Cambridge International AS & A Level

**Cambridge International Examinations**
Cambridge International Advanced Subsidiary and Advanced Level

**ECONOMICS** **9708/22**

Paper 2 Data Response and Essay (Core) **October/November 2014**

**1 hour 30 minutes**

No Additional Materials are required.

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**READ THESE INSTRUCTIONS FIRST**

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

**Section A**
Answer this question.
Brief answers only are required.

**Section B**
Answer any **one** question.

You may answer with reference to your own economy or other economies that you have studied where relevant to the question.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **4** printed pages and **1** Insert.


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## Section A

Answer this question.

### United States hints again 'China is a currency manipulator'

**1** The US Treasury regularly reviews the exchange rate policies of nine economies that account for 70% of US foreign trade, with most of the focus on China, the world's second largest economy.

The Treasury welcomed gains in the value of the Chinese yuan, but said the currency remains 'significantly undervalued'. This undervaluation gives China a large advantage in its bilateral trade with the US. However, the Treasury declined to accuse China of currency manipulation because it could lead to Chinese trade sanctions against the US.

The Treasury argued that the Chinese authorities know that an appreciating currency is of overall benefit to China, and said the yuan had gained 9.3% against the US dollar between June 2010 and November 2012. It said that when inflation was taken into account, the value of the Chinese currency had increased 12.6% since June 2010, when the Chinese authorities agreed to allow the yuan to be bought and sold more freely on the foreign exchange market. Nevertheless, based on China's huge and rising stock of foreign exchange reserves, the US Treasury said that the yuan's appreciation had been insufficient.

These rising reserves, together with other factors, 'suggest that the real exchange rate of the yuan remains significantly undervalued and further appreciation of the yuan against the dollar and other major currencies is justified'.

*Source: Straits Times, Singapore 2012*

**Table 1: Various economic indicators, China 2007 to 2013**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013* |
|---|---|---|---|---|---|---|---|
| Inflation: average consumer price index (1995 = 100) | 227 | 241 | 239 | 247 | 261 | 269 | 277 |
| Current account balance $US billion | 353 | 412 | 261 | 237 | 201 | 190 | 222 |
| Exchange rate: yuan per $US | 7.61 | 6.95 | 6.83 | 6.77 | 6.46 | 6.33 | n/a |

* forecast

*Source: The World Bank and other international economic organisations*

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**(a)** Compare the rate of inflation in China between 2007 and 2008 with that between 2010 and 2011. [2]

**(b)** Explain briefly how the foreign exchange value of a currency is determined in a free market. [3]

**(c)** The US Treasury report states that China's strong trade surplus has led to a 'huge and rising stock of foreign exchange reserves' in China.

Explain how this justifies the claim that China is manipulating the foreign exchange value of its own currency. [3]

**(d)** Explain why China's current account surplus is expected to increase in 2013, despite the rise in prices in China and the appreciation of the yuan. [6]

**(e)** Do you agree with the view of the US Treasury that an appreciating currency is 'of overall benefit' to China? [6]

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**[Turn over**

## Section B

Answer **one** question.

**2** **(a)** With the use of a diagram, explain how prices allocate scarce resources in a market economy. [8]

**(b)** Discuss whether prices are less important in allocating scarce resources in a mixed economy compared with a market economy. [12]

**3** **(a)** Explain why the value of income elasticity of demand for a good can be positive, negative or zero, while the value of its price elasticity of demand is most likely to be negative. [8]

**(b)** Discuss whether price elasticity of demand is a more useful concept than income elasticity of demand for a business that is trying to increase its sales revenue. [12]

**4** **(a)** Explain how a rise in the rate of interest might cause a shift in an economy's aggregate demand curve. [8]

**(b)** Discuss whether inflation is more likely to be caused by a shift in an economy's aggregate demand or a shift in its aggregate supply. [12]

*Copyright Acknowledgements:*

Question 1 © *US again says China not currency manipulator*; Straits Times; Singapore Press Holdings Ltd; 28 November 2012.
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