8. Assume the expectations theory of the term structure of interest rates is correct and the other term structure theories are invalid. If we observe an upward sloping yield curve, which of the following is a correct statement?

a. Investors expect short-term (annual) rates to be constant over time.
b. Investors expect short-term (annual) rates to decrease over time.
c. Investors expect short-term (annual) rates to increase over time.
d. It is impossible to say how interest rates are expected to move unless we know whether investors require a positive or negative maturity risk premium.
e. The maturity risk premium must be positive, because there is less liquidity associated with bonds that have longer terms to maturity.

Explanation: According to the expectations theory of the term structure of interest rates, the shape of the yield curve provides an indication of the direction interest rates will move in the near term. If the yield curve is upward sloping, then the theory suggests that interest rates will increase in the future.

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