Problem 1. Define the following terms:

(a) surplus spending units

(b) deficit spending units

(c) direct finance

(d) indirect finance

Problem 2. Which are the following statements is correct?

(a) If, all else the same, the real interest rate increases, the quantity of loanable funds supplied will increase.

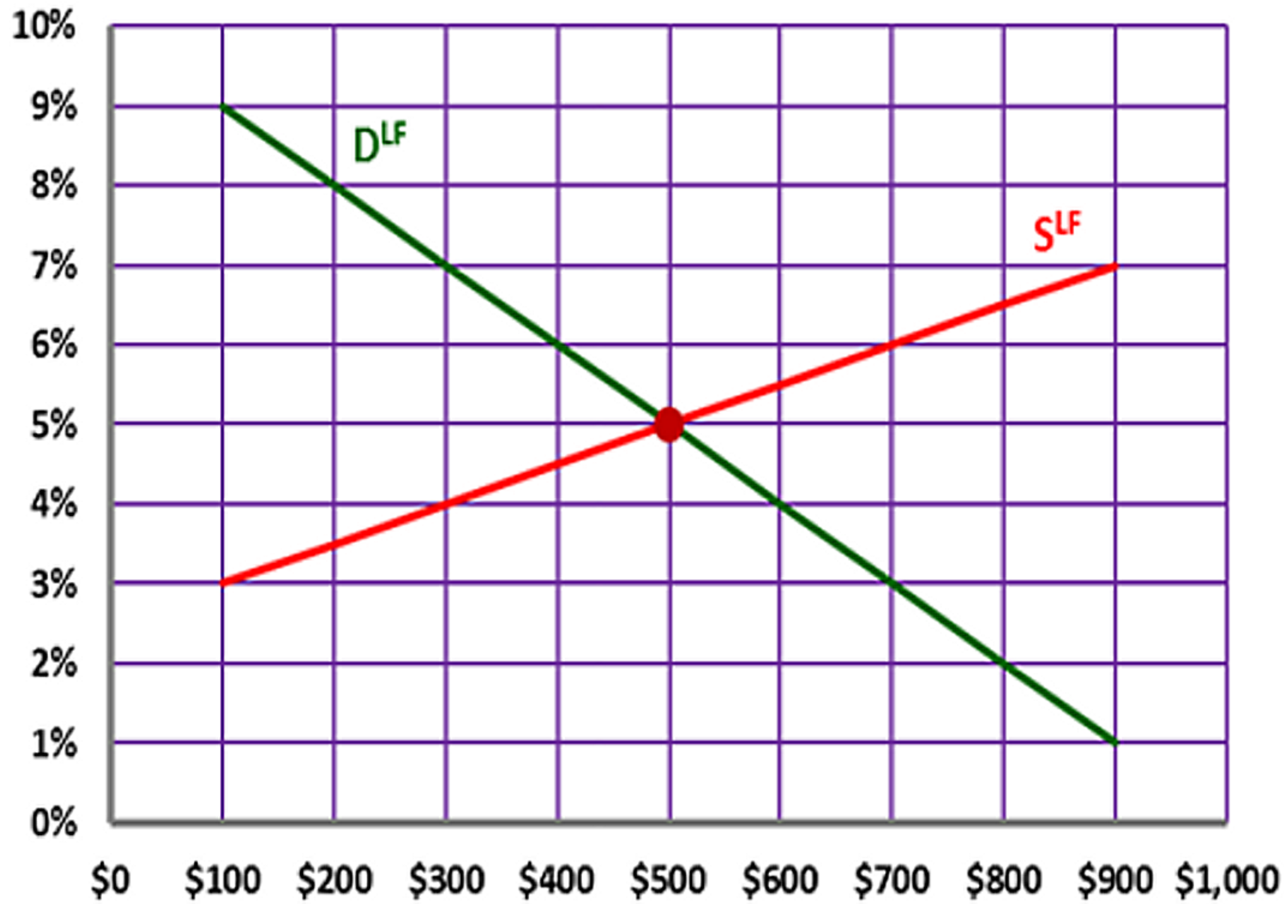
(b) If, all else the same, the real interest rate increases, the quantity of loanable funds supplied will decrease.

(c) If, all else the same, the real interest rate decreases, the quantity of loanable funds supplied will increase.

