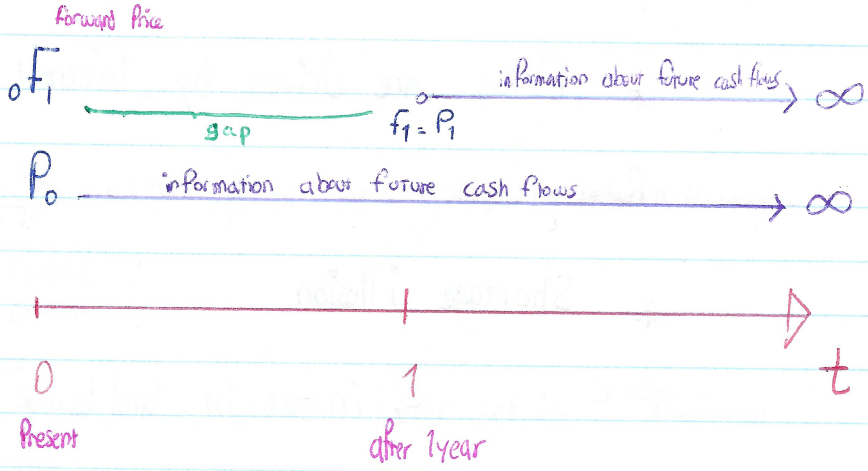
Correlation between ΔP & ΔF



Except for the gap within which forward contracts take place, forward prices and spot prices are highly correlated.

* Forward markets enhance informational efficiency. → more information in less time

Investor	Period A	Period B	Σ
I	$ 60	$ 40	$ 100
II	90	50	140
III	40	70	110

$H_0: P_A^* = \$ 160$

$H_0: P_B^* = \$ 70$

$H_0: {}_AF_B^* = E(P_B^*) = \$ 70$

More information available from future periods will push the spot price higher as buyers rush through buying forward in Period A.

Check "Forwards & Futures Markets" Note on Download Folder

Popular Models

* Prices are driven by interest rates <Popular Economic Model>

Real Estate booms and busts → Bubbles / Crashes because of Jumping on the Band wagon

— Shortage illusion <Samuel Clemens>

↳ invest in land because they are not making anymore land!

People are afraid of missing out!

Temporary Jumping Price, will make people think that prices will persist / continue on rising.

* Recent price changes are the primary source of information

<Popular Psychology Model>

Stock Market Crashes and Corrections

After price went down, people think it will rise up again, so they invest in.

Chapter 5 → after midterm or at the end

Chapter 6. Government Intervention

↳ Price Controls

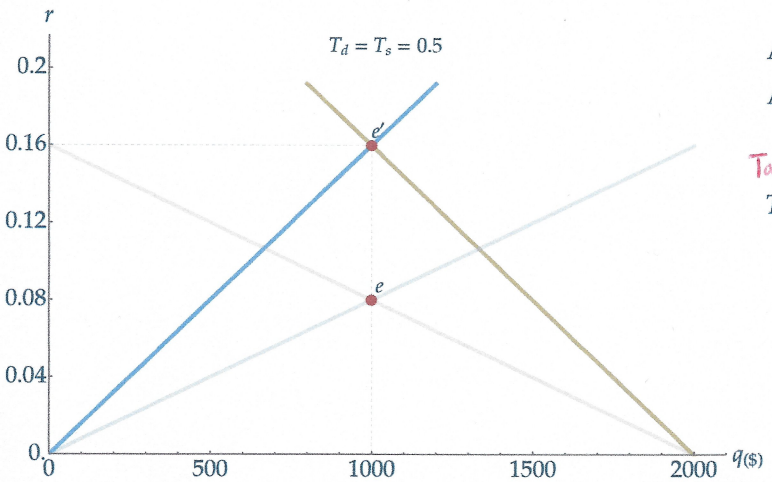
A price ceiling set by the government

↳ Price Supports

A price floor set by the government

↳ Ad valorem and quantity taxes

Neutral when tax rates are the same.



After-tax cost of borrowing $= r'(1-T_d) = .16(1-.50) = .08$

After-tax return on lending $= r'(1-T_s) = .16(1-.50) = .08$

Tax Return

$$TR = (r' \times q') \times T_s$$
$$= (.16 \times \$1{,}000) \times .50$$
$$= \$160 \times .50$$
$$= \$80$$

Tax Shield

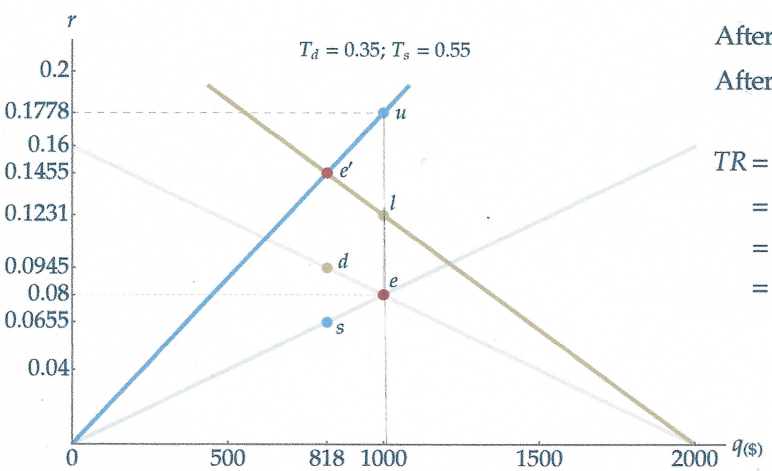
$$TS = (r' \times q') \times T_d$$
$$= (.16 \times \$1{,}000) \times .50$$
$$= \$160 \times .50$$
$$= \$80$$

$$\Delta_{gov't} = (r' \times q') \times (T_s - T_d) = \$0$$

when supply increases and/or demand increases ⟶ interest rate could only go up ↑

when demand changes less than supply → Causes a shift in equilibrium

Non-neutral when tax rates differ.



After-tax cost of borrowing $= r'(1-T_d) = .1455(1-.35) = .0945$

After-tax return on lending $= r'(1-T_s) = .1455(1-.55) = .0655$

$$TR = (r' \times q') \times T_s$$
$$= (.1455 \times \$818) \times .55$$
$$= \$119.019 \times .55$$
$$= \$65.46045$$

$$TS = (r' \times q') \times T_d$$
$$= (.1455 \times \$818) \times .35$$
$$= \$119.019 \times .35$$
$$= \$41.65665$$

$$\Delta_{gov't} = (r' \times q') \times (T_s - T_d)$$
$$= (.1455 \times \$818) \times (.55 - .35)$$
$$= \$119.019 \times .20 = \$23.8038$$

But How much interest rate goes up? It only can be estimated between l and u ; but if government must report one it is e'. → 0.1455 (l: 0.1231, u: 0.1778)