Write out and sign the pledge. No PIFs. This pledge covers the short-answer and multiple choice questions.

Rules and Regulations: You have 1 hour and 15 minutes to complete this exam. Answer all questions. Points for each problem are in parentheses. Work quickly and carefully. There may be a time constraint. Good luck.

1. (7) The yield on a one-year bond issues today is 9% and the yield on two-year bonds issued today is 13%. According to the Expectations Hypothesis, what is the expected yield on a one-year bond issued one year from today? Show your work for full credit.

2. (7) According to the Liquidity Preference Theory, what must be true for yields on long term assets to be less than the yields on short-term assets (downward sloping yield curve). Explain.
3.(15) In the space below, we want to analyze the change in interest rates due to a change in expectations regarding inflation. You can use the bond market or the loanable funds market. Clearly label both axes and both lines. Label the equilibrium values with “0” subscripts.

Assume there is an increase in people’s expectation of inflation from 2.5% to 4.0%.

a. Will the Demand for Bonds (Supply of Loanable Funds) change? If there is a change, explain why. Be sure to indicate whether you are discussing the Dₜ or the Sₜ.

b. Will the Supply of Bonds (Demand for Loanable Funds) change? If there is a change, explain why. Be sure to indicate whether you are discussing the Sₜ or the Dₜ.

c. Show the change(s) described in a & b in the graph above. Label the new equilibrium values with “1” subscripts.

d. What happened to the price of bonds? increased decreased no change

e. According to the Fisher Effect, what should happen to interest rates? Be as specific as possible.
4. (7) A Treasury Bill (face value = 100) that matures in 177 days has a discount yield of 1.62%. Determine the price (in dollars) of this T-Bill. Show your work for full credit.

Price = ___________

5. (7) The following is a quote from the New York Bonds section of the WSJ: “ATT 7½ 06” Assume that the face value of the bond is $100, the price of the bond is $96.38, market interest rate is 4.5%. Determine the Current Yield for this bond. Show your work for full credit.

Current Yield = _______________

6. (7) A zero coupon bond issued by Duke Energy matures in exactly 15 years, has a face value of $10,000, and a price of $3,044.96. Determine the Yield to Maturity for this bond. Show your work for full credit.

Yield to Maturity = _______________
7. (15) The graph below shows the market for money. Label both axes and both lines. Label the equilibrium values with "0" subscripts.

![Graph of the money market](graph.png)

a. Using concepts discussed in class, explain the rational for the slope of the demand curve. Do not simply give the relationship between the values on the two axes, but explain why that relationship exists.

Assume income increases for all households.

b. Does the demand for money curve shift? If so, explain why and show this in the graph above.

c. Does the supply of money curve shift? If so, explain why and show this in the graph above.

d. Label the new equilibrium with "1" subscripts.

e. What happens to the level of money in the economy?

f. What happens to interest rates?