



**GCE A LEVEL**

A520U20-1



**MONDAY, 6 JUNE 2022 – AFTERNOON**

**ECONOMICS – A level component 2**  
**Exploring Economic Behaviour**

2 hours 30 minutes

### **ADDITIONAL MATERIALS**

A calculator.  
A WJEC pink 16-page answer booklet.

### **INSTRUCTIONS TO CANDIDATES**

Use black ink or black ball-point pen.  
Answer **all** questions.

### **INFORMATION FOR CANDIDATES**

The number of marks is given in brackets at the end of each question or part-question.  
You are reminded of the necessity for good English and orderly presentation in your answers.

Answer **all** questions.

### 1. The only way is up?

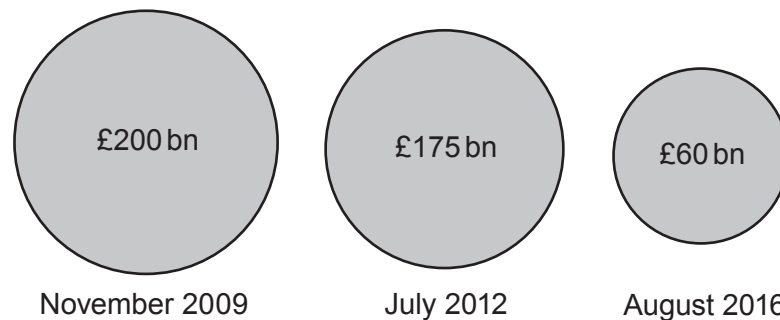
Housebuilders such as Bovis Homes reported record profits in 2018 as the UK housing market continued to expand. Bovis sold 3% more houses in 2018 than in 2017. Profits were also boosted by increased efficiency, which reduced fixed costs.

5 Profits at Bovis in 2018 reflected a long-running rise in average UK house prices, driven by a number of factors. According to Bovis, 'customer demand for new homes [was] supported by attractive mortgage finance and government initiatives to support first-time buyers'.

10 Prices over the last 10 years have also been driven up by foreign investment; one consequence of the UK's persistent current account deficit has been overseas investment into UK property of over £30 bn per year. This has increased house prices in London by over 20% in the last 15 years.

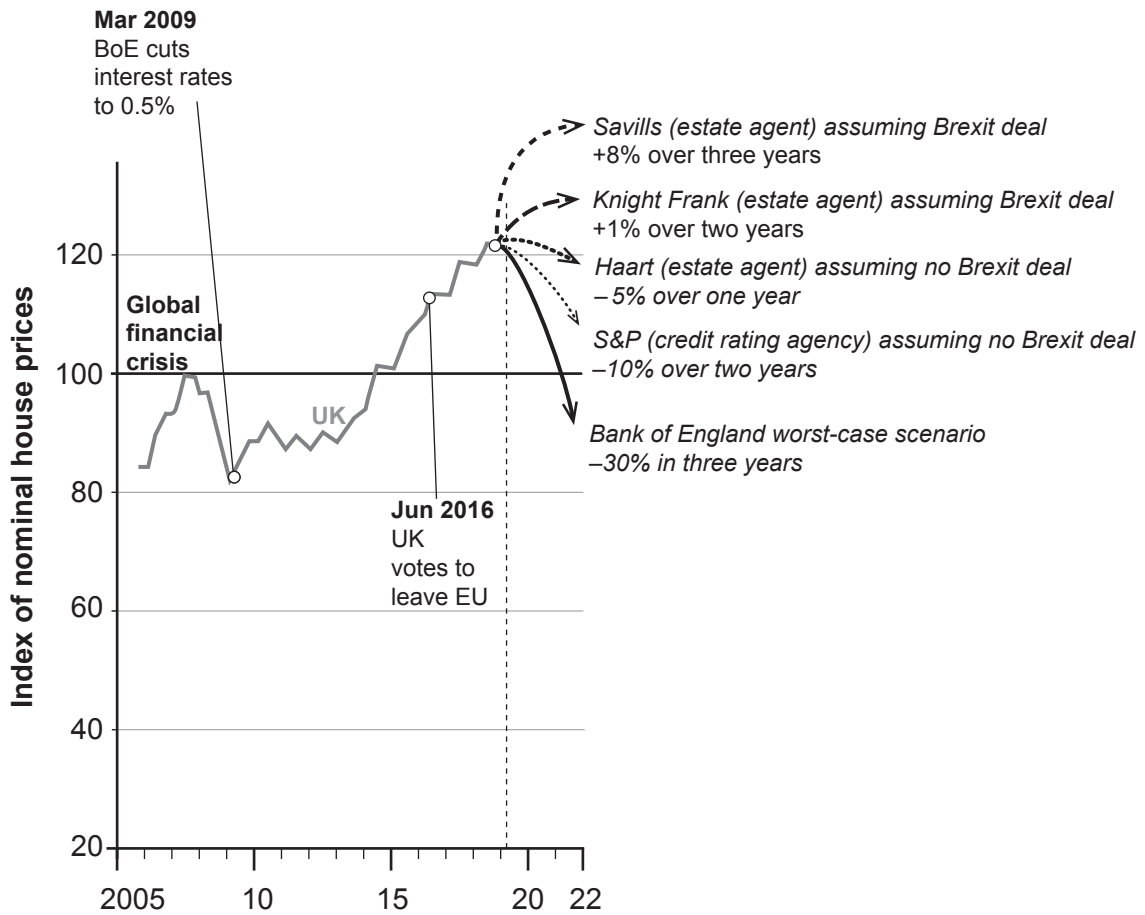
Mortgages in the UK remain cheap partly as a result of the Bank of England's QE (quantitative easing) programme (**Figure 1**), which was further expanded after the results of the Brexit vote in 2016.

