Please check the examination details below before entering your candidate information

Candidate surname: StemUp Model Solution

Other names:

Centre Number | Candidate Number

Pearson Edexcel International Advanced Level

Time 1 hour 45 minutes

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary
UNIT 2: Macroeconomic performance and policy

You must have:
Source Booklet (enclosed)

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **ALL** questions in Sections A, B and C.
- Answer **ONE** question in Section D.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Check your answers if you have time at the end.

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SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 The value of a country's multiplier decreases from 1.7 to 0.9.

Which **one** of the following is a likely cause of a decrease in the value of a country's multiplier?

- ☒ **A** A decrease in the marginal propensity to tax
- ☒ **B** A decrease in the marginal propensity to save
- ☒ **C** An increase in the marginal propensity to consume
- ☒ **D** An increase in the marginal propensity to import

(Total for Question 1 = 1 mark)

2 In 2021 India experienced an 8% increase in real GDP.

Which **one** of the following is most likely to be a cost of economic growth?

- ☒ **A** A decrease in profits for firms
- ☒ **B** An increase in damage to the environment
- ☒ **C** A decrease in government tax revenues
- ☒ **D** An increase in the level of investment

(Total for Question 2 = 1 mark)

3 Between January 2020 and April 2020 the rate of unemployment in the USA increased from 3.5% to 14.8%. This was as a result of the recession caused by the global health crisis.

Which **one** of the following best describes the cause of unemployment experienced in the USA?

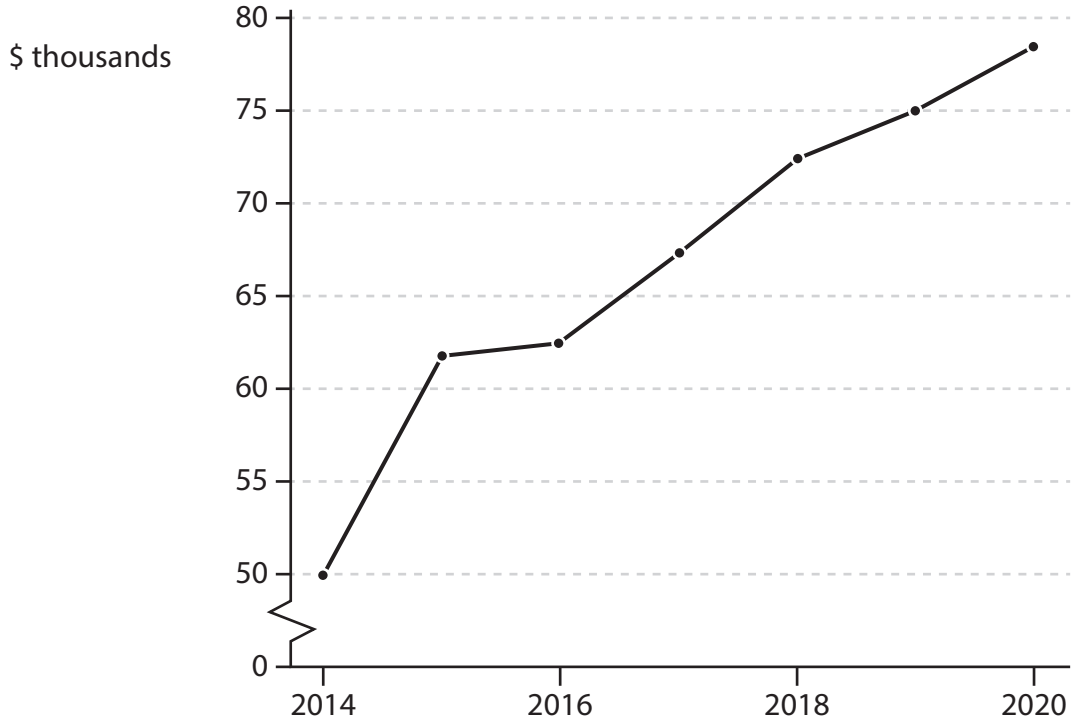
- ☒ **A** Seasonal
- ☒ **B** Structural
- ☒ **C** Demand deficient
- ☒ **D** Frictional

(Total for Question 3 = 1 mark)

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4 The chart shows Ireland's real GDP per capita, 2014–2020.



(Source adapted from: https://data.worldbank.org/)

Which **one** of the following is the most likely effect of this change in real GDP per capita?

- ☒ **A** An increase in the standard of living
- ☐ **B** An increase in the rate of unemployment
- ☐ **C** A decrease in consumer confidence
- ☐ **D** A decrease in the purchasing power of consumers

(Total for Question 4 = 1 mark)

5 In April 2022 the central bank of Sri Lanka increased the country's base rate of interest from 7.5% to 14.5%.

Ceteris paribus, which **one** of the following is the most likely impact of this increase in the base rate of interest?

- ☐ **A** An increase in the rate of economic growth
- ☒ **B** An increase in the rate of unemployment
- ☐ **C** A decrease in the cost of borrowing
- ☐ **D** A decrease in the reward for saving

(Total for Question 5 = 1 mark)

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6 The table shows Qatar's Gross National Income (GNI) between 2018 and 2020.

