Chapter 4
Understanding Interest Rates

■ Multiple Choice

1) Of the following measures of interest rates, which is considered by economists to be the most accurate?
   (a) The yield to maturity
   (b) The coupon rate
   (c) The current yield
   (d) The yield on a discount basis

   Answer: A
   Question Status: Previous Edition

2) The interest rate that economists consider to be the most accurate measure is the
   (a) current yield.
   (b) yield to maturity.
   (c) yield on a discount basis.
   (d) coupon rate.

   Answer: B
   Question Status: Previous Edition

3) The interest rate that equates the present value of payments received from a debt instrument with its value today is the
   (a) simple interest rate.
   (b) discount rate.
   (c) yield to maturity.
   (d) real interest rate.

   Answer: C
   Question Status: Previous Edition

4) Economists consider the _____ to be the most accurate measure of interest rates.
   (a) simple interest rate.
   (b) discount rate.
   (c) yield to maturity.
   (d) real interest rate.

   Answer: C
   Question Status: Previous Edition

5) The concept of _____ is based on the common-sense notion that a dollar paid to you in the future is less valuable to you than a dollar today.

(a) present value
(b) future value
(c) interest
(d) deflation

Answer: A
Question Status: Previous Edition

6) The process of calculating what dollars received in the future are worth today is called

(a) calculating the yield to maturity.
(b) discounting the future.
(c) deflating the future.
(d) none of the above.

Answer: B
Question Status: Previous Edition

7) To claim that a lottery winner who is to receive $1 million per year for twenty years has won $20 million ignores the concept of

(a) amortizing a loan.
(b) par value.
(c) deflation.
(d) discounting the future.
(e) face value.

Answer: D
Question Status: New

8) The present value of a lottery prize paying $1 million each year for twenty years, discounted at a rate of 10 percent, is worth

(a) more then $30 million.
(b) between $20 million and $30 million.
(c) exactly $20 million.
(d) $18 million.
(e) less than $10 million.

Answer: E
Question Status: New

9) With an interest rate of 5 percent, the present value of $100 next year is approximately

(a) $100.
(b) $105.
(c) $95.
(d) $90.

Answer: C
Question Status: Previous Edition

10) With an interest rate of 10 percent, the present value of a security that pays $1,100 next year and $1,460 four years from now is:
(a) $1,000.
(b) $2,560.
(c) $3,000.
(d) $2,000.
Answer: D
Question Status: Previous Edition

11) If a security pays $110 next year and $121 the year after that, what is its yield to maturity if it sells for $200?
(a) 9 percent
(b) 10 percent
(c) 11 percent
(d) 12 percent
Answer: B
Question Status: Previous Edition

12) With an interest rate of 8 percent, the present value of $100 next year is approximately
(a) $108.
(b) $100.
(c) $96.
(d) $93.
Answer: D
Question Status: Previous Edition

13) With an interest rate of 6 percent, the present value of $100 next year is approximately
(a) $106.
(b) $100.
(c) $94.
(d) $92.
Answer: C
Question Status: Previous Edition

14) With an interest rate of 4 percent, the present value of $100 next year is approximately
(a) $104.
(b) $100.
(c) $96.
(d) $92.
Answer: C
Question Status: Previous Edition

15) If a security pays $105 next year and $110 the year after that, what is its yield to maturity if it sells for $200?

(a) 4 percent
(b) 5 percent
(c) 6 percent
(d) 10 percent

Answer: B
Question Status: Previous Edition

16) A security that pays $52.50 in one year and $110.25 in two years, with an interest rate of 5 percent, has a present value of

(a) $150.
(b) $162.50.
(c) $200.
(d) $300.
(e) $400.

Answer: A
Question Status: Study Guide

17) If a security pays $55 in one year and $133 in three years, its present value is $150 if the interest rate is

(a) 5 percent.
(b) 10 percent.
(c) 12.5 percent.
(d) 15 percent.
(e) 20 percent.

Answer: B
Question Status: Study Guide

18) A credit market instrument that provides the borrower with an amount of funds that must be repaid at the maturity date along with an interest payment is known as a

(a) simple loan.
(b) fixed-payment loan.
(c) coupon bond.
(d) discount bond.

Answer: A
Question Status: Previous Edition

19) Which of the following are true of simple loans?

(a) A simple loan requires the borrower to repay the principal and interest at the maturity date.
(b) Commercial loans to businesses are often of this type.
(c) The borrower repays the loan by making the same payment every month.
(d) Both (a) and (b) of the above.
(e) Both (b) and (c) of the above.

Answer: D
Question Status: Previous Edition

20) Which of the following are true of simple loans?
(a) A simple loan requires the borrower to repay the principal and interest at the maturity date.
(b) Installment loans and mortgages are frequently of the fixed payment type.
(c) The borrower repays the loan by making the same payment every month.
(d) Both (a) and (b) of the above.
(e) Both (b) and (c) of the above.
Answer: A
Question Status: Previous Edition

21) For a simple loan, the simple interest rate equals the
(a) real interest rate.
(b) nominal interest rate.
(c) current yield.
(d) yield to maturity.
Answer: D
Question Status: Previous Edition

22) For simple loans, the simple interest rate is _____ the yield to maturity.
(a) greater than
(b) less than
(c) equal to
(d) not comparable to
Answer: C
Question Status: Previous Edition

23) For a two-year simple loan of $1000 at 10 percent interest, the amount payable in two years is
(a) $1010.
(b) $1100.
(c) $1121.
(d) $1200.
(e) $1210.
Answer: E
Question Status: New

24) If $1102.50 is the amount payable in two years for a $1000 simple loan made today, the interest rate is
(a) 2.5 percent.
(b) 5 percent.
(c) 10 percent.
(d) 12.5 percent.
(e) 20 percent.
Answer: B
Question Status: New

25) If the amount payable in two years is $2420 for a simple loan at 10 percent interest, the loan amount is

(a) $1000.
(b) $1210.
(c) $2000.
(d) $2200.
(e) $2400.

Answer: C
Question Status: New

26) For a 3-year simple loan of $10,000 at 10 percent, the amount to be repaid is

(a) $10,030.
(b) $10,300.
(c) $10,333.
(d) $13,000.
(e) $13,310.

Answer: E
Question Status: New

27) If the amount payable in two years is $18,150 for a simple loan at 10 percent interest, the loan amount is

(a) $18,000.
(b) $15,000.
(c) $12,000.
(d) $10,000.
(e) $8,000.

