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91403



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Level 3 Economics 2020

91403 Demonstrate understanding of macro-economic influences on the New Zealand economy

2.00 p.m. Friday 4 December 2020
Credits: Six

Achievement	Achievement with Merit	Achievement with Excellence
Demonstrate understanding of macro-economic influences on the New Zealand economy.	Demonstrate in-depth understanding of macro-economic influences on the New Zealand economy.	Demonstrate comprehensive understanding of macro-economic influences on the New Zealand economy.

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.

TOTAL

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QUESTION ONE: Global economic activity and monetary policyASSESSOR'S
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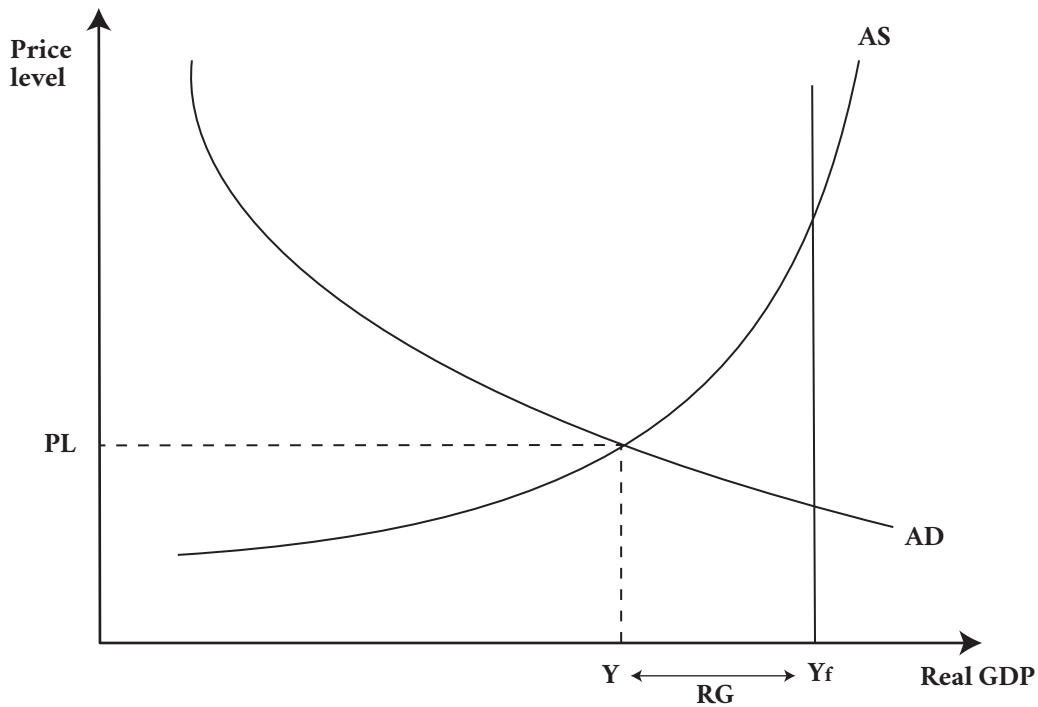
On 7 August 2019, the Reserve Bank of New Zealand (RBNZ) lowered the official cash rate (OCR) to 1%. The Monetary Policy Committee agreed that a lower OCR was necessary to meet its employment and inflation objectives, as GDP growth had slowed over the previous year and global economic activity continued to weaken.

A recessionary gap (RG) can be used to illustrate the difference between the full employment level of real GDP and the current level of real GDP.

Source (adapted): <https://www.rbnz.govt.nz/news/2019/08/official-cash-rate-reduced-to-1-percent>

- (a) On Graph One, show how a weakening of global economic activity could affect the New Zealand economy. Label any changes to the price level, real GDP and the recessionary gap.

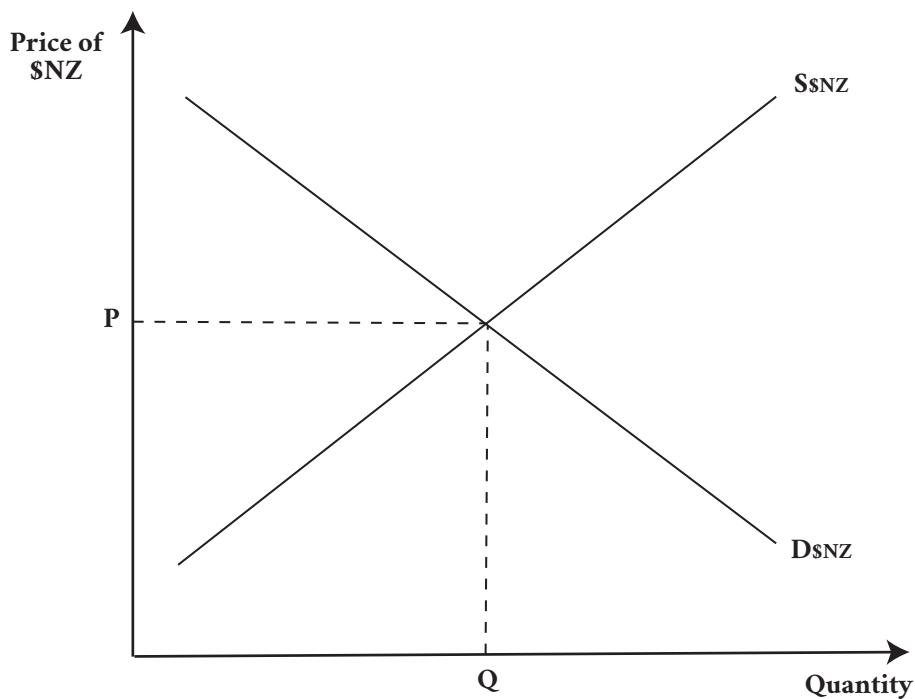
Graph One: The New Zealand economy operating with a recessionary gap (RG)



- (b) Explain, in detail, the changes you made to Graph One.