Year	GNI ($ billion)
2018	179.6
2019	172.0
2020	141.4

Which **one** of the following represents the ratio of GNI in 2018 to GNI in 2020?

☒ **A** 1 : 0.79

☒ **B** 1 : 0.96

☒ **C** 1 : 1.04

☒ **D** 1 : 1.27

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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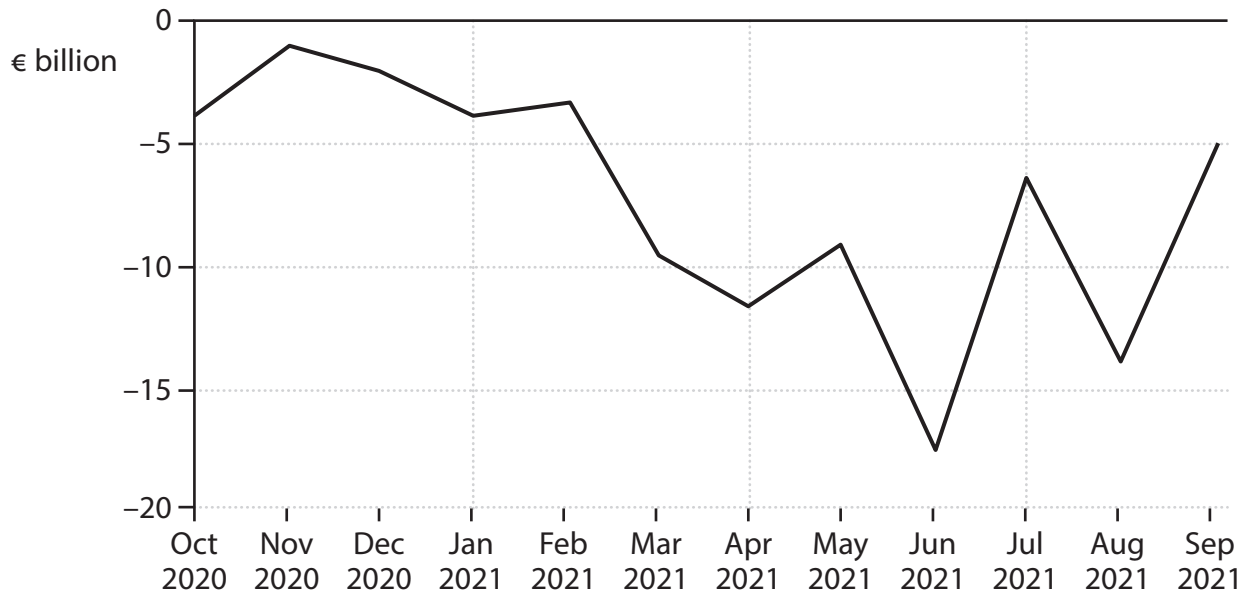
SECTION B BEGINS ON THE NEXT PAGE.

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SECTION B

Answer ALL questions in this section in the space provided.

7 The chart shows Austria's net monthly balance of trade in goods and services, October 2020 to September 2021.



With reference to the chart, explain **one** likely cause of the deficit in Austria's balance of trade in goods and services.

One likely cause is a relatively high rate of inflation in Austria compared with its trading partners. Higher prices make Austrian exports less price competitive abroad, so demand for them falls, while imports become relatively cheaper, so Austrians buy more of them. This lowers export revenue and raises import spending, so M exceeds X. The chart shows a deficit in every month from October 2020 to September 2021, reaching about €17.5 billion in June 2021.

