91222

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NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

QUALIFY FOR THE FUTURE WORLD
KIA NOHO TAKATŪ KI TŌ ĀMUA AO!

Level 2 Economics, 2018

91222 Analyse inflation using economic concepts and models

2.00 p.m. Wednesday 21 November 2018
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 2–11 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.

TOTAL

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QUESTION ONE: THE QUANTITY THEORY OF MONEY

The Quantity Theory of Money states that the quantity of money circulating in the economy is equal to the monetary value of the goods and services available within the economy.

Complete parts (a) and (b) to comprehensively analyse the effects of changes in the money supply and the business cycle on inflation.

(a) (i) Identify each of the four variables used in the Quantity Theory of Money equation.

M:

V:

P:

Q:

(ii) Using the Quantity Theory of Money equation, fully explain how a 4% increase in the money supply could affect the price level, assuming other variables are constant.

The New Zealand economy is forecast to continue its recovery, with an average rate of output growth of 2.9% over the next five years.

Source (adapted): http://www.treasury.govt.nz/budget/forecasts/hyefu2017/hyefu17.pdf.

(b) Compare and contrast the effect on the price level of:

(i) an increase in the money supply, while other variables remain constant

(ii) an increase in the money supply, accompanied by a continued recovery in the New Zealand economy, with its expected change in output.

In your answer, you should:

- refer to the Quantity Theory of Money
- fully explain how economic recovery would affect the change in the price level that results from a 4% increase in the money supply
- fully explain which of the two changes out of (b)(i) and (ii) above will have the greater effect on the price level.

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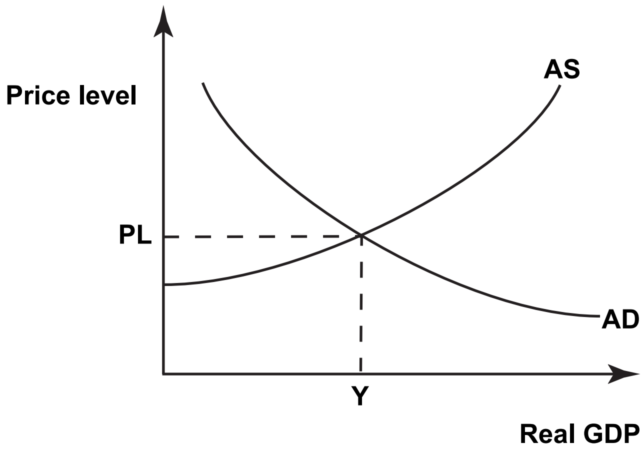
QUESTION TWO: THE AD/AS MODEL

Increasing the population through higher migration will increase both aggregate demand and aggregate supply. Overall, the impact on inflation depends on which effect dominates: aggregate demand or aggregate supply.

Source (adapted): https://treasury.govt.nz/publications/wp/migration-and-macroeconomic-performance-new-zealand-theory-and-evidence-wp-14-10.

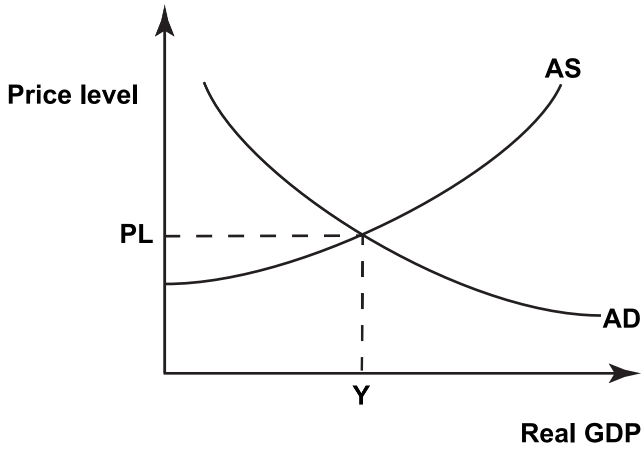
Graph One: AD/AS model of the New Zealand economy



(a) (i) On Graph One, show the impact of immigration into New Zealand on Aggregate Demand.

(ii) Using Graph One, fully explain the impact on inflation of immigration into New Zealand.

Graph Two: AD/AS model of the New Zealand economy



(b) (i) On Graph Two, show the impact of immigration into New Zealand on Aggregate Supply.

(ii) Using Graph Two, fully explain the impact on inflation of immigration into New Zealand.

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(iii) Fully explain why the impact on inflation of immigration, from a change in Aggregate Demand, may be greater than that from a change in Aggregate Supply.

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QUESTION THREE: TRADE AND INFLATION

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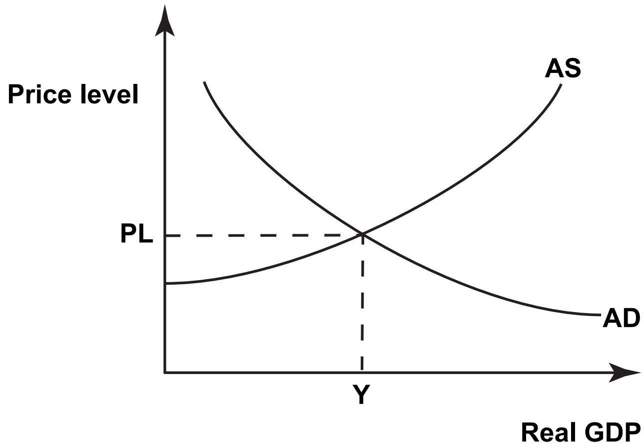
Economic growth in China is forecast to decline over the 2018–2019 period, and as China is a major New Zealand trading partner, this is expected to have flow-on impacts on the New Zealand economy.

Source: *NZ Weekly Commentary* 11 December 2017, https://wibiq.westpac.com.au/.

Graph Three: AD / AS model of the New Zealand economy



(a) (i) On Graph Three, show the impact of a decline in economic growth in China, on New Zealand's Aggregate Demand.

(ii) Using Graph Three, fully explain the impact on New Zealand's inflation, of a decline in economic growth in China.

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New Zealand's CPI inflation rate for 2018 is forecast at 1.5%, while the 2018 forecast rate for Australia is 2.0%, for China is 1.8%, and for the USA is 1.8%.

Source: *NZ Weekly Commentary* 11 December 2017, https://wibiq.westpac.com.au/.

(b) Compare and contrast the effects of a period when New Zealand's inflation rate is lower than that of our trading partners, on:

- New Zealand export firms compared to New Zealand import firms
- New Zealand firms that use a high proportion of labour in their production, compared to firms that use a high proportion of imported capital goods in their production.

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Extra space if required.
Write the question number(s) if applicable.

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