AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



MARK SCHEME

3.2.4.3 CENTRAL BANKS AND MONETARY POLICY

SCORE	PERCENTAGE
/749	%

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1.

Explanation:

Definition: Interest rates are the returns to saving or the cost of borrowing whereas figures have been adjusted to take into account inflation so the real interest rate is the nominal interest rate minus the inflation rate.

Analysis:

For example: as interest rates fall as part of a loose monetary policy speculators will decide there is little return from holding money in the currency in question and will move money to where rates of return are better this will lead to a capital flight from that currency to more profitable currencies which increases supply and also a decreasing demand for the original currency and as a result will depreciate the original currency.
Use of appropriate diagrams, eg supply and demand of currency/exchange rates.
Reference to the UK or other economies.

[9]

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2. **Issues and areas for discussion include**

Introduction	• deflation v inflation • criteria for assessing the economic impact of deflation • the relevance of the issue to the last few years
Developing the response to the question:	• the shorter term benefits in terms of consumer demand for goods and services falling in price • competitiveness • impact on profits and hence possibly on investment and on sustainability of businesses • the impact on confidence, especially where deflation is a feature of a recession • economic growth • employment • trade flows and the impact on the balance of payments on current account • inward investment • UK experience • the potential impact on consumer demand • the impact on the real value of debt, important particularly in light of high UK home ownership • the impact on the exchange rate • any other valid issue
Evaluation	• whether or not deflation has set in worldwide or just nationally • the extent of the deflation • the duration of the deflation • the flexibility/resources the government/central bank has to deal with the problem • the extent of damage to consumer and business confidence • how much it impacts on profits • whether deflation causes consumers to keep delaying purchases hoping for even lower prices *Examiners should note that it may be possible to award some marks for basic evaluation such as a consideration of the advantages and disadvantages of deflation. However, this must be considered as low-level evaluation and awarded accordingly.*
Also give credit for:	• relevant use of evidence and examples from other economies • diagrams

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	• an overall judgement on the issues raised

[25]

3.

Define/explain:

- deflation
- monetary policy, e.g. interest rates, money supply control, exchange rates
- in the current (2010) climate, refer to the liquidity trap in explaining the possible limitations of interest rate policy
- explain how monetary policy might be used to prevent a period of deflation, eg
  - interest rates will help determine the use of credit by consumers and the level of business borrowing for investment. The Monetary Policy Committee sets Bank Rate and by doing so is indicating its wish that other financial institutions follow suit. Both consumption and investment are components of aggregate demand. Assuming no reduction in the other components of AD (X – M, G) a fall in interest rates, for example, will lead to higher AD which may lead to a rise in the general price level assuming that AS does not increase to meet the higher AD
  - the use of exchange rate policy to influence export and import demand and generate an export-led multiplier
  - increases in money supply (note the current policy of 'quantitative easing') with an explanation, perhaps including a reference to the Quantity Theory of Money

Reward references to the UK economy

[15]

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4.

Define any relevant term

- Explain “the pound has fallen against the euro and other currencies”, perhaps by defining and comparing various exchange rates;
  - use the term depreciation and/or devaluation and compare to appreciation/revaluation;
  - use recent real world values to help illustrate the phrase; the impact on export/import prices; the potential impact on the economy

analyse two determinants of such a fall, e.g.

- Overseas investors become less confident about an economy because it may be showing signs of entering a recession, so they begin to withdraw their funds and sell the currency of that economy while potential new investors, deciding not to invest, bring about a reduction in demand for pounds, causing the currency to depreciate.
  - Relative interest rates
  - Government policies, e.g. increased borrowing
  - Speculation against a currency
  - Capital flows
  - Trade flows
  - Loss of business and consumer confidence as economic forecasts worsen
  - Any other valid determinant

Reward references to the UK/other economies

[9]

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5.

It is hoped that candidates will briefly explain the macroeconomic criteria by which consequences can be measured, before providing some discussion of the potential impact of appreciation and arriving at a final judgement.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and / or other issues in the time available.

Issues and areas for discussion include:

Introduction	• appreciation versus depreciation of currency • criteria for measuring macroeconomic consequences • exchange rate systems.
Developing the response to the question:	• the potential impact on economic growth as exports perhaps become more difficult to sell overseas • the possible stimulus to growth as imports of raw materials and energy become cheaper • the possible benefits to inflation as lower demand for exports reduces pressure on domestic production and resources and imports of goods and services are cheaper • the impact on employment as cheap imports threaten domestic production and hence jobs and as the overseas demand for exports falls away • the impact on a significant tourist industry in the economy concerned and hence on growth and jobs in an expanding sector of an increasingly service economy • the impact on the balance of payments on current account given relative changes in exports and imports of goods and services • the strong currency making inward investment less attractive, perhaps affecting growth and jobs.
Evaluation	• the extent of the rise in the exchange rate • the external value of the currency from which the rise begins to take place • the significance of the exchange rate factor compared to other influences on the macro-economy • whether or not exports have been an important, or sole, cause of growth for an economy • elasticity conditions for exports and imports • the period of time in which the appreciation lasts • the role of speculators in terminating the rise • the effectiveness / speed of a corrective market mechanism or a decision to ‘dirty float’

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	• the state of the world economy as the appreciation takes place, eg might a prosperous world merely absorb higher prices arising from a country's exchange rate appreciation? *Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of appreciation, but with minimal reference to the macro-economy. However, this must be considered as low-level evaluation and awarded accordingly.*
Also give credit for:	• reference to the UK / other economies • diagrams • an overall judgement on the issues raised

[25]

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6.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introduction:	• the balance of trade in goods and services • the balance of payments accounts • surplus/deficit.
Developing a response to the question:	• supply-side policies • exchange rate manipulation • protectionist policies • controlling aggregate demand in order to constrain import growth and release more output to the export sector • adoption of an export-led growth strategy • control of inflation if this is perceived to be the cause of the problem • expenditure-switching policies compared to expenditure-dampening policies.
Evaluation:	• the need to distinguish between those policies which offer a possible short-term improvement and those which offer a potential cure for the problem in the long term (e.g. a reference to expenditure-dampening v expenditure switching). • the need to distinguish policies which can be regarded as realistic in the current climate, e.g. supply-side policies, from those which might be politically unacceptable, e.g. protectionism • some policies may not bring immediate improvement, eg the long-term nature of supply-side policies; exchange rate manipulation and the J-curve effect • there may be less significance attached to the deficit if it is seen as part-and-parcel of a maturing economy which, although successful in the trade in services, has lost much of its industrial base, thus needing to import more finished goods • the underlying issue of whether or not a deficit really matters if it does not impede economic growth and job creation and does not damage investor and business confidence.
Also give credit for:	• relevant use of evidence and examples from the UK / other economies

[25]

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7.

