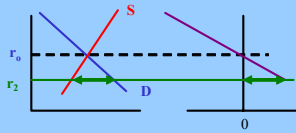
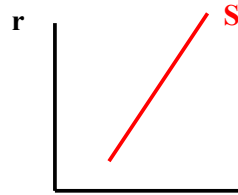


## The Demand for Loans

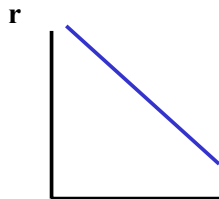


## Saving



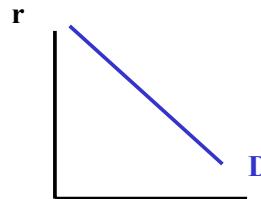
Many things influence saving. We focus here on one: the interest rate.

## Investment



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

## Investment



## Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
3	\$30,000	\$33,000	10%
4	\$30,000	\$31,500	5%

## Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
3	\$30,000	\$33,000	10%
4	\$30,000	\$31,500	5%

If you have money out on loan at less than 20% or if you can borrow at less than 20%, undertake this project.

### Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
3	\$30,000	\$33,000	10%

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

### Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
3	\$30,000	\$33,000	10%
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$r=10\%$

### Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
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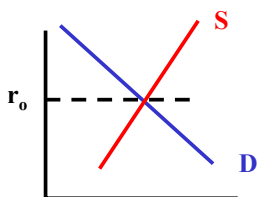
$r=5\%$

### Why?

	Cost	Return	IRR
1	\$30,000	\$36,000	20%
2	\$30,000	\$34,500	15%
3	\$30,000	\$33,000	10%
4	\$30,000	\$31,500	5%

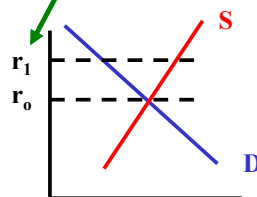
The lower the interest rate, the more attractive investment opportunities you will have, either to be financed out of your own funds or by borrowing.

### Net Demand for Loans



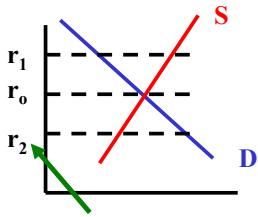
If the interest rate is  $r_0$ , the amount a person wants to save exactly covers his investment

### Net Demand for Loans



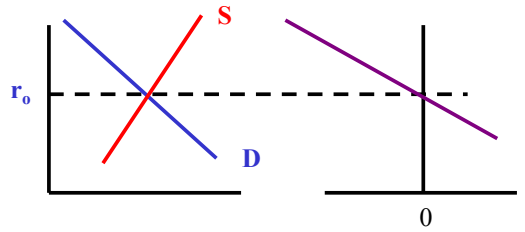
If the interest rate is  $r_1$ , savings exceed investment, and our consumer will lend the difference to others..

### Net Demand for Loans

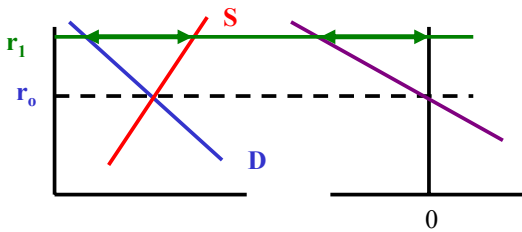


If the interest rate is  $r_2$ , investment exceeds saving; our consumer will borrow the difference.

