2.7 Aggregate Demand: Components and Determinants: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for extended responses and the essay question. Time guidance: 10 minutes.

1 Disposable income and UK household consumption: explain how a rise in household disposable income affects consumer spending, naming the mechanism and likely magnitude qualifier.

(Total for Question 1 is 3 marks)

2 Retained profits and investment: explain why a higher level of retained profits in firms might increase aggregate investment in the UK without any change in bank lending conditions.

(Total for Question 2 is 2 marks)

3 Interest rates and consumer spending in the UK: explain two channels by which a fall in interest rates can increase consumption.

(Total for Question 3 is 3 marks)

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Mark scheme · 2.7 Aggregate Demand: Components and Determinants: 10-minute Pack

Question 1

a rise in disposable income increases households' ability to spend, raising consumption	**M1**
developed: the increase in consumption depends on the marginal propensity to consume (MPC), so only a proportion of the income rise is spent	**A1**
may note that the effect is larger where MPC is high, smaller where households save more or pay down debt	**A1**

Answer: Higher disposable income raises consumption, but the effect is limited by the MPC, so only a fraction of extra income is spent.

Question 2

retained profits provide an internal source of finance, reducing firms' reliance on external borrowing	**B1**
with more internal funds, firms can finance investment projects that raise capital spending and hence aggregate investment	**B1**

Answer: Higher retained profits raise internal funds available for capital projects, so firms invest more even if bank lending conditions are unchanged.

Question 3

lower interest rates reduce the cost of borrowing so households take more loans for big-ticket items, raising consumption	**M1**
developed: lower rates also reduce the return to saving, encouraging spending instead of saving	**A1**
allow further development: lower mortgage rates increase disposable income for mortgagors, or asset price rises via lower rates raise perceived wealth and spending	**A1**

Answer: A fall in interest rates raises consumption by reducing borrowing costs and by lowering the incentive to save; it can also raise real disposable income for mortgagors and boost wealth effects.

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