Q21 — Define 'real interest rate' (Extract B, line 5) [3 marks]

The real interest rate is the nominal interest rate adjusted for inflation. It measures the true cost of borrowing and the real return on savings after allowing for changes in the price level.

Q22 — Decrease in the amount of VAT paid on a television [4 marks]

Original VAT rate = 17.5%
New VAT rate = 15%
Price without VAT = £500

VAT at 17.5% = 0.175 × 500 = £87.50
VAT at 15% = 0.15 × 500 = £75.00

Decrease in VAT paid =
£87.50 − £75.00 = **£12.50**

Q23 — Two significant points of comparison between growth of mortgage lending and consumer credit (4 marks)

Both mortgage lending and consumer credit experienced strong growth before 2008, followed by a sharp fall during the financial crisis. For example, mortgage lending fell from high positive growth rates before 2007 to close to zero or negative growth by 2009.

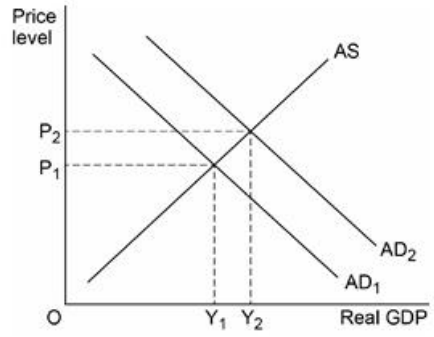
However, after 2012 consumer credit recovered more strongly than mortgage lending. Consumer credit growth rose steadily to around 8% by 2015, while mortgage lending increased more slowly, showing households relied more on unsecured borrowing.

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2 4 ***Extract B*** *(line 8-10) states 'House prices have been rising over the past few years and this has increased homeowners' wealth.'*

Draw an AD/AS diagram to show the impact of an increase in household wealth on both real national income and the price level.

[4 marks]



Accept either LRAS and/or SRAS curve.

First factor:
Extract B states interest rates are very low → borrowing becomes cheaper → cost of servicing debt falls → households are more willing to take out loans → demand for credit increases → household borrowing rises.

Second factor:
Rising house prices increase household wealth → homeowners feel more financially secure → collateral value of property rises → banks are more willing to lend → households borrow more for consumption and housing → household debt increases.

Q26 — Assess the contribution that fiscal policy and monetary policy can make in sustaining the recovery of an economy such as the UK (25 marks)

Introduction:
Extract C states that the UK used both fiscal and monetary policy to support recovery after the financial crisis. The issue is whether these policies can sustainably support long-term economic recovery.

Point 1 — Contribution of monetary policy:
Loose monetary policy supports recovery → Extract C states interest rates were cut to 0.5% and quantitative easing was introduced → lower interest rates reduce the cost of borrowing → consumption and investment increase → aggregate demand rises → helping economic recovery. QE also lowers long-term interest rates → encouraging investment and boosting confidence.

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Evaluation of point 1:
However, very low interest rates may encourage excessive borrowing → Extract B highlights rising household debt → recovery based on debt-fuelled consumption may be unsustainable → when interest rates rise, consumption could fall sharply → limiting long-term recovery.

Point 2 — Contribution of fiscal policy:
Fiscal policy can support recovery through government spending → Extract C states some economists believe more spending on infrastructure and productivity is needed → increased government spending raises aggregate demand → creates jobs → boosts incomes → multiplier effects strengthen recovery → supply-side spending improves long-run growth.

Evaluation of point 2:
However, Extract C also highlights austerity measures to reduce the budget deficit → tight fiscal policy reduces government spending → limits the effectiveness of fiscal stimulus → higher public debt may reduce confidence → crowding out private investment in the long run.

Conclusion:
Both monetary and fiscal policy can play an important role in sustaining economic recovery. Monetary policy is effective in the short run by boosting demand, while fiscal policy is more effective when focused on productivity-enhancing investment. However, reliance on debt-fuelled growth is risky, and long-term recovery depends on balancing demand management with sustainable public finances.

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