



**College of Business Administration
Department of Economics
Seminar in Money and Banking
Lecturer: O. Mikhail
ECO 6226-0001
Summer 2004**

Mid-Term Exam

- This exam is worth 140 points.
- The exam totals 7 questions. All are equally weighted.
- Each question is worth 20 points.
- The exam totals 8 pages including the cover page.
- You are allowed any written information on an 8.5x11" sheet.
- Answer all questions in the given space.
- DO NOT forget to write your name and your student id on the exam booklet.
- Non-Programmable calculators and language dictionaries are allowed.
- At the end of the exam, hand-in the exam booklet to the examiner.
- Be clear and answer in point format (whenever possible).
- **Write clearly. Write clearly. Write clearly. Write clearly.**

June 3, 2004

6:05 p.m. – 8:50 p.m.

BA 1-212

Question I (20 points)

From the U.S. Treasury, you are given the following “Constant Maturity Treasury” rates.

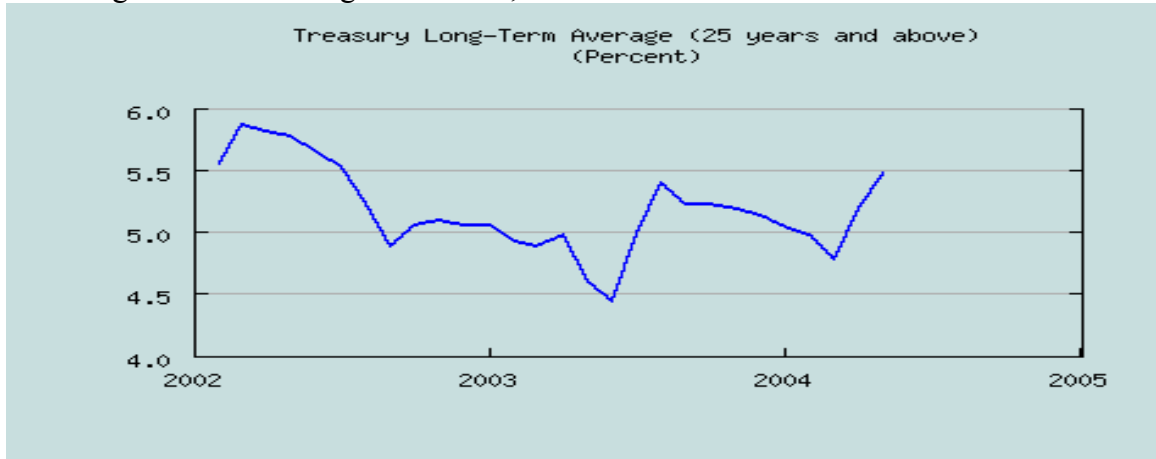
June 2004

Date	1 mo	3 mo	6 mo	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	20 yr
06/01/04	0.97	1.17	1.44	1.89	2.60	3.14	3.86	4.31	4.71	5.45
06/02/04	0.97	1.17	1.45	1.92	2.65	3.19	3.91	4.35	4.75	5.47

1. Define “Constant Maturity Treasury” rates. (3 points)
Assume that the time unit is one year. State all assumptions used to answer the following.
2. For the 2nd of June, 2004, Compute $R_{1,2}$ (show all computations). (7 points)
3. Why is it that the five basis points difference (for 2yr) is not constant across all the rates? Explain. (3 points)
4. Based on the (June 2004) Table, what is your expectations regarding future rates. Explain. (7 points)

Question III (20 points)

You are given the following information,



Series Properties:

Series ID:	LTA
Source:	Board of Governors of the Federal Reserve System
Release:	H.15 Selected Interest Rates
Seasonal Adjustment:	Not Applicable
Frequency:	Monthly
Units:	Percent
Date Range:	2002-02-01 to 2004-05-01
Last Updated:	2004-06-02
Notes:	Based on the unweighted average of the bid yields for all Treasury fixed-coupon securities with remaining terms to maturity of 25 years and over. Averages of business days.

Answer the following, (State all assumptions used to answer)

1. Explain why there was a general downward trend until mid 2003? (5 points)
2. Explain why did the series increase during the mid 2003? (5 points)
3. Can you predict the direction of its behavior in the near future? Explain why and how? (10 points)

Question IV (20 points)

1) In the U.S. Which regulatory agency has the primary responsibility for supervising the following categories of commercial banks? (10 points)

National Banks _____

Bank Holding Companies _____

Non-Federal Reserve State Banks _____

Federal Reserve Member State Banks _____

2) In the U.S. Which regulatory agency has the primary responsibility for insuring the following Financial Institutions? (10 points)

Mutual Funds _____

Bank Holding Companies _____

U.S. Branches of Foreign Banks _____

State Credit Union _____

Question VII (20 points)

The following is from the recent article by Ricardo Caballero and Arvind Krishnamurthy (May 2004), National Bureau of Economic Research (NBER), Working Paper 10532, <http://www.nber.org/papers/w10532>

“Most economists and observers place the lack of fiscal discipline at the core of the recent Argentine crisis. This begs the question of how countries like Belgium or Italy (pre Maastricht) could run large fiscal deficits and accumulate debts far beyond those of Argentina, without experiencing crises nearly as dramatic as that of Argentina? Why is it that Argentina cannot act like Belgium or Italy and pursue expansionary fiscal policy during downturns? We argue that advanced and emerging economies differ in their financial depth, and show that lack of financial depth constrains fiscal policy in a way that can overturn standard Keynesian fiscal policy prescriptions. We also provide empirical support for this viewpoint. Crowding out is systematically larger in emerging markets than in developed economies. More importantly, this difference is extreme during crises, when the crowding out coefficient exceeds one in emerging market economies.”

- 1) Which theory of financial structures do the authors subscribe to? Explain. (5 points)
- 2) Does the financial structure matter? Why and How – if any? (15 points)