

Financial Studies Assignment 3 Text – 20.8.21

1.3.3 A store of value

Money is used to store financial value for future use. For example, people save money in bank and building society accounts and they keep small stores of cash to spend in the future.

1.3.4 A means of borrowing and then repaying the debt

People can borrow money to buy goods now that they cannot afford out of current income. In effect they are delaying payment. Instead of paying the full price of the item, the borrower pays in small amounts over a period of months or years. These small payments are the repayments they make to the lender. During the borrowing term, the lender cannot use the loan money for any other purpose. Borrowers therefore compensate lenders by paying interest. The technical name for this function is that money is acting as a standard measurement of deferred (that is, delayed) payments.

1.4 Considerations when using money

When people plan how to use their money, a key consideration is its current and future purchasing power. The purchasing power of money is the quantity of goods and services it can buy.

1.4.1 Purchasing power and time

A key consideration for savers is that inflation can reduce the purchasing power of the money saved over time. For example, £100 in three years' time will buy fewer goods than £100 today.

Changing prices over time in the UK

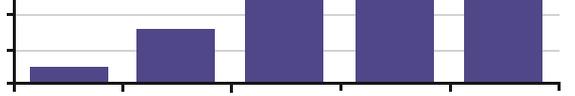
Inflation has caused the price of a 800g white, unwrapped loaf of bread to rise from 9p in 1970 to 108p in 2010, an increase of 1,100% in 40 years:

Increase in price of bread, 1970-2010

1970	9p	Pence
		120
1980	33p	100
		80
1990	50p	60
		40
2000	52p	20
		0
2010	108p	

1970 1980 1990 2000 2010

Source: ONS (2010)



The average wage was £499 per week in 2010. The cost of a loaf of bread was 108p. This means that the loaf of bread represented 0.28% of an average week's wage in 1970 and 0.22% of an average weekly wage in 2010 (ONS, 2010).

In October 2019 the average cost of the loaf was 118p and the average wage was £530 per week (ONS, 2019a, 2019b).

The aim is therefore to find a savings interest rate that is higher than the rate of inflation. This will enable savers to maintain or grow their purchasing power.

The Bank of England website publishes the current rate of inflation (<https://www.bankofengland.co.uk>). Further information can be found about inflation at the Office for National Statistics (ONS) website (<https://www.ons.gov.uk/>) and the GOV.UK website's research and statistics section (<https://www.gov.uk/search/research-and-statistics>).

1.4.2 Purchasing power and other countries

The same goods can cost different prices in different countries because of factors such as the cost of living, wage rates and taxation. These differences can have an impact upon people when they travel or live abroad. A key consideration when budgeting for a stay abroad is therefore to find out the relative costs of accommodation, transport, food, drink and so on. Guide books and travel websites provide information, and exchange rates for currencies are available in newspapers and online.

Exchanging currency for holiday spending

Scott and Rachel are travelling to Paris, France for a holiday. Before they leave the UK they decide to buy some foreign currency so that they have cash to buy meals and metro (underground train) tickets as soon as they arrive in Paris. France's currency is the euro (€). Scott and Rachel do some research online and discover that they can get a set menu three-course meal without wine in a café for about €20 each, €40 in total.

They look up the exchange rate online and discover that 1 euro equals 0.85 British pounds, that is, 85p on that day. The online currency converter uses the abbreviations 'EUR' for euro and 'GBP' for pounds. A meal for the two of them that costs €40 is the equivalent of £33.97 at that exchange rate ($40 \text{ multiplied by } 0.85 = 33.97$). Scott and Rachel think this cost is slightly cheaper than they are used to paying for a similar meal out in Manchester city centre.

Scott and Rachel know that exchange rates vary from day to day and so they decide to exchange £100 for euros to cover two meals and some transport costs when they first arrive in Paris. As they know that every £0.85 equals €1, they expect to get euros to the value of 100 divided by 0.85, that is 117.64. They go to the Post Office and convert £100 into €117.64. This is the same exchange rate of 1 EUR equals 0.85 GBP expressed as 1 GBP equals 1.1764 EUR.

We will look at exchange rates and the cost of living in different countries in more detail in Unit 2.

1.5 Bank account balances

The majority of money is held as bank account balances rather than as coins and banknotes. There are many different types of bank account designed to fulfil the different purposes of money. For example, there are accounts targeted at savers that offer returns on the money stored there in the form of interest. When people borrow money via a personal loan, they have a separate loan account. For now, however, we will focus on current accounts as people can use these to fulfil all the purposes of money.

Current accounts are offered by a range of providers including banks, building societies and the Post Office. People can use them to deposit money and to make payments by withdrawing cash or issuing instructions to the provider. These instructions can take many forms such as cheques, standing orders and payment card transactions. We study these different payment methods in detail in Topic 3.

People monitor the value of their current account holdings using statements. Statements list the incoming and outgoing transactions on the account and the balance at the end of the accounting period. They can be paper-based, provided electronically on a computer or mobile phone screen, or provided over the telephone.

People can use current accounts to store money for future use. If account holders plan to spend the money more than one or two months in the future, however, they would probably benefit from transferring the money into a savings account that offers a higher rate of interest.

Borrowing is also a feature of many current accounts. Overdrafts enable people to borrow from the provider by paying out more money than they have stored in the account. Overdrafts are designed for short-term use – for example, a person might need to pay a bill the week before they receive their monthly salary payment. They overdraw their account to pay the bill and the following week the borrowing is repaid when their salary is paid in. We will compare different methods of borrowing in Topic 6.

1.6 Using money to meet changing needs

We have seen that people use money to make payments, save, borrow and record value. At any one time an individual might be using money for one or more of these purposes. Certain combinations are more likely at certain times in a person's life.

Young children receiving an allowance are likely to spend most of their money. They may save the financial gifts they receive for higher-value items that they want and for unspecified items in the future.

Young adults who have just left home and are earning a low wage are likely to spend most of their money on living expenses.

Adults with more job experience and better wages may spend money on living expenses and 'fun items', borrow money through a mortgage to buy a home and save for the future.

Parents might borrow money to pay for items such as a family-sized car. They may spend most of their income on living expenses and gifts for their children and find it difficult to save.

Middle-aged people are more likely to have paid off their debts and to be saving for their old age.

Retired people are more likely to be spending all of their income which will have fallen since their years in employment.

When people plan their finances they need to consider how much they can afford to spend, save and borrow from their income to be able to pay for the items they want now and in the future. The proportions of spending, saving and borrowing are likely to vary at different stages in a person's life. We will explore these ideas in more detail in Topic 2.

Key ideas in this topic

- ◆ Definition of money.
- ◆ The purposes of money.
- ◆ Bartering and its limitations.
- ◆ The development of money over time.
- ◆ The features money needs to fulfil its purposes.
- ◆ The functions of money.
- ◆ Legal tender.
- ◆ The purchasing power of money.
- ◆ How people's need to spend, save and borrow changes over the course of their life.

References

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