## Solutions

Marking: **K** knowledge, **App** application to the case, **An** analysis (a developed chain of reasoning), **Ev** evaluation (a justified judgement); calculations earn **M1** for the method and **A1** for the answer.

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

**2.1**

- $150\,000 \times 0.05 - 150\,000 \times 0.04$
- $= \$\mathbf{1500}$

**2.2**

- borrowing to buy machines becomes **cheaper** (K)
- so more projects become **profitable**, and firms invest more (An)

**2.3**

any two: the **interest rate**; the **money supply**; the **exchange rate**

**3.1**

**B**

**3.2**

(a)

- $7 - 2 = \mathbf{5}$ percentage points
- $(5 - 3) \div 3 \times 100 = \mathbf{66.7}$ %

(b)

- loan and mortgage repayments **rise**, leaving less **disposable income** (K)
- households with large loans cut spending (App)
- saving earns more **interest**, so some save instead of spending (An)
- borrowing for cars and holidays becomes dearer, so spending **falls** (An)

(c) a developed chain, for example:

- households spend less and firms **invest** less (K)
- total **demand** in the economy falls (An)
- firms find it harder to raise prices; demand-pull inflation eases (An)
- the currency may **rise**, so imports become cheaper, lowering prices of imported goods (App)
- so inflation moves down towards 2 % (An)

(d) for: (An)

- acts on demand quickly to change; the central bank can adjust in small steps
- many households have large loans, so they feel the rise strongly

against: (An)

- a stronger currency makes machinery **exports** dearer, so exporters lose sales and jobs
- if inflation is **cost-push** (oil, wages), higher rates cut output without fixing the cause
- effects take a year or more; alternatives: higher taxes, supply-side policies

judgement: (Ev) for example, a rise is appropriate if inflation comes from strong demand, but it should be modest, combined with supply-side measures, because exporters and indebted households would be hit hard by large rises.

Level 3 (6–8): both sides analysed and a justified judgement. Level 2 (3–5): one side analysed or both explained. Level 1 (1–2): simple points.