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

current: (a), (b), (d), (f)

financial: (c), (e)

2.2

trade balance $300 - 340 + 25 = \mathbf{-15}$

current account $-15 - 10 - 5 = \mathbf{-30}$

2.3

PPP $\dfrac{5.40}{4.00} = \$\mathbf{1.35}$

$\dfrac{1.35}{1.25} - 1$: the pound is cheap by about **8**%

2.4

(a) gains: its whisky is cheaper abroad, or earns more pounds per sale

(b) loses: phones cost more pounds, so it must raise prices or accept lower margins

3.1

(a) trade $-50 + 30 = \mathbf{-20}$; current account $-20 - 15 - 10 = \mathbf{-45}$

(b) $+\mathbf{45}$

(c) $-45 = 180 - I$: $I = £\mathbf{225}$bn

(d) the deficit pays for investment above saving, which can raise future output; it is a worry only if the borrowing pays for consumption or cannot be repaid

3.2

(a) $1.30 \times \dfrac{1.03}{1.06} = \$\mathbf{1.263}$

(b) the trader earns about 3 points more than the loan costs; UIP says the pound should fall by the same 3%, removing the gain, but in the short run it often does not; risk: a sharp fall of the pound wipes out the gain and more

3.3

(a) $\dfrac{40{,}000}{1.20} = £\mathbf{33{,}333}$; $\dfrac{40{,}000}{1.08} = £\mathbf{37{,}037}$

(b) $\dfrac{40{,}000}{1.15} = £\mathbf{34{,}783}$

(c) **4**: the forward costs £1,450 more than today's rate but caps the cost, saving £2,254 if the pound falls to 1.08 (App); unhedged is cheaper only if the pound holds up (An); other choices: local flour, or a price clause with customers (K); judgement, e.g. hedge most of the year's flour, since a small bakery cannot absorb a £3,700 surprise (Ev). **2–3**: options with little use of the numbers. **1**: one relevant point.

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