Edexcel (B) Economics A-level

Theme 4.5: Risk and the Financial Sector

Flashcards

Describe the difference between risk and uncertainty

Describe the difference between risk and uncertainty

Risk is the probability of damage, whereas uncertainty refers to a situation which may or may not happen

When do banks face risk?

PMT
•resources•tuition•courses

When do banks face risk?

When they loan money to consumers, since there is a chance that they may not receive that money back

Define economic shocks

Define economic shocks

Unforeseen events that could have a devastating effect on the economy

What was the biggest economic shock in the 2000's?

What was the biggest economic shock in the 2000's?

The Global Financial Crisis (GFC) of 2008

What is a futures contract?

What is a futures contract?

This is when a price of an asset is agreed upon today, but delivery is in the future

What is insurance designed for?

What is insurance designed for?

To reduce the risk of decisions

What is the role of financial markets?

What is the role of financial markets?

To provide a place for investors and consumers to store their funds

How can financial markets benefit firms?

How can financial markets benefit firms?

These markets can provide firms with funds for them to invest and expand production

What are equity markets?

What are equity markets?

This is where the transfer of shares takes place

What are dividends?

What are dividends?

This is a share of company profits that investors receive

What is the base rate?

What is the base rate?

The interest rate set by a central bank to loan money to commercial banks

Do low interest rates encourage saving or borrowing?

Do low interest rates encourage saving or borrowing

Low interest rates encourage borrowing

What is a lender of last resort?

What is a lender of last resort?

This is when the central bank has the capability of lending to banks in times of major crises or when a bank is about to go into insolvency

What is a ‘run on the bank’?

What is a ‘run on the bank’?

This is when consumers all withdraw their deposits from the bank at the same time, out of fear

Which two regulators watch over the UK banking sector?

Which two regulators watch over the UK banking sector?

The Financial Conduct Authority and the Prudential Regulation Authority

What is the role of the FCA?

What is the role of the FCA?

To ensure banks are protecting consumer interests

What is the role of the PRA?

What is the role of the PRA?

The PRA promotes the stability of banks

How was the 2008 recession caused?

How was the 2008 recession caused?

This was caused by inflated asset prices and too much risk-taking by banks, as they gave loans to consumers with poor credit histories, who therefore then defaulted on their loans

Who went bankrupt in 2008?

Who went bankrupt in 2008?

The Lehman Brothers

How low did interest rates reach?

How low did interest rates reach?

As low as 0.5%

How have banks changed following the crisis?

How have banks changed since the crisis?

They have become more risk averse, enforcing more checks on people applying for loans

Define moral hazard

PMT
resources • tuition • courses

Define moral hazard

This is when banks purposely give out risky loans, because they know they are ‘too big to fail’, meaning the government will bail them out

Define systematic risk

Define systematic risk

This is risk to the economy or financial market as a whole

When does a market bubble occur?

When does a market bubble occur?

When the price of an asset is expected to rise significantly