2

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91222

912220

NZQA

NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

QUALIFY FOR THE FUTURE WORLD
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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.

Merit

TOTAL 16

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QUESTION ONE: CAUSES OF INFLATION

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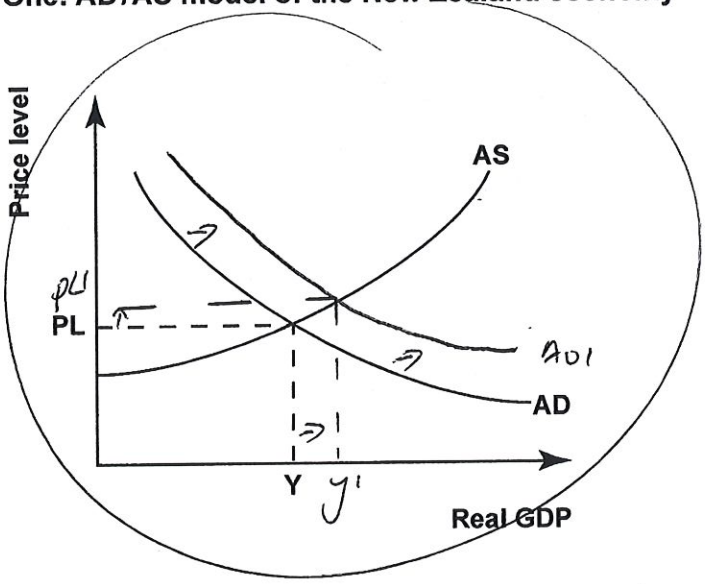
The Government wants to make New Zealand conservation land predator-free by 2050, increasing budget funds to target the eradication of all pests that threaten New Zealand's native birds.

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

increased government Spending



(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.

The gaverment programme aimed at making NZ conservation land predator free by 2050 will increase gaverment Spending. This is because the gaverment will Spend more on eradication of the threatening pests, increasing what they Spend on goods and Services Such as trapp. Also, the programme will increase ~~aggregate demand~~ exports receipts as more tourists will want to see the increasing array of birdlife that are not threatened by predators. This in turn increases aggregate demand from AD to AD1 (outward Shift) and increasing the price level from pL to pL1. Inflation has occured.

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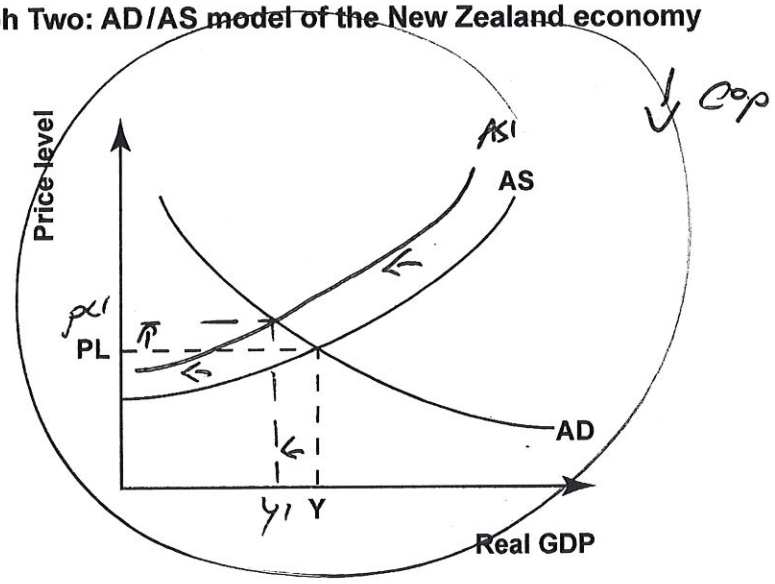
Along with the increase in residential house prices, there has been a similar increase in commercial property prices and business rental costs. During 2016, these price increases spread from the major cities to smaller towns and rural areas in New Zealand.

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.

