



- (b) (9 points) Suppose the bond is held for only one year then re-sold on the secondary market. Suppose you expect interest rates next year to be 6%. What is your expected capital gain?
3. (9 points) Suppose as the economy rebounds from the recession there is an increase in current disposable income and in expected future disposable income. *Describe and illustrate* the impact on the corporate bond market. What should happen to interest rates on corporate bonds and the quantity of corporate bonds in equilibrium?
4. Suppose the Federal Reserve conducts an open market purchase of Treasury bonds.
- (a) (9 points) *Describe and illustrate* the impact on the market for money. What happens to the quantity of money and interest rate in the short run?

- (b) (9 points) *Describe and illustrate* the impact on the market for bonds. What happens to the quantity of bonds and interest rate in the short run?
5. (9 points) Suppose people expect interest rates to rise, but also the degree of uncertainty regarding future interest rates increases. Draw and describe the shape the yield curve will take. If it is possible the yield curve can take more than one shape, draw and describe each scenario.
6. (9 points) Suppose people expect with a great degree of certainty that interest rates will fall and remain low. Draw and describe the shape the yield curve will take. If it is possible the yield curve can take more than one shape, draw and describe each scenario.

7. Homeowners selling their houses always know more about their houses than potential buyers.

(a) (9 points) Describe the type of market failure this causes.

(b) (9 points) What impact does this market failure have on the price of existing homes?

(c) (9 points) What impact does this market failure have on the quality of existing homes?