**Figure 1: UK injections of QE**



15 This has meant that house prices continued to rise, although there was a fall in some areas and for some property types early in 2019. Some commentators suggest that this may be the beginning of a sharp drop in house prices (**Figure 2**), especially with the Bank of England suggesting that it may begin the process of reversing QE once interest rates rise to 1.5%.

**Figure 2: UK House price forecasts**



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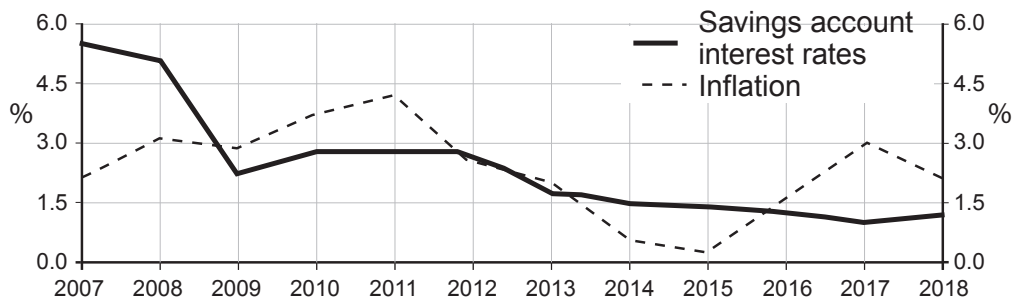
20 QE has been a controversial policy. The Bank of England has argued that the initial £200 bn QE programme increased real GDP by 1.5–2 percentage points and increased inflation by 0.75–1.5 percentage points and that the effects of the 2007–08 financial crisis would have been much worse without it. Others argue that the main effect has been on asset prices (**Figure 3**) and government bond yields and that there is little evidence that the cash has made it through to the wider economy, instead encouraging the sort of speculative behaviour that led to the financial crisis in the first place. Critics also argue that QE has reduced interest rates for savers (**Figure 4**) which has led some to invest in riskier assets than they would have done in normal times.

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**Figure 3: FTSE 100 (Index of UK share prices) (1984=1000)**