For candidates who:

Define / explain

- exchange rate
- exchange rate system
- appreciation of exchange rate
- the concept of the 'average family'
- floating exchange rate system, perhaps with comparative reference to fixed exchange rate systems.

Explain how the exchange rate of a currency may be caused to rise within a floating exchange rate system, e.g:

- trade flows. As exports are demanded there will be a greater demand for the currency of the exporting country by those overseas customers buying those exports and being required to pay with the foreign currency in question. The country concerned will be importing goods and services. This will require buyers to sell the domestic currency in order to buy foreign currencies with which to buy imports. The increase in demand for the currency arising from higher export sales may be greater than the increase in supply of the currency arising from increased imports, all other things being equal, the exchange rate will rise.
- net inward investment
- speculative movements resulting in increased purchases of the currency
- 'dirty floating', i.e. official intervention in the foreign currency market in a floating exchange rate system in order to buy the currency
- higher interest rates relative to other comparable countries
- external economic stimuli, eg a strong and sustained US recovery which can be related to trade and / or investment flows
- external shocks, eg a banking crisis
- any other relevant factor.

For those candidates who adopt a basic supply and demand approach to the question without citing specific determining factors such as trade, award a maximum of 10 marks for the answer as a whole.

Make use of diagrams in the analysis.

[15]

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8.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and / or other issues in the time available.

Issues and areas for discussion include:

Introduction:	• macroeconomic objectives in contrast to microeconomic • the meaning of conflicts between macroeconomic policy objectives • how objectives might be ranked in order of importance by any one government
Developing a response to the question:	• examples of potential conflict, eg ◦ economic growth and price stability ◦ full employment and price stability ◦ demand-led growth and the balance of payments on current account ◦ attempted corrections to the balance of payments deficit on current account and economic growth and / or employment • the differing impact of expenditure-switching and expenditure-dampening policies • supply-side policies
Evaluation:	• some ways of trying to reconcile conflict may not be politically expedient, eg increasing unemployment in order to control inflation • government may attempt to reconcile conflict through fine-tuning which does not have a good track record • conflict can be short term, supply-side remedies long term • limiting growth in order to stabilise prices might harm material living standards • supply-side improvements may be made, eg productivity, but may not bring a reduction of conflict if other countries have seen improvements to a greater extent, eg economic growth increases the flow of imports. An export drive to balance this may be unsuccessful if our productivity improvement is outpaced by that in other countries. • the rate of inflation may be controlled but inflation may still be higher than in the economies of our trading partners, perhaps limiting the desired improvement to the current account (inflation having caused a deterioration) • the policy constraints for members of the eurozone which won't apply to those members of the EU, including the UK, who have not adopted the euro
Also give credit for:	• relevant use of evidence and examples from the UK / other economies

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	• diagrams

[25]

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9. **Issues and areas for discussion include**

Introduction	• interest rates • role of MPC • inflation and government target • understanding of 'high inflation' • cost-push/demand-pull inflation.
Developing the response to the question (analysis and application)	• aggregate demand • aggregate supply • cost-push inflation • Phillips Curve theory • macroeconomic indicators • liquidity trap (examiners note: this is not in the specification) • interest rates and the transmission mechanism • the impact of low interest rates, eg on consumer credit, investment • interest rates as a cost of production • the importance of identifying the prime cause of inflation • other macroeconomic problems at the time of high inflation • the function of interest rates in controlling inflation • analysis of the possible irrelevance of interest rates to inflation given the known cause of inflation • the impact of high interest rates on other aspects of the macroeconomy if they were to be used to control inflation, e.g. unemployment • other anti-inflation policies when interest rates are being kept low • use of diagrams • references to the real world perhaps including the stats included in the preamble to the question, as well as others known by the candidate.
Evaluation	• the importance of having low interest rates because of the condition of the macroeconomy, eg the perceived need to prevent recession and future deflation • interest rate policy as a possible irrelevance given the type of inflation which is prevalent • high inflation seen as a manageable problem irrespective of what happens to interest rates • how permanent/temporary the high inflation is seen to be • the duration of the era of low interest rates • the possible importance of having a favourable exchange rate in world markets which can be achieved through low interest rates • an assessment of the potential contribution of other policies to the battle against inflation, eg supply side, fiscal, so that high interest rates are not so vital even if the inflation arises from high demand • the extent of inflation in an international context: 'high' may be in a historical context domestically, possibly in relation to a government

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	inflation target, rather than in the current international context • a final judgement perhaps in the context of recent UK experience. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

10.

- inflation, with an explanation perhaps in terms of official UK measurement, how measurement is arrived at, recent experiences, other relevant factors

Explain causes of inflation, eg

included within **cost-push factors** could be:

- the rising cost of oil, which for many firms will be a significant cost of production. As oil costs rise, assuming no fall in other costs of the firm a decision has to be made that either profit margins be narrowed or prices of final output need to rise. One consideration will be the price elasticity of demand for the product in question, i.e. the more inelastic is demand, the more likely consumers will absorb any price increase
- wage costs
- supply-side weaknesses, eg low productivity
- imported inflation, perhaps via exchange rate depreciation

Included within **demand-pull factors** could be

- the demand-pull inflationary process
- the impact of monetary policy
- the impact of fiscal policy
- earnings growth

other factors could also be considered, eg

- expectations
- money supply / monetarist explanation

[15]

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11.

