2

NZQA

NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

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Level 2 Economics, 2017

91222 Analyse inflation using economic concepts and models

2.00 p.m. Monday 20 November 2017
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.

Achievement

TOTAL 11

QUESTION ONE: CAUSES OF INFLATION

The Government wants to make New Zealand conservation land predator-free by 2050, increasing budget funds to target the eradication of all pests that threaten New Zealand's native birds.

Source (adapted): http://www.stuff.co.nz/environment/82454116/government-sets-target-to-make-new-zealand-predatorfree-by-2050

This should have the added benefit of attracting more tourists to New Zealand.

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

Pencil
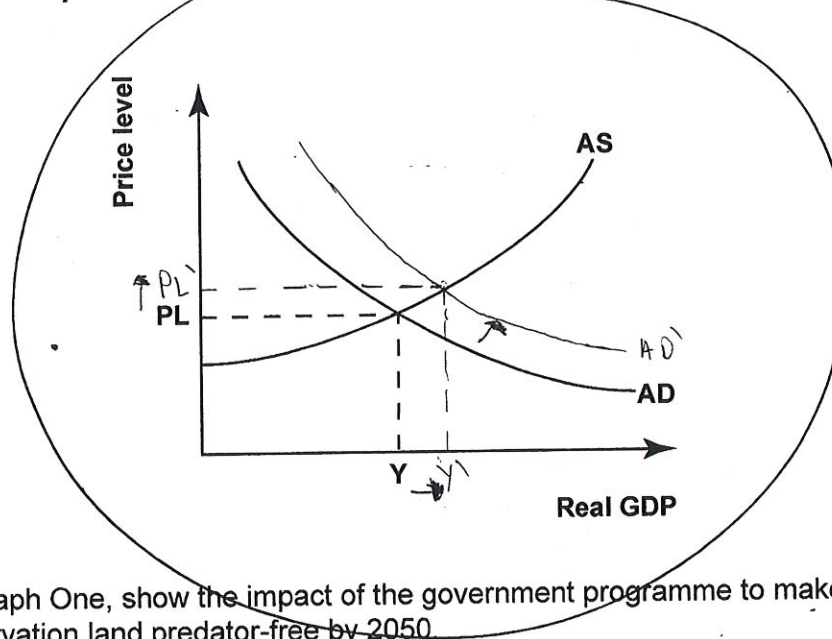
(a) (i) On Graph One, show the impact of the government programme to make New Zealand conservation land predator-free by 2050.

(ii) Using Graph One, fully explain the impact on inflation of the government programme.

As a Result of the government Programme to make New Zealand conservation land Predator-Free by 2050 government Spending will increase. Goverment is a Part of the AD equation (C+I+G(x-m)) So as goverment Spending increases Aggregate demand increases as Shown on the graph (AD to AD). As a Result Real output has increased (Y to Y') and price levels have increased from (P) to PL') Showing inflation has occured.

Along with the increase in residential house prices, there has been a similar increase in commercial property prices and business rental costs. During 2016, these price increases spread from the major cities to smaller towns and rural areas in New Zealand.

Graph Two: AD/AS model of the New Zealand economy
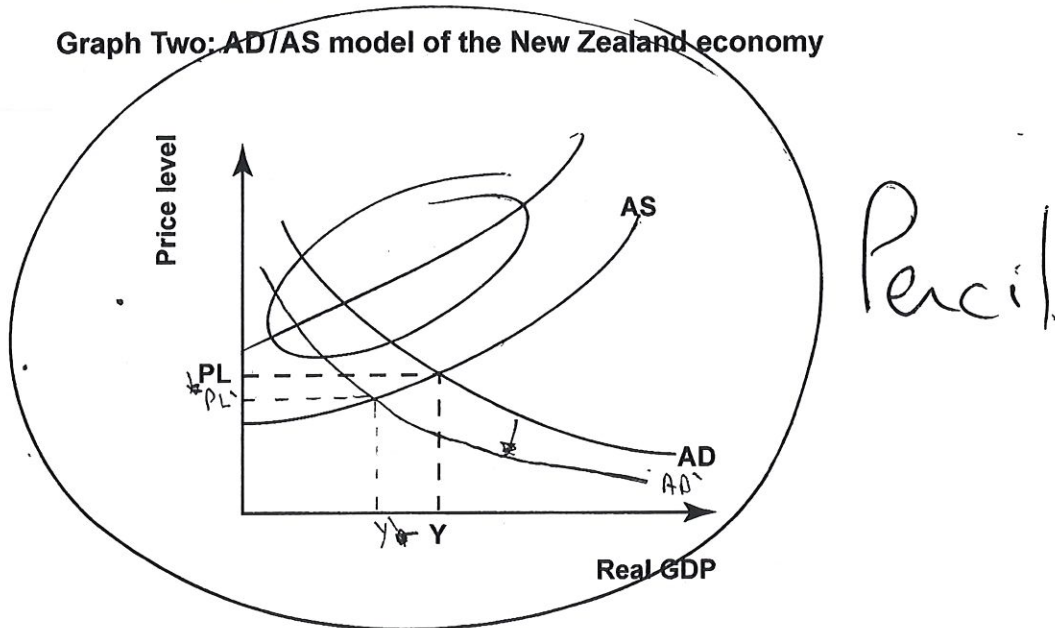
(b) (i) On Graph Two, show the impact of the increase in prices and rental costs of commercial property in New Zealand.