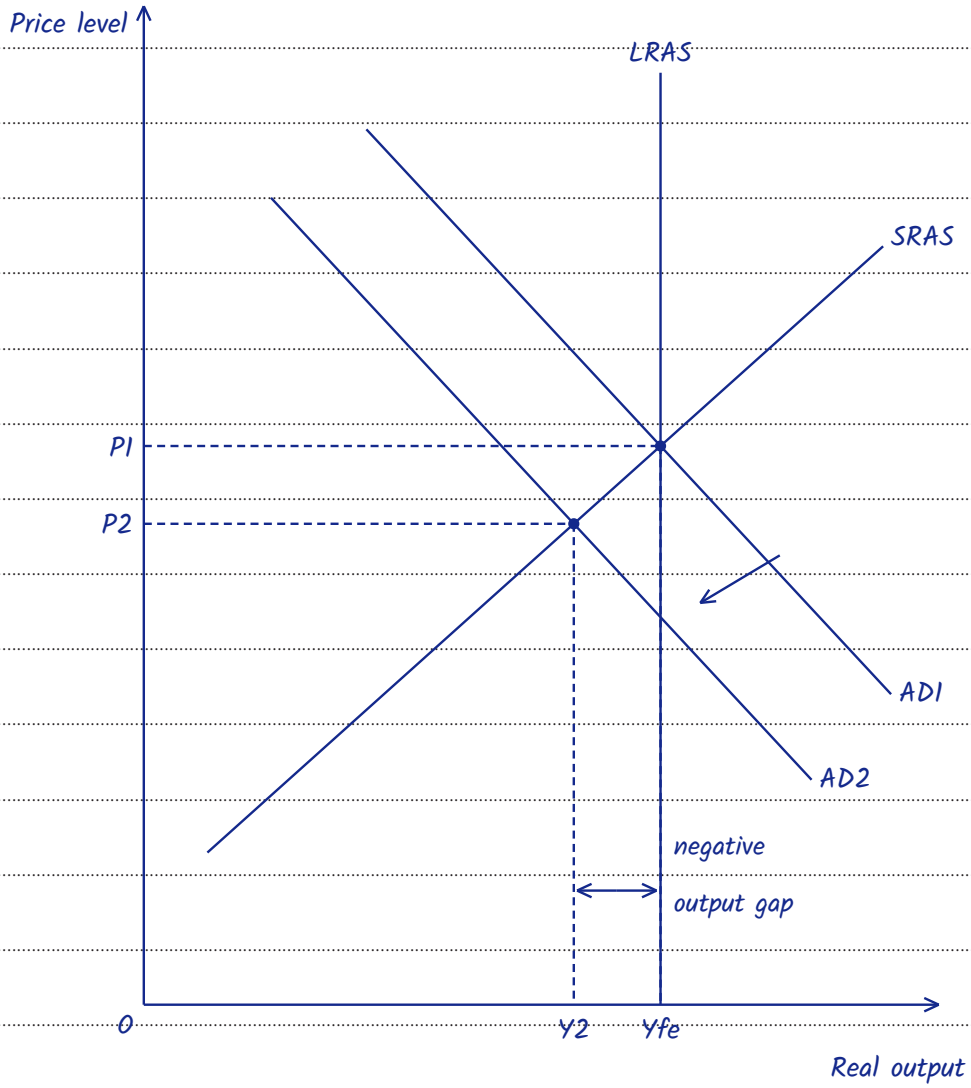
(Total for Question 7 = 4 marks)

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8 As a result of a significant decrease in consumer spending in France in 2020, the country's negative output gap was 5.64%.

Draw an AS and AD diagram to show the negative output gap.



The fall in consumer spending shifts AD left from AD1 to AD2. The new equilibrium is at a lower price level P2 and real output Y2, which is below the full employment level of real output Yfe (where AD1 met SRAS on the LRAS). The distance Y2 to Yfe is the negative output gap of 5.64%, so actual output is below potential output.

(Total for Question 8 = 4 marks)

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9 The table shows the population and GDP per capita of Bulgaria in 2015 and 2020.

	Population (millions)	GDP per capita ($ thousand)
2015	7.18	7 075
2020	6.93	10 079

(Source: https://data.worldbank.org/country/bulgaria)

Based on this information, calculate *the change* in Bulgaria's GDP between 2015 and 2020. Show your workings.

GDP = GDP per capita × population

2015: $7 075 × 7.18 million = $50 798.5 million = $50.80 billion

2020: $10 079 × 6.93 million = $69 847.47 million = $69.85 billion

Change = $69.85 billion − $50.80 billion

Change in GDP = + $19.05 billion (an increase of about 37.5%)

(Total for Question 9 = 4 marks)

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10 In September 2020 the average house price in the UK was £258 155. By September 2021 the average house price had risen by 11.5%.

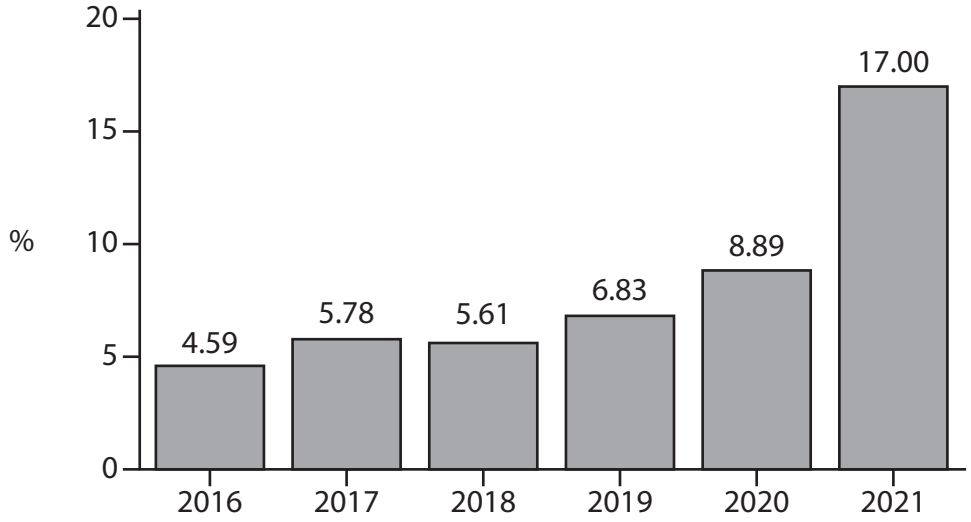
With reference to this information, explain **one** likely macroeconomic impact of an increase in house prices on existing homeowners.

