UNIVERSITY OF THE PEOPLE

BUS 2203-01 Principles of Finance 1 – AY2024-T2

Learning Journal Unit 2

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This week, I expanded my knowledge of interest rates by reading chapter 6 as part of our learning journal assignment. I realized that interest rates play a crucial role in the broader economy and impact other financial areas.

Interest rate movements in the U.S. (rises and falls) are highly correlated over history (Wright, & Quadrini,2009). Rates trended downwards between 1920-1945, then upwards from 1960-1985 before falling again until 2005. Key influences include high bond prices from favorable business conditions in the 1920s; extremely low rates during the Great Depression in the 1930s; and inflationary pressures after WWII that peaked in the 1970s when Americans endured substantial inflation. The Fed subsequently instituted monetary policies that reduced inflation and brought rates down during the 1980s, a trend that continued amid 1990s globalization which enabled greater efficiencies and robust international trade.

Lower interest rates promote business activity, investment, stronger bond markets, and housing upticks. Moreover, when weighing interest rate fluctuations, investors chiefly consider three economic factors:

1. Risk - U.S. Treasury bonds bear no default risk whereas revenue municipal bonds offer low default risk compared to corporate bonds. "Flight to quality" describes investors shifting from risky to safer assets during downturns.
2. Return - Corporate bond yields are higher than Treasuries given greater risk. Over time, yields for riskier corporate bonds exceed those for more stable Munis which offer tax perks.
3. Liquidity - Out of all bond types, Treasuries can be quickly and easily converted into cash at their fair market prices. Treasuries have the highest level of liquidity compared to other

bonds like corporate and municipal bonds. This high degree of liquidity makes Treasuries appealing to investors who want to be able to access their money without delay or difficulty whenever needed.

In crises, investors tend to sell risky assets in bearish markets or shift from stocks to bonds, gold, and other safer havens - a protective stance called a flight to quality.

Reference:
Wright, R.E. & Quadrini, V. (2009). Money and Banking. Saylor Foundation.

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