Introduction	• the economic cycle • the nature of a recovery • interest rates and the role of the MPC • brief reference to other policy options.
Developing the response to the question: **Application / Analysis**	• the relevance of interest rates to bringing about a recovery • consumer credit • investment • housing costs • aggregate demand • economic growth • unemployment • the limitations of interest rate policy • the function of other aspects of monetary policy, e.g. quantitative easing • the potential role of fiscal policy • the importance of a sound supply-side to underpin a recovery • the significance of business and consumer confidence • the potential significance of overseas markets • interest rate changes influencing “hot-money flows” , bringing instability which may impede a recovery but also of potential benefit • ‘hot-money flows’ and the exchange rate • aspects of an economy which may not directly benefit from low interest rates, e.g. structural unemployment • use of diagrams • reference to the UK and / or other economies.
Evaluation	• the extent to which interest rates are allowed to fall • over what period of time low interest rates are tolerated • the support given, if at all, by other aspects of monetary policy • the limitations if, simultaneously, a tight fiscal policy is followed by government • the limitations if business and consumer confidence are very low • low interest rates used to bring about a recovery in an internationally hostile context • business and consumer concern over how long such a policy will be maintained • microeconomic policies may show themselves to be more effective

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	• low interest rates as a cause of inflation which may impede the recovery • a final judgement made on the policy. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

12.

For • defining exports or export of goods • value v volume • placing exports into the context of trade in goods and services • placing exports into the context of the balance of payments on current account.

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Comparative advantage is established or strengthened where an economy can produce a good at a lower opportunity cost than another country and therefore has a greater likelihood of improved competitiveness and more efficient use of resources, so that sales should rise in foreign markets. In the UK the financial services sector has developed this advantage. Reward an illustrative numerical example of comparative advantage.
Rising incomes overseas.
Improved productivity in the exporting economy.
A lower rate of inflation compared to trading partners or perhaps deflation in contrast to competitors' inflation.
Government support for the export sector.
Exchange rate depreciation.
Changes in export prices.
Any other valid cause.
Use of diagrams to help support explanations, e.g. comparative advantage, exchange rates.

Reward references to the UK economy.

Award a maximum of 12 marks if 3 reasons are not considered.

If more than 3 reasons are considered, reward the best 3.

[15]

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13.

Relevant issues/logical chains of analysis include:

- defining/explaining the balance of trade, visibles/invisibles, the balance of payments on current account,(persistent) deficit/surplus
- high exchange rate which has perhaps appreciated steadily over time. It has made the price of exported goods more expensive and the price of imported goods cheaper. If the price elasticity of demand for exports and imports is elastic less export revenue can be expected. Expenditure on imports will show an increase and hence a balance of trade deficit emerges, all other things being equal
- persistent inflation which compares unfavourably to that of trading partners
- high income elasticity of demand for imports
- supply-side weaknesses such as low productivity
- limited structural changes in the economy so that it no longer produces what world markets want
- deindustrialisation making increased imports of imported goods inevitable
- quality of goods compared to other countries
- economic downturns amongst our trading partners not experienced within the UK so that export sales become more difficult while imports of goods stay buoyant or even increase especially if overseas suppliers are desperate to sell and reduce their overseas prices
- comparative advantage
- protectionism in trading partners not replicated in the UK
- diagrams to help support explanations, eg AD/AS, comparative advantage, tariffs/quotas

[15]

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14. **Issues and areas for discussion include:**

Introduction	• inflation and deflation defined • the issue of price stability as an objective • the issue of avoidance of deflation, eg the possibility of being able to do so • other macroeconomic objectives • the UK experience • the current inflation target of 2% (CPI).
Developing the response to the question (application and analysis)	• 'benign' v 'malevolent' • the benefits to competitiveness of a period of deflation • the benefits to real income and real purchasing power, boosting AD • the benefits of reflationary policies to correct deflation • the danger of entering a 'liquidity trap' scenario (examiners note that this term is not in the specification) • the impact on the real value of savings • the impact on business and household confidence • postponement of consumption • the impact on profits, for example, if consumption is postponed or wages are 'sticky' downwards, and hence the impact on investment • the ultimate damage to growth and jobs • the impact on creditors/debtors • the ultimate impact on living standards • deflation increasing the real burden of debt • arbitrary distributional effects • possible adverse macroeconomic implications overall worsening the fiscal position • use of diagrams • reference to the UK • reference to other economies.

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Evaluation	• ‘a’ or ‘the’ major macroeconomic objective • the degree to which the problem can be anticipated and corrective policies followed • the degree of deflation • the duration of the problem • deflation or inflation? Both to be avoided and the control of both seen as a major economic objective • avoidance of deflation as always needing to be the major objective: an assessment of deflation as the major macroeconomic objective in relation to an assessment of the importance of other macroeconomic objectives, eg deflation and the balance of payments as opposed to deflation and economic growth • the issue of whether equal weight needs to be given to all macroeconomic objectives and their interrelationships recognised • such weighting may change to suit changing circumstances • an assessment of deflation in relation to a possible alternative, ie mild inflation which might be welcomed or runaway inflation which would not • the simultaneous experience of other economies • mild deflation as a minor problem compared to the effects of the authorities over-reacting and reflating too strongly • a final judgment, eg price stability needs to be the major macroeconomic objective with control over changes in the price level whether these are pointing to inflation or deflation because this can be seen as the foundation upon which a strong macroeconomy can be built. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

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15.