- (c) On Graph Two, show the impact of lowering the OCR on the value of the New Zealand dollar. Label any changes you make.

Graph Two: The market for the New Zealand dollar



- (d) Refer to Graphs One and Two, and explain in detail:
- the impact of lowering the OCR on the value of the New Zealand dollar
 - the impact of the change in the value of the New Zealand dollar on employment
 - why lowering the OCR may be effective in reducing unemployment, even though there is weakening global economic activity.

Please turn over ►

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The examination continues on the following page.**

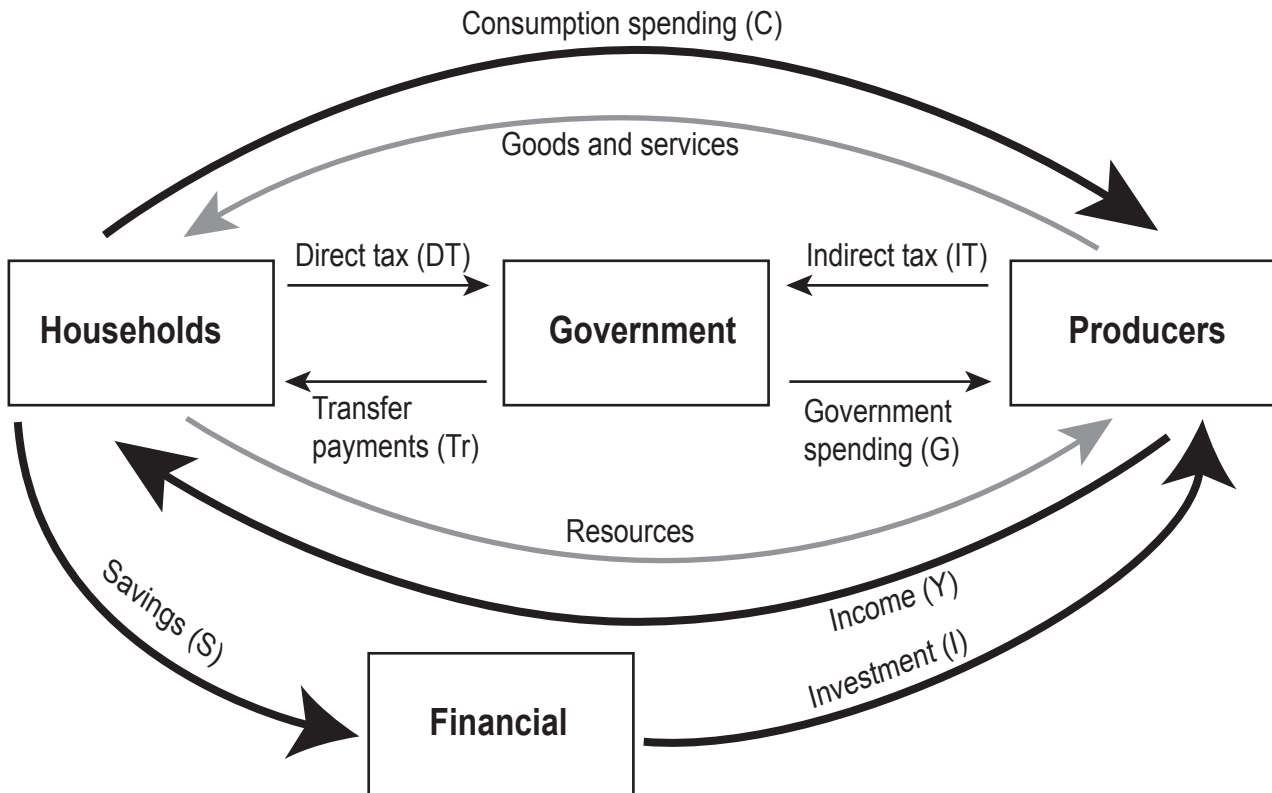
QUESTION TWO: Fiscal policy and the multiplier

In October 2019, the Government announced a surplus of \$7.5 billion, which could be used for income tax cuts or increased welfare spending.

Source (adapted): <https://www.stuff.co.nz/national/116405734/massive-75-billion-surplus-shows-room-for-tax-cuts-and-spending>

- (a) Use the multiplier to explain, in detail, how income tax cuts that result in increased consumer spending of \$500 million could lead to an increase in real GDP of \$2.5 billion. In your answer, include the formula for the multiplier, and calculate the marginal propensity to consume (MPC).

Model One: A circular flow model of the New Zealand economy



(b) Explain, in detail, how increased welfare spending could increase economic growth. In your answer, refer to the relevant flows from Model One.

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(c) Explain, in detail, why income tax cuts may have a greater impact on the Government's goal of economic growth compared to increased welfare spending. In your answer, refer to the multiplier and relevant flows from Model One.

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QUESTION THREE: Impact of Terms of Trade on inflation and the current account

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New Zealand's Terms of Trade rose 1.6% in the three months to June 2019, following a 1.0% gain in the previous period, and beating market expectations of 1.0%.

Export prices increased for lamb, beef and dairy products while fuel import prices also increased.

Source (adapted): <https://tradingeconomics.com/new-zealand/terms-of-trade>

- (a) Explain, in detail, how the Terms of Trade could have risen, even though there were increases in the prices of exports and imports. Include a definition of the Terms of Trade in your answer.

Graph Three: The New Zealand economy

