

Answer EITHER Question 1 OR Question 2.

If you answer Question 1 put a cross in this box .

Question 1 Aggregate demand in the UK

Extract 1: UK country report

There has been a significant slowdown in household spending as a result of the cooling housing market, although output growth has remained close to trend rates since mid-2004 and into the first quarter of 2005. Nevertheless, inflationary pressures are emerging, suggesting that the economy is operating close to, or slightly above, capacity. Looking ahead, growth is likely to moderate further as export demand from Europe weakens in the near term and as the saving ratio continues to rise. 5

Despite the recent pick-up in inflation, prospects for economic growth have weakened. Therefore it is unlikely that the Bank of England's Monetary Policy Committee will have to raise interest rates to maintain inflation close to its target.

The government deficit was 3% of GDP in the year ending in April 2005 but, in the absence of a rise in taxes, a slowdown in public sector spending will be required if the deficit is going to be reduced. 10

Source: adapted from OECD Economic Outlook No.77, www.oecd.org.uk 24 May 2005

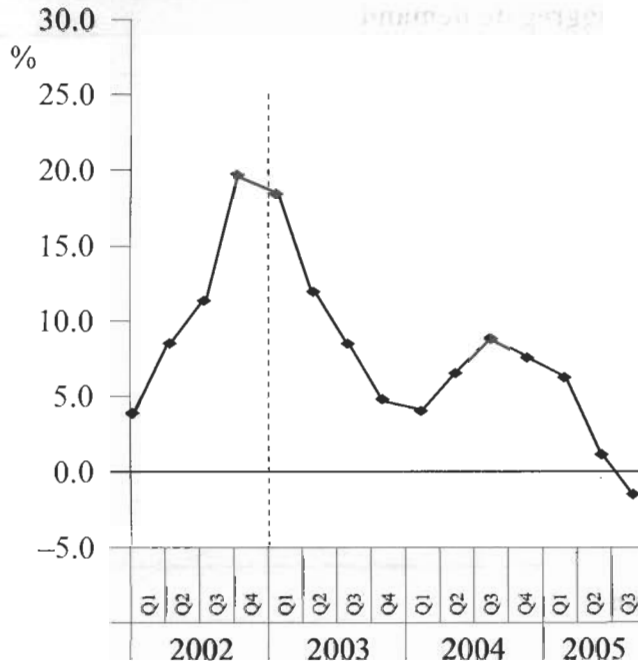
Figure 1: UK aggregate demand and output

	Current prices £ billion	Annual real percentage change	
		2003	2004
Consumption	711.4	3.3	1.7
Government spending on goods and services	220.5	4.7	2.9
Investment	176.6	5.6	4.0
Exports of goods and services	278.2	3.0	2.9
Imports of goods and services	312.0	5.2	3.5
GDP at market prices	1074.7	3.1	2.4

Source: adapted from OECD Outlook 77 and 78 databases

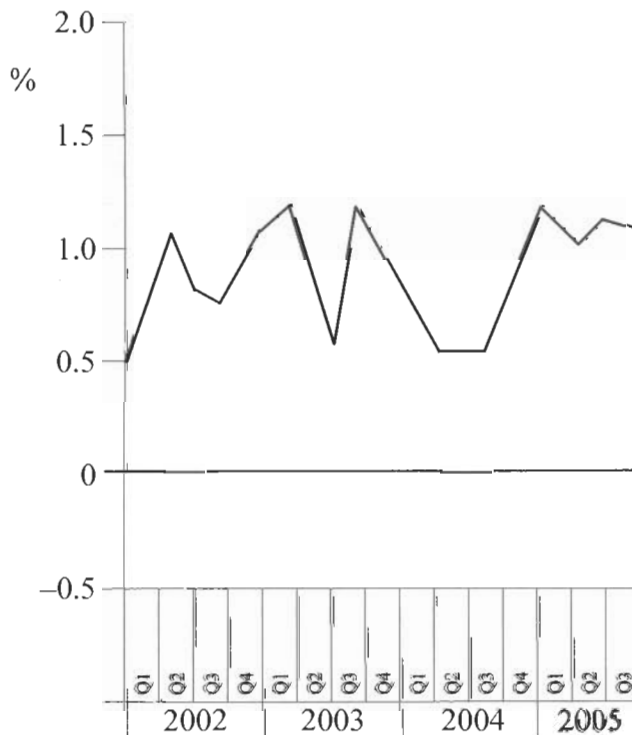


Figure 2: House price changes in the UK (%) Quarterly year-on-year



Source: www.odpm.gov.uk

Figure 3: Changes in consumer spending (%) Three months on previous three months



Source: www.statistics.gov.uk



(a) With reference to Figure 1:

(i) explain what is meant by **aggregate demand**.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(2)

(ii) explain the term **injection**.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(2)



(b) (i) Explain the relationship that might be expected between changes in house prices and changes in consumer spending.