Introduction	• Exchange rate • Floating exchange rate • Other exchange rate systems • Macroeconomic stability.
Developing the response to the question (application and analysis)	• Automatic adjustment under a floating exchange rate • The significance of automatic adjustment for macroeconomic stability • Interest rates determined by domestic conditions but nevertheless impacting on the exchange rate • Speculation and its impact • Global economic shocks • Economic growth and stability • The exchange rate and prices • The exchange rate and the balance of payments on current account • The exchange rate and employment • A floating exchange rate and business confidence • The possible significance of intervention by the authorities in an era of managed flexibility • Other factors which are more effective in achieving stability
Evaluation	• The likelihood of automatic adjustment occurring efficiently or at all • Whether other conditions potentially able to secure stability can counteract any destabilising effect of a floating exchange rate or will it be vice versa? • The extent of changes to an exchange rate under a floating system • The impact of economic shocks making it very unlikely that stability can be achieved whatever the exchange rate system in operation • The preparedness of a government to intervene to influence an exchange rate in order that macroeconomic stability can be achieved • In reality, how long is 'a period of macroeconomic stability' expected to be? • Are changes in an exchange rate, within reason, really relevant to achieving macroeconomic stability? • The need to recognise that a floating exchange rate may help to stabilise one aspect of the macroeconomy, eg prices, but not do a great deal for another aspect, eg economic growth. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for:	• Reference to the UK/other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

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16.

Introduction	• Definition of inflation • Global experiences of inflation • UK inflation and the scenario of 'worsening inflation' • The balance of payments and its various parts.
Developing the response to the question (application)	• Low inflation for achieving economic stability and sustained growth **Extract B** (lines 2–3) • Reference to energy costs and primary commodity prices **Extract B** (lines 12 & 13) • The brake on hesitant recovery **Extract B** (lines 21 & 22) • The dangers of loose monetary policy in the UK **Extract C** (lines 7–11) • The breeding of 'uncertainty' **Extract C** (line 11) • Disruption to trade and investment flows (**Extract B** lines 19 & 20) • Cost-push inflation • Demand-pull inflation • AD/AS analysis • Balance of payments • Competitiveness.
Analysis	• The notion of 'impact' • Measurement of impact in the context of the balance of payments • World commodity prices increases and the UK import bill • UK competitiveness given the authorities' success or failure in controlling inflation • The impact of imported inflation on future balance of payments' performance • Inflation, the UK exchange rate and the balance of payments • The impact of global inflation on the macroeconomy of other countries and how this will inevitably impact on the UK's balance of payments • Investment flows and the capital account.
Evaluation	• Is the problem in almost every part of the global economy and what, therefore, is the relevance of this to the UK balance of payments? • Is the problem one experienced by the UK's major trading partners? • 'Increasing inflation' but is the deterioration still from low initial levels of inflation? • UK inflation compared to inflation amongst our trading partners • A worsening, but still mild, inflation as a stimulant to the world of business, to investment, and the impact on the capital account • An inflation scenario which still compares favourably to the prospect of deflation for the balance of payment • The severity of any anti-inflation policies pursued by other governments which may impact on global demand for UK goods and services • The impact on the current account of success or failure in UK authorities' attempts to deal with any national problem of inflation. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for:	• Reference to the UK/other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

17.

Relevant issues/logical chains of analysis include:

- defining economic shock, eg what maybe an unexpected event or one that at least some had predicted which affects an economy either positively or negatively (it is anticipated that the majority of candidates will see shock in negative terms because of the reference to 'harm' and this should not be penalised. Please make sure that credit is not given where the preamble to the question is simply copied out, ie an economic shock is something which can have significant consequences)
- distinguishing a demand-side shock from a supply-side shock, perhaps with examples, such as the euro crisis, the 'credit crunch'; oil price increase or a natural disaster.
- defining economic growth, eg an increase in real GDP or an increase in productive capacity.
- distinguishing between actual and potential growth
- Supply: A significant increase in global oil prices will impact on an economy having to import most or all of its oil from the international market, causing the SRAS curve to shift to the left. Higher oil prices will lead to higher unit costs and hence higher prices and hence cost-push inflation. The impact of inflation on real incomes will affect AD (1mark). Demands from labour for higher wages will worsen the inflation problem. Inflation will cause an increase in unemployment and eventually cause economic growth to falter so that stagflation becomes a real possibility.
- Supply: A significant increase in prices of primary commodities generally and/or food prices.
- Supply: A major war/significant natural disaster/a series of devastating terrorist attacks around the world in major economies.
- Demand: The severity of the Eurozone crisis
- Demand: An unanticipated and sudden downturn in emerging economies such as India and China.
- Demand: credit crunch/crisis in major financial markets
- any other economic shock explained which potentially harms growth
- diagrams to help support explanations, eg AD/AS showing shifts of AD and/or AS, micro supply and demand diagrams, PPF

[15]

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18.

Introduction	• Saving ratio • Macroeconomic performance.
Developing the response to the question: **Application / Analysis**	• Increased consumption benefiting standards of living • Increased short-run economic growth • Positive multiplier arguments • Increased deficits on the balance of payments on current account • Increased problems of personal debt • Demand pull inflationary pressures caused by too much consumption • Over-reliance on credit • Lack of funds in financial institutions for lending and investment • Lack of funds for long-run growth • Effects on confidence • Paradox of thrift arguments (not in specification) • Effects on employment.
Evaluation	• Is the saving ratio important in an economy or is it a by-product of economic conditions? • Has increased economic integration and international finance diminished the importance of the savings ratio? • Savings creating the condition for investment in the long run • Low savings and the effects of future policy changes • Changes in the saving ratio as an effect of having a strong economy rather than the cause of a problem. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• Reference to the UK/other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

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19.

Relevant issues/logical chains of analysis include:

- defining the price level, eg the average level of prices of all goods and services in an economy; for defining inflation, eg a general sustained rise in the price level, or the rate of inflation, eg the change in average prices in an economy over a given time period. (A definition of inflation on its own and not linked to price level is not credited)
- linking the definition of price level to the RPI and/or CPI
- explaining the basic principle of indices
- explaining that a price index such as the RPI calculates the average price level for the average household
- explaining the Quantity Theory of Money, eg reference to the Fisher equation from which the theory is developed, explaining the components of the Fisher equation, and developing the idea that the velocity and transactions are held constant leading to the central principle of the theory that inflation is caused solely by increases in the money supply through processes such as QE
- Reference to monetarism/monetarists and the basic argument that inflation is demand-pull in nature and the idea that increases in money supply lead to increases in AD and to increases in the price level
- Reference to the Monetary Transmission Mechanism (the term may not be explicitly used because it does not feature in the specification). For example, reference to the impact of increases in money supply on the rate of interest charged by high street institutions to consumers and businesses, and hence the impact on AD
- Low interest rates lowering the exchange rate, causing import prices to rise, perhaps causing higher costs for firms and hence higher inflation
- Any other valid analysis, eg rising MS and falling interest rates raising expectations about future inflation
- appropriate diagrams, eg a diagram showing the impact of money supply increases on the rate of interest; AD/AS diagrams

[9]

22.