(d) If, all else the same, the real interest rate increases, demand for money will decrease.

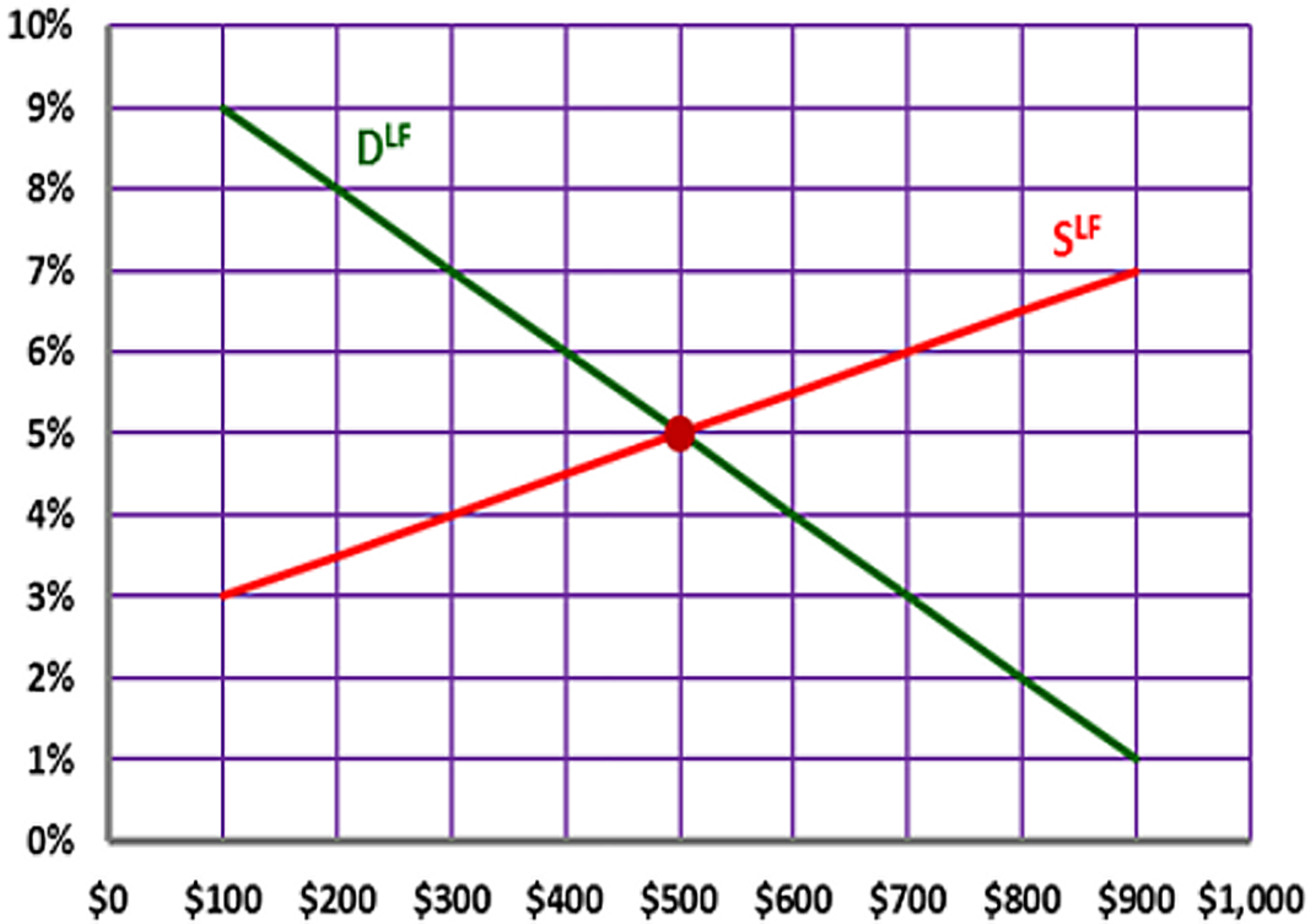
(e) None of the above.

Problem 3.



If demand for loanable funds increases by $300, what happens to the equilibrium interest rate?

Problem 4. If the government increases spending by $300 without raising taxes or printing money, then the new equilibrium interest rate will be what? How much will the quantity of loanable funds increase by? How much private borrowing is crowded out?