Answer: B
Question Status: New

28) If $22,050 is the amount payable in two years for a $20,000 simple loan made today, the interest rate is

(a) 5 percent.
(b) 10 percent.
(c) 22 percent.
(d) 25 percent.
(e) 205 percent.

Answer: A
Question Status: New

29) A loan that requires the borrower to make the same payment every period until the maturity date is called a

(a) simple loan.
(b) fixed-payment loan.
(c) discount loan.
(d) a same-payment loan.
(e) none of the above.

Answer: B
Question Status: Previous Edition

30) A credit market instrument that requires the borrower to make the same payment every period until the maturity date is known as a
(a) simple loan.
(b) fixed-payment loan.
(c) coupon bond.
(d) discount bond.

Answer: B
Question Status: Previous Edition

31) Which of the following are true of fixed payment loans?
(a) The borrower repays both the principal and interest at the maturity date.
(b) Installment loans and mortgages are frequently of the fixed payment type.
(c) The borrower repays the loan by making the same payment every month.
(d) Both (a) and (b) of the above.
(e) Both (b) and (c) of the above.

Answer: E
Question Status: Previous Edition

32) A fully amortized loan is another name for
(a) a simple loan.
(b) a fixed-payment loan.
(c) a commercial loan.
(d) a secured loan.
(e) an unsecured loan.

Answer: B
Question Status: New

33) A coupon bond pays the owner of the bond
(a) the same amount every month until maturity date.
(b) the face value of the bond plus an interest payment once the maturity date has been reached.
(c) a fixed-interest payment every period and repays the face value at the maturity date.
(d) the face value at the maturity date.
(e) none of the above.

Answer: C
Question Status: Previous Edition

34) A credit market instrument that pays the owner a fixed coupon payment every year until the maturity date and then repays the face value is called a
(a) simple loan.
(b) fixed-payment loan.
(c) coupon bond.
(d) discount bond.

Answer: C
Question Status: Previous Edition

35) A _____ pays the owner a fixed coupon payment every year until the maturity date, when the _____ value is repaid.
(a) coupon bond; discount
(b) discount bond; discount
(c) coupon bond; face
(d) discount bond; face

Answer: C
Question Status: Previous Edition

36) Which of the following are true of coupon bonds?
(a) The owner of a coupon bond receives a fixed interest payment every year until the maturity date, when the face or par value is repaid.
(b) U.S. Treasury bonds and notes are examples of coupon bonds.
(c) Corporate bonds are examples of coupon bonds.
(d) All of the above.
(e) Only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

37) A coupon bond is identifiable in which of the following ways?
(a) The issuing government agency or firm.
(b) The maturity date of the bond.
(c) The bond's coupon rate.
(d) All of the above.
(e) Only (b) and (c) of the above.

Answer: D
Question Status: Previous Edition

38) A coupon bond is identifiable in which of the following ways?
(a) The issuing government agency or firm
(b) The maturity date of the bond
(c) The bond's yield to maturity
(d) All of the above
(e) Only (a) and (b) of the above

Answer: E
Question Status: Previous Edition

39) Which of the following are true for a coupon bond?
(a) When the coupon bond is priced at its face value, the yield to maturity equals the coupon rate.
(b) The price of a coupon bond and the yield to maturity are negatively related.
(c) The yield to maturity is greater than the coupon rate when the bond price is below the par value.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: D
Question Status: Previous Edition

40) Which of the following are true for a coupon bond?
(a) When the coupon bond is priced at its face value, the yield to maturity equals the coupon rate.
(b) The price of a coupon bond and the yield to maturity are negatively related.
(c) The yield to maturity is greater than the coupon rate when the bond price is above the par value.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.
Answer: E
Question Status: Previous Edition

41) Which of the following are true for a coupon bond?
(a) When the coupon bond is priced at its face value, the yield to maturity equals the coupon rate.
(b) The price of a coupon bond and the yield to maturity are positively related.
(c) The yield to maturity is greater than the coupon rate when the bond price is above the par value.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.
Answer: A
Question Status: Previous Edition

42) The price of a consol
(a) equals the coupon payment times the interest rate.
(b) equals the coupon payment plus the interest rate.
(c) equals the coupon payment minus the interest rate.
(d) equals the coupon payment divided by the interest rate.
(e) cannot be determined.
Answer: D
Question Status: New

43) The interest rate on a consol
(a) equals the price times the coupon payment.
(b) equals the price divided by the coupon payment.
(c) equals the coupon payment plus the price.
(d) equals the coupon payment divided by the price.
(e) equals the price minus the coupon payment.
Answer: D
Question Status: New

44) A consol paying $20 annually when the interest rate is 5 percent has a price of
(a) $100.
(b) $200.
(c) $400.
(d) $800.
(e) $1000.
Answer: C
Question Status: New

45) A consol paying $100 annually when the interest rate is 10 percent has a price of
(a) $110.
(b) $500.
(c) $1000.
(d) $1100.
(e) $10,000.
Answer: C
Question Status: New

46) A consol paying $1 annually when the interest rate is 4 percent has a price of
(a) $4.
(b) $20.
(c) $25.
(d) $100.
(e) $400.
Answer: C
Question Status: New

47) When the price of a consol paying $1 annually is $20, the interest rate is
(a) 1 percent.
(b) 2 percent.
(c) 4 percent.
(d) 5 percent.
(e) 20 percent.
Answer: D
Question Status: New

48) If the price of a consol paying $75 annually is $1000, the rate of interest is
(a) 5 percent.
(b) 7.5 percent.
(c) 10 percent.
(d) 15 percent.
(e) 75 percent.
Answer: B
Question Status: New

49) If a consol has a price of $500 and an annual interest payment of $25, the interest rate is
(a) 2.5 percent.
(b) 5 percent.
(c) 7.5 percent.
(d) 10 percent.
(e) 12.5 percent.
Answer: B
Question Status: New

50) If a consol pays $1 interest annually, and its price is $50, the interest rate is
(a) 1 percent.
(b) 2 percent.
(c) 5 percent.
(d) 10 percent.
(e) 20 percent.
Answer: B
Question Status: New

51) If a $5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is
(a) $650.
(b) $1,300.
(c) $130.
(d) $13.
(e) none of the above.
Answer: A
Question Status: Previous Edition

