Name: ____________________

Final
266: Fi. Markets and Institutions
Spring 2016
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Directions: You have 2 hours (120 min.) to do the exam (unless other arrangements have been made).

Some questions offer a bit of choice on which parts you do, so read carefully. If you answer too many parts, we will grade the first ones and ignore extras.

Where computations are required, full points will be given for the correct answer. Partial points will be given.

You may write on the backs of the exam pages. If your answer extends outside the space provided, you must label clearly where the additional portion is located.

Each part of each question will be given equal value.

1 Definitions.

1.1 Fiduciary

1.2 The voting members of the FOMC

1.3 Dual mandate central bank

1.4 Sovereign wealth fund

1.5 Open market operation

1.6 Private equity fund

2 **Do 8 of 9.** Facts/Real world stuff.

2.1 What is the value of U.S. nominal GDP?

2.2 Give the approximate value of assets held by U.S. mutual funds.

2.3 Name three investment vehicles other than mutual funds and ETFs through which many individuals indirectly hold corporate equities.

2.4 Over half of shares of stock (equities) in the U.S. are now held by mutual funds and exchange traded funds. Pick one: True/False

2.5 Name three countries for which 10-year sovereign debt yields are negative or very near zero.

2.6 Over the last two years, the value of the dollar versus the euro has appreciated by about 15%. True/False.

2.7 Historically, nations that adhered to the gold standard generally experienced, low and steady positive consumer price inflation. True/False and explain.

2.8 Public sector pensions in the U.S. are currently underfunded by more than $1 trillion, which may evolve into some sort of crisis. Pick one: True/False.

2.9 Many private pensions in the U.S. are backed by government insurance; thus, they are as safe as government-insured bank deposits. Pick one: True/False

Short questions

3 Describe the characteristics of the main assets held by each of the following categories of financial institution. Specifically for each institution state whether main assets tend to be i) long term or short term, ii) liquid or illiquid, and iii) debt or equity.

3.1 Money market mutual funds

i)

ii)

iii)

3.2 Private equity funds

i)

ii)

iii)

3.3 Pension funds

i)

ii)

iii)

3.4 Property and casualty insurance companies

i)

ii)

iii)

4 Monetary policy basics. Suppose that the Fed raises the federal funds rate, causing agents in the economy to expect higher short-term rates for the next couple of years.

4.1 When the Fed makes this decision, it is probably trying to promote [pick one: higher/lower] employment? And promote [pick one: higher/lower] inflation?

4.2 List 4 main channels through which the Fed's action will affect the economy.

4.3 Briefly explain the effect on employment and inflation operating through 2 of these channels.

4.4 Use the expectations theory of the term structure to explain what higher expected short-term rates should imply for longer-term yields.

5 Foreign exchange.

5.1 Explain the investment strategy known as *the carry trade* in foreign exchange. What empirical regularity about interest rates and exchange rates makes this a profitable strategy?

5.2 Suppose a country, say, Trumpland, is suffering weak economic conditions. It may find it attractive to take actions that depreciate the value of its currency. True/False and explain.

5.3 Why might other countries be opposed to Trumpland taking this action?

6 QE, or in Fed speak, LSAPs. In what is often called QE, the Fed engaged in large-scale asset purchases.

6.1 What did the Fed purchase?

6.2 Why did the purchases result in a huge increase in reserves in the banking system?

6.3 Approximately what is the current value of total reserves in the U.S. banking system?

6.4 Explain the main intended effect on financial conditions that the Fed wanted to achieve through these purchases?

6.5 The Fed pays interest on excess reserves. As interest rates rise, these interest payments to banks could become quite large. Why might the LSAPs, nonetheless, have a net positive effect on the U.S. taxpayer—that is, on the fiscal position of the U.S. government?

7 Politics and the Fed.

7.1 Under current law, the Congress and the President acting together can overrule monetary policy decisions of the Fed. Pick one: Yes/No.

7.2 When a new President takes office, the Fed Chair is generally among the first positions appointed by the new President. Pick one: True/False.

7.3 The Fed's monetary policy decision making structures were designed to insulate Fed decision making from populist political forces. True/False and explain.

Congratulations. The End.