Exercise walk-through

6.1

Output measures, spending and the multiplier / Inflation, unemployment and policy judgement

Pearson Edexcel · International GCSE · Economics

The macroeconomic objectives (2)

- **recovery** : output starts to grow again.
- **demand-pull inflation** : total spending rises faster than the economy can produce, so firms raise prices;
- **cost-push inflation** : firms' costs rise (energy, wages, imported materials) and they pass them on in higher prices. The UK's inflation in 2022 was mainly cost-push: gas and food prices jumped after Russia invaded Ukraine.

Relationships between objectives and policies

- The objectives can conflict, so a policy that helps one may harm another:
- The UK in 2022–2023 shows the first conflict.
- Higher interest rates brought inflation down from 11.1% to 4.0% by the end of 2023, but growth almost stopped and unemployment began to rise.
- China in 2023 faced the other side: with prices flat, it could cut interest rates to support jobs without much risk of inflation.

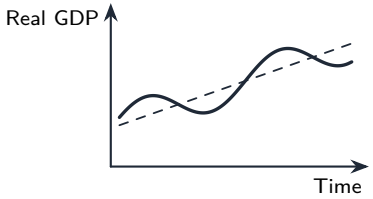
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Common errors (2)

- Saying a **supply-side policy** works quickly. Education, training and infrastructure take years.
- Calling any fall in output a **recession**. A recession is falling **real GDP** for two quarters in a row.
- Naming a policy without its trade-off: every policy helps one objective and may harm another.

Exercises 2.1·2.2

2.1 Define economic growth and name one limitation of GDP as its measure. [2]

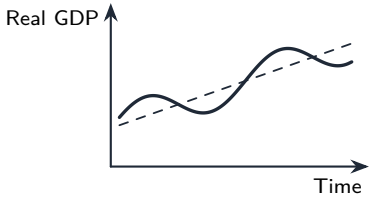


2.2 A CPI basket has weights 50, 30 and 20 with price relatives 110, 100 and 120. Calculate the CPI and the inflation rate. [3]

food: weight 50, relative 110
housing: weight 30, relative 100
transport: weight 20, relative 120

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2.1 An increase in real GDP over a period (1). Limitation: GDP misses non-market activity (or ignores distribution; excludes environmental damage) (1).

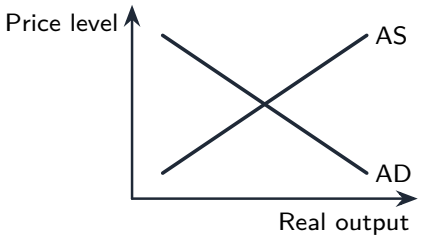
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2.2 CPI $= 0.5 \times 110 + 0.3 \times 100 + 0.2 \times 120 = 55 + 30 + 24 = 109$; inflation $= 9\%$.

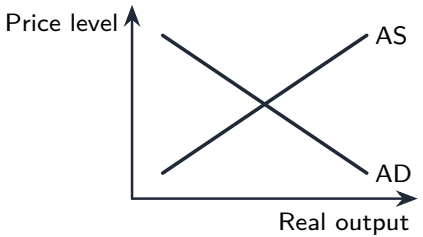
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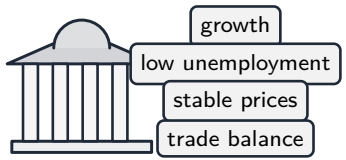
2.3 Demand-pull: the AD curve shifts RIGHT – prices and output both rise. Cost-push: the SRAS curve shifts LEFT – prices rise but output falls.

Exercise 2.4

2.4 Name any four of the five types of unemployment. [2]



2.5 Name the four trade-offs between macroeconomic objectives. [2]

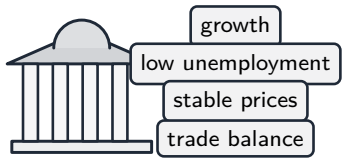


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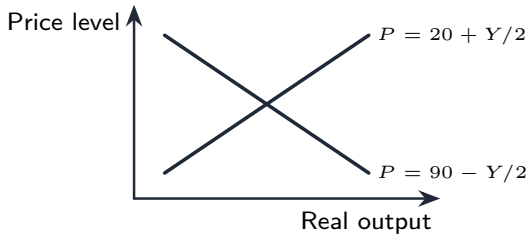


2.4 Any four of: cyclical; structural; seasonal; voluntary; frictional.

2.5 Unemployment and inflation; economic growth and inflation; economic growth and environmental protection; inflation and the current account.

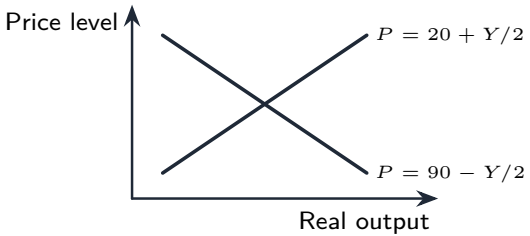
Exercise 3.1

3.1 *(Original.)* On AD $P = 90 - Y/2$ and SRAS $P = 20 + Y/2$, equilibrium is $(70, 55)$. A reflationary policy shifts AD up by 15 at every output. Find the new equilibrium and state the effect on output and the price level. [4]



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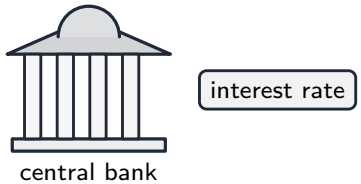
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3.1 New AD: $P = 105 - Y/2$. Setting $105 - Y/2 = 20 + Y/2$ gives $85 = Y$; price level $= 105 - 42.5 = 62.5$. Output rises from 70 to 85 and the price level from 55 to 62.5 – reflation buys output at the cost of inflation.

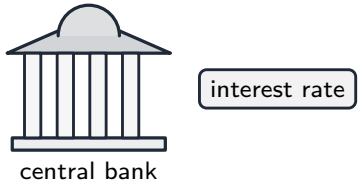
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3.2 *(Original.)* The central bank raises interest rates. Explain the mechanism by which this is expected to reduce inflation, and name one trade-off the policy accepts. [4]



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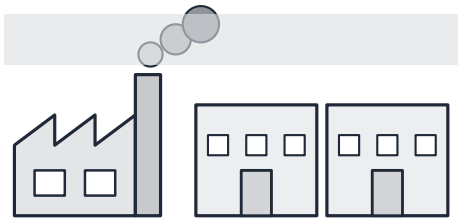
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3.2 Higher interest rates raise the cost of borrowing and the reward to saving: consumption and investment fall, so AD shifts left and demand-pull inflation eases. Trade-off accepted: lower AD raises unemployment and slows growth (the unemployment–inflation trade-off).

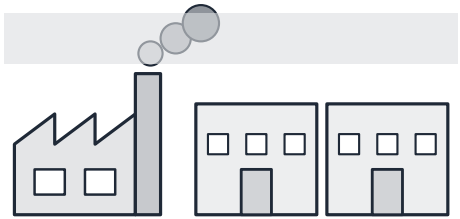
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3.3 The trade-off: growth raises output and incomes but its energy and transport demand increases air pollution – an external cost the market price omits. Policy (any one, explained): a pollution tax internalises the cost; regulation caps emissions; permits fix the total – each lets growth continue while cutting the pollution per unit.

Local review guidance: the CPI shows each weighted product before the sum; the AD/AS solution sets the equations before reading either variable; (R1) trade-off answers NAME both objectives and the direction of the conflict. This is authored classroom guidance.