(ii) Using Graph Two, fully explain the impact on inflation of the increase in prices and rental costs of commercial property in New Zealand.

As a Result of to an increase in price and rental cost of commercial Property in New Zealand, Consumption and investment will decrease* Consumption is a part of the AD equation CtItG (X-M) So as consumption and investment decreases Aggregate demand decreases as shown on the graph (AD→AD'). As a Result real output has decreased from (Y to Y') and price levels have decreased from (PL to PL') Showing the deflation has occured //

* as houses are less affordable at higher price. //

(iii) Fully explain why the impact on inflation of the government programme in part (a) may be less than the impact of increases in the price and rental costs of commercial property in New Zealand in part (b).

Government Programme was less in the consumer price index (CPI) meaning it is a with increase inflation from will only effect government spending (G) from the AD equation $(C+I+G(x-m))$ while the increase in price and rental cost of property and commercial building in NZ will effect both consumption and inflation $(C+I)$ of the AD equation $C+I+G(x-m)$

QUESTION TWO: RECOVERY AND INFLATION

> Economic forecasts suggest that New Zealand will experience inflation throughout 2017, increasing to 2.2% by 2020, after hitting a low of 0.1% in January 2016. This increase in inflation is expected to come from the economy experiencing a recovery and growing through increased consumer and business confidence.

Graph Three: AD/AS model of the New Zealand economy
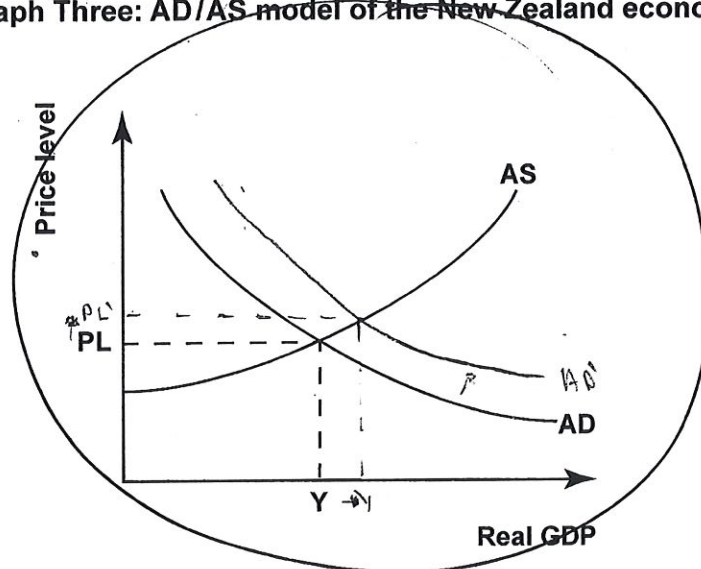
(a) (i) On Graph Three, show the impact of a recovery on the Aggregate Demand curve.

(ii) Using Graph Three, fully explain how a recovery could lead to a period of inflation.

As a Result of a Recovery New Zealand Consumers Confidence increases, meaning that they will spend more. As consumer spending increases AD will increase from (AD→AD') as consumption is a part of the AD equation C+I+G(x-m). This causes Real output to increase from (Y to Y') and causes Price level to increase from (PL to PL') showing that inflation has occured.

From 2014 to the start of 2016, the New Zealand economy experienced a period of disinflation. Projections by economic forecasters suggest that from the beginning of 2016 until 2020, there will be steady and constant inflation in the New Zealand economy.

Source (adapted):http://www.tradingeconomics.com/new-zealand/inflation-cpi/forecast (accessed 17 January 2017)

(b)   Compare and contrast the effects of a period of steady and constant inflation on:
- New Zealand export firms compared to New Zealand import firms
- New Zealand savers compared to New Zealand borrowers.

New Zealand export firms will be positively effect by inflation as the Prices of their goods increase they become realitivly less Price competitive. So they are worse off.

