Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

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

2.1

structural: a long-term mismatch between workers' skills or location and the jobs available, e.g. after an industry declines; cyclical: caused by a fall in aggregate demand in a recession

2.2

labour force = 30 million; rate = $1.8 \div 30 \times 100 = \mathbf{6}\%$

2.3

any two, explained: people on fixed incomes or savers lose purchasing power; uncertainty makes firms delay investment, slowing growth; exports become less competitive if inflation is higher than abroad; menu costs / time spent managing money

2.4

$0.5 \times 110 + 0.3 \times 105 + 0.2 \times 120 = 55 + 31.5 + 24 = \mathbf{110.5}$; inflation = $\mathbf{10.5}\%$

2.5

pushing unemployment below the natural rate raises inflation; workers then expect higher inflation and ask for higher wages, so the short-run Phillips curve shifts up; unemployment returns to the natural rate at a higher inflation rate: no long-run trade-off

3.1

(a) a sustained fall in the general price level

(b) consumers delay purchases, expecting lower prices later; AD falls further, so firms cut output and jobs; a downward spiral of falling prices and spending; the real value of debts rises, so borrowers cut spending and some default; firms' profits fall, so investment falls; interest rates cannot go much below zero, so monetary policy loses power

3.2

award up to [8]: diagram: downward-sloping SRPC with the two points; rising AD lowered unemployment and raised inflation: a short-run trade-off; if 3% is below the natural rate, workers expect higher inflation and demand higher wages; the SRPC shifts up / out; unemployment returns to the natural rate with higher inflation: vertical LRPC; evaluation: if supply-side policies have lowered the natural rate, a low rate could last; Keynesians see more room for demand policy

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