One likely macroeconomic impact is an increase in consumer spending. UK house prices rose by 11.5%, so the average house rose in value from £258 155 to about £287 843, an increase of £29 688. This creates a positive wealth effect: existing homeowners feel wealthier and more confident because the value of their main physical asset has risen, so they save less and may borrow against the higher value of their home (equity withdrawal). Consumption, the largest component of AD (C+I+G+(X−M)), therefore rises, shifting AD to the right. This increases real output and economic growth, but may also add to demand-pull inflationary pressure.

(Total for Question 10 = 4 marks)

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11 The chart shows the savings ratio for Latvia between 2016 and 2021.



(Source adapted from: https://tradingeconomics.com/latvia/gross-household-saving-rate-b8g-b6gd8net100-eurostat-data.html)

With reference to the trend shown in the chart, explain what is meant by the 'savings ratio'.

The savings ratio is the percentage of total household disposable income that is saved rather than spent: savings ratio = (total savings ÷ total disposable income) × 100.

The chart shows an overall upward trend in Latvia's savings ratio, which rose from 4.59% in 2016 to 17.00% in 2021, an increase of 12.41 percentage points. So in 2021 households saved 17% of their disposable income, the highest in the period, with the sharpest rise from 8.89% in 2020.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C BEGINS ON THE NEXT PAGE.

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SECTION C

Study Figures 1 and 2 and Extract A in the Source Booklet before answering Question 12.

Write your answers in the space provided on the following pages.

12 (a) Define the term 'seasonally adjusted' (Figure 1).

(2)

(b) With reference to Figure 2, explain the difference between disinflation and deflation.

(4)

(c) With reference to Extract A, analyse **two** roles of a central bank.

(6)

(d) With reference to Figure 1 and Extract A, examine the likely impact of a fall in business confidence on Germany's real output.

(8)

(e) With reference to the information provided, discuss the likely macroeconomic effects of a high rate of inflation on the German economy.

(14)

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12 (a) Define the term 'seasonally adjusted' (Figure 1).

(2)

Seasonally adjusted data is time series data that has been adjusted to remove the effect of regular seasonal variations (eg Christmas or summer), so underlying trends can be seen.

(b) With reference to Figure 2, explain the difference between disinflation and deflation.

(4)

Disinflation is a fall in the rate of inflation while it is still positive, so the average price level is still rising but more slowly than before. In Figure 2 German inflation fell from 1.7% in February 2020 to 0.6% in May 2020, and from 2.5% in May 2021 to 2.3% in June 2021.

Deflation is a negative rate of inflation, so the average price level is actually falling. In Figure 2 Germany had deflation from September to December 2020, eg the inflation rate was −0.2% in September 2020 and −0.3% in November and December 2020.

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(c) With reference to Extract A, analyse **two** roles of a central bank.

(6)

One role of a central bank is to implement monetary policy to achieve an inflation target. The ECB has an inflation target of 2% for the eurozone, but the Bundesbank forecast that German inflation would be 3.6% in 2022. The ECB can raise the base rate of interest, which increases the cost of borrowing and the reward for saving. Consumption and investment fall, so AD falls and demand-pull inflationary pressure is reduced, bringing inflation back towards 2%.

A second role is to forecast the future state of the economy so that policy can be set in advance. The Bundesbank estimated that Germany's real output was likely to fall in the last quarter of 2021 and predicted that savings would "strongly boost consumption". Because monetary policy works with time lags, accurate forecasts of output and inflation allow the central bank to change interest rates early, so it can stabilise real output and employment as well as inflation.

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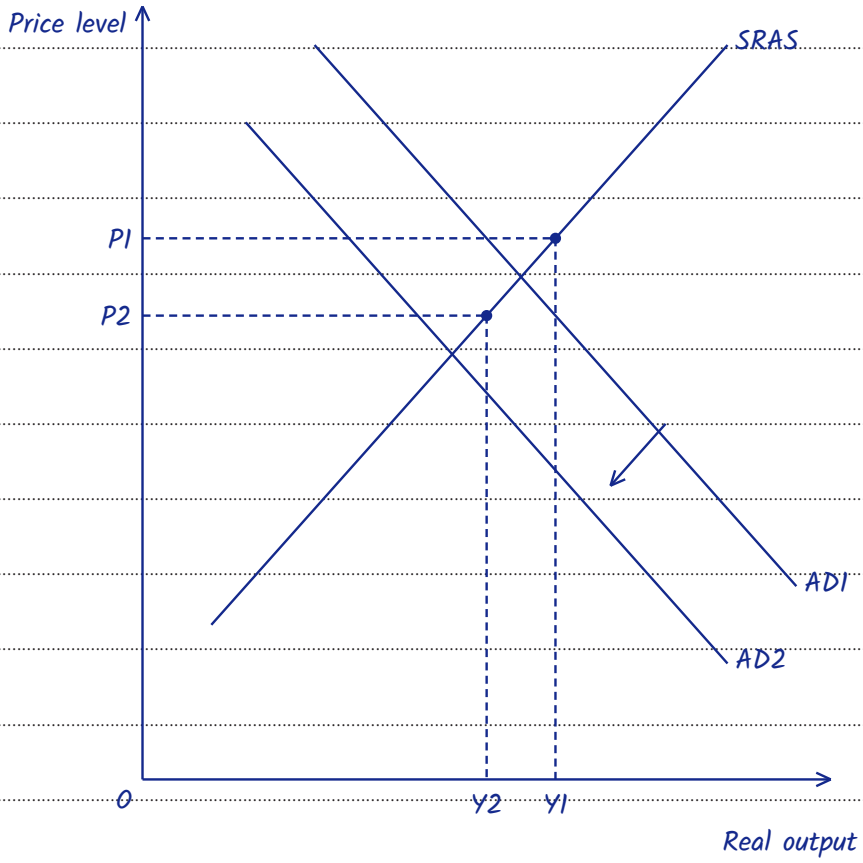
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(d) With reference to Figure 1 and Extract A, examine the likely impact of a fall in business confidence on Germany's real output.