52) An $8,000 coupon bond with a $400 coupon payment every year has a coupon rate of
(a) 5 percent.
(b) 8 percent.
(c) 10 percent.
(d) 40 percent.
Answer: A
Question Status: Previous Edition

53) A $16,000 coupon bond with an $800 coupon payment every year has a coupon rate of
(a) 4 percent.
(b) 8 percent.
(c) 10 percent.
(d) 40 percent.
(e) none of the above.
Answer: E
Question Status: Previous Edition

54) A $10,000 coupon bond with an $800 coupon payment every year has a coupon rate of
(a) 4 percent.
(b) 8 percent.
(c) 10 percent.
(d) 40 percent.
Answer: B
Question Status: Previous Edition

55) A $10,000 8 percent coupon bond that sells for $10,000 has a yield to maturity of
(a) 8 percent.
(b) 10 percent.
(c) 12 percent.
(d) 14 percent.
Answer: A
Question Status: Previous Edition

56) If a $10,000 coupon bond has a coupon rate of 8 percent, then the coupon payment every year is
(a) $40.
(b) $80.
(c) $400.
(d) $800.
(e) none of the above.
Answer: D
Question Status: Previous Edition

57) If a $10,000 coupon bond has a coupon rate of 4 percent, then the coupon payment every year is
(a) $40.
(b) $140.
(c) $400.
(d) $640.
Answer: C
Question Status: Previous Edition

58) If a $10,000 coupon bond has a coupon rate of 5 percent, then the coupon payment every year is
(a) $40.
(b) $140.
(c) $400.
(d) $600.
(e) none of the above.
Answer: E
Question Status: Previous Edition

59) If a $20,000 coupon bond has a coupon rate of 8 percent, then the coupon payment every year is
(a) $40.
(b) $80.
(c) $400.
(d) $800.
(e) none of the above.
Answer: E
Question Status: Previous Edition

60) If a $20,000 coupon bond has a coupon rate of 4 percent, then the coupon payment every year is
(a) $40.
(b) $80.
(c) $400.
(d) $800.
Answer: D
Question Status: Previous Edition

61) If a $20,000 coupon bond has a coupon rate of 5 percent, then the coupon payment every year is
(a) $50.
(b) $100.
(c) $500.
(d) $1000.
Answer: D
Question Status: Previous Edition

62) If a $20,000 coupon bond has a coupon rate of 8 percent, then the coupon payment every year is
(a) $80.
(b) $160.
(c) $800.
(d) $1600.
(e) none of the above.
Answer: D
Question Status: Previous Edition

63) If a $6,000 coupon bond has a coupon rate of 8 percent, then the coupon payment every year is
(a) $48.
(b) $240.
(c) $480.
(d) $320.
(e) none of the above.
Answer: C
Question Status: Previous Edition

64) If a $12,000 coupon bond has a coupon rate of 8 percent, then the coupon payment every year is
(a) $48.
(b) $240.
(c) $480.
(d) $960
(e) none of the above.
Answer: D
Question Status: Previous Edition

65) A $6,000 coupon bond with a $240 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 4 percent.
(c) 6 percent.
(d) 8 percent.
Answer: B
Question Status: Previous Edition

66) A $6,000 coupon bond with a $360 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 4 percent.
(c) 6 percent.
(d) 8 percent.
Answer: C
Question Status: Previous Edition

67) A $6,000 coupon bond with a $480 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 4 percent.
(c) 6 percent.
(d) 8 percent.
Answer: D
Question Status: Previous Edition

68) A $5,000 coupon bond with a $250 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 4 percent.
(c) 5 percent.
(d) 10 percent.
Answer: C
Question Status: Previous Edition

69) At a coupon rate of 5 percent, a $5000 coupon bond has an annual interest payment of
(a) $25.
(b) $50.
(c) $100.
(d) $250.
(e) $500.
Answer: C
Question Status: Study Guide

70) A $4,000 coupon bond with a $480 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 6 percent.
(c) 8 percent.
(d) 12 percent.
Answer: D
Question Status: Previous Edition

71) A $4,000 coupon bond with a $240 coupon payment every year has a coupon rate of
(a) 2 percent.
(b) 6 percent.
(c) 8 percent.
(d) 12 percent.
Answer: B
Question Status: Previous Edition

72) A $4,000 coupon bond with a $360 coupon payment every year has a coupon rate of
(a) 3 percent.
(b) 6 percent.
(c) 9 percent.
(d) 12 percent.
Answer: C
Question Status: Previous Edition

73) Which of the following $1,000 face-value securities has the highest yield to maturity?
(a) A 5 percent coupon bond selling for $1,000
(b) A 10 percent coupon bond selling for $1,000
(c) A 12 percent coupon bond selling for $1,000
(d) A 12 percent coupon bond selling for $1,100
Answer: C
Question Status: Previous Edition

74) Which of the following $1,000 face-value securities has the highest yield to maturity?
(a) A 5 percent coupon bond selling for $1,000
(b) A 10 percent coupon bond selling for $1,000
(c) A 15 percent coupon bond selling for $1,000
(d) A 15 percent coupon bond selling for $900
Answer: D
Question Status: Previous Edition

75) Which of the following $1,000 face-value securities has the highest yield to maturity?
(a) A 5 percent coupon bond with a price of $600
(b) A 5 percent coupon bond with a price of $800
(c) A 5 percent coupon bond with a price of $1,000
(d) A 5 percent coupon bond with a price of $1,200
(e) A 5 percent coupon bond with a price of $1,500
Answer: A
Question Status: Previous Edition

76) Which of the following $1,000 face-value securities has the lowest yield to maturity?
(a) A 15 percent coupon bond with a price of $600
(b) A 15 percent coupon bond with a price of $800
(c) A 15 percent coupon bond with a price of $1,000
(d) A 15 percent coupon bond with a price of $1,200
(e) A 15 percent coupon bond with a price of $1,500
Answer: E
Question Status: Previous Edition

77) Which of the following $1,000 face-value securities has the lowest yield to maturity?
(a) A 5 percent coupon bond selling for $1,000
(b) A 10 percent coupon bond selling for $1,000
(c) A 15 percent coupon bond selling for $1,000
(d) A 15 percent coupon bond selling for $900
Answer: A
Question Status: Previous Edition

