying the types of questions that will be on each exam (obviously the questions themselves will be different). Much of the material in the exams focuses on problem solving. If a problem appears at length in the practice exam, there is a good chance it will also appear in the proctored test in some form. Practice exams will not be graded or proctored, and should NOT be submitted to your instructor. Answers for the practice exams are found toward the end of this course guide.

See *Grading* for specific information on exams, points, and percentages.

Proctor Selection/Scheduling Exams

All exams require a proctor.

To submit your *Proctor Information Form* online, visit the ISI website and select *Forms, Proctor Information Form*. Submit this form at least two weeks before your first exam. Refer to *About ISI Policies* on the ISI website for information on acceptable and unacceptable proctors.

Grading

The course grade will be based upon the following:

Examination 1: 175 points

Examination 2: 175 points

Examination 3: 175 points

Examination 4: 175 points

700 points

Lessons 1–13: 273 points (21 points each)

Lesson 14: 27 points

300 points

Total: 1000 points

The following scale applies in determining your final grade.

Minimum required for:

A 90 percent = 900–1000 points

B 80 percent = 800–899 points

C 70 percent = 700–799 points

D 60 percent = 600–699 points

Your instructor retains the option of applying a grading curve to lower the minimums listed above, in order to make the Independent Study in Idaho grades compatible with those of courses taught on campus. Since the minimums can be lowered but not raised, this will work to your advantage. A hypothetical example would be to lower the minimum of an “A” grade from 90 percent to 88 percent. If you have any questions on grading, contact your instructor.

The final course grade is issued after all assignments and exams have been graded.

Acts of academic dishonesty, including cheating or plagiarism, are considered a very serious transgression and may result in a grade of F for the course.

About the Course Developer

Hi. I am a Research Economist at the University of Idaho and an Instructor in the Department of Economics, Finance, and Information Systems at the University of Idaho, where I have been employed for 15 years. My teaching interests are introductory macroeconomics, microeconomics, money and banking, environmental economics, and intermediate macroeconomics. My research interests are regional economic development and impact analysis. I have conducted studies on the economic impact on local Idaho communities from reductions of timber harvests on federal forests, the economic impact of colleges and universities, the economic impacts of inland ports and dam removal to save salmon, tribal gaming, and other interesting subjects. I look forward to assisting you in your exploration of economics.

Contacting Your Instructor

Instructor contact information is posted in the *Course Rules* on your BbLearn site under *Course Rules*.

Assignment Submission Log

- **Textbook:** Mishkin, Frederic S. *The Economics of Money, Banking, and Financial Markets*. 8th ed. Boston: Addison-Wesley, 2007. ISBN: 0-321-28726-6
- **Readings:** Federal Reserve (FR) articles: available online on the Blackboard version of this course, or for purchase (print copy) at the University of Idaho Bookstore.

Lesson	Reading Assignment	Written Assignment	Date Submitted
1	Chapter 1, pages 3–22 (FR) Reading: “U.S. Monetary Policy: An Introduction”	essay/multiple choice	
2	Chapters 2–3, pages 23–63 (FR) Reading: Hetzel, Robert L., “The Contributions of Milton Friedman to Economics”	essay/multiple choice	
3	Chapters 4–5, pages 67–126 (FR) Reading: Grubb, Farley, “Benjamin Franklin and the Birth of a Paper Money Economy”	essay/multiple choice	
Self-Study Review: Practice Exam 1			Do not submit.
It is now time to make arrangements with your proctor to take Exam 1. (Please choose a proctor and submit your <i>Proctor Information Form</i> to ISI at least 2 weeks prior to taking Exam 1.)			
4	Chapters 6–7, pages 127–177 (FR) Reading: Steindel, Charles, “How Worrisome Is a Negative Savings Rate?”	essay/multiple choice	
5	Chapter 9, pages 219–246 (FR) Reading: Gould, David, M., Roy J. Ruffin, and Graeme L. Woodbridge, “The Theory and Practice of Free Trade”	essay/multiple choice	
6	Chapter 10, pages 247–277 (FR) Reading: Wheelock, David C., “Monetary Policy in the Great Depression: What the Fed Did, and Why”	essay/multiple choice	
7	Chapter 11, pages 279–307 (FR) Reading: Neumann, Manfred J.M., “Seigniorage in the United States: How Much Does the U.S. Government Make from Money Production?”	essay/multiple choice	

