

UNDERSTANDING ECONOMIC TERMS

MONEY TALKS

The U.S. economy runs on **credit**. People almost always need to borrow money for large purchases, such as a house or a car. Businesses, from a pizzeria that needs to buy a new oven to a car manufacturer that wants to open a new factory, have to take out loans, too. This constant borrowing and paying back is part of the engine that drives a healthy economy.

Yet credit would be impossible if the people lending the money didn't believe that they would be repaid. That is one of the things that has caused today's problems. Several years ago, during a period when the value of homes was rising steeply, banks began lending money

to many people who actually couldn't afford to buy homes. Bankers believed that if those people couldn't pay the **mortgage**, banks could **foreclose** on the homes and sell them to someone else at a higher price.

Then housing prices stopped rising, and banks were stuck with billions of dollars in bad debts. To complicate matters, many banks had bought the right to get paid back from those first bankers, in the form of **mortgage-backed securities**. This meant the bad debts had spread to the biggest financial institutions in the economy, even to some that others depend on for credit.

Below are terms to help you understand the economy.

assets (n): all things of worth owned by a person or business, including cash, property, equipment, and money owed to them, as well as the value of the company's brand name and reputation.

bailout (n): a rescue from financial difficulties.

bond (n): a certificate issued by a company or government to an investor who has loaned it money, promising to repay the amount with interest.

credit (n): money or goods granted for use, under agreement that it will be repaid on a regular schedule.

depression (n): a severe economic downturn, with very high unemployment and many businesses failing.

equity (n): the value of property or a company after debts are deducted. A homeowner's equity is the value of the home minus **mortgage** payments owed.

foreclose (v): seize property from someone who has failed to make payments on a loan used to purchase it.

leverage (v): make an investment using borrowed money, assuming that it will earn enough to pay off the debt and leave a profit.

mortgage (n): loan from a bank for the purchase of a home or other major property worth as much or more than the loaned amount.

mortgage-backed security (n): when a bank bundles the money owed it from multiple mortgages and sells shares in the right to be paid back.

recession (n): a period of reduced economic activity, less severe than a depression. To economists, it is when the country's gross domestic product (GDP) drops for two consecutive three-month periods.

QUESTIONS *(Write your answers on a separate sheet of paper.)*

- Which is worse, a recession or a depression? Explain.
- Why is credit important to the economy?
- Which of the following is most likely to happen during a recession?
 - Companies would hire more workers.
 - The GDP would increase.
 - More new businesses would start up.
 - People would lose their jobs.
- Which of the following would *not* be considered part of the assets of a car company?
 - the cars its workers own
 - the computers in its offices
 - the factories it owns in Detroit and Tennessee
 - its reputation for making good cars
- If your house is worth \$275,000 and you owe \$220,000 on the mortgage, what is the equity?