Past-paper walk-through

Monetary policy ▪ 5.3

eXercise

Questions in this set

- 9708/11 N25 Q23 ▪ 1 mark
- 9708/12 N25 Q19 ▪ 1 mark
- 9708/12 N25 Q21 ▪ 1 mark
- 9708/14 N25 Q22 ▪ 1 mark
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Question 23

9708/11 N25 ▪ Q23 ▪ 1 mark

23 A central bank increases interest rates to reduce inflation.

When will this policy be most likely to succeed?

A When household spending is inelastic in response to interest rate changes.

B When the country has a floating exchange rate that appreciates.

C When the government has an increasing budget deficit.

D When trade unions demand higher wages to protect the living standards of their members.

Solution 23

Answer: **B**

Why

- Raising interest rates reduces inflation by cutting borrowing and spending.
- That only works if households and firms actually respond to the rate change.
- So the policy succeeds when spending is *elastic* with respect to interest rates, not inelastic.

Question 19

9708/12 N25 ▪ Q19 ▪ 1 mark

19 A central bank is asked by the government to help achieve price stability.

If inflation rises steeply, which policy will **not** be directly within the control of the central bank?

A increasing the rate of interest to reduce consumer spending

B managing a reduction of the money supply

C using credit restrictions to regulate lending by commercial banks to households

D restricting wage increases in the private and public sectors

Solution 19

Answer: **D**

Why

- A central bank controls interest rates and the money supply.
- It does not control taxation or government spending – those belong to the government.
- So a fiscal measure is the one outside the central bank's direct control.

Question 21

9708/12 N25 ▪ Q21 ▪ 1 mark

21 What is an example of expansionary monetary policy?

A the central bank increasing the money supply

B the central bank causing an appreciation of the country's foreign exchange rate

C the central bank increasing controls on credit lending

D the central bank increasing the minimum lending rate of interest

Solution 21

Answer: **A**

Why

- Expansionary monetary policy increases the money supply or lowers the cost of borrowing.
- Increasing the money supply directly is the clearest example.
- Causing the currency to appreciate would reduce demand for exports – that is contractionary.

Question 22

9708/14 N25 ▪ Q22 ▪ 1 mark

22 An economy has both increasing imported raw material prices and demand-pull inflation.

Which combination of policies is most likely to help its government achieve its macroeconomic objective of price stability?

	budget deficit	exchange rate	rate of interest
A	decreases	depreciates	decreases
B	decreases	appreciates	increases
C	increases	depreciates	decreases
D	increases	appreciates	increases

Solution 22

Answer: **B**

Why

- Imported raw material prices rising is cost-push inflation, which shifts AS left.
- Demand-pull inflation shifts AD right.
- So a policy mix must restrain demand while also raising capacity – contractionary demand policy plus supply-side measures.

Question 21

9708/12 J25 ▪ Q21 ▪ 1 mark

21 What is likely to be an expansionary monetary policy?

A a decrease in the availability of credit

B a decrease in the exchange rate

C an increase in government spending

D an increase in subsidies for training

Solution 21

Answer: **B**

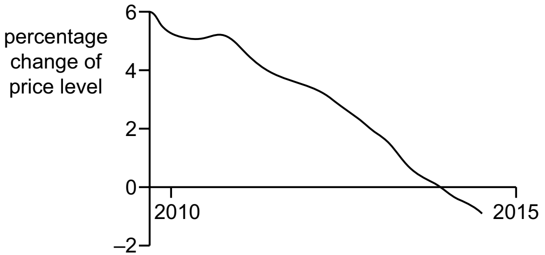
Why

- Expansionary monetary policy makes borrowing easier and cheaper, raising aggregate demand.
- Lower interest rates or greater credit availability both do that.
- Changing government spending is *fiscal* policy, not monetary.

Question 23

9708/1 23 ▪ Q23 ▪ 1 mark

23 In recent years an economy has experienced changes in its price level as shown.



Which government policy is most effective in reversing the trend shown in the price level?

Question 23

A encourage firms to expand production through tax incentives

B introduce an incomes policy to directly control wage increases

C promote household savings by advertising saving schemes

D reduce interest rates and increase money supply

Solution 23

Answer: **D**