**Figure 4: Savings Account Interest Rates vs Inflation (CPI) (%)**



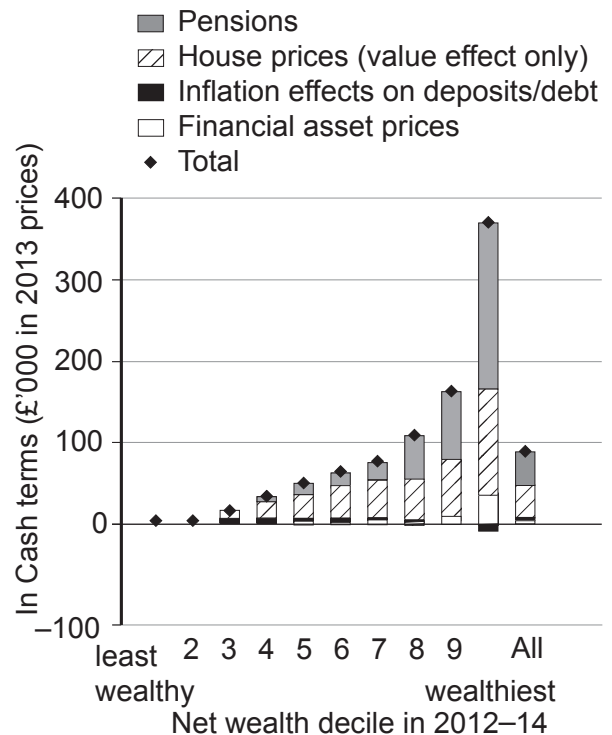
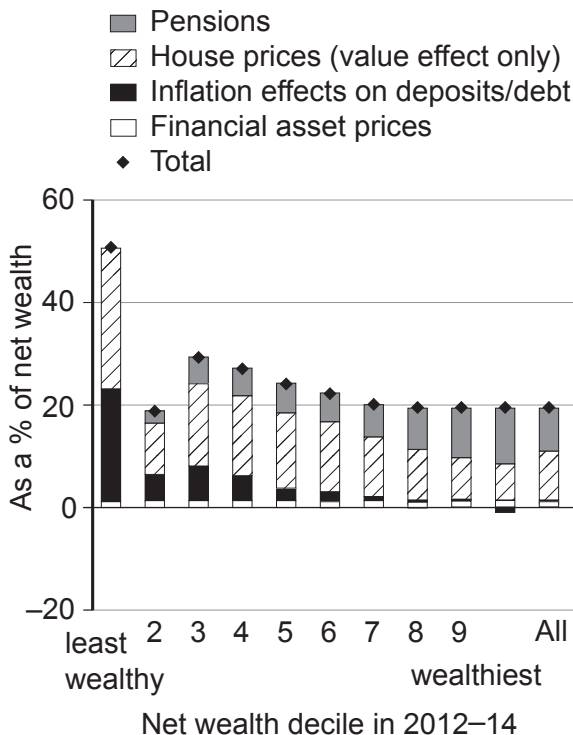
The Bank of England also argues that QE reduced inequality in the UK (**Figure 5**), although the effects have clearly been mixed. The impact on the rental sector hasn't helped, with average private sector rents unaffordable for average working families across half of the UK. Recent research by Shelter (a charity for the homeless) showed that 38% of families with children who are renting privately have cut down on buying food to pay their rent. This issue has led a number of politicians to call for maximum rents to be introduced in the UK, although critics of the scheme say that such schemes simply cause private landlords either to sell (reducing house prices for middle income earners) or to cut back on investments such as home improvements.

**Figure 5: Impacts of QE on household wealth**

QE effects: those on lower incomes saw a bigger proportional rise in net wealth ...

... but wealthier households saw much larger cash gains

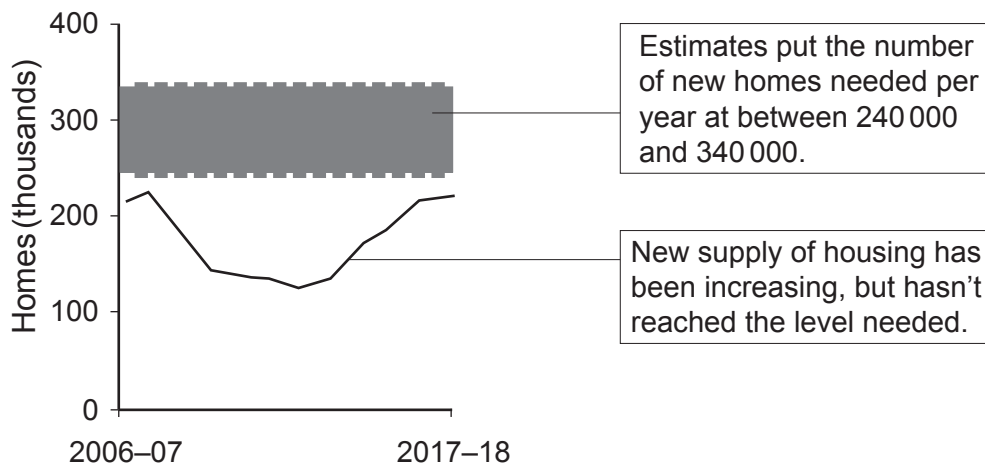
Average cumulative real effect of changes in monetary policy on net wealth, 2007 to 2012–14