(8)

Business confidence measures firms' expectations of future sales and profits. Figure 1 shows German business confidence fell from 101.7 in June 2021 to 96.6 in November 2021 (and to 94.7 in December), and Extract A says confidence declined in both manufacturing and services.

Lower confidence means firms expect lower returns, so they postpone or cancel investment and may use profits to repay loans instead. Investment is a component of AD (C+I+G+(X−M)), so AD shifts left from AD1 to AD2, and through the negative multiplier effect real output falls from Y1 to Y2. Lower investment also reduces future capital stock and productivity. This is why the Bundesbank expected real output to fall in the last quarter of 2021, with a possible recession in 2022.



However, the fall in confidence is small compared with April 2020, when the index fell to 75.4,

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so the impact on real output may be limited. It may also be short-term: vehicle production had started to increase in the third quarter of 2021, so net exports were likely to rise in 2022, and the extra savings worth 10% of disposable income could boost consumption. Other components of AD may therefore offset the fall in investment, so real output may fall only slightly and only briefly.

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(e) With reference to the information provided, discuss the likely macroeconomic effects of a high rate of inflation on the German economy.

(14)

Inflation is a sustained rise in the average price level. The Bundesbank forecast German inflation of 3.6% for 2022, well above the ECB target of 2%, and Figure 2 shows inflation rising from 1.0% in January 2021 to 5.2% in November 2021.

First, high inflation reduces the purchasing power of money. If wages rise more slowly than prices, real incomes fall, so German consumers can afford fewer goods and services and consumer confidence falls. Consumption falls, AD falls and real output growth slows. Those on fixed incomes, such as pensioners and benefit recipients, who are often the poorest, lose most, so inequality may widen.

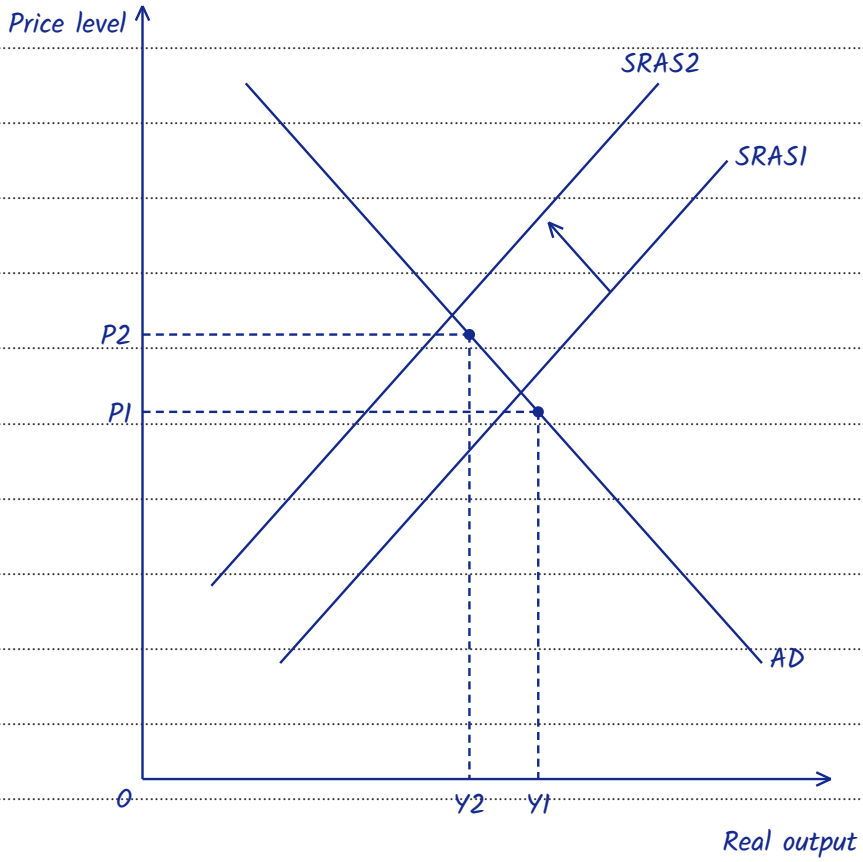
Second, if German inflation is higher than in its trading partners, German exports become less price competitive while imports become relatively cheaper. Germany depends heavily on manufactured exports such as vehicles, so export volumes fall, the current account position worsens and net exports reduce AD, causing lower growth and job losses in exporting industries.

