# Exercise walk-through

## The Loanable Funds Market ▪ 4.7

eXercise

# You must be able to

- describe the **loanable funds market 可贷资金市场**, where saving is supplied and borrowing demanded
- determine the **equilibrium real interest rate 实际利率**
- analyse how government borrowing, saving, or investment demand shift the market

# Method — The loanable funds market

**Savers** supply loanable funds; **borrowers** (firms investing and the government) demand them.

# Method — Equilibrium

The **real interest rate** where the quantity of funds saved equals the quantity borrowed.

# Method — Shifts

- More **government borrowing** $\rightarrow$ demand shifts right $\rightarrow$ real rate **up** (crowding out).
- More **saving** $\rightarrow$ supply shifts right $\rightarrow$ real rate **down**.

# Practice 2.1 ▪ 2 marks

State who supplies and who demands loanable funds.

# Solution 2.1

Method: The loanable funds market

**Worked steps**

savers supply funds; borrowers (firms and government) demand them **B1** **B1**.

# Practice 2.2 ▪ 1 mark

State what is determined in the loanable funds market.

# Solution 2.2

Method: The loanable funds market

**Worked steps**

the equilibrium real interest rate **B1**.

# Practice 2.3 ▪ 1 mark

State the effect of increased government borrowing on the real interest rate.

# Solution 2.3

Method: Shifts

**Worked steps**

it rises B1.

# Exam-style 3.1 ▪ 1 mark

In the loanable funds market, the “price” is the

**A** nominal interest rate

**B** real interest rate

**C** exchange rate

**D** price level

# Solution 3.1

Method: The loanable funds market

**A** nominal interest rate

**B** real interest rate ✓

**C** exchange rate

**D** price level

## Worked steps

**B**.

# Exam-style 3.2 ▪ 1 mark

An increase in saving shifts the supply of loanable funds

**A** to the left

**B** to the right

**C** not at all

**D** vertically

# Solution 3.2

- **A** to the left
- **B** to the right ✓
- **C** not at all
- **D** vertically

**Worked steps**

**B**.

# Exam-style 3.3 ▪ 1 mark

The government runs a large budget deficit and borrows heavily.
(a) State the effect on the demand for loanable funds.
(b) State the effect on the real interest rate.
(c) Name the effect this has on private investment.

# Solution 3.3

**Worked steps**

(a) it increases (shifts right) **B1**. (b) it rises **B1**. (c) crowding out of private investment **B1**.