PHS 204

No calculator

2pm Sunday, Review Session

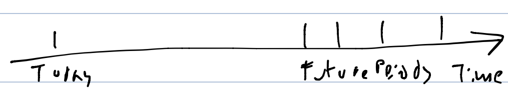
Long-run GDP Growth Rate: 3%

The Loanable Funds Market

Capital Goods: Goods that are used to produce other goods and services.

- A means to an end
- The purpose: help us produce

Investment: Spending on capital



Somebody must save → Borrow → Invest → GDP

output = income

Every dollar borrowed requires a dollar saved

Good:	Savings / Loans
Buyers / Demanders:	Borrowers
Sellers / Suppliers:	Savers / Lenders
Price:	Interest Rate

Ex: Borrow $50,000 for one year

Interest rate = 4%

$0.04 \times 50{,}000 = \$2{,}000$

Dollar price = 2000 dollars

Supply = Savings

1. Interest Rate (Price) (+)

The reward for saving

Law of Supply

↑ price → ↑ quantity supplied

Incentives affect behavior

2. Income and wealth (+)

Domestic and foreign

↑ income → ↑ supply

3. Time Preferences (−)

Now is preferred to later

Time Preference: Goods and services are more valuable the sooner they are delivered.

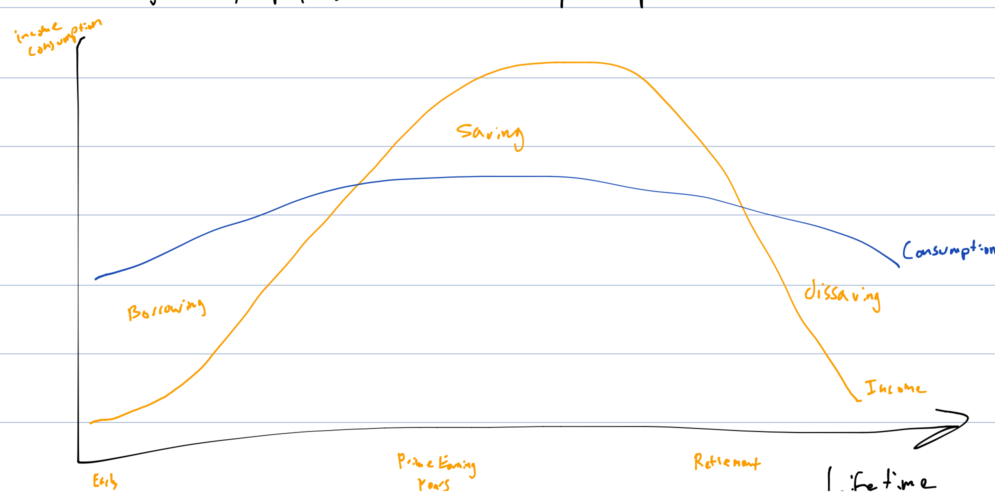
Time preference means...

... you must pay people to save

↑ TP → ↓ supply

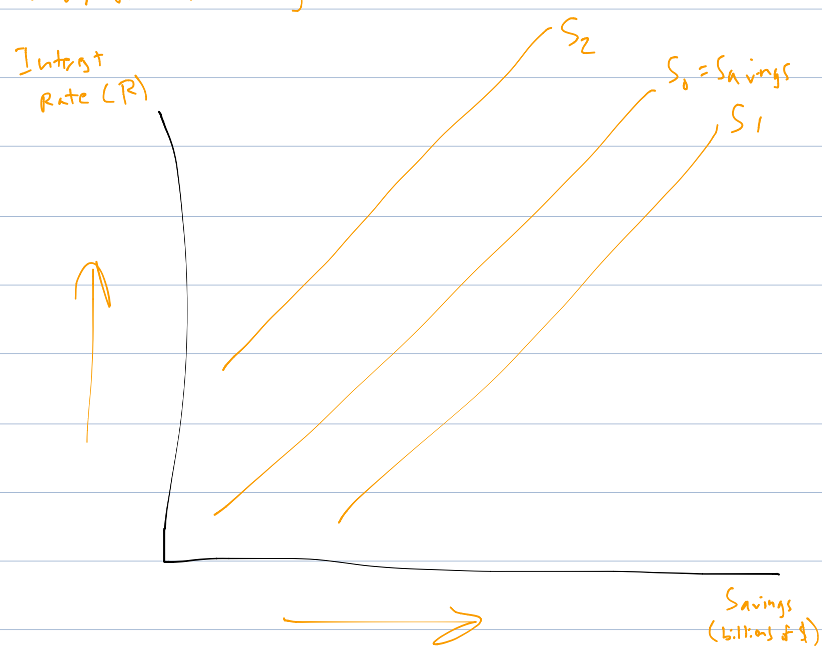
4. Consumption Smoothing

People generally prefer smooth consumption patterns



4 Factors

1. Interest Rate (Price) (+)
2. Income and wealth (+)
3. Time Preferences (-)
4. Consumption Smoothing



Demand (Investment)

1. Interest Rate (Price) (-)

The cost of borrowing

Law of Demand:

↑ Price → ↓ quantity demanded

Incentives affect behavior

Firms borrow iff:

Expected return on Investment > Cost of Loan (R)

How many investments have expected returns greater than:

15% Very few

10% few more

5% lots.