78) Which of the following $5,000 face-value securities has the lowest yield to maturity?
(a) A 6 percent coupon bond selling for $5,000
(b) A 6 percent coupon bond selling for $5,500
(c) A 10 percent coupon bond selling for $5,000
(d) A 10 percent coupon bond selling for $4,500
(e) A 12 percent coupon bond selling for $5,000
Answer: B
Question Status: New

79) Which of the following $5,000 face-value securities has the lowest highest to maturity?
(a) A 6 percent coupon bond selling for $5,000
(b) A 6 percent coupon bond selling for $5,500
(c) A 10 percent coupon bond selling for $5,000
(d) A 12 percent coupon bond selling for $4,500
(e) A 12 percent coupon bond selling for $5,000
Answer: D
Question Status: New

80) Which of the following bonds would you prefer to be buying?
(a) A $10,000 face-value security with a 6 percent coupon selling for $10,000
(b) A $10,000 face-value security with a 7 percent coupon selling for $10,000
(c) A $10,000 face-value security with a 9 percent coupon selling for $10,000
(d) A $10,000 face-value security with a 10 percent coupon selling for $10,000
(e) A $10,000 face-value security with a 10 percent coupon selling for $9,000
Answer: E
Question Status: New

81) Which of the following bonds would you prefer to be selling?
(a) A $10,000 face-value security with a 6 percent coupon selling for $10,000
(b) A $10,000 face-value security with a 6 percent coupon selling for $9,000
(c) A $10,000 face-value security with a 6 percent coupon selling for $11,000
(d) A $10,000 face-value security with a 7 percent coupon selling for $10,000
(e) A $10,000 face-value security with a 7 percent coupon selling for $9,000
Answer: C
Question Status: New

82) A credit market instrument that pays the owner the face value of the security at the maturity date and nothing prior to then is called a
(a) simple loan.
(b) fixed-payment loan.
(c) coupon bond.
(d) discount bond.
Answer: D
Question Status: Previous Edition

83) A bond that is bought at a price below its face value and the face value is repaid at a maturity date is called a
(a) simple loan.
(b) fixed-payment loan.
(c) coupon bond.
(d) discount bond.
Answer: D
Question Status: Previous Edition

84) A _____ is bought at a price below its face value, and the _____ value is repaid at the maturity date.
(a) coupon bond; discount
(b) discount bond; discount
(c) coupon bond; face
(d) discount bond; face
Answer: D
Question Status: Previous Edition

85) A discount bond
(a) pays the bondholder a fixed amount every period and the face value at maturity.
(b) pays the bondholder the face value at maturity.
(c) pays all interest and the face value at maturity.
(d) pays a fixed amount each period until the loan is repaid.
(e) pays the face value at maturity plus any capital gain.
Answer: B
Question Status: Study Guide

86) Examples of discount bonds include
(a) U.S. Treasury bills.
(b) U.S. savings bonds.
(c) zero-coupon bonds.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

87) Examples of discount bonds include
(a) U.S. Treasury bills.
(b) U.S. savings bonds.
(c) U.S. Treasury notes.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

88) The yield to maturity for a one-year discount bond equals
(a) the increase in price over the year, divided by the initial price.
(b) the increase in price over the year, divided by the face value.
(c) the increase in price over the year, divided by the interest rate.
(d) none of the above.
Answer: A
Question Status: Previous Edition

89) Which of the following are true for discount bonds?
(a) A discount bond is bought at a price below its face value.
(b) The purchaser receives the face value of the bond at the maturity date.
(c) U.S. Treasury bills, U.S. savings bonds, and so-called zero-coupon bonds are examples of discount bonds.
(d) All of the above.
(e) Only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

90) Which of the following are true for discount bonds?
(a) A discount bond is bought at a price below its face value.
(b) The purchaser receives the face value of the bond at the maturity date.
(c) U.S. Treasury bonds and notes are examples of discount bonds.
(d) All of the above.
(e) Only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

91) Which of the following are true for discount bonds?
(a) A discount bond is bought at par.
(b) The purchaser receives the face value of the bond at the maturity date.
(c) U.S. Treasury bonds and notes are examples of discount bonds.
(d) Only (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

92) Examples of discount bonds include:
(a) U.S. Treasury bills.
(b) U.S. savings bonds.
(c) so-called zero-coupon bonds.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

93) Examples of discount bonds include:
(a) U.S. Treasury bonds.
(b) U.S. Treasury notes.
(c) so-called zero-coupon bonds.
(d) all of the above.
Answer: C
Question Status: Previous Edition

94) Examples of discount bonds include:
(a) U.S. Treasury bonds and notes.
(b) U.S. savings bonds.
(c) so-called zero-coupon bonds.
(d) all of the above.
(e) only (b) and (c) of the above.
Answer: E
Question Status: Previous Edition

95) If a $10,000 face-value discount bond maturing in one year is selling for $5,000, then its yield to maturity is

(a) 5 percent.
(b) 10 percent.
(c) 50 percent.
(d) 100 percent.

Answer: D
Question Status: Previous Edition

96) If a $5,000 face-value discount bond maturing in one year is selling for $5,000, then its yield to maturity is

(a) 0 percent.
(b) 5 percent.
(c) 10 percent.
(d) 20 percent.

Answer: A
Question Status: Previous Edition

97) If a $10,000 face-value discount bond maturing in one year is selling for $8,000, then its yield to maturity is

(a) 10 percent.
(b) 20 percent.
(c) 25 percent.
(d) 40 percent.

Answer: C
Question Status: Previous Edition

98) If a $10,000 face-value discount bond maturing in one year is selling for $9,000, then its yield to maturity is

(a) 9 percent.
(b) 10 percent.
(c) 11 percent.
(d) 12 percent.

Answer: C
Question Status: Previous Edition

99) If a $10,000 face-value discount bond maturing in one year is selling for $6,000, then its yield to maturity is

(a) 30 percent.
(b) 33 percent.
(c) 60 percent.
(d) 66 percent.

Answer: D
Question Status: Previous Edition

100) A discount bond selling for $15,000 with a face value of $20,000 in one year has a yield to maturity of
(a) 3 percent.
(b) 20 percent.
(c) 25 percent.
(d) 33.3 percent.
(e) 66.7 percent.

Answer: D
Question Status: Study Guide

101) A discount bond currently selling for $4000, that matures in one year with a face value of $5000, has a yield to maturity of
(a) 5 percent.
(b) 10 percent.
(c) 20 percent.
(d) 25 percent.
(e) 50 percent.

