Bond Markets: Key

1.

$$P_b = \frac{1000}{1 + i_{1,t}} = 960 \tag{1}$$

$$i_t = 4.1\% \tag{2}$$

2. Long-term yields are a function of current short-term yields and expected future short-term yields. When the latter rise, so do current long-term yields. We would thus expect any current yield over two years to rise as well.

3.

$$P_b = \frac{100}{1 + i_{3,t}}^{3} = 85 \tag{3}$$

$$i_t = 5.7\% \tag{4}$$

4. This increases the supply of bonds, resulting in lower bond prices. Because bond yields and prices and inversely related, yields rise.

5. This increases the demand for bonds, resulting in higher bond prices. Because bond yields and prices and inversely related, yields fall.

6. In general, higher yields result from increased default risk. A non-exhaustive list includes: i) worse current profits, 2) worse expected future profits, and 3) higher current debt levels.

7. A non-exhaustive list includes: i) a higher current debt to GDP ratio, 2) a higher current or future budget deficits 3) high tax rates, making it harder to raise additional revenues, and 4) political uncertainty/disfunction.

8. A non-exhaustive list includes: i) a smaller or less flexible endowment, 2) a higher acceptance rate 3) fewer students who pay most or all of the sticker price, 4) higher debt levels, and 5) weaker leadership.

9. 2%. Recall that $r = i - \pi$

10. False. The word "must" is critical. Higher default risk is one potential reason but there are many others. This includes higher issuance (see #4), reduced demand)see the reverse of #5), or the Fed switching to a more contractionary monetary policy.