Whitman College
Econ 407
Exam 1
October 18, 2013

Write all answers in your blue book. Show all of your work. The exam ends at noon.

1. Consider the 2011 article "Why Didn't Canada Have a Banking Crisis in 2008 (or in 1930, or in 1907, or…)?" by Michael D. Bordo, Angela Redish and Hugh Rockoff.

(a) (4pts) According to the authors, what were the twin weaknesses of the United States financial system that produced banking panics in the 19th and early 20th centuries?

(b) (2pts) Why, in the 19th and early 20th centuries, did small rural U.S. banks choose to hold high levels of reserves compared to Canadian banks?

(c) (6pts) What do the authors mean by saying, when discussing Great Depression-era regulatory reforms in the U.S., that "as important as what did happen, is what did not"?

(d) (8pts) What, according to the authors, are plausible explanations for the financial stability the U.S. experienced in the 1950s and 1960s?

(e) (8pts) In what ways did financial deregulation after the 1980s move the U.S. closer to the Canadian financial model, and in what ways did it not?

2. (6pts) Consider the speech "Lessons from the Financial Crisis: Canada in Comparative Perspective" given in 2011 by Nicholas Le Pan, Superintendent of Financial Institutions for Canada from 2001 to 2006. How did the Canadian government's refusal over the previous dozen years to permit mergers among major financial institutions help Canada weather the financial crisis?

3. (10pts) Consider the articles "Deflating the Case for Zero Inflation" and "Response to a Defense of Zero Inflation" by Rao Aiyagari.

Aiyagari argues that a monetary policy targeting zero inflation would not provide the benefits claimed by many of the proponents of such a policy. Consider Aiyagari's argument that proponents of zero-inflation policy exaggerate the benefits from reductions in **unanticipated** inflation. Explain his argument.

4. (a) (2pts) Define money.
(b) (2pts) Define commodity money.
(c) (2pts) Define representative money.
(d) (2pts) Define fiat money.
(e) (2pts) What kind of money were the Bills of Credit issued by the American colonies? Explain your reasoning.
(f) (2pts) What kind of money was the United States Greenback when it was first issued in 1862? Explain your reasoning
(g) (2pts) What kind of money was the Bully Mark, as described by R. A. Radford in "The Economic Organization of a P.O.W. Camp"? Explain your reasoning.

For questions 5, 6 and 7 consider the Pure Expectations (PE) Theory of the term structure of interest rates and consider the October 17, 2013 yield curve for United States Treasury debt given below.

Treasury Yield Curve Rates

Date	1 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
10/17/13	0.01%	0.13%	0.33%	0.61%	1.35%	1.98%	2.61%	3.36%	3.66%

5. Use the PE Theory to forecast the annual yield to maturity on each of the following forward securities.

(a) (5pts) The two year Treasury note that will be offered one year from now.
(b) (5pts) The two year Treasury note that will be offered three years from now.
(c) (5pts) The two year Treasury note that will be offered five years from now.

6. Consider the zero-coupon two year Treasury note that has a face value of $1,000.

(a) (3pts) What was the price of that note when it was issued October 17, 2013?
(b) (3pts) What does PE forecast will be the price of that note when it is offered on October 17, 2014?
(c) (3pts) What does PE forecast will be the price of that note when it is offered on October 17, 2016?
(d) (3pts) What does PE forecast will be the price of that note when it is offered on October 17, 2018?

7. Consider the fact that interest rate forecasts using PE are systematically biased.

(a) (5pts) In what direction are these forecasts biased?

(b) (10pts) Why are these forecasts biased? Explain.