Lesson	Reading Assignment	Written Assignment	Date Submitted
Self-Study Review: Practice Exam 2			Do not submit.
It is now time to make arrangements with your proctor to take Exam 2.			
8	Chapter 12, pages 311–332 (FR) Reading: Hetzel, Robert L., “Making the Systematic Part of Monetary Policy Transparent”	essay/multiple choice	
9	Chapters 13–14, pages 333–372 (FR) Reading: Estrella, Arturo, and Frederic S. Mishkin, “The Yield Curve as a Predictor of U.S. Recessions”	essay/multiple choice	
10	Chapters 15–16, pages 373– 428 (FR) Reading: “Understanding the Persistence of Poverty”	essay/multiple choice	
Self-Study Review: Practice Exam 3			Do not submit.
It is now time to make arrangements with your proctor to take Exam 3.			
11	Chapter 17, pages 431–457 (FR) Reading: Nakamura, Leonard I., “National Income Accounts”	essay/multiple choice	
12	Chapter 18, pages 459–490 (FR) Reading: Hunt, Robert M., “A Century of Consumer Credit Reporting in America”	essay/multiple choice	
13	Chapter 19, pages 493–512 (FR) Reading: Furlong, Frederick T., and Simon H. Kwan, “Safe and Sound Banking Twenty Years Later: What Was Proposed and What Has Been Adopted”	essay/multiple choice	
14	Chapters 22, 24, pages 561–582, 613–637 (FR) Reading: Bordo, Michael, D., “Globalization and Imbalances in Historical Perspective”	essay/multiple choice	
Self-Study Review: Practice Exam 4			Do not submit.
It is now time to make arrangements with your proctor to take Exam 4.			

Lesson 1

Introduction to Money, Banking, and the Financial Markets

Humor in Economics

Murphy's Law of economic policy: Economists have the least influence on policy where they know the most and are most agreed; they have the most influence on policy where they know the least and disagree most vehemently.

—Alan S. Blinder

Source: www.etla.fi/pkm/JokEc.html

For Your Interest

Famous People Who Majored in Economics in College

Dick Armey: U.S. Congressman	Young M.C.: Singer
Steve Balmer: Executive VP, Microsoft	Mike Mussina: MLB Pitcher
William F. Buckley: Journalist	Merlin Olson: Actor/Former NFL player
Jim Bunning: U.S. Congress/Baseball Hall of Fame	Ronald Reagan: Former U.S. President
George H.W. Bush: Former U.S. President	Roy Romer: Gov. of Colorado
Sandra Day-O'Connor: U.S. Supreme Court	Lionel Ritchie: Singer/Songwriter
John Elway: Former NFL quarterback	George Schultz: Former U.S. Secretary of State Phil
Gramm: U.S. Senator	Arnold Schwarzenegger: Actor/Gov. of California
William Isaac: Former Chairman of FDIC	Richard Trumka: Pres. United Mine Workers
Mick Jagger: Rolling Stones	Ted Turner: CNN, Atlanta Braves/Hawks
Alex Keaton: TV sitcom character	Mario Van Peebles: Actor/Director
Bernie Kosar: NFL quarterback	Lenny Wilkens: NBA Coach

Source: <http://web.centre.edu/~econed/Subpages/famous.htm> (1/1/03)

Web-links

Resources for Economists on the Web: <http://rfe.org/>

Business News—U.S. News and World Report: www.usnews.com/

Lesson Objectives

The primary objective of Chapter 1 is to introduce the role of financial markets in the economy and illustrate their importance in macroeconomic stability. A second objective is to illustrate the importance of money, banking, and the financial markets in your own life and how they affect your decisions. A third objective is to provide you with a broad perspective on the layout and operation of the U.S. financial system.

This chapter will introduce you to new terminology that will be utilized throughout the text. You will discover new economic relationships that you may not have previously realized. This chapter sets the framework and foundation on which all future chapters are built.

Reading Assignment

- Chapter 1: Why Study Money, Banking, and Financial Markets?
- Reading: “U.S. Monetary Policy: An Introduction,” U.S. Federal Reserve Bank of San Francisco, 2004. This article is a primer on the structure of the U.S. central bank (i.e., the Fed), and the goals and tools of the Fed. We will discuss this in greater detail in later chapters.

Important Terms

aggregate income	central bank	gross domestic product
aggregate output	common stock	inflation, inflation rate
aggregate price level	Federal Reserve System (the Fed)	money (money supply)
asset	financial intermediaries,	price level
banks	financial markets	recession
bond	fiscal policy	security
bond market	foreign exchange market	stock
budget deficit	foreign exchange rate	stock market
budget surplus	interest rate	unemployment rate
business cycles	monetary policy	
e-finance	monetary theory	

Lecture

A high rate of unanticipated **inflation**, which greatly increases prices, can be viewed as a tax. It redistributes income from creditors to debtors, from savers to borrowers, from households to firms, and from individuals to the government. Inflation reduces the efficiency of the financial system in the United States and reduces economic growth. A little inflation, on the other hand, may be healthy for the economy, allowing economic adjustments to occur in a way that is less painful than other alternatives.

Inflation became a major problem in the U.S. in the 1970s. Many individuals reacted by transferring assets from monetary forms such as savings accounts to non-monetary sources. Real estate investment, for example, became a popular source of “hedging” against inflation. The U.S. central bank (The Federal Reserve System) put the brakes on inflation by reducing the growth of the money supply in a policy change that began in the late 1970s and lasted into the early 1980s. However, the cost of reducing inflation was high, throwing the U.S. into the worst recession (1980–1982) since the Great Depression.

