1. Draw a loanable funds diagram depicting equilibrium in the loanable funds market:

2. Now suppose there is an increase in the government deficit financed by the Treasury issuing new bonds. Show what this will do to the demand and/or supply in the above diagram. (Indicate the appropriate shifts)

3. What has happened to the equilibrium interest rate?

4. Now draw a bond market diagram showing at first an equilibrium in the bond market and then what happens when there is an increase in the government deficit as in #3.

5. Now draw another loanable funds diagram and show what happens when there is slow down
(decrease) in inflation and inflationary expectations. Be sure to show what happens to the
demand and/or supply curves). Now what has happened to the equilibrium interest rate?