Answer: D
Question Status: Study Guide

102) In Japan in 1998, interest rates were negative for a short period of time because investors found it convenient to hold six-month bills as a store of value because
(a) of the high inflation rate.
(b) these bills sold at a discount from face value.
(c) the bills still returned more than cash.
(d) the bills were denominated in large amounts and could be stored electronically.
(e) the bills were denominated in small amounts and could be stored electronically.

Answer: D
Question Status: New

103) Which of the following are true for the current yield?
(a) The current yield is defined as the yearly coupon payment divided by the price of the security.
(b) The formula for the current yield is identical to the formula describing the yield to maturity for a consol.
(c) The current yield will be a close approximation for the yield to maturity the longer the time to maturity, and the closer the bond price to its par value.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: D
Question Status: Previous Edition

104) Which of the following are true for the current yield?
(a) The current yield is defined as the yearly coupon payment divided by the price of the security.
(b) The formula for the current yield is identical to the formula describing the yield to maturity for a consol.
(c) The current yield will be a close approximation for the yield to maturity the shorter the time to maturity, and the closer the bond price to its par value.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

105) Which of the following are true for the current yield?
(a) The current yield is defined as the yearly coupon payment divided by the price of the security.
(b) The formula for the current yield is identical to the formula describing the yield to maturity for a consol.
(c) The current yield is always a poor approximation for the yield to maturity.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

106) Which of the following are true for the current yield?
(a) The current yield is defined as the yearly coupon payment divided by the price of the security.
(b) The formula for the current yield is identical to the formula describing the yield to maturity for a discount bond.
(c) The current yield is always a poor approximation for the yield to maturity.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: A
Question Status: Previous Edition

107) Which of the following are true for the current yield?
(a) The current yield is defined as the yearly coupon payment divided by the price of the security.
(b) The current yield and the yield to maturity always move together.
(c) The formula for the current yield is identical to the formula describing the yield to maturity for a discount bond.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

108) The current yield
(a) more accurately approximates the yield to maturity when the bond's price is near par value and its maturity is short.
(b) less accurately approximates the yield to maturity when the bond's price is near par value and its maturity is long.
(c) more accurately approximates the yield to maturity when the bond's price is near par value and its maturity is long.
(d) more accurately approximates the yield to maturity when the bond's price is far from par value and its maturity is short.
(e) never provides a good approximation of current yield.

Answer: C
Question Status: Study Guide

109) The current yield, which equals the coupon payment divided by the price of a coupon bond, is a less accurate measure of the yield to maturity the _____ the maturity of the bond and the _____ the price is from/to the par value.
(a) shorter; closer
(b) shorter; farther
(c) longer; closer
(d) longer; farther

Answer: B
Question Status: Previous Edition

110) The current yield is a less accurate measure of the yield to maturity the _____ the time to maturity of the bond and the _____ the price is from/to the par value.
(a) shorter; closer
(b) shorter; farther
(c) longer; closer
(d) longer; farther

Answer: B
Question Status: Previous Edition

111) For a consol, the current yield is an _____ of the yield to maturity.
(a) underestimate
(b) overestimate
(c) exact measure
(d) approximate measure

Answer: C
Question Status: Previous Edition

112) The _____ is a better approximation for the _____, the nearer the bond's price is to the bond's par value and the longer the maturity of the bond.
(a) current yield; yield to maturity
(b) current yield; coupon rate
(c) yield to maturity; current yield
(d) yield to maturity; coupon rate
Answer: A
Question Status: Previous Edition

113) For a bond selling for $4000, with a par value of $5000 and a coupon rate of 10 percent, the current yield is
(a) 5 percent.
(b) 10 percent.
(c) 12.5 percent.
(d) 20 percent.
(e) 25 percent.
Answer: C
Question Status: Study Guide

114) The current yield on a $5,000, 8 percent coupon bond selling for $4,000 is
(a) 5 percent.
(b) 8 percent.
(c) 10 percent.
(d) 20 percent.
(e) none of the above.
Answer: C
Question Status: Previous Edition

115) The current yield on a $6,000, 10 percent coupon bond selling for $5,000 is
(a) 5 percent.
(b) 10 percent.
(c) 12 percent.
(d) 15 percent.
Answer: C
Question Status: Previous Edition

116) The current yield on a $10,000, 10 percent coupon bond selling for $5,000 is
(a) 30 percent.
(b) 33 percent.
(c) 60 percent.
(d) 20 percent.
Answer: D
Question Status: Previous Edition

117) The current yield on a $10,000, 10 percent coupon bond selling for $8,000 is
(a) 10.0 percent.
(b) 12.5 percent.
(c) 15.0 percent.
(d) 17.5 percent.
Answer: B
Question Status: Previous Edition

118) The current yield on a $10,000, 10 percent coupon bond selling for $9,000 is
(a) 9 percent.
(b) 10 percent.
(c) 11 percent.
(d) 12 percent.
Answer: C
Question Status: Previous Edition

119) The current yield on a $10,000, 5 percent coupon bond selling for $9,000 is
(a) 5.0 percent.
(b) 5.5 percent.
(c) 7.5 percent.
(d) 8.0 percent.
Answer: B
Question Status: Previous Edition

120) The current yield on a $10,000, 5 percent coupon bond selling for $8,000 is
(a) 5 percent.
(b) 6 percent.
(c) 7 percent.
(d) 8 percent.
Answer: B
Question Status: Previous Edition

121) The current yield on a $10,000, 5 percent coupon bond selling for $5,000 is
(a) 5.0 percent.
(b) 7.5 percent.
(c) 10.0 percent.
(d) 12.5 percent.
Answer: C
Question Status: Previous Edition

122) Dealers in U.S. Treasury securities always refer to prices by quoting the
(a) yield to maturity.
(b) coupon rate.
(c) current yield
(d) yield on a discount basis.
Answer: D
Question Status: Previous Edition

123) The formula for the measure of the interest rate called the yield on a discount basis has two peculiarities:
(a) it uses the percentage gain on the face value of the bill, rather than the percentage gain on the purchase price of the bill.
(b) it ignores the time to maturity.
(c) it puts the yield on the annual basis of a 360 day year.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.

