

## Short Answer Questions

### Chapter 26.

1. What is the financial system and why is it so important in modern economies?
2. Outline the function of the bond and stock markets in an economy.
3. Using a numerical example, explain why there is an inverse relationship between the price and yield of a bond.
4. Using an appropriate example, explain the function of credit default swaps.
5. What are collateralised debt obligations and do they represent the unacceptable face of risk taking in the financial system? Explain your answer.
6. Explain why, in a closed economy,  $S = I$
7. Outline the factors that affect the demand and supply of loanable funds.
8. Why do governments often try to create schemes to encourage households to save more in an economy? Doesn't higher saving simply mean lower consumption and so lower economic growth?
9. What would happen to the market for loanable funds if both the demand and supply of loanable funds increased at the same time? Explain your answer and clearly state any assumptions that you make.
10. Why do government budget deficits lead to an increase in the interest rate (other things equal) and why should this be a concern to the financial markets?