EZY ECONOMICS

# Sample Papers – Set 1

# AQA A Level – Paper 2 (National and International Economy)

## Question Paper

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## Time Permitted: 2 hours

## Paper Instructions:

- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay question.
- There are 80 marks available in this paper
- The mark allocation for each question are shown in the accompanying brackets.
- You may require the use of a calculator to answer certain questions.

## Note from the Editors:

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**SECTION A**

Answer **EITHER Context 1 OR Context 2.**

**EITHER**

**Context 1** **Total for this content: 40 marks.**

**Exchange Rates**

Study **Extracts A, B and C** and then answer **all** parts of Context 1 which follow.

**Extract A: UK Exchange Rate, UK Current Account Balance and UK Inflation Rate (2007-2017*)**

| Year | Pound to Dollar Exchange Rate | UK Current Account Balance (£m) | UK Inflation Rate (CPI) |
|---|---|---|---|
| 2007 | $2.00 | -37,490 | 2.32% |
| 2008 | $1.85 | -55,002 | 3.61% |
| 2009 | $1.57 | -44,831 | 2.17% |
| 2010 | $1.55 | -43,062 | 3.29% |
| 2011 | $1.60 | -29,088 | 4.48% |
| 2012 | $1.58 | -61,433 | 2.83% |
| 2013 | $1.56 | -76,442 | 2.53% |
| 2014 | $1.65 | -84,998 | 1.47% |
| 2015 | $1.53 | -80,233 | 0.05% |
| 2016 | $1.36 | -94,185 | 0.64% |
| 2017 | $1.23 | -94,860 | 2.7% |

**All figures stated are average annual values. *Figures for 2017 represent a forecast.**

**Source: ONS and Bank of England, January 2017**

## Extract B: Brexit: The Falling Pound

The UK exchange rate against the dollar is a floating exchange rate that represents the numbers of dollars that are received when one pound is exchanged on the foreign exchange market at any given time. The value of the exchange rate is determined by the interaction of the demand and supply for pounds. The value of a currency continually fluctuates as traders around the world buy or sell Pounds based on their understanding and confidence on the prospects of the UK economy. For instance, any changes in the economic fundamentals of a country or an uncertain period politically or economically is likely to cause a shift in demand and/or supply of the currency and therefore the value that the currency trades at against another currency.

On the 23rd of June 2016, more than 30 million people made the short trip to local polling stations up and down the country to submit their vote in one of the most important referendums in recent memory for the UK. The decision was a simple binary choice over whether to stay or leave the European Union, but the economic ramifications of this decision was significant. The result – 52% of voters voted for economic change via the exit of the European Union, whilst the remaining 48% voted for political and economic stability by wanting to remain part of the European bloc.

In the build-up to the referendum vote, the pound had risen to $1.50 as traders became more confident and optimistic that the vote would swing towards remaining a part of the European Union. This is because it is seen by many economists and institutions as a political and economic union that helps create stability and certainty for the economy and encourages the amount of commercial activities that firms undertake and conduct in the UK because firms gain access to a larger and more homogenised market to sell goods and services and from the production point of view a greater pool of skilled labour readily available to fill unfilled UK job vacancies.

However, as the night of the 23rd drew in, strong votes for Brexit in the North East of England - a geographical area of the country predicted to favour remaining a member of the EU – started to come in and this caused the pound to fall to $1.43 and it continued to dive throughout the night as the Leave vote secured its lead.

By the morning, the decision for the UK to leave the European Union, caused the pound to slump by 10% to $1.32, a 30-year low and the move in Sterling represented the biggest one day trading fall ever recorded. Markets despise uncertainty and this is exactly what they faced of the morning of the vote as investors believed the vote would result in a sustained period of economic and political turbulence, reduced trade, a shortage in skilled labour for productive areas of the economy and a reduction in competitiveness of one of the UK's largest and most important sectors of the economy – the financial sector.

