

Name..... ID.....

FN 211: Practice Questions (Determinants)

1. Explain why you would be more or less willing to buy a share of Apple stock in the following situations:

a. Your wealth falls.

Less, because your wealth has declined

b. You expect it to appreciate in value.

More, because its relative expected return has risen

c. The bond market becomes more liquid.

Less, because it has become less liquid relative to bonds

d. You expect gold to appreciate in value.

Less, because its expected return has fallen relative to gold

e. Prices in the bond market become more volatile.

More, because it has become less risky relative to bonds

2. What effect will a sudden increase in the volatility of gold price have on interest rates?

Interest rates fall. The increased volatility of gold prices makes bonds relatively less risky relative to gold and causes the demand for bonds to increase. The demand curve, B_d , shifts to the right and the equilibrium bond price rises and the interest rate falls.

3. Predict what will happen to interest rates if prices in the secondary bond market become more volatile.

Interest rates will rise. When bond prices become volatile and bonds become riskier, the demand for bonds will fall. The demand curve B_d will shift to the left, and the equilibrium bond price falls and the interest rate will rise.