(4)

(ii) To what extent is this relationship supported by the data as shown in Figures 2 and 3?

(4)



(c) Analyse **two** additional pieces of information, **other than those shown in Figures 1–3**, which the Bank of England’s Monetary Policy Committee might consider when making its interest rate decisions.

(7)



(d) Examine the relative merits of monetary and fiscal policy as methods for controlling inflation in the UK in the context of the information provided.

Blank writing area with horizontal lines.



Leave blank

Handwriting practice area with horizontal lines.

(15)

Q1

(Total 40 marks)

OR



If you answer Question 2 put a cross in this box .

Question 2 **Differing growth rates between countries**

Extract 1: **Uneven recovery in the EU**

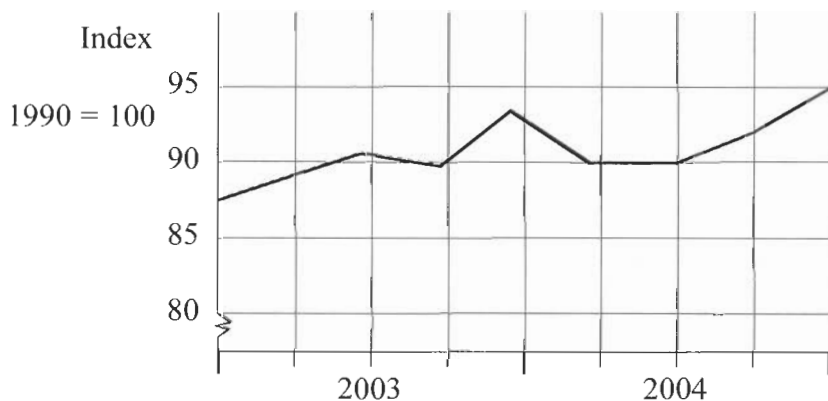
We are not seeing the hoped-for recovery in the EU, outside the UK. Increases in oil prices, the appreciation in the euro against the US dollar, the war in Iraq, and fundamental problems with the operation of the eurozone policies have meant growth has had several false starts.

However, the UK has been more successful in maintaining growth, despite an appreciation in the value of its currency. This is explained by the successful application of supply side reforms. 5

Source: Chairman of OECD webcast speech to introduce *Economic Outlook, No.77*, www.oecd.org.uk, 24 May 2005

