AP MACROECONOMICS • EXERCISE SHEET

4.1 Financial Assets

Name: ____________ Class: ________ Date: __________ **Total: 9 marks**

KEY WORDS bonds 债券 • financial asset 金融资产 • stocks 股票 • liquidity 流动性

Objective

Build the skills to answer exam questions on **financial assets**.

You must be able to:

- describe common **financial assets** 金融资产: stocks, bonds, and bank deposits
- explain the inverse relationship between a **bond's price** and its **interest rate** (yield)
- relate the **risk** and **return** of an asset to its **liquidity** 流动性

1 Worked examples

Study these first. Each one shows the method for a question type used later.

> ■ **Financial assets**
>
> **Stocks** (part-ownership of a firm), **bonds** (loans that pay interest), and **bank deposits** (cash held at a bank).
>
> ■ **Bond price and yield**
>
> A bond's price and its interest rate move in **opposite** directions: when market rates **rise**, the price of existing bonds **falls** (their fixed payments look less attractive).
>
> ■ **Risk, return, liquidity**
>
> Higher **risk** usually brings higher **return**; a more **liquid** asset (easily turned into cash) usually offers a lower return.

2 Practice

2.1 Name three financial assets. [2]

2.2 State the relationship between a bond's price and interest rates. [1]

2.3 State the general link between an asset's risk and its return. [1]

3 Exam-style questions

3.1 When interest rates rise, the prices of existing bonds [1]

- **A** rise
- **B** fall
- **C** stay the same
- **D** double

3.2 A more liquid asset is one that is [1]

- **A** harder to sell
- **B** easily converted into cash
- **C** always riskier
- **D** always a stock

3.3 Interest rates in the economy rise.

(a) State the effect on the price of existing bonds. [1]

(b) Explain why. [2]

Solutions

2.1 any three of: stocks, bonds, bank deposits.

2.2 they move in opposite directions (an inverse relationship).

2.3 higher risk generally brings a higher return.

3.1 **B**.

3.2 **B**.

3.3 (a) it falls. (b) new bonds now pay the higher rate, so an old bond's fixed lower payments are worth less, and its price drops to match the new yield.