The value of the pound has been affected through two different channels. Current investors in the UK continue to sell-off their UK holdings, creating a surplus of pounds on the foreign exchange market. At the same time, the protracted negotiation process between the UK and the EU has continued to put underlying pressure on the pound as potential future investors into the UK are discouraged, decreasing the number of pounds that investors wish to hold.

**Source: News Reports, January 2017**

## Extract C: The Harsh Economic Reality of a Weak Pound

The economic consequences of the fall in the value of the pound on the overall performance of the UK economy has been debated by many economists who stand by contrasting economic schools of thought. Traditional economic theory suggests that as the value of a country's currency falls, the competitiveness and trade performance of that country should improve, as the relative price of domestically produced exports and foreign produced imports favourably change to improve a country's terms of trade and help a country achieve a more sustainable rate of economic growth.

In 2016, the UK recorded the highest annual growth rate of any other leading developed and industrialised country included in the G7, at a 1.8% expansion on 2015’s figure. The UK retail sector continued to report strong figures - 4.3% year-on-year growth in retail sales over the crucial festive period. The UK labour market remained strong with wage growth at 2.4% and employment rate remained at a record high of 74%. These figures appear to suggest that the competitive boost that a weaker pound grants the UK has provided the UK with an economic boost and has not significantly dented the confidence of economic agents, despite a hovering cloud of looming business and political uncertainty in the form of Brexit.

On the other hand, some other important economic indicators have performed worse than expected over this period signalling this will be just a short-term boost as the weaker pound is effectively a one-time drop. This reflected by the fact that inflation has jumped rather than gradually rise to a two-year high at 1.6%. The trade deficit with the rest of the world has widened, as import growth has exceeded export growth, contributing to a balance of payments deficit of 6%. Public finances have also worsened as the government has been required to borrow more to cover the weakened in flow of tax receipts. The raw economic data suggests that the long-term outlook for the economy is weak in a post-Brexit world.

The growth forecasts for the UK post-2016 is less optimistic with the IMF and Bank of England, which both predict a sharp drop off in economic growth in the coming years to 2020. Why might this be the case? Well the onset of inflation imported into the country through the soaring price of raw materials and commodities priced in dollars, takes hold of a country and erodes the competitive advantage that a weaker currency may generate. Higher import prices due to the falling pound will push up inflation to above 2.5% in each year until 2020 - the longest period of inflation above the Bank’s stable 2% inflation target. If the growth in prices outstrips the growth in wages, households' purchasing power will slow and consumer spending, contributes to thirds of a country’s GDP, will slow. The loss of economic momentum is predicted to continue to squeeze consumes living standards, push inflation higher and a create a self-fulfilling wave of pessimism amongst firms, which means wage growth is limited and hiring decisions are scrapped or delayed.

However, some economists have pointed to the fact that Brexit will create a trade-off for the UK economy as the fall in the pound reflects a fall in a currency that was previously overvalued which encourage the economy to transition from a consumption fuelled economy to a production based economy.

**Source: News Reports, January 2017**

**Q1**

Using the data in **Extract A**, calculate, to 1 decimal place, the percentage change in the average annual pound to dollar exchange rate from 2008 to 2016.

**[2 marks]**

**Q2**

Explain how the data in **Extract A** show a decline in investor confidence in the UK economy following the UK's decision to leave the European Union on the 23rd of June.

**[4 marks]**

**Q3**

**Extract B, (lines 26-28)** explains that following the UK's decision to leave the European Union, the Pound fell from $1.50 to $1.32 overnight.

With the help of a diagram, explain how the decision of the UK to leave the European Union has resulted in a weaker pound.

**[9 marks]**

**Q4**

In **Extract C**, **(lines )** states that the 'long-term outlook for the UK economy is weak in a post-Brexit world' despite the short-term performance of the UK economy.

Using the data in the extracts and your own economic knowledge, evaluate the macroeconomic consequences of a fall in the value of the pound for the UK economy.

**[25 marks]**