Past-paper walk-through

Links between macroeconomic problems and their interrelatedness ▪ 10.2

eXercise

Questions in this set

- 9708/31 N25 Q19 ▪ 1 mark
- 9708/31 N25 Q23 ▪ 1 mark
- 9708/32 N25 Q21 ▪ 1 mark
- 9708/34 N25 Q21 ▪ 1 mark

Question 19

9708/31 N25 ▪ Q19 ▪ 1 mark

19 A country's trade balance has worsened. The country has a fixed exchange rate.

Which additional changes for unemployment and price level are likely to follow?

	the level of unemployment	the price level
A	decreases	decreases
B	decreases	increases
C	increases	decreases
D	increases	increases

Question 19

Solution 19

Answer: **C**

Why

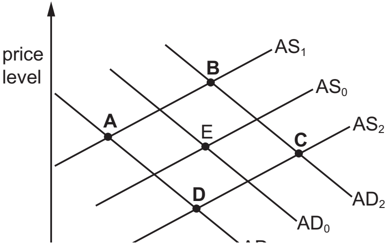
- A worsening trade balance means net exports have fallen, so aggregate demand falls.
- Lower aggregate demand means lower output and so higher unemployment.
- With a fixed exchange rate the currency cannot depreciate to correct it, so the price level falls rather than the rate.

Question 23

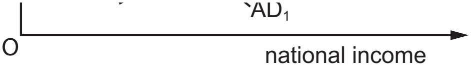
9708/31 N25 ▪ Q23 ▪ 1 mark

23 The diagram shows the aggregate demand, AD, and aggregate supply, AS, curves for an economy. The initial equilibrium is at point E. There is a revaluation of the exchange rate.

If the Marshall-Lerner rule applies, which point on the diagram would show the new long-run equilibrium?



Question 23



Solution 23

Answer: **D**

Why

- A revaluation makes exports dearer abroad and imports cheaper at home.
- Net exports fall, so aggregate demand shifts to the left.
- Output falls and the price level falls – cheaper imports also reduce costs, easing inflation.

Question 21

9708/32 N25 ▪ Q21 ▪ 1 mark

21 Which combination shows the most likely outcome if a government increases the level of direct taxation?

A balance of payments deteriorates and inflation increases

B economic growth increases and balance of payments improves

C inflation decreases and unemployment increases

D unemployment decreases and balance of payments improves

Solution 21

Answer: **C**

Why

- Higher direct taxation cuts disposable income, so consumption and aggregate demand fall.
- Lower demand means less inflation and fewer imports, so the current account improves.
- But growth slows and unemployment rises – the classic conflict between objectives.

Question 21

9708/34 N25 ▪ Q21 ▪ 1 mark

21 What does the Phillips curve show?

A the relationship between economic growth and employment

B the relationship between inequality and income per capita

C the relationship between inflation and unemployment

D the relationship between prices and national income

Solution 21

Answer: **C**

Why

- The Phillips curve plots the rate of inflation against the rate of unemployment.
- The short-run curve shows a trade-off: less unemployment comes with more inflation.
- The long-run curve is vertical at the natural rate, so the trade-off disappears.