Problem 5. If lenders and borrowers expect the inflation rate to increase by 2%, according to the Fisher effect the equilibrium nominal interest rate will increase by how much?

Problem 6. If the volatility of inflation rate increases, then

(a) Both supply and demand will increase

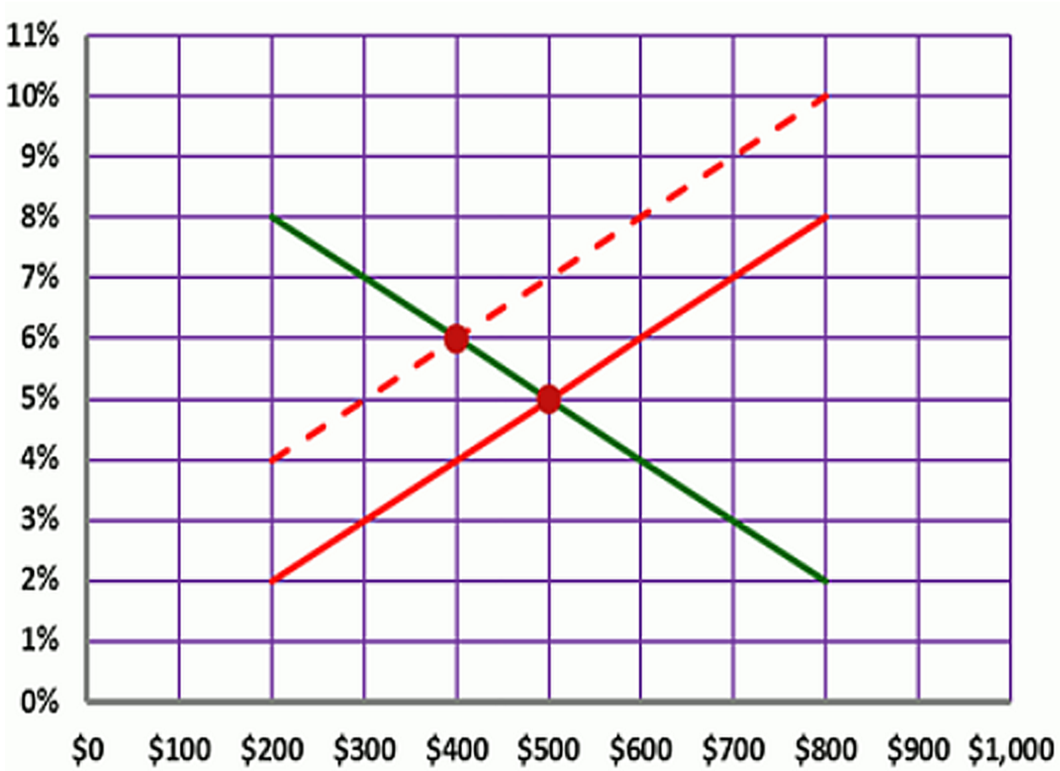
(b) Both supply and demand will decrease

(c) Supply will increase, demand will decrease

(d) Supply will increase, demand will decrease

(e) None of the above

Problem 7. Which of the following could cause the following event?



(a) a recession

(b) an increase in expected future corporate profits

(c) a decrease in the expected rate of inflation

(d) an increase in credit risk

(e) none of the above

Shifts in Demand of Loanable funds

(a) **Expected future economic conditions.** If you feel good about the future, you feel like you can afford to borrow more (shift right). If you feel bad about the future, you act cautious and borrow less (shift left).

(b) **Uncertainty about the level of future profits.** If firms are uncertain about the future, they are hesitant to borrow (shift left).

(c) **Government budget deficit.** If the government is spending more than it brings in in tax revenue, it has to borrow to cover the spending (shift right).

(d) **Inflation volatility.** If inflation is volatile, then borrowers cannot form reliable beliefs about the future and hence will not want to borrow (shift left).

Shifts in the Supply of Loanable Funds

(a) **Income and wealth.** As the income and wealth of households increase, they can save more and, thus, lend more (shift right).

(b) **Credit risk.** If lending is riskier, then lenders don't lend out as much (shift left).

(c) **Inflation volatility.** If inflation is volatile, then lenders cannot form reliable beliefs about the future and hence will not want to borrow (shift left).