Edexcel (B) Economics A-level

Theme 4: Making Markets Work

4.5 Risk and the Financial Sector

4.5.2 The role of the financial sector

Notes

Financial liquid assets are exchanged in a financial market. For example, the stock market and the bond market are two examples of financial markets. In the UK, the financial sector has become more important to the economy in recent years.

To facilitate saving

Financial markets provide somewhere for consumers and firms to store their funds. Savings are rewarded with interest payments from the bank.

To lend to businesses and individuals

The transfer of funds between agents is aided by financial markets. The funds can be used for investment or consumption.

To facilitate the exchange of goods and services

The transfer of real economic resources is facilitated in a financial market. Financial markets can make it easier to exchange goods and services from the physical market, by providing a way that buyers and sellers can interact and transfer funds.

To provide forward markets in currencies and commodities

The currency market is another kind of financial market. They are used to trade one currency for another currency. Currencies can have speculative attacks taken on them, which can affect the value of the exchange rate.

In commodity markets, investors trade primary products, such as wheat, gold and oil. Future contracts are a method for investing in commodities. This involves buying or selling an asset with an agreed price in the present, but a delivery and payment in the future.

A forward market is an informal financial market where these contracts for future delivery are made.

To provide a market for equities

Equity markets involve the trade of shares. It is also called a stock market. Equity markets provide access to capital for firms, and allow investors to own part of a market. Returns on the investment, usually in the form of dividends, are based on future performance. A dividend is a share of the firm's profits.