Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

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

2.1

- the use by the central bank of the interest rate (and the money supply or exchange rate) to influence aggregate demand (2 for a clear definition; 1 for a partial idea)

2.2

- the interest rate (1)

2.3

- any two of: borrowing is dearer so spending/investment falls; saving is rewarded so consumption falls; the currency rises so exports fall (1 + 1)

3.1 B

- A higher interest rate lowers AD and slows demand-pull inflation

3.2

- *[8]* AO1 1 + AO3 up to 7 (the transmission mechanism) — a higher rate makes borrowing dearer (less consumption and investment) and saving more attractive, and tends to raise the currency (fewer exports, more imports)
- all three lower aggregate demand
- with lower demand, firms raise prices less
- inflation slows

3.3

- *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **For:** the rate is flexible and can be changed quickly, directly affecting borrowing and demand. **Against:** long time lags (a year or more), and in a deep slump even very low rates may not encourage worried firms and households to borrow (a liquidity trap); it cannot fix cost-push inflation easily. Judgement: monetary policy is effective against demand-pull inflation in normal times, but weaker in a slump or against cost-push inflation — it depends on confidence and the cause of inflation