Past-paper walk-through

The Circular Flow and GDP ▪ 2.1

eXercise

Questions in this set

- 2024 Set 2 Q2

Reading the mark scheme

- **B1** a mark that stands on its own – the point is either made or not.
- **M1** a *method* mark: the right approach, even if the number is wrong.
- **A1** an *answer* mark, and it usually needs its M mark first.
- **C1** a working mark on the way to the answer.
- // separates answers the examiner accepts equally.
- **ecf** = error carried forward: a later part is marked on your own earlier answer.
- **owtte** = "or words to that effect" – the wording need not match.

Question 2

2024 Set 2 ▪ Q2

The table provided shows the quantity and price of food and clothing, the only two goods produced and consumed in the country of Maltrose, in year 1 and year 2. Assume that year 1 is the base year.

	Year 1 Price	**Year 1 Quantity**	**Year 2 Price**	**Year 2 Quantity**
Food	$10	12	$13	10
Clothing	$5	16	$4	20

Question 2

(a) Calculate the nominal GDP in year 2. Show your work.
(b) Calculate the GDP deflator in year 2. Show your work.
(c) What was the numerical value of the inflation rate from year 1 to year 2?
(d) Assuming that the expected inflation rate between years 1 and 2 was 3%, were each of the following better off, worse off, or unaffected as a result of the economic conditions between year 1 and year 2?
(d)(i) People living on a fixed income
(d)(ii) Borrowers with fixed interest-rate loans. Explain.

Solution 2

(a)

Mark scheme

- Nominal $\text{GDP}_{Year\,2} = (\$13 \times 10) + (\$4 \times 20) = \$130 + \$80 = \$210$. Award the point for computing price $\times$ quantity for each good in year 2 and summing to \$210.

Solution 2

(b)

Mark scheme

- $\text{GDP Deflator}_{Year\,2} = \dfrac{\text{Nominal GDP}_{Year\,2}}{\text{Real GDP}_{Year\,2}}\times100 = \dfrac{\$210}{(\$10\times10)+(\$5\times20)}\times100 = \dfrac{\$210}{\$200}\times100 = 105$. Real GDP values year-2 quantities at year-1 (base-year) prices \$10 and \$5. Award the point for the correct setup and result of 105.

Solution 2

(c)

Mark scheme

- With the GDP deflator equal to 100 in the base year (year 1) and 105 in year 2, the inflation rate from year 1 to year 2 is $\frac{105-100}{100} \times 100\% = 5\%$.

Solution 2

(d)

Mark scheme

- Stem only — asks whether (i) people on a fixed income and (ii) borrowers with fixed-rate loans were better off, worse off, or unaffected, given actual inflation of 5% versus an expected inflation rate of 3%. Scored in (d)(i) and (d)(ii) below.

Solution 2

(d)(i)

Mark scheme

- People living on a fixed income were worse off. Actual inflation (5%) exceeded expected inflation (3%), so the real purchasing power of their fixed nominal income fell by more than they had anticipated.

Solution 2

(d)(ii)

Mark scheme

- Borrowers with fixed interest-rate loans were better off. Explanation: because actual inflation (5%) exceeded expected inflation (3%), the real interest rate they ended up paying (nominal rate minus actual inflation) was lower than the real rate they had expected (nominal rate minus expected inflation), so the real value/burden of their fixed debt payments decreased by more than expected.