4. More interest rate determination 6

Morgan Motors has three-year bonds that currently yield 8.25%. The real risk-free rate (r*) is 2.50% and is expected to remain constant. Inflation is expected to be 3.0% per year for each of the next four years and 4.50% thereafter. The maturity risk premium (MRP) is determined from the formula: 0.1(t – 1)%, where t is the security's maturity. The default risk and liquidity premiums on all of Morgan's bonds are equal. What is the yield on a six-year bond issued by Morgan Motors? Disregard cross-product terms; that is, if averaging is required, use the arithmetic average.

- ○ 8.97%
- ◉ 9.05%
- ○ 8.69%
- ○ 9.31%
- ○ 9.13%

❖ Graded

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