Answer: E
Question Status: Previous Edition

124) Which of the following are true of the yield on a discount basis as a measure of the interest rate?
(a) It uses the percentage gain on the face value of the security, rather than the percentage gain on the purchase price of the security.
(b) It puts the yield on the annual basis of a 360-day year.
(c) It ignores the time to maturity.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

125) Which of the following are true of the yield on a discount basis as a measure of the interest rate?
(a) It uses the percentage gain on the purchase price of the security, rather than the percentage gain on the face value of the security.
(b) It puts the yield on the annual basis of a 360-day year.
(c) It ignores the time to maturity.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: B
Question Status: Previous Edition

126) A problem with the yield on discount basis is that it _____ the yield to maturity, and this _____ increases, the _____ the maturity of the discount bond.
(a) understates; understatement; longer
(b) understates; understatement; shorter
(c) overstates; overstatement; longer
(d) overstates; overstatement; shorter
(e) approximates; approximation; longer

Answer: A
Question Status: Study Guide

127) The yield on a discount basis of a 90-day, $1,000 Treasury bill selling for $950 is
(a) 5 percent.
(b) 10 percent.
(c) 15 percent.
(d) 20 percent.
(e) none of the above.
Answer: D
Question Status: Previous Edition

128) The yield on a discount basis of a 30-day, $1,000 Treasury bill selling for $950 is
(a) 5 percent.
(b) 10 percent.
(c) 20 percent.
(d) 50 percent.
(e) none of the above.
Answer: E
Question Status: Previous Edition

129) The yield on a discount basis of a 90-day $1,000 Treasury bill selling for $900 is
(a) 10 percent.
(b) 20 percent.
(c) 25 percent.
(d) 40 percent.
Answer: D
Question Status: Previous Edition

130) The yield on a discount basis of a 180-day $1,000 Treasury bill selling for $900 is
(a) 10 percent.
(b) 20 percent.
(c) 25 percent.
(d) 40 percent.
Answer: B
Question Status: Previous Edition

131) The yield on a discount basis of a 180-day $1,000 Treasury bill selling for $950 is
(a) 10 percent.
(b) 20 percent.
(c) 25 percent.
(d) 40 percent.
Answer: A
Question Status: Previous Edition

132) The yield on discount basis of a 360-day Treasury bill selling for $975 is
(a) 2.5 percent.
(b) 5 percent.
(c) 7.5 percent.
(d) 10 percent.
(e) 15 percent.
Answer: A
Question Status: Study Guide

133) The true yield on a $10,000 Treasury bill selling for $9,800 with 73 days to maturity is approximately
(a) 2 percent.
(b) 5 percent.
(c) 10 percent.
(d) 20 percent.
Answer: C
Question Status: Previous Edition

134) When referring to changes in yields, a basis point equals
(a) 10 percent.
(b) 1 percent.
(c) 0.1 percent.
(d) 0.01 percent.
(e) 0.001 percent.
Answer: D
Question Status: New

135) To say that a yield increased by twenty basis points means the interest rate increased by
(a) 20 percent.
(b) 2 percent.
(c) 0.2 percent.
(d) 0.02 percent.
(e) 0.002 percent.
Answer: C
Question Status: New

136) If the yield on Treasury bills falls from 5.27 percent to 5.22 percent, then the yield has
(a) increased by 5 basis points.
(b) increased by 0.5 basis point.
(c) decreased by 0.05 basis point.
(d) decreased by 0.5 basis point.
(e) decreased by 5 basis points.
Answer: E
Question Status: New

137) If the yield on Treasury bills increases from 6.34 percent to 6.44 percent, the yield has
(a) increased by 0.01 basis point.
(b) increased by 0.1 basis point.
(c) increased by 1 basis point.
(d) increased by 10 basis points.
(e) increased by 100 basis points.

Answer: D
Question Status: New

138) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $1,200 next year?
(a) 5 percent
(b) 10 percent
(c) −5 percent
(d) 25 percent
(e) None of the above

Answer: D
Question Status: Previous Edition

139) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $900 next year?
(a) 5 percent
(b) 10 percent
(c) −5 percent
(d) −10 percent
(e) None of the above

Answer: C
Question Status: Previous Edition

140) Suppose you are holding a 5 percent coupon bond maturing in one year with a yield to maturity of 15 percent. If the interest rate on one-year bonds rises from 15 percent to 20 percent over the course of the year, what is the yearly return on the bond you are holding?
(a) 5 percent
(b) 10 percent
(c) 15 percent
(d) 20 percent

Answer: C
Question Status: Previous Edition

141) If the interest rates on all bonds rise from 5 to 6 percent over the course of the year, which bond would you prefer to have been holding?
(a) A bond with one year to maturity
(b) A bond with five years to maturity
(c) A bond with ten years to maturity
(d) A bond with twenty years to maturity

Answer: A
Question Status: Previous Edition

142) If the interest rates on all bonds fall from 7 to 6 percent over the course of the year, which bond would you prefer to have been holding?
(a) A bond with one year to maturity
(b) A bond with five years to maturity
(c) A bond with ten years to maturity
(d) A bond with twenty years to maturity
(e) A consol
Answer: E
Question Status: New

143) An equal increase in all bond interest rates
(a) increases the price of a five-year bond more than the price of a ten-year bond.
(b) increases the price of a ten-year bond more than the price of a five-year bond.
(c) decreases the price of a five-year bond more than the price of a ten-year bond.
(d) decreases the price of a ten-year bond more than the price of a five-year bond.
(e) increases all bond prices by the same dollar amount.
Answer: D
Question Status: New

144) An equal decrease in all bond interest rates
(a) increases the price of a five-year bond more than the price of a ten-year bond.
(b) increases the price of a ten-year bond more than the price of a five-year bond.
(c) decreases the price of a five-year bond more than the price of a ten-year bond.
(d) decreases the price of a ten-year bond more than the price of a five-year bond.
(e) increases all bond prices by the same dollar amount.
Answer: B
Question Status: New

145) An equal increase in all bond interest rates
(a) increases the return to all bond maturities by an equal amount.
(b) decreases the return to all bond maturities by an equal amount.
(c) has no effect on the returns to bonds.
(d) increases long-term bond returns more than short-term bond returns.
(e) decreases long-term bond returns more than short-term bond returns.
Answer: E
Question Status: New

146) The return on a 10 percent coupon bond that initially sells for $1,000 and sells for $1,200 next year is
(a) 15 percent.
(b) 25 percent.
(c) 30 percent.
(d) 33 percent.
Answer: C
Question Status: Previous Edition