New Zealand import firms will be possitivly effected by inflation as we can import more goods for the same amount of $NZ. they are better off as they are more affortable at the lower value of the $NZ

New Zealand savers will be positively effected as the real value of their saving is decreasing as inflation occurs. worse off

New Zealand borrowers will be possitivly effected as the real value of their dept will decrease over time during inflation.

Inflation is an increase in general price levels.

A4

QUESTION THREE: THE IMPACTS OF INFLATION

Forecast figures from Treasury indicate the possibility of a decrease in real wages during 2017.

Source (adapted): http://www.treasury.govt.nz/economy/overview/2016/10.htm

(a) Fully explain how real wages can fall even when there is an increase in nominal wages. In your answer, include a definition of nominal wages and real wages.

nominal wages are ~~wages~~ value not including inflation
real wages are wages value (including) inflation //

real wages can fall as nominal wages increase if the rate of inflation is higher than the increase in wages. As price levels are increasing more than income. meaning the real value of your wages are decreasing. //

New measures of inflation being developed for groups of households by the Statistics Department will provide greater insight into the inflation experienced by these household groups.

Source (adapted): http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_indexes/ HouseholdLivingCostsPriceIndexes_HOTPSep16qtr

Table One: Household living cost inflation rates

Household group	Average rate of inflation between 2008 and 2016	Cumulative rate of inflation between 2008 and 2016	Major items in household spending basket 2014 (approx. % of total spending)
Superannuitants	2.375 %	19.0 %	Housing 42 Transport 9 Clothing 1.5
Top 20 % of Households by expenditure	1.137 %	9.1 %	Housing 15 Transport 17 Clothing 5
National average (CPI)	1.625 %	13.0 %	

Created from figures available from http://www.stats.govt.nz/browse_for_stats/economic_indicators/prices_ indexes/HouseholdLivingCostsPriceIndexes_HOTPSep16qtr

(b) (i) Using the information on household spending baskets, fully explain why different household groups have experienced a rate of inflation different from the national average.

different

Different household groups have experienced a different rate of inflation from the national average as the different household groups have different spending needs. Superannuitants have higher inflation rates as they ~~buy~~ ~~may what~~ Items with high weight on the CPI and rarely buy anything unnecessary meaning the inflation on their needs is higher.

The question continues on the following page.

(ii) Compare and contrast the impact of inflation on the living standards of:
- superannuitants
  AND
- the top 20% of households by expenditure

if the incomes of both groups increased by the same percentage between 2008 and 2016.

The real wages of the superannuitants will be lower than that of the top 20% of households by expenditure as the Inflation rates for superannuitants are higher than for the top 20% of households by expentiure

This means the disposable income for superannuitants is likely to be lower than the disposable income for top 20% of households by expenditure meaning it is likely that Superannuitants have a lower living Standard in comparasion to the top 20% of households by expenditure due to inflation

A4

Achievement exemplar 2017

Subject:	Economics		Standard:	91222	Total score:	11
Q	**Grade score**	**Annotation**				
1	A3	The A3 gained in this question is from (a). The explanation identifies one of the two components (government spending but not export receipts) affected and explains the effect on aggregate demand and price level. To gain an M5 the candidate would have needed to identify export receipts as a secondary cause. The candidate did not get an A4 as part b(i and ii) is wrong. The candidate did not read the question and note that the scenario was the increase in commercial property costs and instead discussed the effect on consumption of rising residential house prices.			
2	A4	To gain an A4 the candidate requires three of the answers at Achievement level; this candidate gains all five, however does not provide explanations for any at Merit level. In (a) the candidate only identifies one component of aggregate demand (consumption) when investment was also needed. In (b) the candidate identifies whether each group is better or worse off correctly but only gives the reason for the decision (e.g. savings is eroded in value or the value of their debt is decreased). The candidate does not give an outcome for each group, thus for savers the fact that purchasing power is decreased or that for borrowers they can pay their debt back quicker is not explained.			
3	A4	The candidate gains an A4 for this question from two correct explanations, one in (a) and the other in b(i). In (a) the the candidate correctly explains that the rate of inflation must be higher than the increase in nominal wages for real wages to rise but does not link this to the decrease in purchasing power. Poor definitions of nominal and real wages (including or not including inflation is not enough for an accurate definition) also mean this answer does not gain a Merit. In b(i) the candidate correctly explains that different inflation rates are caused by different spending, but though they try the candidate does not compare this accurately to inflation as measured by the CPI. The answer for b(ii) is wrong as the candidate compares living standards through income levels rather than inflation rates caused by different expenditure.			