The 1980s, in contrast to the 1970s, were marked by relatively low inflation. There was even **deflation**—falling prices—in some sectors of the economy. Deflation has been relatively unknown in the U.S. since World War II. Yet deflation was one of the factors that made the Great Depression so terrible. Prices fell dramatically, redistributing income from debtors to creditors. Imagine a situation where your wage is falling (along with prices), but the payments on your home mortgage and other debts remain constant. This may explain why your grandparents or great-grandparents are afraid of ever going into debt. They learned a bitter lesson during the Great Depression.

The 1990s to 2001 was overall an era of low inflation, relatively high growth (excepting the recession in 2001), and low unemployment. The 1990s seemed, in contrast, the exact opposite of the 1970s. Since 2001, the economy has experienced a modest recovery, with relatively low inflation and low unemployment, although both rose in late 2008 as the economy was on the verge of entering a recession.

As you can see, the monetary system dramatically affects the lives of everyone. If too much money is produced and a high rate of inflation occurs, individuals and the economy are harmed. If too little money

is produced and deflation and/or a **recession** occur, individuals and the economy are also harmed. Thus, the Federal Reserve System walks a tightrope in conducting monetary policy.

The first three chapters of your text introduce the importance of the monetary system to the U.S. economy, the function of financial markets, and the regulatory structure that supports it. Furthermore, this section covers the various methods of transferring savings from lenders to borrowers. One important method is *financial intermediation*, which is the role that banks play as a “mediator” between savers and borrowers.

Written Assignment

Essays (length varies, 10 points)

1. What effect might a rise in stock prices have on consumers' decisions to spend?
2. Compare the rate of money supply growth and the business cycle. What typically happens to money supply growth before each recession?
3. What is the typical relationship between interest rates on three-month Treasury bills, long-term Treasury bonds, and Baa (medium quality) corporate bonds?

Objective Questions (11 points)

1. Accountants refer to an economic event as a
 - a. channeling funds from investors to savers .
 - b. creating inflation.
 - c. channeling funds from savers to investors.
 - d. reducing investment.
2. Markets in which funds are transferred from those who have excess funds available to those who have a shortage of available funds are called
 - a. commodity markets.
 - b. fund-available markets.
 - c. derivative exchange markets.
 - d. financial markets.
3. The bond markets are important because they are
 - a. easily the most widely followed financial markets in the United States.
 - b. where foreign exchange rates are determined.
 - c. where interest rates are determined.
 - d. where all borrowers get their funds.
4. The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of \$100 per year) is commonly referred to as the
 - a. inflation rate.
 - b. exchange rate.
 - c. interest rate.
 - d. aggregate price level.
5. The interest rate on Baa (medium quality) corporate bonds is _____ on average that other interest rates, and the spread between it and the other rates became _____ in the 1970s.
 - a. lower; smaller
 - b. lower; larger
 - c. higher; smaller
 - d. higher; larger
6. High interest rates might cause a corporation to _____ building a new plant that would provide more jobs.
 - a. complete
 - b. consider
 - c. postpone
 - d. contemplate

7. The stock market is important because it is
 - a. where interest rates are determined.
 - b. the most widely followed financial market in the United States.
 - c. where foreign exchange rates are determined.
 - d. the market where most borrowers get their funds.

8. Stock prices since the 1950s have been
 - a. relatively stable trending upward at a steady pace.
 - b. relatively stable trending downward at a moderate rate.
 - c. extremely volatile.
 - d. unstable trending downward at a moderate rate.

9. When stock prices fall
 - a. an individual's wealth is not affected nor is his/her willingness to spend.
 - b. a business firm will be more likely to sell stock to finance investment spending.
 - c. an individual's wealth may decrease but his/her willingness to spend is not affected.
 - d. an individual's wealth may decrease and his/her willingness to spend may decrease.

10. Fear of a major recession causes stock prices to fall, and everything else is held constant, which in turn causes consumer spending to
 - a. increase.
 - b. remain unchanged.
 - c. decrease.
 - d. cannot be determined.

11. The Dow reached a peak of over 11,000 before the collapse of the _____ bubble of 2000.
 - a. housing
 - b. manufacturing
 - c. high-tech
 - d. banking

12. The price of one country's currency in terms of another country's currency is called the
 - a. exchange rate.
 - b. interest rate.
 - c. Dow Jones industrial average.
 - d. prime rate.

13. Everything else constant, a stronger dollar will mean that
 - a. vacationing in England becomes more expensive.
 - b. vacationing in England becomes less expensive.
 - c. French cheese becomes more expensive.
 - d. Japanese cars become more expensive.

14. Which of the following is most likely to result from a stronger dollar?
 - a. U.S. goods exported abroad will cost less in foreign countries, and so foreigners will buy more of them.
 - b. U.S. goods exported abroad will cost more in foreign countries and so foreigners will buy more of them.
 - c. U.S. goods exported abroad will cost more in foreign countries, and so foreigners will buy fewer of them.
 - d. Americans will purchase fewer foreign goods.

15. The gross domestic product is the
 - a. value of all wealth in an economy.
 - b. value of all goods and services sold to other nations in a year.
 - c. market value of all final goods and services produced in an economy in a year.
 - d. market value of all intermediate goods and services produced in an economy in a year.