Session 11: Post class test solutions -

1. **e. None of the above.** Very high nominal rates are consistent with high expected inflation and negative nominal rates are consistent with deflation. Real interest rates can be negative during severe economic slowdowns and can climb to high levels when economic growth is very strong.
2. **b. 2.00%.** Short cut answer = Expected inflation = T.Bond rate – TIPS rate = 3%-1% = 2.00%. More precise answer = (1.03/1.01)-1 = 1.98%
3. **c. When you expect inflation to be high and everyone else expects inflation to be low for the next 10 years.** The 10-year treasury bond rate will reflect consensus expectations about inflation and be low, but the TIPS rate is a real rate and buy buying the bond, you will get the real rate plus actual inflation
4. **e. None of the above.** The central bank sets none of these rates.
5. **d. Short term rates are high, long term rates are lower**. Historically, downward sloping curves have been associated with slower economic growth, though the evidence is weak.