For defining/explaining

- Saving ratio/saving
- Marginal/average propensity to save/consume
- Trade deficit
- Income/disposable income.

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For example: During periods of economic prosperity, employment is likely to rise which leads to increased disposable incomes as individuals have more income, consumption increases this often causes a rise in house prices which creates the so called wealth effect and increases consumption even further as individuals now have increased equity in their homes this means that individuals can access more finance due to increased security which leads to an increased marginal propensity to consume as individuals become less risk averse and as a result a falling marginal propensity to save and as such the savings ratio falls. **Other examples could include**: The rate of interest, the demographics of the population, time preference, government legislation or consideration of inflation and the real rates of return of saving.
Use of diagrams to help support explanations, eg AD/AS or the trade cycle.
Reference to the UK and/or other economies.

[15]

23.

For defining/explaining • Globalisation • Balance of payments on current account • Trade deficit • Import controls.

For example: By carrying out supply-side policies such as training and education this would hopefully improve productivity in the domestic market which should improve the potential output per worker which increases the long run productive potential of the economy. This could reduce the general price level which makes domestic goods and services more competitive abroad which may lead to other countries increasing demand for the UK's exports such as financial services in which the UK holds a comparative advantage and if the value of imports remains the same this may reduce the balance of payments on the current account. **Other examples could include**: issues such as exchange rate depreciation, expenditure reducing policies or export subsidies.
Use of diagrams to help support explanations, eg LRAS increasing or exchange rate depreciation.
Reference to the UK and/or other economies.

[15]

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24.

Introduction	• Inflation and the types of inflation • The role of the Bank of England • Explanation of the target rate of inflation.
Developing the response to the question: **Application / Analysis**	• Why the UK has inflation targets • The importance of the other macroeconomic goals • How the independent Bank of England has control of the tools to control inflation • The importance of low inflation greasing the wheels of the economy. • Limitations to the use of policy tools • The importance of inflationary expectations • The effects of deflation • Trade-offs in macroeconomic goals • How inflation can affect growth • How inflation can affect the Balance of payments • How inflation can affect unemployment or vice versa • How focusing on other goals may impact on inflation • How the prioritisation may change • How other policies affect inflation • The role of supply side policy in controlling inflation • Short-run vs long-run considerations.
Evaluation	• Whether control of inflation depends on where the economy is operating in the trade cycle • Whether the UK has the ability to control cost push inflation to the same extent as demand pull • How 'independent' is the Bank of England in setting policy • Historical perspectives compared to current economic policies. • The prospects of inflation as opposed to deflation • The effects on the UK when the UK went outside of the target in the past • The relative importance of inflation compared to other goals • Is there an inevitable trade off with unemployment? • Short-run vs long-run considerations. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for	• Reference to the UK/other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

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Mark schemes

1. In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22 to 25 marks** *Mid-Point 24 marks*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17 to 21** *Mid-Point 19 marks*
Level 3	**Reasonable including some correct analysis <u>but</u> very limited evaluation**	**10 to 16** *Mid-Point 13 marks*
Level 2	**Weak with some understanding**	**4 to 9** *Mid-Point 7 marks*
Level 1	**Very weak**	**0 to 3** *Mid-Point 2 marks*

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Introduction	• Monetary policy • Exchange rates • Macroeconomic performance
Developing the response to the question: **(Application)**	Drawing on the information in the extracts: • Currency wars and potential retaliation **(Extract B)** • Investor confidence **(Extract B)** • Threats to economic growth in the UK and USA **(Extract B)** • Effects of interest rates on exchange rates **(Extract B)** • Methods of reducing trade deficits **(Extract C)** • Effects on other Monetary Policy instruments and targets **(Extract C)** • Problems that Switzerland faced in a fixed system **(Extract C)** • Effects on trade and stability due to stable exchange rates **(Extract C)**
(Analysis)	**Arguments why managing the exchange rate may be beneficial:** • Stability leading to investment • More certainty regarding export revenue for firms • More certainty regarding import prices for firms • Consumers benefitting from stable prices • Possible avoidance of deflationary pressure if revalued • Improving competitiveness of firms if devalued • Increased trade flows with the EU due to increased transparency in prices if fixed to Euro. **Arguments why managing the exchange rate may not be beneficial:** • Loss of ability to use interest rates effectively • May be expensive for government • Loss of BoE's independence and use of policy instruments • Conflicts and trade-offs with other macroeconomic objectives • Potential of choosing "the wrong rate" to fix at • The UK's historical experience with the ERM • Loss of automatic adjustment or stabilisation
Evaluation	• The relative success or lack of success in the use of interest rates in the past • The possible success or lack of success in the use of quantitative easing in the past • The relative importance of the trade deficit in terms of other macroeconomic goals, is it more important to focus on domestic consumption? • Can the government afford to prop up the currency if needed or does this contradict aims to reduce the budget deficit? • Is the currency the major problem with the UK's export competitiveness or is it due to structural problems and a lack of productivity? • Would fixing the exchange rate low lead to a "race to the bottom" with other currencies? *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss issues not not mentioned above.

[25]

2. C

[1]

3. **Areas for discussion include:**

- UK experience of recent years
- definitions of inflation and deflation
- why price stability is a key objective
- impact of inflation on UK competitiveness
- impact on growth/employment/trade
- the distributional impact of inflation and deflation
- mild v high inflation
- impact of anti-inflationary policies on the economy
- why deflation may lead to even lower spending by consumers/firms
- impact of deflation on the real value of both public and private sector debt
- impact on confidence of households and firms
- effect on business profits
- benefits of deflation
- impact on other macroeconomic objectives
- malign v benign deflation
- policy options to deal with deflation
- extent and magnitude of each problem
- reference to other economies, e.g. Japan, EU , including differences between the situation in the UK and other economies

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

[25]

4.