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Some hope for slower house price increases has come from the government's attempts to encourage more housebuilding, especially in the south-east. However, attempts to increase supply have run into a number of difficulties. Restrictions on housebuilding in rural areas have been one factor and a recent report analysing housebuilding companies looked in detail at how these companies deliberately build slowly to keep house prices high in order to maximise their profits from a housing development. These factors have meant that in spite of major efforts to increase housebuilding, demand is still above supply (**Figure 6**).

**Figure 6:** UK housing demand and housebuilding

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The Government acknowledged in December 2018 that the private sector would be unlikely to build enough homes to meet demand, and critics argued that cuts in funding to local government and limitations on their ability to borrow would restrict the amount of social housing that could be built.

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The direction of house prices may also depend on Brexit and the nature of it. On the one hand, Brexit might cause the supply of skilled construction workers from abroad to fall, impacting supply. On the other hand, reduced inward migration might mean a fall in the demand for housing. Mark Carney, the former Governor of the Bank of England, suggested that in a worst-case no-deal Brexit scenario, house prices could fall by a third, well and truly ending the housing bubble.

- (a) Using a revenue and costs diagram and with reference to the data, outline why Bovis Homes' profits rose in 2018. [6]
- (b) Explain the link identified in the data between the UK's balance of payments and house prices in the UK. (lines 7–10) [6]
- (c) With reference to the data and using a diagram, discuss whether the Government should introduce maximum rents in the UK rental market. [9]
- (d) Based on the information available in the data (written in March 2019), discuss whether, at that time, house prices were more likely to rise than fall. [8]
- (e) With reference to the data, explain how the Bank of England's QE programme affects households **and** discuss the extent to which it has been beneficial for them. [11]

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## 2. Australia – out on its own

The last time Australia suffered a recession, the Internet did not exist and people still bought CDs, with Australia even avoiding the worst of the financial crisis of 2008–09. Public sector debt is only 41% of GDP and the healthcare and welfare systems are the envy of many other developed economies. Australia has an HDI of 0.939 and a GDP per capita of \$53 800 – both higher than the UK.

Australia is rich in natural resources and is a major exporter of iron ore, liquefied natural gas (LNG) and coal, as well as agricultural products. Although agriculture and natural resources are only 3% and 5% of GDP respectively. China is Australia's top trading partner and the biggest buyer of its iron ore. However, with the Chinese economy slowing, economic growth in Australia is threatened. Indeed, by the end of 2018 there was concern that Australia was in trouble having entered a 'per capita recession'. Growth in the economy was subdued, reflecting slow-growing household spending and a reduction in investment in housing.

### Extract 1: The Australian economy in 2018

- Australia's economy slowed from 4% annualised growth at the start of 2018, to around 1% growth in the second half
- Growth of 2.3% in 2018 was below forecast and placed more pressure on the central bank to cut interest rates
- Australia's economic output shrank 0.2% per capita in the fourth quarter of 2018, after a 0.1% decline in the third

Australia's Treasury Secretary Phil Gaetjens gave an optimistic assessment of the economy, highlighting a growth in mining output, unemployment at a 6-year low and the government's budget returning to surplus in 2019–20. However, he went on to say that the economic outlook was complicated by the prolonged drought in the eastern states and the growing risk to consumption and investment if banks excessively tighten their lending following the Royal Commission on Banking's report into banking misconduct (**Extract 2**). "With income growth expected to increase gradually, household consumption is expected to continue to support economic growth" Mr Gaetjens said. However, because consumer spending was forecast to rise faster than wages, the household savings ratio was expected to decline further. (**Figure 1**).