Third, inflation can become self-reinforcing through expectations. Workers who expect prices to keep rising demand higher wages to protect their real incomes; this raises firms' costs, shifts SRAS left and causes further price rises, a wage-price spiral. Firms also face menu costs and consumers face higher search costs, and uncertainty about future prices discourages investment, reducing long-run growth.

However, the effects depend on the cause. Extract A shows the producer price index rose by 19.2% because of energy, metal and wood prices and supply chain constraints, so this is cost-push inflation. Higher interest rates from the ECB cannot fix supply problems and would

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risk a recession as well.



As the diagram shows, SRAS shifts left from SRAS1 to SRAS2, so the price level rises from P1 to P2 and real output falls from Y1 to Y2, which is stagflation. The duration also matters: the Bundesbank predicted the supply chain constraints would last until the end of 2022, so the harmful effects may be long-lasting. Yet 3.6% inflation is only moderately above target, and some inflation is preferable to the deflation Germany suffered in late 2020, as it reduces the real burden of debts. Competitiveness depends on relative inflation: if other eurozone countries have similar inflation, German exports will not lose much price competitiveness. Overall, high inflation is likely to reduce real incomes and growth in Germany in the short run, but the impact depends mainly on how long the supply constraints last.

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(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

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SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 Between May 2020 and March 2022 the global oil price increased from $39 a barrel to $106 a barrel.

Evaluate the view that very high global oil prices will always harm a country's macroeconomy.

(Total for Question 13 = 20 marks)

OR

14 Between June 2021 and November 2021 the rate of employment in Australia decreased from 63% to 61.5%.

Evaluate government policies that could be used to increase the rate of employment. Refer to a country of your choice in your answer.

(Total for Question 14 = 20 marks)

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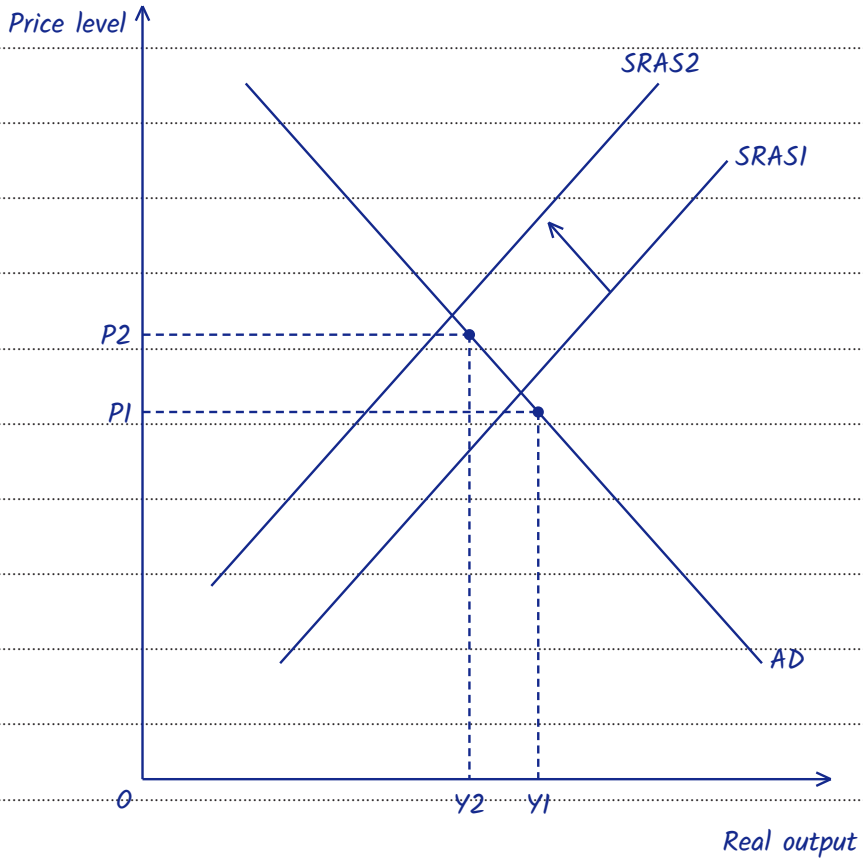
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: **Question 13** ☒ **Question 14** ☐

Write your answer here:

Between May 2020 and March 2022 the global oil price rose from $39 to $106 a barrel, an increase of about 172%. Whether this harms a country's macroeconomy depends on whether it is a net importer or a net exporter of oil, and on the state of its economy.

For a net oil importer such as India, the UK or Japan, oil is a key input for transport, energy and manufacturing. A large rise in oil prices increases firms' costs of production, so SRAS shifts left from SRAS1 to SRAS2. As the diagram shows, the price level rises from P1 to P2 (cost-push inflation) and real output falls from Y1 to Y2. This is stagflation: the government misses its objectives of low and stable inflation and of economic growth at the same time.



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Lower real output means firms need fewer workers, so unemployment rises. Higher petrol, heating and transport prices also reduce households' real disposable incomes, so consumption falls, reducing AD and, through the negative multiplier, reducing real GDP further.

