Many things influence saving. We focus here on one: the interest rate.

People also invest in productive projects. The demand for investment funds is a downward sloping function of the interest rate.

<table>
<thead>
<tr>
<th>Cost</th>
<th>Return</th>
<th>IRR</th>
</tr>
</thead>
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<td>$36,000</td>
<td>20%</td>
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If you have money out on loan at less than 20% or if you can borrow at less than 20%, undertake this project.
The Demand for Loans

Why?

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If you have money out on loan at less than 15% or if you can borrow at less than 15%, undertake these projects.

The lower the interest rate, the more attractive investment opportunities you will have, either to be financed out of your own funds or by borrowing.

Net Demand for Loans

If the interest rate is \( r_o \), the amount a person wants to save exactly covers his investment.

If the interest rate is \( r_i \), savings exceed investment, and our consumer will lend the difference to others.
If the interest rate is $r_2$, investment exceeds saving; our consumer will borrow the difference.

When the interest rate is below $r_o$, an individual is a net borrower.
The Demand for Loans

An Individual’s Net Demand

When the interest rate is above $r_o$, an individual is a net lender.

The “trick”: A saver is said to be a negative demander of loans.

Aggregate Net Demand

The total demand for loans is found by adding up individual demands for loans.

While individuals can be net borrowers or lenders, society cannot. Net demand must be zero.
The Demand for Loans

The World Market

We assume that people cannot borrow or lend on the world market. We come to that later.

Drill Work

If investment goes up, the net demand curve shifts to the right. The interest rate goes from r* to r'.

More Drill Work

If saving goes down, the net demand curve shifts to the right. The interest rate goes from r* to r'.

Points

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• They would tell you that the Federal Reserve System meets and sets the rate.

Points

• This is not the theory of interest rates that newspapers spout.
• They would tell you that the Federal Reserve System meets and sets the rate.
  – Not so.
  – It will take us some time to sort out this confusion.
End

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