DISCUSSION QUESTION

Name:
Instructor:
Course:

Define the market for loanable funds. What role do interest rates play?

PEER GROUP PROBLEM SOLVING

Name:
Instructor:
Course:

Identify and discuss the three roles financial institutions play in the loanable funds market. Provide an example of each which is not given in the book.

IN-CLASS EXPERIMENT / ACTIVE EXERCISE

Stocks are risky investments because shares may lose their value or even become worthless if a company goes bankrupt. Visit one of the following websites, cnbc.com or finance.yahoo.com and look up Facebook (FB), Delta Airlines Inc. (DAL), and American Residential Properties Inc. (ARPI). What is the 52 week high and low for each? Do any of them pay dividends? Based just on this past year's performance, which stock appears to be the riskiest? Would you buy any of these and, if so, under what conditions?

SOLUTIONS AND INSTRUCTOR NOTES

Discussion Question

Define the market for loanable funds. What role do interest rates play?

The market for loanable funds is a model that describes the financial market for saving and investment. Interest rates are the price of money. At higher interest rates, people (savers) will save more in order to obtain more interest income. Thus there is a positive relationship between interest rates and the supply of funds. However, when interest rates are high, the demand for loanable funds will decrease as borrowers are less likely to borrow at higher rates.

Peer Group Problem Solving

Identify and discuss the three roles financial institutions play in the loanable funds market. Provide an example of each which is not given in the book.

Three roles financial institutions play in the loanable funds market (note - examples will vary):

1. *Reducing information costs: - Information costs are those costs involved in gathering information on the creditworthiness of borrowers. - Financial institutions screen, evaluate, and monitor borrowers to be sure that they are creditworthy and are using the funds appropriately.*

2. *Reducing transaction costs: - Costs associated with finding, selecting, and negotiating contracts between savers and borrowers. - Costs are reduced as financial institutions provide standardized financial products such as savings accounts, mortgages, stocks, bonds, etc.*

3. *Diversifying assets to reduce risk: Financial institutions pool funds from many savers into a portfolio of financial instruments while still allowing savers access to their funds.*

In-Class Experiment / Active Exercise

Stocks are risky investments because shares may lose their value or even become worthless if a company goes bankrupt. Visit one of the following websites, cnbc.com or finance.yahoo.com and look up Facebook (FB), Delta Airlines Inc. (DAL), and American Residential Properties Inc. (ARPI). What is the 52 week high and low for each? Do any of them pay dividends? Based just on this past year’s performance, which stock appears to be the riskiest? Would you buy any of these and, if so, under what conditions?

The 52 week high and low will vary. However, the riskiest stock is probably American Residential Properties. Regarding conditions under which someone would buy the stock, students need to look at the current selling price to determine if it is near the 52 week high. In addition, as stocks tend to offer higher returns in the long run, the timing of when an investor would need funds is important in the determination of which (or even whether) stocks to purchase.

For more in-class experiment and active learning ideas, visit www.econedactive.com