The Behavior of Interest Rates
ECON 4673
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Problems

1. Explain why you would be more or less willing to buy a share of Microsoft stock in the following situations:
   a. Your wealth falls.
   b. You expect the stock to appreciate in value.
   c. The bond market becomes more liquid.
   d. You expect gold to appreciate in value.
   e. Prices in the bond market become more volatile.
2. Explain why you would be more or less willing to buy long-term AT&T bonds under the following circumstances:
   a. Trading in these bonds increases, making them easier to sell.
   b. You expect a bear market in stocks (stock prices are expected to decline).
   c. Brokerage commissions on stocks fall.
   d. You expect interest rates to rise
   e. Brokerage commissions on bonds fall.
3. What is the effect of a sudden increase in the volatility of gold prices on bond prices and interest rates?
4. Explain how a large federal deficit impacts bond prices and interest rates.
5. According to the portfolio choice theory, name and briefly explain the four factors that affect the demand for a particular asset.
6. The President of the United States announces that he or she will fight a high inflation rate with a new anti-inflation program. Predict what will happen to bond prices and interest rates if the public believes the President.

7. The demand curve and supply curve for one-year discount bonds with a face value of $1,000 are represented by the following equations:

$$B^d\text{: Price} = -\,0.6\times\text{Quantity} + 1{,}140$$
$$B^s\text{: Price} = \text{Quantity} + 700$$

a. What is the expected equilibrium price and quantity of bonds in this market?

b. Given your answer to part (a), what is the expected interest rate in this market?