Figure 1: **The value of sterling against the euro, 1990 = 100***

Average and equivalent

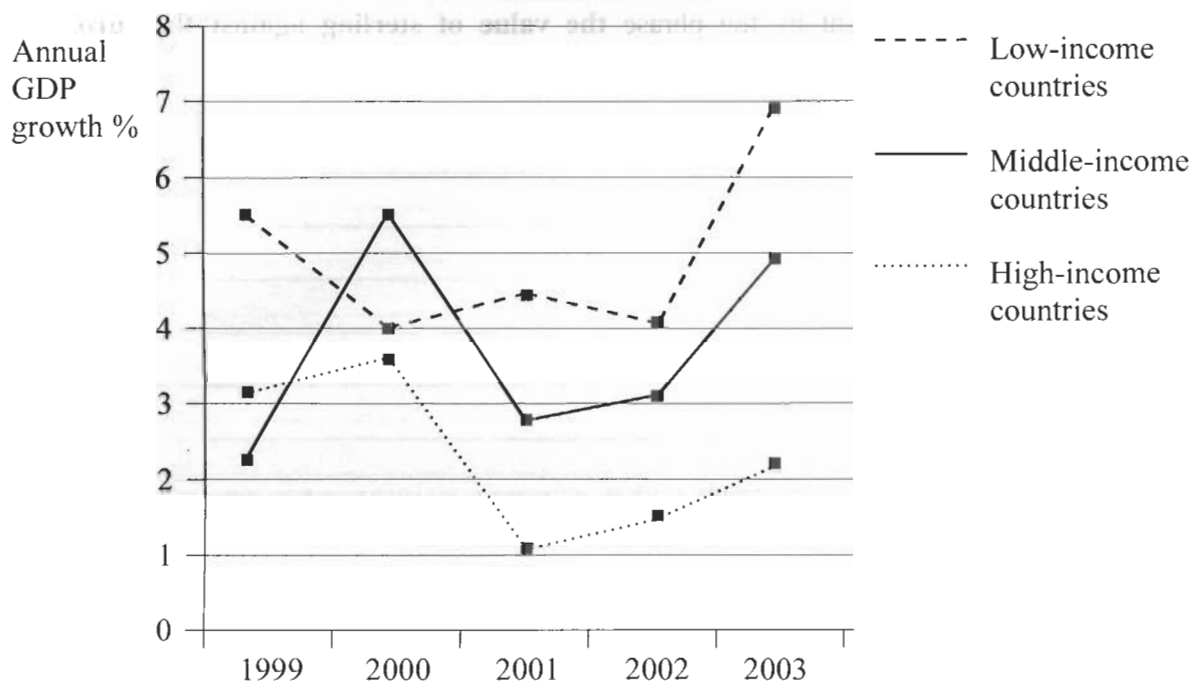


Source: Statistics Interactive Database, www.bankofengland.co.uk

* (Average euro equivalent)

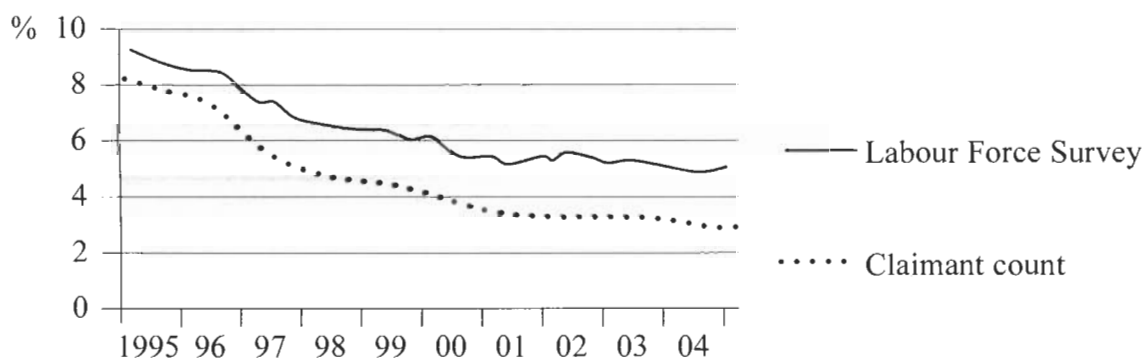


Figure 2: Contrasting growth rates between high, middle and low-income countries



Source: OECD World Fact book, www.oecd.org.uk

Figure 3: Percentage unemployment rates in the UK 1995-2004



Source: May 2005 Inflation Report, www.bankofengland.co.uk



(a) With reference to Extract 1 and Figure 1:

(i) explain what is meant by the phrase **the value of sterling against the euro, 1990 = 100**.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(2)

(ii) estimate the percentage change in the value of the UK pound against the euro between the start of 2003 and the end of 2004.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(2)



(iii) using aggregate demand and supply analysis, outline the likely effect on a country's economic growth rates of an increase in the value of its currency.

(6)



(b) With reference to Figure 2:

(i) contrast the growth rates of the high and low income countries.

(2)

(ii) **apart from fluctuations in exchange rates**, explain **two** possible causes of the differing growth rates that you have identified.

(4)



(iii) examine **one** likely effect on a country's balance of payments of an increase in its growth rate.

(4)

(c) With reference to Figure 3:

(i) distinguish between the *claimant count* and the *Labour Force Survey* rates of unemployment.

(2)



Blank writing area with horizontal lines.



(15)

Q2

(Total 40 marks)

TOTAL FOR PAPER: 40 MARKS

END

Every effort has been made to contact the copyright holders where possible. In some cases, every effort to contact copyright holders has been unsuccessful and Edexcel will be happy to rectify any omissions of acknowledgement at the first opportunity.



BLANK PAGE



BLANK PAGE

