IGCSE ECONOMICS · 2.1 GOVERNMENT AND THE ECONOMY · CHAPTER 32 · PAPER 2

Monetary Policy

Topic question sheet L32 | **Total: 30 marks** | **Time: 35 minutes** | **Student Book pp. 259–265**

Instructions: answer **all** questions. Write your answers on lined paper. The marks for each question are shown in brackets: use them as a guide to how much to write.

Calculators may be used. Show your working. Draw diagrams in pencil and label them fully. The mark scheme starts on a new page: do not look at it until you have finished.

Section A: Multiple choice

One mark each. Choose **one** answer: A, B, C or D.

1 Which of the following is most likely to rise if the money supply grows too quickly? **(1)**

A Inflation
B Supply of labour
C Voluntary unemployment
D Current account surplus

2 An increase in interest rates is likely to: **(1)**

A increase inflation
B reduce unemployment
C increase demand for imported cars
D increase savings

3 The interest rate at which a central bank lends to commercial banks is the: **(1)**

A mortgage rate
B base rate
C exchange rate
D inflation rate

4 Quantitative easing involves a central bank: **(1)**

A raising interest rates
B selling government bonds
C buying financial assets from commercial banks
D cutting taxes

Section B: Short answers

Define, state, calculate, draw and explain. Show your working for calculations.

5 Define **monetary policy**. **(1)**

6 If the mortgage interest rate follows the base rate up by 1.5 percentage points, calculate the extra annual interest on a US$120 000 mortgage. You are advised to show your working. **(2)**

7 State **two** roles of a central bank. **(2)**

8 Explain why a rise in interest rates might worsen the current account. **(3)**

© Doshonomics. Written in the style of the exam. Not an official Pearson paper or mark scheme.

Section C: Data response

Read the extract, then answer the questions. Use evidence from the extract in every answer.

Extract: Interest Rates in Valdia

Inflation in the fictional country of Valdia has risen from 2% to 6.5%, well above the central bank's 3% target. House prices rose 14% last year and consumer borrowing grew 11%.

The central bank is considering raising its base rate from 2.5% to 4%. Exporters warn that this could strengthen the currency. A typical household has a mortgage of US$120 000.

Fictional case, written for this sheet.

9 With reference to the extract, analyse how raising the base rate could reduce inflation in Valdia. **(6)**

10 With reference to the extract, evaluate whether the central bank should raise the base rate to 4%. **(12)**

© Doshonomics. Written in the style of the exam. Not an official Pearson paper or mark scheme.

IGCSE ECONOMICS · 2.1 GOVERNMENT AND THE ECONOMY · CHAPTER 32 · PAPER 2

Mark scheme: Monetary Policy

How to mark: Multiple choice, Define, State: 1 mark. **What is meant by** (2): two separate parts to the definition. **Calculate**: working and answer (with units). **Draw** (3): one mark per correct labelled feature. **Explain** (3): 1 for a point, 2 for developing it in context. **Analyse** (6): knowledge 2, application 2, analysis 2. **Assess** (9) and **Evaluate** (12) are marked by levels: choose the level that best fits the whole answer. Indicative content is a guide: credit other valid points.

Section A

1 *Which of the following is most likely to rise if the money supply grows too quickly? (1 mark)*

Answer: A (Inflation). More money chases the same goods.

2 *An increase in interest rates is likely to: (1 mark)*

Answer: D (increase savings). Saving is more rewarding.

3 *The interest rate at which a central bank lends to commercial banks is the: (1 mark)*

Answer: B (base rate). Other rates follow it.

4 *Quantitative easing involves a central bank: (1 mark)*

Answer: C (buying financial assets from commercial banks). Increases the money supply.

Section B

5 *Define monetary policy. (1 mark)*

The use of interest rates and the money supply to control aggregate demand (1).

6 *If the mortgage interest rate follows the base rate up by 1.5 percentage points, calculate the extra annual interest on a US$120 000 mortgage. You are advised to show your working. (2 marks)*

Working: 120 000 × 1.5% (1).

Answer: US$1800 a year (1).

7 *State two roles of a central bank. (2 marks)*

Any two (1 each): implement monetary policy; regulate banks; lender of last resort; control inflation; stabilise the currency; set interest rates.

8 *Explain why a rise in interest rates might worsen the current account. (3 marks)*

Point: higher rates raise the exchange rate (1).

Development: exports become dearer abroad (1) and imports cheaper at home, so exports fall and imports rise (1).

© Doshonomics. Written in the style of the exam. Not an official Pearson paper or mark scheme.

Section C

9 *With reference to the extract, analyse how raising the base rate could reduce inflation in Valdia. (6 marks · K2 · Ap2 · An2)*

Knowledge (2): higher rates make borrowing dearer and saving attractive; AD falls.

Application (2): base rate 2.5% → 4%; borrowing up 11%; mortgages US$120 000 cost US$1800 more.

Analysis (2): households cut spending as mortgage costs rise and borrowing falls; house price boom slows; lower AD brings inflation back towards 3%.

Knowledge 2 · Application 2 · Analysis 2.

10 *With reference to the extract, evaluate whether the central bank should raise the base rate to 4%. (12 marks · levels)*

For: inflation 6.5% vs 3% target; borrowing and house price boom suggest demand-pull inflation; higher rates target that directly.

Against: stronger currency hurts exporters and the current account; higher mortgage costs hit households; may slow growth and raise unemployment; time lags.

Judgement: yes, but perhaps in smaller steps; depends on whether inflation is demand-pull (rate rises work) or cost-push (less effective).

Levels: L1 1–3 · L2 4–6 · L3 7–9 · L4 10–12 (balanced, well-developed arguments using the data throughout, and a justified conclusion that answers the question).

Original practice questions written in the style of the Pearson Edexcel International GCSE Economics (4EC1) papers. This is not an official paper. Unless a source is given, the firms, countries and figures are fictional and made up for practice.

© Doshonomics. Written in the style of the exam. Not an official Pearson paper or mark scheme.