Question 21 (Answer: **B**)

- When one commodity is 90% of exports, the economy is extremely exposed to its price.
- A fall in the oil price cuts export revenue sharply, so aggregate demand falls.
- Both output and the price level then fall, and the current account worsens.

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Question 16 (Answer: **C**)

- Read where the AD and AS curves cross to find the equilibrium.
- A shift in either curve moves both the price level and real output.
- Whether output or price responds more depends on how steep the AS curve is at that point.

Question 17 (Answer: **A**)

- The aggregate *supply* curve shifts when the economy's capacity or costs change.
- So a change in wage rates, raw material prices, technology or the size of the workforce will do it.
- A change in spending shifts aggregate *demand* instead.

Question 22 (Answer: **C**)

- An increase in the money supply makes credit more plentiful, so the interest rate falls.
- Cheaper borrowing raises consumption and investment.
- So aggregate demand shifts to the *right* while the interest rate falls.

Question 28 (Answer: **A**)

- A depreciation makes exports cheaper in foreign currency and imports dearer at home.
- Read the diagram to see which curve shifted and by how much.
- The trade balance improves only if the volumes respond enough to outweigh the higher import prices.

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<table>
<tr><td rowspan="4">5(a)</td><td>With the help of an AD /AS diagram, explain why two components of AD may increase and consider the extent to which an increase in AD will always lead to inflation.

Follow the point-based marking guidance at the top of this mark scheme and award:
up to 3 marks for AO1 Knowledge and understanding up to 3 marks for AO2 Analysis
up to 2 marks for AO3 Evaluation.

AO1 Knowledge and Understanding (max 3 marks)

An accurately labelled AD/AS diagram e.g., axes labelled price level and GDP showing an increase in AD and the increase in the price level (1) plus two components from consumption, investment, government spending and net exports and briefly explain why each may increase (2 x1)

AO2 Analysis (max 3 marks)

A rise in AD will lead to possible demand-pull inflation (1). However, the extent to which this may occur depends on the position of AD in relation to AS (1). It also depends on the supply side effect of the increase in AD e.g., government spending on subsidies may increase LRAS and therefore minimise any inflationary pressure (1).

AO3 Evaluation (max 2 marks)

For an overall assessment of the possible impacts which may result in inflation or not. Reserve 1 mark for a valid conclusion.</td></tr>
<tr><td>AO1 Knowledge and understanding</td></tr>
<tr><td>AO2 Analysis</td></tr>
<tr><td>AO3 Evaluation</td></tr>
</table>

5(b)	**Assess the view that the effects of a high rate of inflation are always more damaging for consumers than for firms.** Use Table A: AO1 Knowledge and understanding and AO2 Analysis and Table B: AO3 Evaluation to mark candidate responses to this question. AO1 and AO2 out of 8 marks. AO3 out of 4 marks. **Indicative content** Responses may include: **AO1 Knowledge and understanding and AO2 Analysis** For consumers problems include: • A loss of purchasing power that particularly affects fixed income earners and those with weak wage bargaining power • Fiscal drag pulling individuals into higher tax brackets • Shoe leather costs • A loss of consumer confidence particularly at a time of high rates of inflation leading to an increased use of alternative methods of payment **However** • Consumers with debts gain as the value of their debts is eroded with inflation • Consumers with assets gain e.g., house owners For firms problems include: • A loss of sales domestically and overseas due to higher prices / loss of competitiveness • Menu costs • Increased costs of production due to raw material costs and wages rising. • At a time of high inflation, this will lead to a loss of confidence and lower investment • Inflationary noise leading to poor decision making **However** • If it is demand led and sales increase, then firms will make increased profits. • If the price level is rising at a faster rate than production costs then profits will rise. **Level 1 responses** will be assertive and lacking in explanations / mainly descriptive and/or or mainly lacking in relevance to the question. **Level 2 responses** may contain some inaccuracies and may be one sided. Analysis will be explained at least in part and will be largely relevant to the question.

5(b)	**Level 3 responses** will consider alternative policies / concepts etc. and will be balanced. Explanations of points raised will be offered and will be accurate and relevant to the question. **Guidance:** Answers that refer to a moderate or low rate of inflation cannot gain more than mid-level 2 mark. **AO3 Evaluation** That clearly considers and compares both sides of the analysis and reaches a justified conclusion. Accept all valid responses. **A one-sided response cannot gain any marks for evaluation.**
	AO1 Knowledge and understanding and AO2 Analysis
	AO3 Evaluation

Question 19 (Answer: **A**)

- The long-run aggregate supply curve shows capacity, so it can be vertical (classical) or horizontal.
- A Keynesian LRAS is horizontal at low output and then becomes steeper.
- But it can never be *downward* sloping – a lower price level cannot raise capacity.

Question 25 (Answer: **B**)

- Infrastructure investment is government spending, so aggregate demand shifts right immediately.
- It also raises the economy's productive capacity, so aggregate supply shifts right in the long run.
- So output rises on both counts, with less upward pressure on the price level than a demand-only rise.

Question 17 (Answer: **A**)

- Aggregate demand shifting right means more is demanded at every price level.
- That happens if consumption, investment, government spending or net exports rise.
- A smaller budget surplus means the government is injecting more than it withdraws, so AD rises.