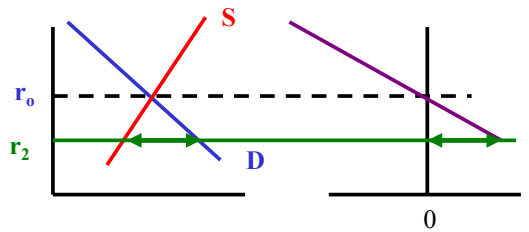
### Net Demand for Loans



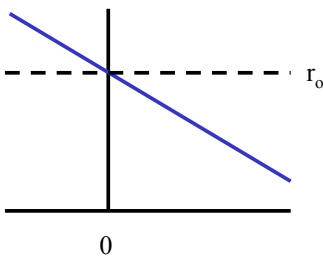
### Net Demand for Loans



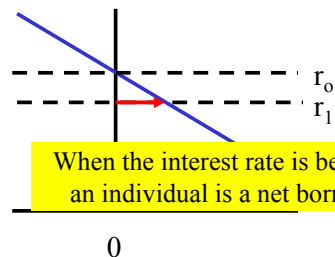
### Net Demand for Loans



### An Individual's Net Demand

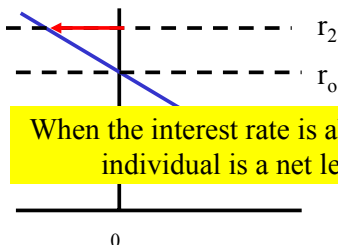


### An Individual's Net Demand



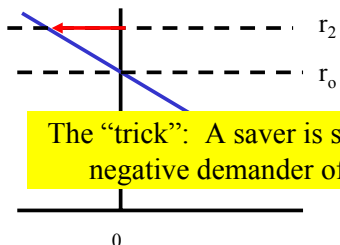
When the interest rate is below  $r_0$ , an individual is a net borrower

### An Individual's Net Demand



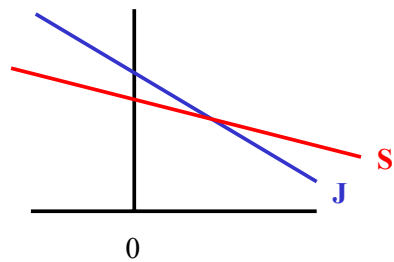
When the interest rate is above  $r_0$ , an individual is a net lender

### An Individual's Net Demand

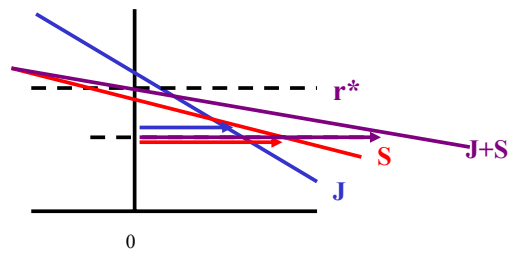


The "trick": A saver is said to be a negative demander of loans.

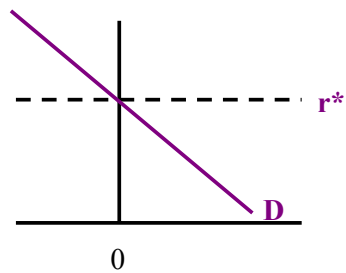
### Aggregate Net Demand



### Aggregate Net Demand

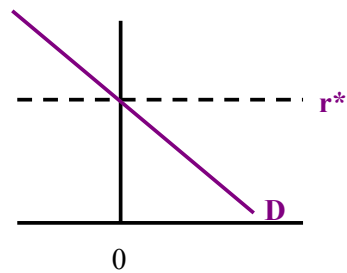


### Points



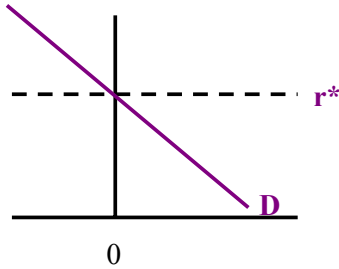
The total demand for loans is found by adding up individual demands for loans.

### Points



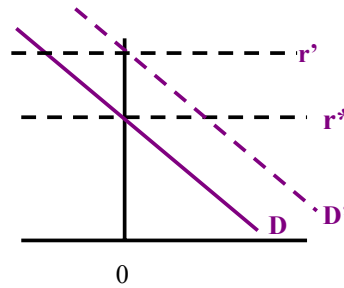
While individuals can be net borrowers or lenders, society cannot. Net demand must be zero.

## The World Market



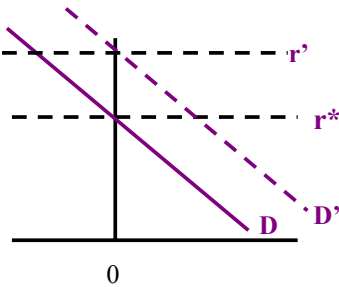
We assume that people cannot borrow or lend on the world market. We come to that later.

## 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

- This is not the theory of interest rates that newspapers spout

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- 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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