2.8 The role of financial markets

Key Words

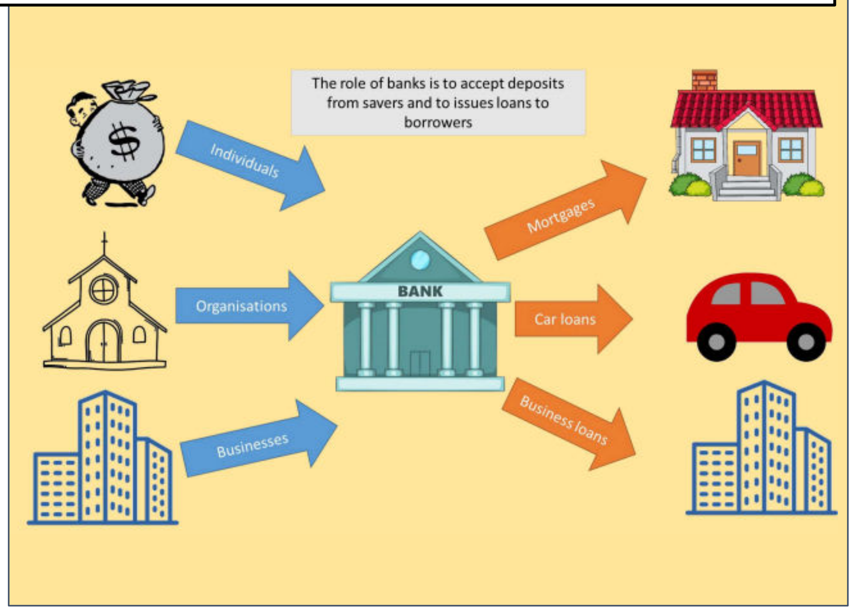
Commercial bank	A financial institution that takes deposits or savings from customers and turns them into assets for the banks eg Barclays, Lloyds, Santander
Central Bank	The central bank is an independent financial institution with responsibility for monetary policy and regulating banks and ensuring financial stability in the economy.
Mortgage	An agreement with a financial institution to borrow money to purchase a property
Loan	A loan is money, given to another person in exchange for repayment at a future date with interest added on.
Overdraft	An overdraft is a type of loan where you take out more money than you have in your current account. There is usually a charge for this.
Credit card	Enables you to buy goods and services whether or not you have money in your account. After 30 days you are charged interest on it. Retailers are charged for allowing you to use credit cards as a form of payment
Debit card	Transfers money from your current account to the seller. If you do not have enough money in your current account you cannot buy the product
Interest rate	The cost of borrowing money and the reward for saving. The interest rate is set by the central bank ie Bank of England
Savings	Is the part of an individual's income which is not spent on consumption
Borrowing	Is receiving money in exchange for an obligation to pay it back at a specified time in the future

Commercial Banks

Commercial banks are part of the financial sector of the economy.
The financial sector helps markets to work by enabling consumers to save, borrow and spend for example.
In particular commercial banks:

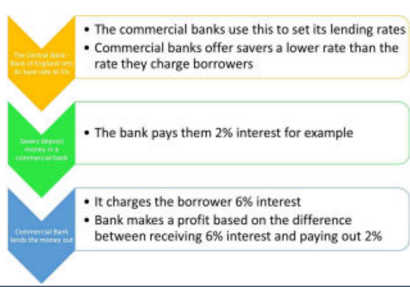
- Take deposits (savings) from customers and turn them into assets for the bank. Generally charging interest rates higher than the bank rate.
- Accept deposits and pay interest on them
- Make payments on behalf of their customers
- Issue loans to individuals and firms and issue overdraft facilities
- Offer safe deposit boxes for very expensive items

Role of Commercial Banks

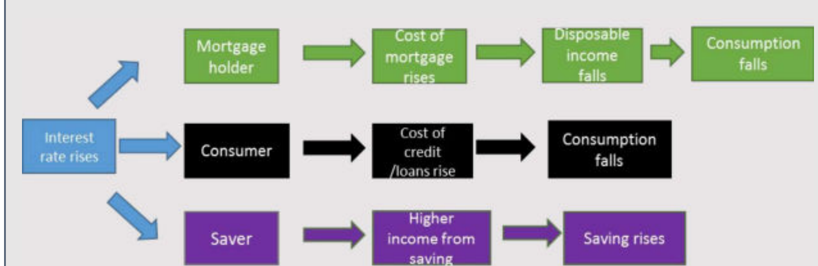


The central bank and interest rates

The central bank is an independent bank with a range of responsibilities one of which is setting the base rate (which impacts interest rates) in the economy. In the UK the central bank is the Bank of England. The commercial banks can borrow from the central bank at the base rate. The commercial banks will then set their own interest rates for loan and overdrafts based on the base rate set by the central bank.



The impact of interest rates and saving and borrowing



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