EE431 Economics of Financial Markets and Institutions
Debt Market and Structure of Interest Rate

1. Consider a 5% coupon bond with the par value of 2,000 Baht, selling for 2,228.46372 Baht. The bond will mature in 4 years. Find the modified duration of the coupon bond and explain its meaning.

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2. When interest rates fall, the prices of outstanding bonds .... (rise or fall).

3. The market price of longer maturity bonds fluctuates .... (more or less) compared with shorter maturity bonds as interest rates change.

4. Write the Fisher Equation, relating the nominal interest rate i, the real interest rate r, and expected (or anticipated) inflation π^e :

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5. Suppose your earns 7% nominal interest from your deposit account. If inflation is 5%, what is the real rate of return?

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6. How does real interest rate in the financial market relate to marginal product of capital?

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7. Use the following information. Answer all parts of this question.

   Government Bond Yield

TTM (Time To Maturity)	January 2015	February 2015
1	3%	4%
2	5%	6%
3	7%	9%

(a) Sketch the yield curves in January 2015 and February 2015 in the same graph.

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(b) Use the government bond yield data in January 2015. Suppose the expectation theory of the yield curve holds, what is the expected one-year government bond rate for 2016 and 2017?

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(c) Use the government bond yield in January 2015. Suppose liquidity premium for 1 year and 2 years are 0% and 0.5% respectively. According to the liquidity premium theory of the yield curve, what is your prediction for the interest rate on one-year bonds in 2016?

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