

## Problem Set 2

***Answer the following questions:***

1) What is the role of the financial system? Name and describe two markets that are part of the financial system in our economy. Name and describe two financial intermediaries.

2) What is national saving? What is private saving? What is public saving? How are these three variables related?

3) For each of the following pairs, which bond would you expect to pay a higher interest rate? Explain.

a. a bond of the U.S. government or a bond of an eastern European government

b. a bond that repays the principal in 2020 or a bond that repays the principal in 2040

c. a bond from Coca-Cola or a bond from a software company you run in your garage

4) Suppose GDP is \$8 trillion, taxes are \$1.5 trillion, private saving is \$0.5 trillion, and public saving is \$0.2 trillion. Assuming this economy is closed, calculate consumption, government purchases, national saving, and investment.

5) Suppose that Intel is considering building a new chipmaking factory.

a. Assuming that Intel needs to borrow money in the bond market, why would an increase in interest rates affect Intel's decision about whether to build the factory?

b. If Intel has enough of its own funds to finance the new factory without borrowing, would an increase in interest rates still affect Intel's decision about whether to build the factory? Explain.