In addition, because demand for oil is price inelastic in the short run, the quantity imported falls by proportionately less than the price rises, so the value of oil imports increases. For India, which imports most of its oil, this widens the trade and current account deficit and puts downward pressure on the exchange rate, which makes imported oil even more expensive and adds to inflation. Lower incomes and higher unemployment also reduce tax revenue and raise benefit spending, worsening the government's budget balance.

However, high oil prices will not always harm a country. For net exporters such as Saudi Arabia, Norway or Nigeria, the value of exports rises sharply. Net exports increase, so AD shifts right and, with positive multiplier effects, real GDP and employment rise and the current account improves. Higher oil revenues increase government tax and royalty income, improving the budget balance; Norway saves much of this in its sovereign wealth fund. Even for these countries the benefit is not guaranteed: if the economy is near full capacity, the rise in AD mainly causes demand-pull inflation, and dependence on oil may discourage diversification, leaving the economy exposed when oil prices fall again.

The impact also depends on the magnitude and duration of the price rise. A short spike may be absorbed by firms through lower profit margins, but prices stayed high for almost two years, which makes cost-push inflation more likely to feed into wage demands and inflation expectations. Time lags matter too, as effects on output and the current account take time to appear.

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The structure of the economy is also important. Economies that are energy efficient or use more renewable energy, such as those investing in wind and solar power, are affected less, while oil-intensive manufacturing economies are affected more. High oil prices also give importers an incentive to invest in renewables, which may benefit the environment and reduce oil dependence in the long run.

Finally, the effect on inflation depends on the starting point. If inflation was below target, as in many economies in 2020 when there was a risk of deflation, some extra inflation may not be harmful. However, by 2022 inflation was already above target in many countries, so higher oil prices made the problem worse and forced central banks to raise interest rates, which further reduced growth.

In conclusion, very high global oil prices do not always harm a country's macroeconomy. They are likely to harm net oil importers such as India and the UK through cost-push inflation, lower growth, higher unemployment and a worse current account, especially when the rise is large and long-lasting as in 2020 to 2022. However, net exporters such as Saudi Arabia and Norway are likely to gain, at least in the short run, so the overall effect depends mainly on whether a country is a net importer or exporter of oil and how dependent its economy is on oil.

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TOTAL FOR SECTION D = 20 MARKS
TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Time 1 hour 45 minutes

Paper reference **WEC12/01**

Economics

International Advanced Subsidiary
UNIT 2: Macroeconomic performance and policy

Source Booklet

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Sources for use with Section C

The German economy

Figure 1 Index of business confidence (January 2015=100), seasonally adjusted, January 2020 to December 2021