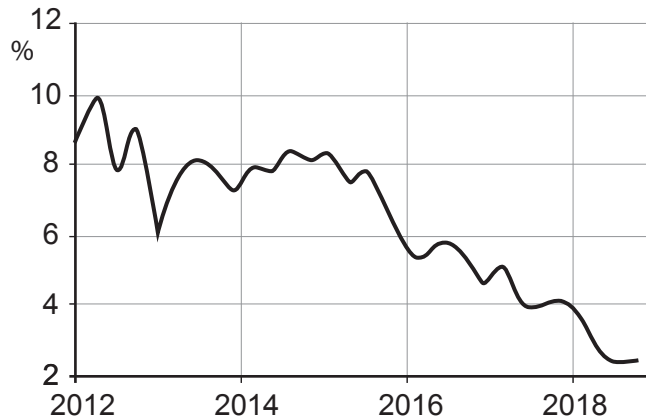
### Extract 2: Royal Commission report into Banking

The recent Royal Commission report into misconduct in the banking and financial services industry followed revelations in the media of a culture of greed within several Australian financial institutions.

The report exposed several scandals, including billing the dead for financial advice, deliberately misleading regulators, lending to those with no capacity to repay, and the profit-motivated selling of misleading financial advice and unnecessary insurance products. However, critics have warned that the Royal Commission has failed to recommend major structural changes or be tougher on individuals and banks that ought to be criminally prosecuted.



**Figure 1: Household savings ratio (Savings as a percentage of GDP)**



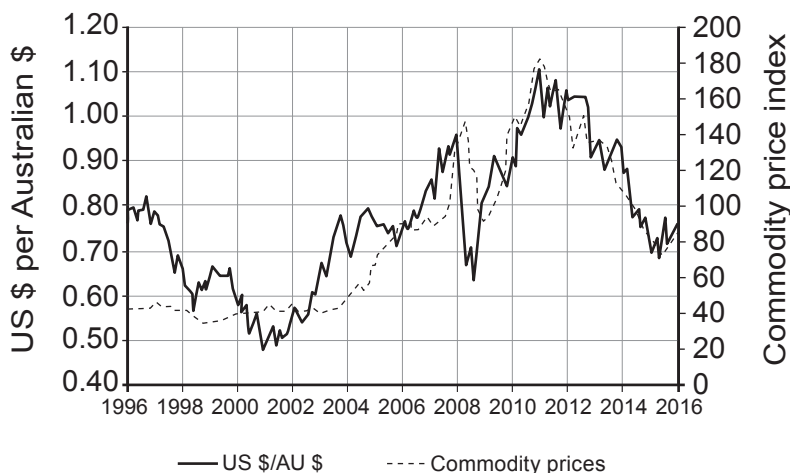
25 The savings ratio is also affected by asset prices. When asset prices are rising people tend to save a smaller proportion of their income, but the reverse happens when asset prices are falling – people become more cautious and save more of their income. The housing market in Australia was weak in 2018 with house prices falling in some areas. By the end of 2018 average Australian house prices were down by 3.5% from their peak.

30 While this can be good news from an affordability point of view, it can also be bad news for consumer spending going forward. However, most households do not immediately change their consumption in response to short-term changes in their wealth according to the governor of the central bank. He also recently suggested interest rates would stay at their record low of 1.5% for the foreseeable future.

35 The value of Australia’s coal exports had been forecast to decline sharply over the next 18 months as coal prices fell by 25%. The value of iron ore export earnings was also forecast to decline. On the other hand, the value of Australia’s LNG exports was forecast to increase and to overtake coal as Australia’s second highest resource export in 2018–19.

40 Like Australia, many developing countries are also well endowed with natural resources such as oil, gas and minerals. However, many suffer from a ‘resource curse’ tending to have lower growth rates and levels of economic development. Even Australia isn’t immune with a clear correlation between commodity prices and exchange rates (**Figure 2**) harming their international competitiveness.

**Figure 2: US \$ per Australian \$ and commodity prices**



Nevertheless, with almost 40 years without a recession, Australia has apparently avoided the resource curse. Clearly it remains, at least for the moment, out on its own.

- (a) With reference to **Extract 1**, outline the difference between a GDP recession and a 'per capita' recession. [4]
- (b) Discuss the possible effects of the changes in the household savings ratio shown in **Figure 1** on Australian households and the Australian economy. [8]
- (c) Based on the information available in the data (written May 2019) assess the extent to which consumer spending in Australia was likely to continue to grow. [10]
- (d) With reference to **Extract 2**, explain the need for regulation of financial systems. [8]
- (e) To what extent is being 'well endowed with natural resources' (line 38) always a barrier to economic development? Use the data and your own knowledge to support your answer. [10]

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