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OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Monday 6 June 2022 – Afternoon

A Level Economics

H460/02 Macroeconomics

Stimulus Material



SECTION A

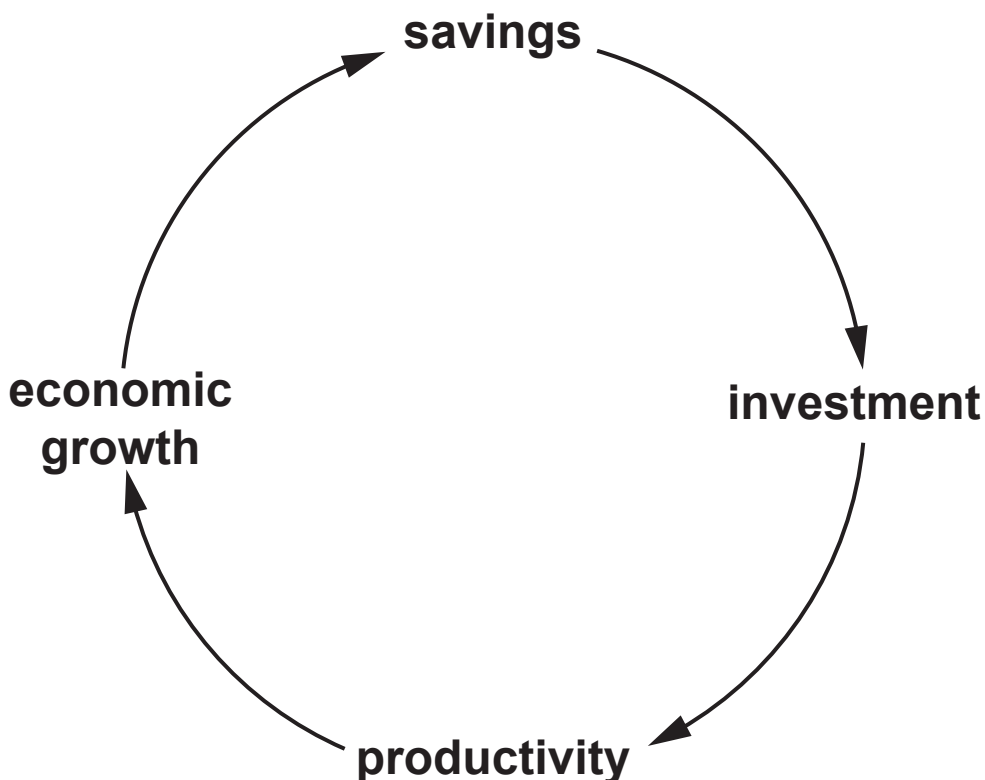
Does rising national debt matter?

At the start of 2020, there were reasons to think there was both a greater need for government borrowing and a reduced concern about rising national debt. There had been a slowdown on the growth of aggregate demand. Although interest rates were low, private sector investment was not making full use of available savings. Fig. 1 shows a virtuous circle between savings and economic growth.