An increase in prices and rental prices of commercial property will increase costs of production for firms. This is because they will now have to pay higher amounts of rent to occupy their buildings, which increases costs and decreases profit. Firms will decrease their production in the economy to maintain profit margins. This in turn decreases aggregate supply, or indicated by an outward shift of the curve from AS to AS1, increasing the price level and causing inflation.

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(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).

Both situations increase the price level which causes inflation to occur. However, the government scheme of tackling part can have less of an effect than increasing prices and rent of commercial property. This is because the government scheme only allows greater spending in a restricted area of the economy, which is conservation and tourism of native birds/exports receipts/government spending). Not all tourists want to visit nz to experience native birds. However, increasing commercial prices will increase costs of firms who rent, but will encourage investment and consumption through firms who own businesses. Greater rental incomes will encourage consumption of goods/services and investment which increases aggregate demand and causes inflation. All commercial property owners and firms who rent are affected. However, only a restricted part of exports and increased govt spending are affected with the gaernment programe, making commercial property have a greater impact of inflation.

M6

QUESTION TWO: RECOVERY AND INFLATION

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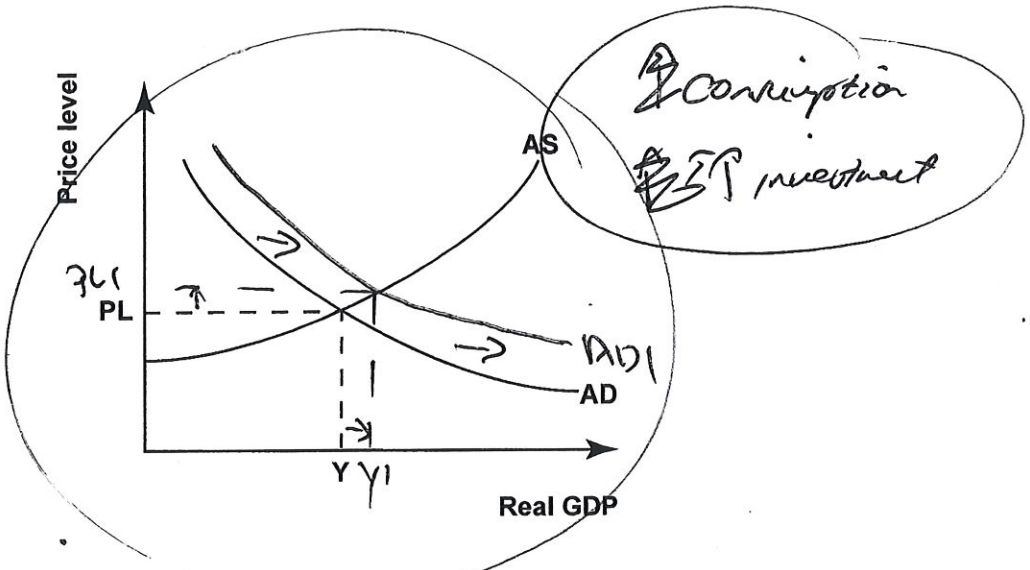
Economic forecasts suggest that New Zealand will experience inflation throughout 2017, increasing to 2.2% by 2020, after hitting a low of 0.1% in January 2016. This increase in inflation is expected to come from the economy experiencing a recovery and growing through increased consumer and business confidence.

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.

During a recovery stage in the New Zealand economy, levels of consumer confidence and business confidence will rise. This results in greater consumption through consumption spending by consumers and greater investment into capital resources by producers. Consumers spend more as they have more confidence in the economy, greater employment etc, while businesses increase investment to purchase capital goods to increase production and satisfy consumption. As a result, this increases aggregate demand, shown by an outward shift of the curve from ~~P to P1~~ AD to AD1. The price level also increases from PL to PL1, causing inflation.

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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.

In period of constant inflation, different sectors in the economy will be affected in different ways. Those New Zealand firms who export goods and services will lose out as they export sales and their export receipts will decrease. This is because purchasing exports from NZ by overseas becomes less price competitive and those costs are higher, less incentive to purchase exports firms will purchase in other markets that are more price competitive. Those NZ export firms may decrease their investment as there is not as great a need to produce capital goods to increase productivity. However, those who import will benefit as the imports become more price competitive / more affordable, which decreases import firms costs and increases their demand for imports.