For defining/explaining:

- Quantitative easing.
- Inflation.
- Monetary policy (along with the other instruments).

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For Example: The Bank of England (in agreement with the Treasury) by crediting its own account expanding the bank's balance sheet increasing the money supply It then uses this additional credit to purchase previously issued government assets and/or other corporate assets such as bonds from financial institutions. This increases the amount of liquid assets in the banking system. As financial institutions seek profitable returns they increase lending by either reducing lending rates or increasing the availability of credit which may increase consumption and as consumption is a component of aggregate demand this may push the economy towards its productive capacity causing demand pull inflation.
Use of diagrams to help support explanations, eg increased aggregate demand, marginal efficiency of capital (although this is not in the specification) or diagrams linking the money supply and interest rates.
Relevant real world examples and/or relevant reference to the UK and/or other economies

[15]

5.

Areas for discussion include:

- nature of monetary policy
- the Bank of England/MPC and the operation of monetary policy in the UK
- what is meant by macroeconomic stability and the indicators of macroeconomic performance
- how monetary policy affects macroeconomic performance, eg by influencing aggregate demand, influencing expectations, impacts on financial markets
- monetary policy transmission mechanisms
- role of interest rates in affecting aggregate demand
- limitations of changes in bank rate, eg likely to be less effective when confidence is low, may not be reflected in market interest rates, the lower pound problem
- quantitative easing, Funding for Lending, Forward Guidance and other less conventional monetary measures
- monetary policy as a means of fine-tuning the economy and responding to economic shocks
- monetary policy and long-run growth
- monetary policy, debt and asset prices
- monetary policy and the exchange rate
- monetary policy in a world of floating exchange rates and 'unrestricted' capital flows
- the contribution, or otherwise, of monetary policy to the period of stability (eg 1993-2006)
- the contribution of monetary policy to the credit crunch
- the impact of monetary policy since the credit crunch.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

[25]

6.

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

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Level 5	**Good analysis <u>and</u> good evaluation**	**22 to 25 marks** *Mid-Point 24 marks*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17 to 21** *Mid-Point 19 marks*
Level 3	**Reasonable including some correct analysis <u>but</u> very limited evaluation**	**10 to 16** *Mid-Point 13 marks*
Level 2	**Weak with some understanding**	**4 to 9** *Mid-Point 7 marks*
Level 1	**Very weak**	**0 to 3** *Mid-Point 2 marks*

Introduction	• Inflation / deflation • MPC / target rate • Monetary Policy • Macroeconomic performance
Developing the response to the question: **(application and analysis)**	**Arguments why a low inflation rate may be damaging:** • Indication that an economy may be stagnating and subsequent lack of confidence • Effects on jobs/growth if it is stagnating • Difficulties of policy response to low levels of inflation • Possible damage to investment if firms don't see rising prices • Possible effects on inflationary expectations of low rates of current inflation • Wages may not rise causing problems in the labour market • Inflation may be below target of 2% but still within the boundary of acceptable figures 1-3% • The possibility that very low inflation could lead to deflation and the consequences. **Arguments why a low inflation rate may be beneficial:** • In relative terms it may boost competitiveness if the inflation rate is lower than in other countries and should benefit the current account of the balance of payments • The ability to maintain low interest rates and as a result, the effects on consumer expenditure, employment and economic growth. • The ability to maintain low interest rates and as a result, the effects on investment, employment and economic growth. • The possibility that costs can remain low, and firms do not have to pay higher wages • Cost of living arguments • Possibly allows the government's finances to improve due to not having to raise welfare payments some of which are index linked.
Evaluation	• The cause of the low rates is vital in ascertaining the potential effects • Low inflation could be beneficial in the short run as cost of living remains low, however this must be weighed up against the growth of wages • A vital aspect is how low is "low"? Low rates that are just under target may be more acceptable than low rates close to zero • The extent to which inflation "greases the wheels" of the economy • The duration of the low levels of inflation. It may be that low levels are good if sustained but a volatile low inflation rate may be damaging • The current state of the economy and the government/MPC's ability to be able to respond with credible policy • The possibility that other countries may be suffering deflation and its potential effects • Does the target rate really matter? *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

7.

Areas for discussion include:

- definitions/explanations: inflation, low-stable inflation, government economic objectives
- explaining the other main macroeconomic objectives of governments: economic growth, minimising unemployment and a stable balance of payments on current account
- other economic objectives such as the reduction of inequalities or protection of the environment
- the role of central banks, such as the Bank of England or Monetary Policy Committee (MPC) and inflation targets
- ways that central banks can use monetary policies such as interest rates and the transmission mechanism
- ways that central banks can use other variables such as forward guidance, operational independence and forecasting to influence inflationary expectations
- other policies such as supply-side policies which may create low inflation
- other policies such as contractionary or expansionary fiscal policies in attempting to maintain low, stable rates of inflation
- the possible beneficial effects of maintaining low stable inflation such as:
    - the creation of confidence and stability
    - the avoidance of wage-price spirals
    - the avoidance of deflation and possible creation of delayed consumption
    - allowing economic agents to factor in changes to decision making and the effects on consumption and investment
    - maintaining international competitiveness
    - the avoidance of hyperinflation
    - the effects on households, such as those on fixed incomes and the effects on savings
    - effects on government finances
- the possible negative effects of maintaining low stable inflation such as:
    - the possible trade-off with unemployment if inflation is too low
    - the possible trade-off with growth if inflation is too low
    - the focus on achieving low, stable inflation may impact upon certain groups more than others for example borrowers with variable rate mortgages
- considering the effectiveness of policies to control inflation
- the relative merits and problems of policies designed to create low stable inflation
- external shocks such as the pandemic, may force governments to alter economic targets
- the possibility that objectives may be achieved simultaneously
- whether deflation is more of a concern than low stable inflation
- whether the control of inflation depends upon the stage of the economic cycle and priorities may change
- the importance of other objectives of economic policy

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

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Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21–25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16–20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgments but these are not well-supported by arguments and/or data.	**11–15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context and/or data to the question • includes some limited analysis but it may lack focus and/or become confused • includes some evaluation which is weak and unsupported.	**6–10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which is, at best, very weak • includes attempted analysis which is weak and unsupported.	**1–5 marks**

[25]

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8.