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FIG. 1

A virtuous circle

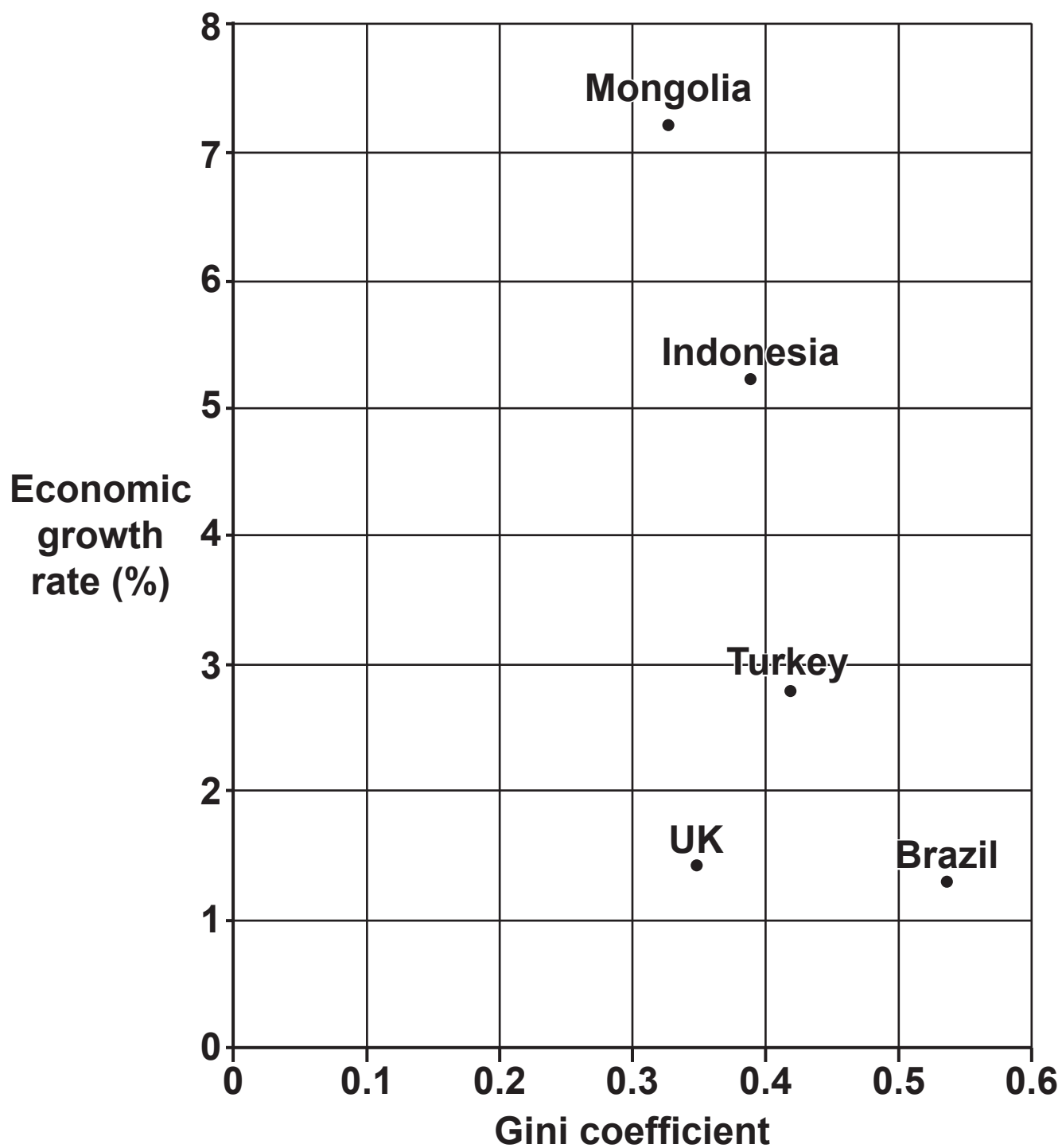


However, more savings, if not used for investment, can slow down economic growth. One cause of an increase in savings can be greater income inequality. Fig. 2 shows the Gini coefficient and economic growth rates for selected countries.

