

“A financial shock is an unexpected disturbance which originates from the financial sector and has a significant effect on an economy (e.g. national, regional, or global). The term is largely used to refer to events which have negative impacts” (Hubrich et al., 2013). Additionally, a financial shock refers to an unexpected or unpredictable event that sharply impacts financial markets and the overall economy. One major financial shock from recent history is the 2008 global financial crisis. This began with the burst of the United States housing bubble, as housing prices that had risen sharply for years suddenly reversed course. This led to massive losses and failures of major financial institutions that had invested heavily in mortgage-backed securities, triggering a massive credit crunch and stock market crash. Unemployment spiked as the shock rippled through the global economy, causing the Great Recession. Governments and central banks had to take aggressive intervention measures in response.

The concept of rational expectations assumes that people make choices based on all available information and past experiences. “Rational expectations is an economic theory that states that individuals make decisions based on the best available information in the market and learn from past trends. Rational expectations suggest that people will be wrong sometimes, but that, on average, they will be correct” (Team, 2023). It also assumes that on average, people's expectations for the future will be valid. An example of rational expectations from my own experience would be estimating my weekly grocery costs. Having regularly purchased groceries for years, I have a reasonable expectation of what an average weeks' worth will cost based on past spending, inflation, and current food prices. This allows me to budget appropriately. My estimate won't be perfect each time due to fluctuations, but over the long run my expectations

are largely rational. This is unlike making a speculation or guess without supporting data or previous experience. My grocery cost expectations are grounded in both historical information and a reasoned analysis of the present.

References:

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