Solutions

Marking: **K** = knowledge, **App** = using the data or case, **An** = analysis (explaining each step: cause, then effect), **Ev** = evaluation (a judgement with a reason). In calculations, **M1** is for the method and **A1** for the answer. Longer answers are marked in levels: the top level needs clear analysis **and** a judgement with a reason.

Each answer shows the steps, then the **result**.

2.1

- $2 \div 2$
- **1** point

2.2

- 80×0.25
- \$**20**bn

2.3

- high or rising inflation
- high or rising unemployment, with low growth

3.1

- lower unemployment raises inflation; workers then expect higher inflation and ask for higher wages (An)
- firms' real costs return to normal, so they cut jobs and unemployment goes back to the natural rate (An)
- each attempt shifts the short-run curve up, so in the long run there is no trade-off: only inflation is higher (An)

3.2

- rising incomes raise spending, and part of it goes on imports (An)
- if growth is faster than in trading partners, imports rise faster than exports (An)
- rising prices also make exports less competitive, so the current account balance falls (An)

3.3

(a) $(6 - 2)/2$; **2** points a year

(b) unemployment below the natural rate pushes wages and prices up (An); workers expect higher inflation and bargain for more pay, so the short-run curve shifts up (An); firms' costs rise, so they hire fewer workers (An); unemployment returns to 5% but inflation stays higher, along the vertical long-run curve (An)

(c) points to include:

- in the short run, extra demand can lower unemployment below the natural rate (An)
- but expectations adjust and inflation keeps rising, so the gain is only temporary (An)
- the natural rate itself can be lowered by supply-side policies: training, better job matching (An)
- some evidence shows a flat Phillips curve in recent years, with low unemployment and low inflation (Ev)
- judgement: not with demand policy alone; lasting falls in unemployment need supply-side policy (Ev)

Levels: **top** (6–8) clear analysis, each step explained, and a judgement with a reason; **middle** (3–5) some analysis, judgement weak or missing; **bottom** (1–2) relevant points, little explanation.