During constant / steady inflation savers, consumption will be slowed as more people save. People who save will be better off as they will receive better returns on their deposits through increased interest rates as a result of inflation. Borrowers will be worse off as they will have to pay higher levels of interest on their borrowed money, which will decrease their consumption (less discretionary income).

after paying interest. Also, the real value of the borrowed money falls with inflation, decreasing borrowers purchasing power with the borrowed funds. //

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M5

QUESTION THREE: THE IMPACTS OF INFLATION

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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 the amount of wages that is earnt current adjusting it to current periods of inflation e.g. 2% per annum. Whereas, real wages are adjusted to current inflation levels or a certain period of time - i.e. it is expressed in current terms. Real wages can fall even if there is an increase in nominal wages when there are periods of deflation, where the price level decreases. This makes real wages fall below nominal wages that are increasing.

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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.

The different groups outlined above have experienced different inflation levels than the national average because the groups each spend different percentages on items in the household basket. Superannuitants spend more on ~~housing~~ housing (42%) and less on transport (9%), whereas the top 20% of households ~~who spend~~ spend a more even amount on items i.e. less on Housing (~~£~~15), more on transport (17) This has different affects on the inflation rate these groups experience as some items are weighted more heavily than others in the consumer price index and therefore more affect inflation accordingly.

The question continues on the following page.

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(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.

If the incomes of Superannuitants and the top 20% of earners increased by the same rate, the group would experience different impacts of inflation on living standards. Superannuitants tend to spend more of their income on housing, whereas the top 20% of spenders spend similar amounts on housing and transport and less on clothing. Housing is considered to be a cost that Superannuitants spend on so increased inflation would ~~increase~~ increase their rents. Since Superannuitants are considered to be low income earners and spend they would spend a larger proportion of their income on the rent, decreasing their ability to purchase other goods/services such as food etc. With inflation, the value of the Superannuitants saving is eroded making it more difficult to purchase items, due to the real value of money increasing.

The top 20% will ~~be~~ experience smaller impacts of inflation as they are generally higher income earners who are able to afford ~~luxuries~~ luxuries. They spend less of their income on expenses and therefore

M5

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

QUESTION NUMBER

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may be less affected by inflation. although spending increases they are more likely to be able to manage the increased prices caused by inflation //

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

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QUESTION NUMBER

2 b) ii) weighted heavily and where there is greater spending on this item spread to others will increase inflation by a greater amount, as indicated by greater inflation weight of Superannuitants spread to top 20% of spenders.

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Merit exemplar 2017

Subject:	Economics	Standard:	91222	Total score:	16

Q	Grade score	Annotation
1	M6	The candidate has the potential to gain a merit from both (a) and b(ii) though one at this level is enough. In (a) the candidate clearly identifies the changes of the correct components of aggregate demand (using the correct terms) giving a reason sourced from the resource. The graph is also well integrated with AD and price level movements identified. In b(ii) the answer is also well explained using the key terms of cost of production and profit margins, however, there is an error in not linking price changes to profit motives. The answer is not an E7 as the candidate does not clearly link the effect on the number of firms as the reason for greater movements in price between the two scenarios.
2	M5	The Merit in this question comes from Q2a. The components of aggregate demand; investment and consumption are correctly identified using the right terms and linked to changes in aggregate demand and price level (using labels). Q2b does not reach a Merit level even though they correctly give a reason for the effects on export firms and import firms. The candidate needed to predict an outcome for both to gain M6. The discussion on savers and borrowers is wrong as they discuss the effect of changes in interest rates rather than the effect of inflation itself.
3	M5	The candidate gains an MS from part b(i) in this question. The candidate effectively compares the personal inflation rate being created by a particular basket of goods and services whereas the average is created by the weighted CPI for the average household. The candidate does not gain an M6 as Q3a is incorrect, i.e. an increase in nominal wages and deflation would make real wages rise. The candidate does not get an E7 as b(ii) compares how the inflation rates for the two groups are created not the effects of the inflation rates.