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FIG. 2

The Gini coefficient and economic growth rate for selected countries 2018

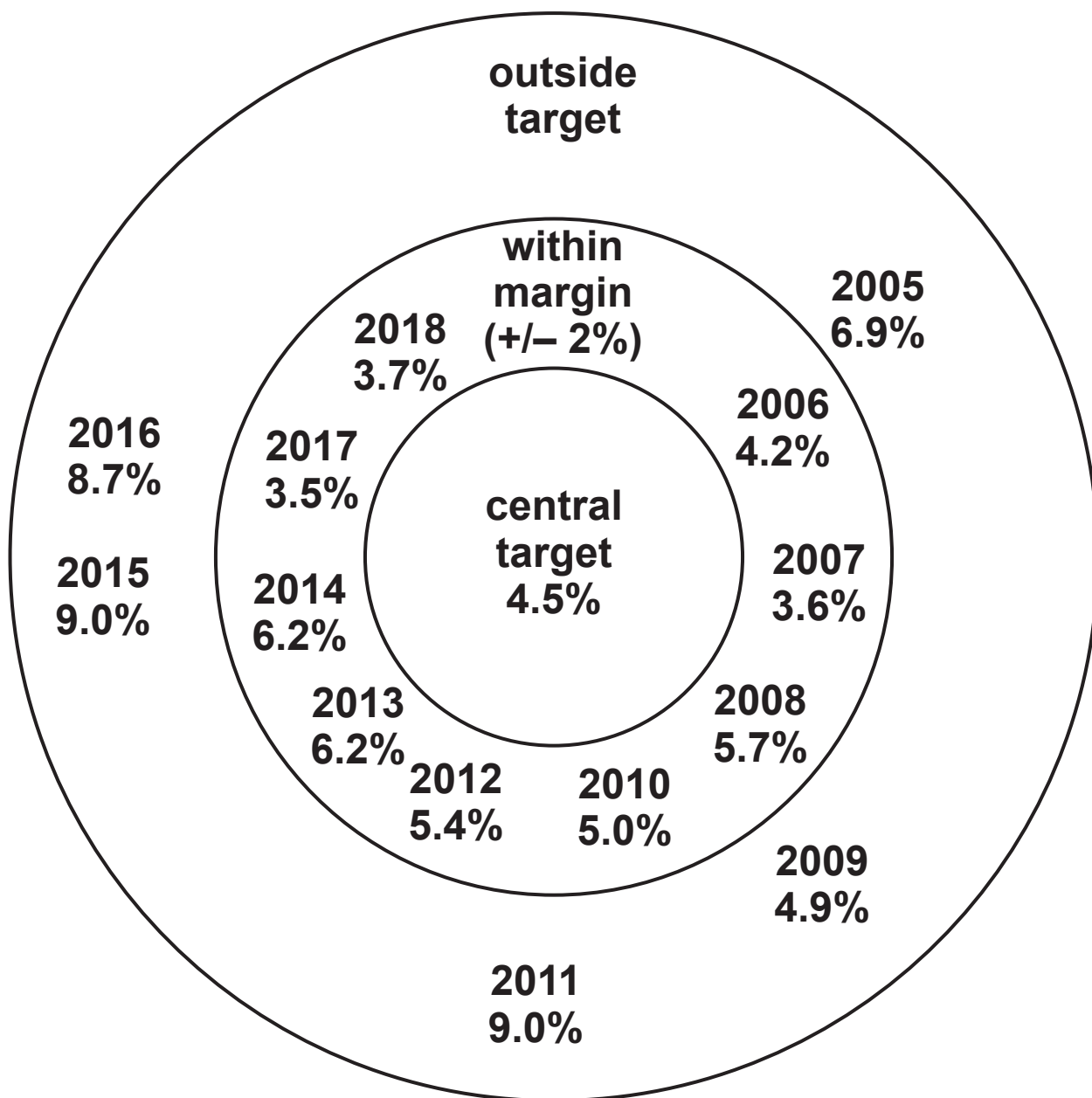


15 The slowdown in aggregate demand in the UK kept the country's inflation rate low. Between January 2019 and January 2020, the Consumer Prices Index increased from 106.3 to 108.2. If a central bank can convince households, workers and firms that inflation will be at a low and stable rate, it can affect
20 expectations and investment in a beneficial way. One way of doing this is by setting an inflation rate target. Of course, trying to achieve an inflation rate target can be affected by adverse demand-side and supply-side shocks. If the target is not met, it can also
25 cause households, workers, and firms to question the central bank's ability to control inflation.

Some governments change their inflation rate target. For example, the Brazilian government between 2005 and 2018 had kept the inflation rate target fixed
30 at 4.5% with a margin of plus or minus 2%. In 2019 however, the target was changed to 4.25% and in 2021 it was set at 3.75%. In both years the margins were set at plus or minus 1.5%. Fig. 3 shows Brazil's inflation rate performance in terms of its target rate over the
35 period 2005–2018.

FIG. 3

Brazil's performance in meeting its inflation rate target



The UK's low inflation rate at the start of 2020 was combined with a low economic growth rate. The economy was experiencing a negative output gap. There was the possibility that higher government spending, financed by borrowing, could increase economic growth. Higher government borrowing, however, increases the national debt, at least in the short run. In January 2020, the UK's national debt was 72% of GDP. An increase in government debt also runs the risk of increasing the inflation rate. This is influenced by, among other factors, who the government borrows from. There is the possibility that higher government debt may make it more difficult to attract lenders who are willing to buy the debt. Japan, however, which had a much higher national debt of 230% of GDP at this date, was not having any difficulty selling its debt.

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