147) The return on a 10 percent coupon bond that initially sells for $1,000 and sells for $1,100 next year is
(a) 17 percent.
(b) 20 percent.
(c) 24 percent.
(d) 30 percent.
Answer: B
Question Status: Previous Edition

148) The return on a 5 percent coupon bond that initially sells for $1,000 and sells for $1,100 next year is
(a) 5 percent.
(b) 10 percent.
(c) 14 percent.
(d) 15 percent.
Answer: D
Question Status: Previous Edition

149) The return on a 10 percent coupon bond that initially sells for $1,000 and sells for $900 next year is
(a) −10 percent.
(b) −5 percent.
(c) 0 percent.
(d) 5 percent.
Answer: C
Question Status: Previous Edition

150) The return on a 10 percent coupon bond that initially sells for $1,000 and sells for $950 next year is
(a) −10 percent.
(b) −5 percent.
(c) 0 percent.
(d) 5 percent.
Answer: D
Question Status: Previous Edition

151) The return on a 5 percent coupon bond that initially sells for $1,000 and sells for $950 next year is
(a) −10 percent.
(b) −5 percent.
(c) 0 percent.
(d) 5 percent.
Answer: C
Question Status: Previous Edition

152) Which of the following are true concerning the distinction between interest rates and return?
(a) The rate of return on a bond will not necessarily equal the interest rate on that bond.
(b) The return can be expressed as the sum of the current yield and the rate of capital gains.
(c) The rate of return will be greater than the interest rate when the price of the bond rises between time t and time t + 1.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: D
Question Status: Previous Edition

153) Which of the following are true concerning the distinction between interest rates and return?
(a) The rate of return on a bond will not necessarily equal the interest rate on that bond.
(b) The return can be expressed as the difference between the current yield and the rate of capital gains.
(c) The rate of return will be greater than the interest rate when the price of the bond falls between time t and time t + 1.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: A
Question Status: Previous Edition

154) Which of the following are true concerning the distinction between interest rates and return?
(a) The rate of return on a bond will not necessarily equal the interest rate on that bond.
(b) The return can be expressed as the sum of the current yield and the rate of capital gains.
(c) The rate of return will be greater than the interest rate when the price of the bond falls between time t and time t + 1.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

155) Which of the following are generally true of all bonds?
(a) The only bond whose return equals the initial yield to maturity is one whose time to maturity is the same as the holding period.
(b) A rise in interest rates is associated with a fall in bond prices, resulting in capital losses on bonds whose terms to maturity are longer than the holding periods.
(c) The longer a bond's maturity, the greater is the size of the price change associated with an interest rate change.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: D
Question Status: Previous Edition

156) Which of the following are generally true of all bonds?
(a) The only bond whose return equals the initial yield to maturity is one whose time to maturity is the same as the holding period.
(b) A rise in interest rates is associated with a fall in bond prices, resulting in capital losses on bonds whose terms to maturity are longer than the holding periods.
(c) The longer a bond's maturity, the smaller is the size of the price change associated with an interest rate change.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

157) Which of the following are generally true of all bonds?
(a) The only bond whose return equals the initial yield to maturity is one whose time to maturity is the same as the holding period.
(b) A rise in interest rates is associated with a fall in bond prices, resulting in capital gains on bonds whose terms to maturity are longer than the holding periods.
(c) The longer a bond's maturity, the smaller is the size of the price change associated with an interest rate change.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: A
Question Status: Previous Edition

158) Which of the following are generally true of all bonds?
(a) The longer a bond's maturity, the lower is the rate of return that occurs as a result of the increase in the interest rate.
(b) Even though a bond has a substantial initial interest rate, its return can turn out to be negative if interest rates rise.
(c) Prices and returns for long-term bonds are more volatile than those for shorter term bonds.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: D
Question Status: Previous Edition

159) Which of the following are generally true of all bonds?
(a) The longer a bond's maturity, the greater is the rate of return that occurs as a result of the increase in the interest rate.
(b) Even though a bond has a substantial initial interest rate, its return can turn out to be negative if interest rates rise.
(c) Prices and returns for short-term bonds are more volatile than those for longer term bonds.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: B
Question Status: Previous Edition

160) Which of the following are generally true of all bonds?
(a) The longer a bond's maturity, the lower is the rate of return that occurs as a result of the increase in the interest rate.
(b) Even though a bond has a substantial initial interest rate, its return can turn out to be negative if interest rates rise.
(c) Prices and returns for short-term bonds are more volatile than those for longer term bonds.
(d) All of the above are true.
(e) Only (a) and (b) of the above are true.

Answer: E
Question Status: Previous Edition

161) The riskiness of an asset's returns due to changes in interest rates is
(a) uncertainty.
(b) price risk.
(c) asset risk.
(d) interest-rate risk.
(e) exchange-rate risk.

Answer: D
Question Status: New

162) Interest-rate risk is
(a) the riskiness of an asset's returns due to interest-rate changes.
(b) the riskiness of an asset's returns due to changes in the coupon rate.
(c) the riskiness of an asset's returns due to default of the borrower.
(d) the riskiness of an asset's returns due to changes in the exchange rate.
(e) the riskiness of an asset's returns due to changes in the asset's maturity.

Answer: A
Question Status: New

163) Prices and returns for _____ bonds are more volatile than those for _____ bonds.
(a) long-term; long-term
(b) long-term; short-term
(c) short-term; long-term
(d) short-term; short-term

Answer: B
Question Status: Previous Edition

164) The _____ states that the nominal interest rate equals the real interest rate plus the expected rate of inflation.
(a) Fisher equation
(b) Keynesian equation
(c) Monetarist equation
(d) Marshall equation

Answer: A
Question Status: Previous Edition

165) The Fisher equation states that
(a) the nominal interest rate equals the real interest rate plus the expected rate of inflation.
(b) the real interest rate equals the nominal interest rate less the expected rate of inflation.
(c) the nominal interest rate equals the real interest rate less the expected rate of inflation.
(d) both (a) and (b) of the above are true.
(e) both (a) and (c) of the above are true.

