Solutions

Marking: **K** knowledge, **App** use of the case or data, **An** analysis (a chain of reasons: cause, then effect), **Ev** evaluation (a judgement with a reason). In calculations, **M1** is for the method and **A1** for the answer; **B1** is an independent mark.

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

2.1

$112.0 \times 1.03 = \mathbf{115.4}$

112 is the index level: prices are 12% above the base year, not 112%

2.2

labour force $4.6 + 0.4 = 5.0$ million

unemployment $\dfrac{0.4}{5.0} = \mathbf{8}\%$; participation $\dfrac{5.0}{7} = \mathbf{71.4}\%$

2.3

$\dfrac{1.06}{1.04} - 1 = \mathbf{1.92}\%$

2.4

(a) frictional

(b) structural

(c) cyclical

3.1

(a) last year $60 + 900 + 60 = £\mathbf{1{,}020}$; this year $66 + 945 + 63 = £\mathbf{1{,}074}$

(b) CPI $\dfrac{1{,}074}{1{,}020} \times 100 = \mathbf{105.3}$; inflation $\mathbf{5.3}\%$

(c) $\dfrac{45}{1{,}020} = \mathbf{4.4}$ points; rent rose only 5%, but its large weight makes it most of the inflation

(d) people switch to items that rise less (substitution); quality improves, so part of a price rise buys a better good

3.2

(a) $u = 4$: $\pi = \mathbf{3.8}\%$; $u = 6$: $\pi = \mathbf{2.2}\%$

(b) this year $3 + 1.6 = \mathbf{4.6}\%$; next year $4.6 + 1.6 = \mathbf{6.2}\%$; holding unemployment below the natural rate makes inflation keep rising: there is no lasting trade-off

3.3

(a) expected $\dfrac{1.05}{1.04} - 1 = +\mathbf{0.96}\%$; actual $\dfrac{1.05}{1.06} - 1 = -\mathbf{0.94}\%$

(b) workers lose and Nimbus gains on wages; Nimbus also gains as a borrower: the loan's real cost falls; the bank loses

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(c) linking removes the risk for workers and may keep staff (App); but Nimbus's costs then rise with inflation even if its prices cannot (An); judgement: agree a link with a cap, e.g. inflation up to 5% (Ev)