Level of response	An answer that:	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately.	**7-9 marks**
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question • includes some reasonable analysis but it might not be adequately developed and may be confused in places • may include a relevant diagram.	**4-6 marks**
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	**1-3 marks**

An AD/AS diagram is expected.

Relevant issues include:

- growth, aggregate demand and potential output
- the impact of faster growth on the size of the output gap
- impact of rising interest rates on aggregate demand
- growth and inflation
- growth and the balance of payments.

[9]

11. In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

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Level 5	**Good analysis <u>and</u> good evaluation**	**22 to 25 marks** *Mid-Point 24 marks*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17 to 21** *Mid-Point 19 marks*
Level 3	**Reasonable including some correct analysis <u>but</u> very limited evaluation**	**10 to 16** *Mid-Point 13 marks*
Level 2	**Weak with some understanding**	**4 to 9** *Mid-Point 7 marks*
Level 1	**Very weak**	**0 to 3** *Mid-Point 2 marks*

Introduction	• Unemployment • Demand-side / Supply-side • Types of unemployment
Developing the response to the question: **(Application)**	Drawing on the information in the extracts: • Labour market reforms **(Extract E and Extract F)** • EU possibly recovering **(Extract E and Extract F)** • Supply-side reforms **(Extract E)** • Effects on firms / workers **(Extract E)** • Comparisons with other EU countries **(Extract E)** • The current state of the UK labour market and wage growth **(Extract F)** • Subsidies / training / introduction of living wage **(Extract F)** • Benefits cap and limiting JSA **(Extract F)**
(Analysis)	**Arguments as to why demand-side factors may cause further falls:** • Rising real incomes in the UK • Increased confidence • Possible increases in domestic investment • Possible increases in FDI • Multiplier effects • Improved export opportunities (if the EU grows) **Arguments as to why supply-side factors may cause further falls:** • Consideration of the "voluntary" nature of some types of unemployment • Changes to incentives • Changes to benefits forcing people into low paid jobs • Consideration that living wage may actually entice more people into jobs market • So called "carrot and stick" approaches • Changes to structural unemployment • Improvements to mobility (occupational and geographical) • The UK's experiences under the "Work Programme" and government policy • Focus on particular groups, such as the 16-24 age group or the long term unemployed.
Evaluation	• The UK could be approaching NRU / NAIRU / full capacity, the supply-side may be vital in order to gain further improvements • Both approaches are not mutually exclusive, improvements could be made on both at the same time • Some factors may be beyond the control of the UK, e.g. external demand in the EU, is trade a significant issue? • Consideration of regional aspects – unemployment rates mask a regional issue which is very difficult to solve with policies which aren't targeted • Consideration that more jobs may be created but the incomes or conditions provided by those jobs maybe are not as good as others *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss issues not not mentioned above.

[25]

12. B

[1]

13. In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22 to 25 marks** *Mid-Point 24 marks*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17 to 21** *Mid-Point 19 marks*
Level 3	**Reasonable including some correct analysis <u>but</u> very limited evaluation**	**10 to 16** *Mid-Point 13 marks*
Level 2	**Weak with some understanding**	**4 to 9** *Mid-Point 7 marks*
Level 1	**Very weak**	**0 to 3** *Mid-Point 2 marks*

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Issues and areas for discussion include

Introduction	• Interest rates • Monetary policy • Economic growth (short-run and long-run)
Developing the response to the question: **(application and analysis)**	**Beneficial effects of low interest rates:** • Effects of low interest rates on savings, increased consumption and increased growth • Effects of low interest rates on tracker mortgages, increased disposable income and consumption increasing growth • Effects of low interest rates on credit, consumption and growth • Effects of low interest rates on firms and investment • Effects of low interest rates and its effects on currency and trade flows • Benefits to both short-run and long-run growth. **Negative effects of low interest rates:** • The effect on long-term investment and bank's willingness and ability to lend • The building up of personal debt and future problems • The potential damage that a rise in interest rates may have after such a sustained low rate • The effects on the housing market of inflated volumes of borrowing and other microeconomic arguments • Arguments regarding the long-term damage of sustained low rates. **Other causes of economic growth:** • Consideration of the other factors leading to economic growth such as fiscal / other monetary or supply-side policies or exogenous factors.
Evaluation	• The effects are difficult to quantify due to the economy never having experienced such persistent low rates • The fact that the bank rate is very different from lending and borrowing rates and therefore the private sector sets many of these rates • The effect of the credit crunch and confidence in determining the level of consumption and investment • The so called "liquidity-trap" (not in specification) and the ineffectiveness of interest rate as they reach low levels • The importance of other factors rather than interest rates in determining growth • Time-lags • Effectiveness of interest rates *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised

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It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

14.

Areas for discussion include:

- definitions/explanations: the balance of payments, the current account, current account deficit
- explaining the difference between a surplus or deficit on current account
- explaining the composition of the current account of the balance of payments
- explaining the historical experience of the UK's current account
- explaining the causes of deficits
- explain possible measures to reduce the deficit such as:
    - exchange rate manipulation
    - changes in interest rates potentially affecting the exchange rate
    - expenditure-reducing policies
    - expenditure-switching policies
    - the role of protectionism
    - government role in export promotion/trade deals
    - the role of fiscal and monetary policy
    - supply-side improvements which might begin to provide a solution to the weakness, such as:
        - competitiveness/unit labour costs
        - investment (human and physical capital)
        - technology, R&D and productivity
        - infrastructure
- consideration of the UK's membership of the WTO and EU restricting its ability to use protectionism
- consideration of whether the deficit is a problem if the capital account is in surplus
- consideration of the impact on other macroeconomic goals of trying to reduce the deficit on the current account of the balance of payments.