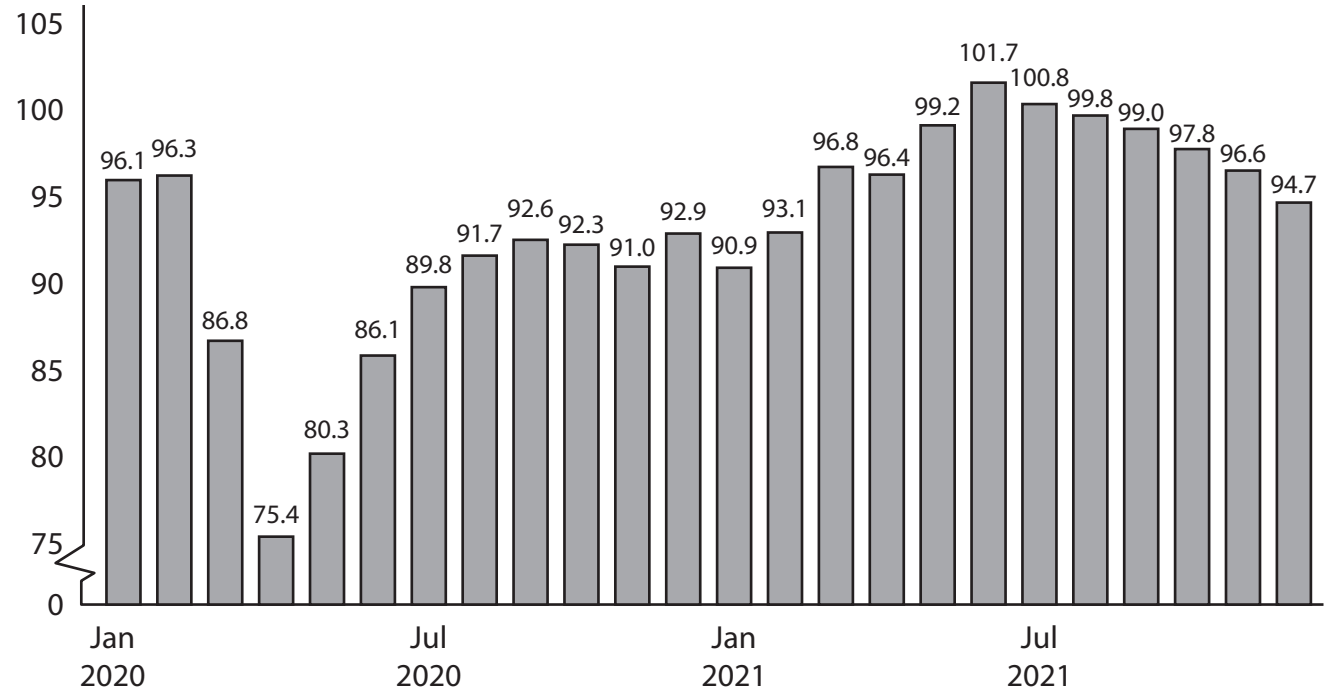
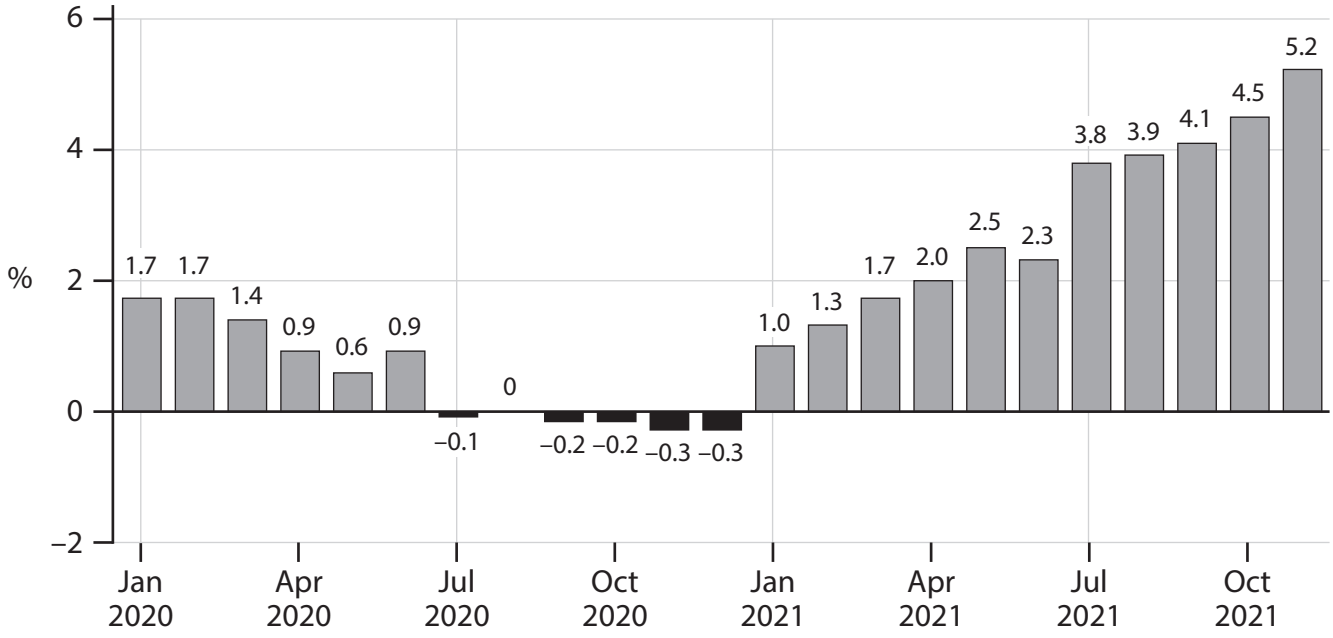


Figure 2 Inflation rate*, as measured by the consumer price index (CPI), January 2020 to November 2021



***This is the year-on-year inflation rate calculated monthly**

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Extract A Economic outlook

In 2021 production in Germany's large manufacturing sector suffered from delays and shortages of materials caused by supply chain constraints. Its larger services sector, including retail, tourism and hospitality, was also negatively affected by the global health crisis. These factors led to a decline in business confidence in both the manufacturing and services sectors from June 2021 onwards.

Consequently, the country's central bank, the Bundesbank, estimated that Germany's real output was likely to fall in the last quarter of 2021. Many economists predicted that the German economy could enter a recession in 2022. However, industrial production, especially vehicle manufacturing, had started to increase in the third quarter of 2021. Therefore, it was likely that net exports would increase in the first six months of 2022.

According to the Bundesbank, households had built up extra savings worth 10% of their disposable income during the global health crisis. The Bundesbank predicted that "this will strongly boost consumption" once consumer confidence increased.

The Bundesbank also warned of inflation risks. It raised its forecast for Germany's annual rate of inflation to 3.6% for 2022. This is above the European Central Bank's (ECB) inflation target rate of 2% for the eurozone area. The Bundesbank has therefore indicated that the ECB will need to increase the base rate of interest to control the rising rate of inflation in the eurozone.

There was evidence that the supply chain constraints caused an increase in inflationary pressures. In November 2021, Germany's producer (wholesale) price index increased by 19.2% from the previous year. This was primarily as a result of rising prices for energy, metal and wood. The Bundesbank predicted that the supply chain constraints would not be resolved until the end of 2022.

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Acknowledgements

Figure 1 adapted from https://tradingeconomics.com/germany/business-confidence

Figure 2 adapted from https://tradingeconomics.com/germany/inflation-cpi

Extract A adapted from https://www.ft.com/content/fe2e23ed-95b4-4031-a1c5-0d3a3ae72d6e