



Economics lesson 1 – Answer sheet

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What is an interest rate?

The reward for saving the cost of borrowing.

Extension task

What sort of things do we associate interest rates with? Talk to the person next to you about it.

- Credit cards
- Mortgages
- Savings accounts
- Loans
- Different banks charge different interest rates as they are all competing with each other for business. *E.g. Banks that can offer lower interest rates on loans are going to be able to attract more customers as it becomes cheaper.*
- The amount paid to borrowers is higher than the amount given to savers. This allows banks to make a profit.

Discuss in pairs the impact of high interest rates on the following:

- Saving
- Borrowing
- Investment

Saving

A rise in interest rates offered to savers will encourage people to increase their level of savings. A fall in interest rates will reduce the incentive to save and people will reduce their level of savings.

Borrowing

Higher interest rates increase the cost of borrowing. This higher rate means that both individuals and firms tend to borrow less as they are having to pay more money back. Lower interest rates will encourage borrowing as it is cheaper, and customers will be paying less back to the bank.

Investment

Investment has an inverse relationship with the rate of interest.

If interest rates fall, the level of investment should increase.

A fall in the rate of interest will reduce the cost of borrowing, so it will be cheaper to borrow for investment.

Activity

In August 2023, the Bank of England's Monetary Policy Committee voted to increase the base interest rate by 0.25 percentage points to 5.25%. Rupert is Head of Finance at Harrowell Council and needs help on whether he should go ahead with an investment decision. The council are hoping to build a new cancer research centre at Nortonwick Park Hospital. In order for this to go ahead, the council will need to apply for a loan from the bank.

Question

In pairs or groups of three, discuss whether Harrowell Council should go ahead with this investment decision or not. Consider reasons for:

- why they should go ahead with this investment decision.
- why they should not go ahead with this investment decision.

You should bullet point some of your ideas.

Ideas for discussion could be as follows:

- As interest rates have gone up to 5.25%, it would be more expensive for the council to take out a loan. They would end up paying more money back to the bank.
- If the council has to pay higher interest on their loan, it creates an opportunity cost - as this money cannot be spent on other areas such as education.
- The building of the new cancer research centre will create a large number of jobs, leading to the positive multiplier effect. This will also contribute to a rise in tax revenues for the council in the future.
- The cancer research centre will contribute to a healthier population. This will contribute to less sick days and higher levels of productivity, leading to a rise in economic growth.