The use of relevant diagrams such as AD/AS diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

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Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21 – 25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16 – 20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these are not well-supported by arguments **and/or** data.	**11 – 15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context **and/or** data to the question • includes some limited analysis but it may lack focus **and/or** become confused • includes some evaluation which is weak and unsupported.	**6 – 10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

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15.

Areas for discussion include:

- definitions/explanations: monetary policy, deflation, developed economies
- deflation and the different types (malign v benign)
- the effects of deflation
- the nature of developed economies and different experiences of deflation
- the role of interest rates and the transmission mechanism
- the effects of interest rates on investment, employment, saving and consumption
- the link between long-term saving and long-term investment
- the effectiveness of interest rates at very low levels including negative interest rates
- consideration of the MPC's role, primarily in targeting inflation but also in targeting growth
- consideration of differences in the two economies which may determine the effectiveness of monetary policy
- the use of quantitative easing and consideration of its success
- the possible role of the exchange rate in stimulating the economy
- the use of fiscal policy and fiscal stimulus
- considering how government debt may affect the ability to use fiscal policy
- considering how private-sector debt may influence the effectiveness of policies designed to combat deflation
- consideration of the potential conflicts in policy
- the significance of economic shocks and their impact on policies to tackle deflation.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21 – 25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16 – 20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these are not well-supported by arguments **and/or** data.	**11 – 15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context **and/or** data to the question • includes some limited analysis but it may lack focus **and/or** become confused • includes some evaluation which is weak and unsupported.	**6 – 10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

16. A

[1]

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17. D

[1]

18. C

[1]

19. B

[1]

20. D

[1]

21. **Areas for discussion include:**

- definitions/explanations: inflation, deflation
- explaining the different types of inflation (demand-pull and cost-push)
- explaining the different types of deflation (malign and benign)
- explaining the UK's recent history of inflation and deflation
- explaining the causes of inflation and deflation
- explaining the effects of inflation or deflation upon:
  - individuals, such as inflation causing a higher cost of living
  - borrowers, such as the relative value of debt falling with inflation
  - savers, such as inflation eroding the value of savings
  - those on fixed incomes such as the current government policy of raising JSA at 1% or inflation (whichever is lowest)
  - real interest rates and borrowing
  - firms and investment
  - labour markets, such as individuals with low bargaining power being unable to negotiate higher wages
  - consumption decisions, such as delayed consumption due to deflation
  - international competitiveness
  - activity and stability
- considering the different types of inflation in terms of creeping or hyper-inflation
- considering that inflation may benefit one group but at the expense of another
- considering that the type of deflation may determine the effects
- considering the duration of the inflation or deflation
- considering the ability of the MPC to return to the target of 2% inflation, eg the problem of the lower bound to interest rates (liquidity trap).

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

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Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21 – 25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16 – 20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these aren't well-supported by arguments and/or data.	**11 – 15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principle but some errors are likely • includes some limited application of relevant economic principles to the given context and/or data to the question • includes some limited analysis but it may lack focus and/or become confused • includes some evaluation which is weak and unsupported.	**6 – 10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which is, at best, very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

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22. **Relevant issues include:**

- definitions/explanations: monetary policy, transmission mechanism, Bank Rate, interest rates
- the role of the MPC in achieving 2% +/- 1% CPI inflation and supporting the government's objectives regarding growth and employment
- explaining how a rise in Bank Rate may reduce household consumption:
  - due to a rise in saving
  - due to credit becoming more expensive
  - due to variable rate mortgages becoming more expensive
- explaining how a rise in Bank Rate may reduce investment:
  - due to credit becoming more expensive
  - due to investment appraisal being unfavourable
  - more pessimism
- explaining how a rise in Bank rate may appreciate the exchange rate:
  - due to a rise in demand for the currency and/or a fall in supply of the currency on the FOREX (hot money flows)
- the impact on asset prices and the consequent wealth effects
- explaining how all of the above affect AD.

The use of relevant diagrams such as AD/AS or the supply of and demand for currency, to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1 – 5 marks**

[15]

23. **Relevant issues include:**

- definitions/explanations: inflation, cost-push inflation, demand-pull inflation, the general price-level, price indices
- explaining possible causes of rises in demand-pull inflation through an increase in the components of AD such as:
  - increased consumption due to the falling unemployment
  - increased investment due to falling interest rates
  - increased government spending due to a discretionary policy to raise welfare spending, e.g. pensions
  - increased exports due to higher economic growth in a trade partner
  - decreased imports and increased exports due to a depreciation in the currency
  - a rise in the money supply supporting the monetarist view and using the Fisher equation
- explaining possible causes of rising cost-push inflation through an increase in the costs of the factors of production such as:
  - rising wage costs
  - rising raw material costs
  - rising commodity prices such as oil

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- explaining external shocks which may impact upon inflation
- explain microeconomic issues which may impact upon inflation such as rising housing costs affecting the RPI measure or possible collusion in energy markets affecting domestic fuel prices
- explaining possible short-run reasons for increases in prices and long-run reasons.

The use of relevant diagrams to support the analysis such as rising AD/AS should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1 – 5 marks**

[15]

24. A

[1]

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25. **Relevant issues include:**

- definitions/explanations: exchange rate, floating exchange rate, depreciation, the role of the FOREX market
- giving examples of depreciation (such as a numerical example)
- explaining that the value of a currency is determined by the demand for and supply of the currency
- explaining why a fall in demand for or increase in supply of currency will lead to a fall in the equilibrium exchange rate
- identifying and explaining reasons why the demand for currency may fall such as:
  - a fall in exports
  - a fall in inward FDI
  - a fall in tourism
  - a fall in the interest rate causing a reduction in hot money flows into the country
  - speculation
- identifying and explaining reasons why the supply of a currency may increase such as:
  - a rise in imports
  - a rise in FDI going abroad
  - a rise in tourism to another country
  - a fall in interest rates leading to a rise in hot money flows out of a country
  - speculation
- explaining government intervention which may occur if the floating exchange rate is not a "free" float.

The use of relevant diagrams, such as a diagram showing the supply of and demand for currencies, to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1 – 5 marks**

[15]

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