





Level 2 Economics, 2013

91222 Analyse inflation using economic concepts and models

2.00 pm Monday 11 November 2013 Credits: Four

| Achievement | Achievement with Merit | Achievement with Excellence |
|---|--|---|
| Analyse inflation using economic concepts and models. | Analyse inflation in depth using economic concepts and models. | Analyse inflation comprehensively using economic concepts and models. |

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

You should attempt ALL the questions in this booklet.

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–12 in the correct order and that none of these pages is blank.

YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

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You are advised to spend one hour answering the questions in this booklet.

QUESTION ONE: THE BUSINESS CYCLE

"Inflation expectations are easing, if the Reserve Bank's latest quarterly survey of expectations is anything to go by . . . The latest Statistics New Zealand data indicates real production-based GDP increased by 1.4% between March 2010 and March 2011". Source (adapted): www.idealog.co.nz/news/2011/08/inflation-unemployment-tipped-fall

Complete (a) and (b) to comprehensively analyse the effects of the business cycle on inflation.

(a) Explain in detail the impact of real output increasing on inflation.

In your answer:

- refer to the Quantity Theory of Money
- explain in detail how an increase in real output will affect the price level.

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(b) Discuss how the recovery stage of the business cycle may affect inflation.

In your answer, explain in detail:

- why the velocity of circulation might increase during the recovery stage of the business cycle
- the impact on the price level of the velocity of circulation increasing during the recovery stage of the business cycle
- the overall impact on the price level of real output increasing, **and** the velocity of circulation increasing, during the recovery stage of the business cycle.

QUESTION TWO: AGGREGATE DEMAND AND AGGREGATE SUPPLY

"In 2010, New Zealand issued a series of tax reforms which included lower (personal) income tax rates".

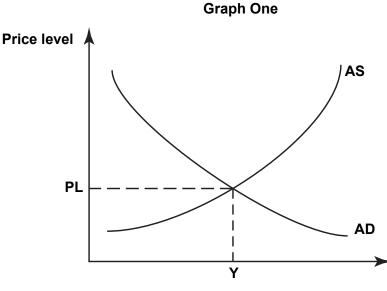
Source (adapted): www.business.otago.ac.nz/econ/econz/2010/econz_issue_25.pdf

Complete (a) and (b) to comprehensively analyse the effects of lower income tax rates and interest rates on inflation.

(a) Explain in detail the impact on inflation, of lower personal income tax rates.

In your answer:

- fully label Graph One to show the impact of lower personal income tax rates on inflation
- explain in detail how lower personal income tax rates could affect inflation. Refer to the change you made on Graph One to support your answer.



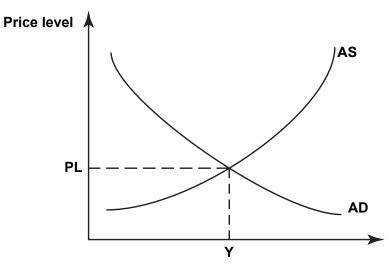
Real GDP



(b) Compare and contrast the impact on inflation of lower personal income tax rates with the impact of lower interest rates.

In your answer:

- fully label Graph Two to show the impact of lower interest rates on inflation
- explain in detail how lower interest rates would affect inflation
- explain in detail how lower personal income tax rates may have a smaller or greater impact on inflation than lower interest rates
- refer to the changes you made on Graphs One and Two to support your explanations.



Graph Two

Real GDP

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QUESTION THREE: THE IMPACT OF INFLATION

"Annually, the CPI increased 0.9% in the year to the December 2012 quarter, due to increased prices for cigarettes and tobacco (up 13%), rentals for housing (up 2.4%), and electricity (up 5.2%)".

Source (adapted): www.stats.govt.nz/browse_for_stats/economic_indicators/CPI_inflation/ ConsumersPriceIndex_MRDec12qtr.aspx

Complete (a) and (b) to comprehensively analyse the effects of inflation on high- and low-income households.

(a) Explain in detail the impact of inflation resulting from the changes specified in the resource material above, on low-income households.

In your answer:

- explain in detail how the specific changes above might impact on low-income households
- refer to the resource material.

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"The increase in prices for cigarettes and tobacco, and rentals for housing and electricity, were partly offset by decreases in the price of telecommunication services (down 5.7%), and audio-visual equipment (down 17%)".

Source (adapted): www.stats.govt.nz/browse_for_stats/economic_indicators/CPI_inflation/ ConsumersPriceIndex_MRDec12qtr.aspx

(b) Compare and contrast the impact of inflation on low-income households, with the impact on high-income households who own their own homes.

In your answer:

- explain in detail how the price changes stated in the resource material above might impact on high-income households who own their own homes
- explain in detail which group high-income or low-income households might be more disadvantaged by the price changes stated in the resource material above, AND on page 8.

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