Business Cycles: Asset Pricing: Problems

1. Suppose that a three year Treasury Bond promises to pay the holder \$100 when it matures. Supposing that the bond sells for \$90 on the open market, what is the corresponding bond yield?

2. The Federal Reserve currently holds well over \$1 trillion in Treasury Bonds. Suppose that the Fed decides to immediately sell all of its Treasuries in order to purchase Scotch for the next meeting of the Federal Open Market Committee. What will be the effect on Treasury Bond yields?

3. Suppose that the Federal Government needs to borrow more in order to finance its budget deficit. All else equal, what will be the effect on bond prices and yields?

4. Both governments and firms often roll over their bond issues and may face adverse effects if they are unable to locate buyers for new bond issues. How do these effects differ for governments as opposed to private firms?

5. Suppose that interest rates always equal 1%. If a stock promises to pay \$10 this year, \$20 next year, and then never pays another dividend again, what is its fundamental value?

6. Consider a stock that is not expected to pay a dividend within the next 20 years. Provide two explanations for why this stock may still have a positive price.

7. How might a stock market crash affect aggregate output and unemployment?

8. How might an economic downturn adversely affect stock prices?