Answer: D
Question Status: Revised

166) The nominal interest rate minus the expected rate of inflation
(a) defines the real interest rate.
(b) is a better measure of the incentives to borrow and lend than is the nominal interest rate.
(c) is a more accurate indicator of the tightness of credit market conditions than is the nominal interest rate.
(d) indicates all of the above.
(e) indicates only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

167) The nominal interest rate minus the expected rate of inflation
(a) defines the real interest rate.
(b) is a less accurate measure of the incentives to borrow and lend than is the nominal interest rate.
(c) is a less accurate indicator of the tightness of credit market conditions than is the nominal interest rate.
(d) defines the discount rate.

Answer: A
Question Status: Previous Edition

168) If you expect the inflation rate to be 15 percent next year and a one-year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
(a) 7 percent.
(b) 22 percent.
(c) −15 percent.
(d) −8 percent.
(e) none of the above.

Answer: D
Question Status: New

169) In which of the following situations would you prefer to be the lender?
(a) The interest rate is 9 percent and the expected inflation rate is 7 percent.
(b) The interest rate is 4 percent and the expected inflation rate is 1 percent.
(c) The interest rate is 13 percent and the expected inflation rate is 15 percent.
(d) The interest rate is 25 percent and the expected inflation rate is 50 percent.

Answer: B
Question Status: Previous Edition

170) In which of the following situations would you prefer to be borrowing?
(a) The interest rate is 9 percent and the expected inflation rate is 7 percent.
(b) The interest rate is 4 percent and the expected inflation rate is 1 percent.
(c) The interest rate is 13 percent and the expected inflation rate is 15 percent.
(d) The interest rate is 25 percent and the expected inflation rate is 50 percent.
Answer: D
Question Status: Previous Edition

171) If you expect the inflation rate to be 5 percent next year and a one-year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
(a) −12 percent.
(b) −2 percent.
(c) 2 percent.
(d) 12 percent.
Answer: C
Question Status: Previous Edition

172) If you expect the inflation rate to be 12 percent next year and a one-year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
(a) −5 percent.
(b) −2 percent.
(c) 2 percent.
(d) 12 percent.
Answer: A
Question Status: Previous Edition

173) If you expect the inflation rate to be 4 percent next year and a one year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
(a) −3 percent.
(b) −2 percent.
(c) 3 percent.
(d) 7 percent.
Answer: C
Question Status: Previous Edition

174) If the nominal rate of interest is 2 percent, and prices are expected to fall (negative inflation) by 10 percent, the real rate of interest is
(a) 2 percent.
(b) 8 percent.
(c) 10 percent.
(d) 12 percent.
(e) −8 percent.
Answer: D
Question Status: New

175) If the nominal rate of interest is 5 percent, and the expected rate of deflation (negative inflation) is 5 percent, the real rate of interest is

(a) 0 percent.
(b) −5 percent.
(c) −10 percent.
(d) 5 percent.
(e) 10 percent.

Answer: E
Question Status: New

176) The interest rate on Treasury Inflation Protected Securities is a direct measure of

(a) the real interest rate.
(b) the nominal interest rate.
(c) the rate of inflation.
(d) the rate of deflation.
(e) the exchange rate.

Answer: A
Question Status: New

177) The difference between the yield on a Treasury Inflation Protected Security and the yield on a nonindexed Treasury security provides insight into

(a) the nominal interest rate.
(b) the real interest rate.
(c) the nominal exchange rate.
(d) the real exchange rate.
(e) expected inflation.

Answer: E
Question Status: New

178) When the interest rate on a Treasury Inflation Protected Security is 3 percent, and the yield on a nonindexed Treasury bond is 8 percent, the expected rate of inflation is

(a) 3 percent.
(b) 5 percent.
(c) 8 percent.
(d) 11 percent.
(e) 24 percent.

Answer: B
Question Status: New

Questions for Web Appendix

179) Duration is
(a) an asset's term to maturity.
(b) the time until the next interest payment for a coupon bond.
(c) the average lifetime of a debt security's stream of payments.
(d) the time between interest payments for a coupon bond.
(e) none of the above.
Answer: C
Question Status: New

180) Comparing a discount bond and a coupon bond with the same maturity,
(a) the coupon bond has the greater effective maturity.
(b) the discount bond has the greater effective maturity.
(c) both bonds have the same effective maturity.
(d) effective maturity cannot be calculated for a discount bond.
(e) effective maturity cannot be calculated for a coupon bond.
Answer: B
Question Status: New

181) Duration is
(a) the average lifetime of a debt security's stream of payments.
(b) a weighted average of the maturities of an asset's cash payments.
(c) an asset's term to maturity.
(d) all of the above.
(e) both (a) and (b) of the above.
Answer: E
Question Status: New

182) The duration of a coupon bond increases
(a) the longer is the bond's term to maturity.
(b) when interest rates increase.
(c) the higher the coupon rate on the bond.
(d) all of the above.
(e) both (a) and (b) of the above.
Answer: A
Question Status: New

183) An asset's interest rate risk _____ as the duration of the asset _____.
(a) increases; decreases
(b) decreases; decreases
(c) decreases; increases
(d) remains constant; increases
(e) remains constant; decreases
Answer: B
Question Status: New

■ Essay Questions

1) A relative has just won a state lottery paying $20 million in installments of $1 million per year for twenty years. Your relative states that she is $20 million richer. Is she correct? Create a simple example for two years to illustrate your position.

   Answer: The relative is incorrect. The discounted present value of the payments is less than $20 million. The example should demonstrate that the discounted value of the payment due in one year is less than $1 million.

2) A friend tells you that he can purchase a 10 percent coupon bond at face value. Your friend states that 10 percent is a "high" rate of interest. You know that the current rate of inflation is 8 percent, and you expect inflation to increase. What advice should you give to your friend about this bond?

   Answer: The high nominal rate is reduced to a much lower real rate due to inflation. Interest-rate risk should be a concern. An increase in expected inflation will increase nominal rates due to the Fisher Effect. This will result in a capital loss, and the higher nominal rate reduces the real value of the 10 percent coupon rate.

3) Explain the Fisher equation. Construct a numerical example demonstrating that, depending on the expected rate of inflation, a lower nominal rate may still reflect a higher real cost of borrowing. Explain your example thoroughly.

   Answer: The answer should list the equation that the nominal rate equals the real rate plus the expected rate of inflation, or an equivalent variant. The terms should be clearly defined. The example should have a higher real rate for the lower nominal rate due to relatively lower expected inflation. The example and the resultant impact on real borrowing costs should be thoroughly explained.