Lesson 3: The economic climate: interest rates and employment

KNOWLEDGE ORGANISER

🎯 Learning goals

- ✓ Explain what interest rates are
- ✓ Explain how rising interest rates affect businesses and spending
- ✓ Explain how employment levels affect demand
- ✓ Apply these ideas to a fashion retailer

🔑 Key words

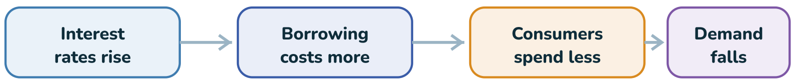
Interest rate The cost of borrowing money, or the reward for saving.

Consumer spending How much customers spend on goods and services.

Employment The number of people in work.

Demand How much of a product customers want to buy.

📘 What you need to know



Rising interest rates ripple through to lower demand.

1. Interest rates

Interest rates are the cost of borrowing money, or the reward for saving. When interest rates **rise**, two things happen. First, businesses that have **loans or overdrafts** must pay more to repay them, so their costs go up. Second, customers' own borrowing — credit cards, car finance and mortgages — also costs more, and saving pays better, so people **spend less**.

> *"When interest rates rise, borrowing costs more, so businesses' costs rise and customers spend less."*

This hits hardest the businesses that rely on loans, and those selling **non-essential** goods like fashion, because these are the first things shoppers cut back on when money is tight.

2. Employment and demand

Employment is the number of people in work. When employment is **high**, more people are earning, incomes rise, and **consumer spending** goes up — so demand rises. When employment **falls**, incomes drop and demand for goods and services usually falls too. Demand for non-essentials, like fashion, changes the most.

When the economy is strong

- ✓ High employment and incomes.
- ✓ More consumer spending.
- ✓ Demand for non-essentials rises.

When interest rates rise

- ✗ Borrowing costs more.
- ✗ Consumers spend less.
- ✗ Demand can fall.

✅ Test yourself

Cover the answers below, answer Q20–Q25, then check.

Q20 What are interest rates?

Q21 How do rising interest rates affect businesses?

Q22 How do rising interest rates affect consumer spending?

Q23 Why are businesses reliant on loans affected by interest rate changes?

Q24 How does high employment affect consumer spending?

Q25 How does falling employment affect demand?

ANSWERS

A20 The cost of borrowing money or the reward for saving.

A21 Loan and overdraft repayments become more expensive.

A22 Consumers are likely to spend less.

A23 Because borrowing becomes more or less expensive.

A24 Higher employment leads to higher incomes and more spending.

A25 Demand for goods and services usually falls.