2.7 Aggregate Demand: Components and Determinants: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 20 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for extended responses and the essay question. Time guidance: 20 minutes.

1 Aggregate demand identity in the context of the UK economy: state the AD equation and name each component.

(Total for Question 1 is 2 marks)

2 Wealth effects and household spending in the UK: define the wealth effect and explain how a fall in house prices might affect consumption.

(Total for Question 2 is 2 marks)

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3 AD curve shift diagram: UK scenario where the Bank of England cuts interest rates by 0.5 percentage points. Identify which AD component is primarily affected, indicate the direction of the shift of the AD curve, and explain why. Draw an AD curve diagram showing labelled axes, the initial equilibrium and the new equilibrium after the shift.



(Total for Question 3 is 6 marks)

4 The accelerator effect for UK investment: state the accelerator principle and give a brief numeric example showing how a 2% rise in demand could cause a larger percentage change in investment if the capital output ratio is 4.

(Total for Question 4 is 2 marks)

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Mark scheme · 2.7 Aggregate Demand: Components and Determinants: Test Pack

Question 1

AD = C + I + G + (X - M) **B1**

names of components: C = consumption, I = investment, G = government spending, X = exports, M = imports (so X - M = net exports) **B1**

Answer: AD = C + I + G + (X - M); C is consumption, I investment, G government spending, X exports, M imports.

Question 2

definition: the wealth effect is the change in consumption resulting from changes in the value of household assets such as housing or financial assets **B1**

explanation: a fall in house prices reduces perceived wealth and may lead households to cut spending, lowering consumption **B1**

Answer: The wealth effect is how asset price changes alter spending; a fall in house prices reduces perceived wealth and tends to lower consumption.

Question 3

identifies the components primarily affected: C and I (consumption and investment) due to lower borrowing costs and reduced incentive to save **B1**

states the AD curve shifts right (AD1 -> AD2), increasing real GDP and the price level **B1**

explains mechanism: lower interest rates reduce cost of credit, increase mortgage disposable income, encourage consumer durables and business borrowing for capital, raising C and I and hence AD **M1**

developed explanation: mentions MPC/accelerator or wealth effects or that the magnitude depends on levels of spare capacity and confidence **A1**

diagram credit: correctly labelled axes and AD curves with arrow showing rightward shift **M1**

diagram credit: initial equilibrium labelled and new equilibrium labelled with PL and Y changes shown **A1**

Answer: Primary components: C and I. AD shifts right from AD1 to AD2 because cheaper borrowing and higher disposable income for mortgagors boost consumption and investment; diagram shows AD rightward shift, labelled axes, E1 and E2, PL1/PL2 and Y1/Y2.

Question 4

statement: the accelerator says investment depends on changes in output, so a rise in demand leads firms to raise investment to expand capacity **B1**

example: with capital output ratio 4, a 2% rise in demand implies roughly 8% additional investment demand (2% x 4 = 8%) **B1**

Answer: Accelerator: investment responds to changes in output. Example: 2% demand rise times capital output ratio 4 implies about an 8% rise in investment demand.

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