

Learning Outcomes

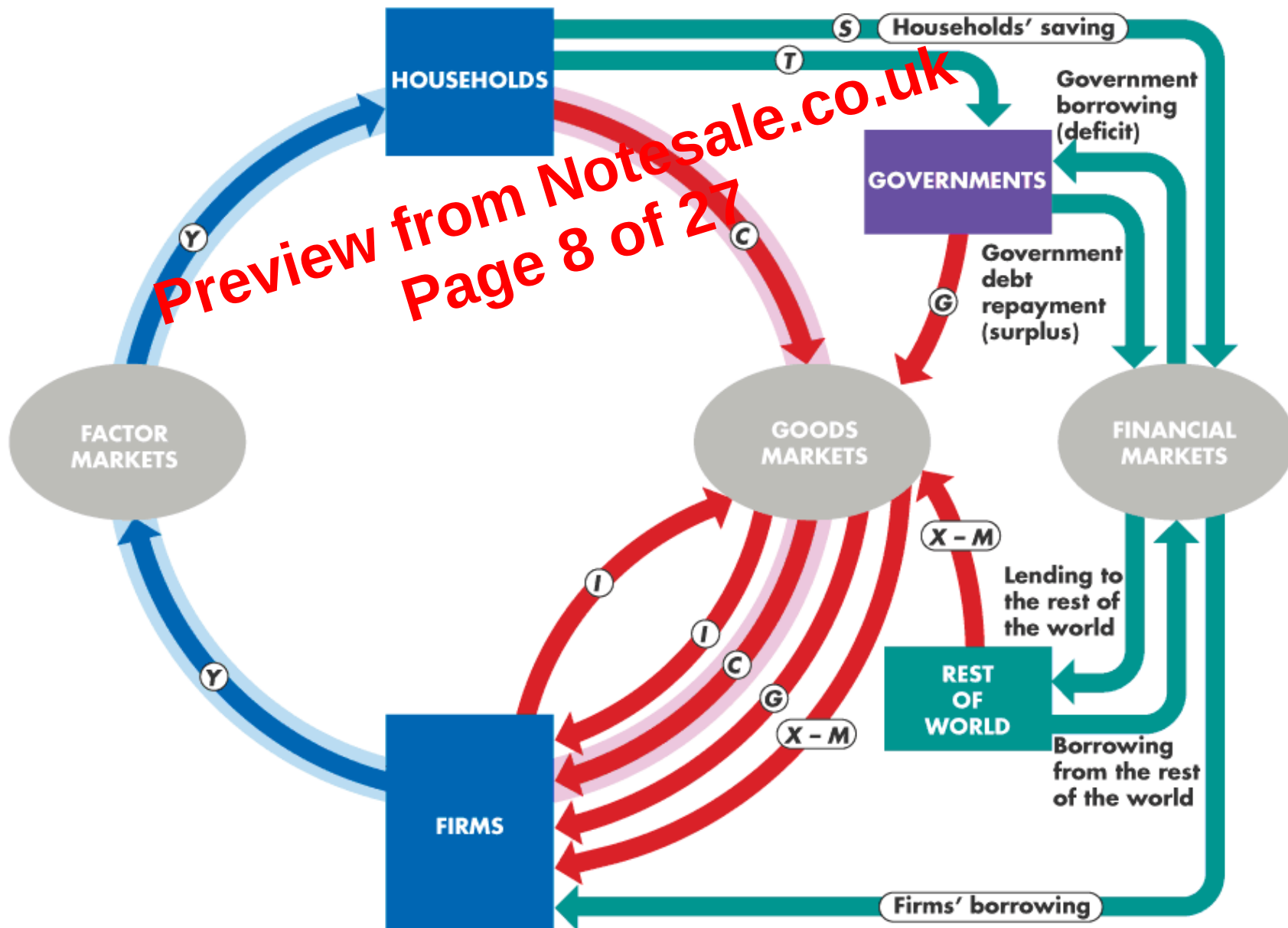
- ◆ Describe the flow of funds through financial markets and institutions
- ◆ Explain how investment and saving and borrowing and lending decisions are made and interact in the loanable funds market
- ◆ Explain how a government deficit (or surplus) influences the real interest rate, saving and investment
- ◆ Explain how international borrowing and lending influence the real interest rate, saving and investment

On 17 September 2007, long queues of depositors wanting to withdraw their funds formed outside the branches of the mortgage lender Northern Rock.

On that same day in Detroit, Michigan, a distraught family loaded its pick-up truck, locked the door of its mortgaged home and drove away from its debt.

How are these two events connected?

They are connected through the global financial market that you study in this chapter.



The Loanable Funds Market

The Real Interest Rate

The real interest rate is the nominal interest rate adjusted to remove the effects of inflation on the buying power of money.

The real interest rate is approximately equal to the nominal interest rate minus the inflation rate.

The real interest rate is the opportunity cost of borrowing.