

SYNOPTIC PLACE MAT

1 When was the Financial Crisis?

2 What is meant by sub-prime debt?

3 What are the functions of a Central Bank?

4 Give one reason FOR and one AGAINST having an independent Central Bank

5 How is economic development measured?

16 How much QE has the Bank of England undertaken? What about the ECB, and the Federal Reserve?

15 Draw an AD/AS diagram to illustrate the likely impact of ultra-loose monetary policy on the economy

14 Find out the following macro data for China: inflation rate, growth rate, unemployment rate

13 State and explain 2 factors that have contributed to globalisation

12 What's the difference between an endogenous and exogenous shock?

11 If demand for buying new houses falls, what is the likely impact on the market for rental homes?

10 State and explain 2 problems that result from an ageing population

6 Explain why bond prices and bond yields are inversely related

7 What do you think is meant by a negative interest rate? How might this affect the distribution of income?

8 What is the law of demand?

9 Why do markets theoretically achieve allocative efficiency?

CASE STUDY



The Economics of a Low-Rate World

In the aftermath of the Financial Crisis, central banks in many developed economies were highly praised for their prompt actions of cutting interest rates to record low levels and using quantitative easing (printing money to purchase bonds). But by mid-2016, their ultra-loose monetary policies were under the spotlight, with a growing number of critics worrying about negative interest rates (which exist at the ECB, or European Central Bank for commercial banking), and too much reliance on government policy rather than markets for allocating resources.

Whilst central banks have certainly played their part in ensuring continued low interest rates, there are other factors at play too. One factor is the integration of China into the global economy; China is a "savings-rich" country. As with any market, an increase in supply (in this case, savings) leads to a fall in the price (in this case, the interest rate). A second factor is the ageing population in much of the developed world. Because the length of retirement is now longer due to people living longer, savings have to increase in order to fund retirement. Similarly, it is now harder for many younger people to buy property and take out large mortgages – they are saving more for longer in order to build up deposits. Finally, the Great Recession and Financial Crisis created an economic shock that radically altered the perception of risk in many households; when faced with a riskier future, people tend to save as a sort of 'insurance' against job loss or other misfortune.

SYNOPTIC PLACE MAT SUGGESTED ANSWERS

1 When was the Financial Crisis?

2007 – 2009

2 What is meant by sub-prime debt?

Sub-prime debt refers to loans made to people who are regarded as 'risky' borrowers, because they are less likely than the average person to pay back the debt i.e. more likely to default

3 What are the functions of a Central Bank?

The main functions of a Central Bank are: control the money supply in the economy, ensure stability in the financial system/markets, act as the banker for the government and lender of last resort, use monetary policy to manage the economy, act as the custodian of the country's foreign exchange reserves

4 Give one reason FOR and one AGAINST having an independent Central Bank

Reasons for having an independent Central Bank: reduces volatility associated with the 'politicisation' of monetary policy (i.e. the temptation by governments to lower interest rates prior to an election), improves the credibility of the Bank in controlling inflation which in turn reduces inflationary expectations.

Arguments against Central Bank independence: the Bank may stick to the 'wrong' or inappropriate target which conflicts with the policies of the government of the day; the Bank is usually run by people who are not elected and therefore have no democratic accountability for their decisions.

5 How is economic development measured?

The most common measurement of development is the Human Development Index, which is a composite index measuring real GNI per head, life expectancy at birth, and the number of years of schooling.

6 Explain why bond prices and bond yields are inversely related

A bond is printed with a "coupon rate" – a specific amount that will be paid annually to the holder of the bond. When demand for bonds rises, the price of bonds rises (as in any market). The coupon rate, as a % of the new bond price, falls. This is the "yield" on the bond.

7 What do you think is meant by a negative interest rate? How might this affect the distribution of income?

A negative interest rate is one in which savers have to pay a fee to the bank in order to deposit their money. Income will therefore be redistributed from savers to borrowers (often from the old to the young).

8 What is the law of demand?

The law of demand states that the price of a good is inversely related to the quantity demanded.

9 Why do markets theoretically achieve allocative efficiency?

Allocative efficiency refers to consumers maximising their utility and their needs being met; this occurs at a market equilibrium where demand is equal to supply at the market price.

10 State and explain 2 problems that result from an ageing population

There are many consequences of an ageing population: greater demand for healthcare services, changing nature of demand for goods (the "grey economy" e.g. stairlifts, teabags, care homes etc), increased dependency ratio / smaller working population.

11 If demand for buying new houses falls, what is the likely impact on the market for rental homes?

New home and rental homes are substitute goods with a positive XED, so falling demand for new homes is likely to increase demand for rental homes, leading to an increase in rents

12 What's the difference between an endogenous and exogenous shock?

An exogenous shock is one that occurs outside the AD model e.g. an ageing population, financial crisis in Greece. An endogenous shock is one that occurs within the system of AD e.g. a sudden fall in consumer spending.

13 State and explain 2 factors that have contributed to globalisation

There are many factors that have contributed to globalisation: improved communications/internet, containerisation, improved transport links, end of the Cold War, deregulation, growth of MNCs

14 Find out the following macro data for China: inflation rate, growth rate, unemployment rate

Chinese data at the time of writing this resource: inflation rate 1.3%, economic growth rate 1.8%, unemployment rate 4.05%

15 Draw an AD/AS diagram to illustrate the likely impact of ultra-loose monetary policy on the economy

The diagram should show the AD curve increasing i.e. shifting to the right [due to the increase in consumer spending, investment spending and net exports as a result of the fall in interest rates]. The diagram could also show an increase in LRAS, assuming that the lower interest rates stimulate investment spending thus boosting the productive potential of the economy.

16 How much QE has the Bank of England undertaken? What about the ECB, and the Federal Reserve?

Bank of England: £375bn. ECB: at least 1.1trillion. Federal Reserve: \$4.5trillion