

Problem Set # 7

Econ 1015

- 1) Which of the following would satisfy Peter's wish to increase his future consumption? Give a brief explanation for each using an expression for his assets and liabilities.
  - Take a larger fraction of his income and use it to reduce his credit card balance.
  - Increase his credit card balance today.
  - Liquidate his holdings of Treasury securities to pay off his credit card balance.
  - Put a larger fraction of his portfolio into financial instruments that pay a lower interest rate.
  
- 2) Explain how a decrease in government spending would result in higher national saving.
  
- 3) You currently own a share of EconNews.com. One year from today you expect to be able to sell the share for \$65. You also expect that the company will pay a \$2 dividend one year from today. If the market interest rate is 8% and you would be selling the share today, compute the minimum price you would be willing to sell the share.
  
- 4) Suppose you have two Treasury securities. Each has a face value of \$1,000. Let's call security A matures in two years and Security B matures in 12 years. The current market interest rate is 10%. Suppose the coupon rate on both securities is 10%. Compute the price for each security. Next, suppose that the market interest rate falls tomorrow to 8%. Compute the new price for each security. Give a brief intuitive explanation for why the prices changed.