91403

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Level 3 Economics, 2015

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

2.00 p.m. Wednesday 18 November 2015
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.

Excellence

TOTAL 20

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QUESTION ONE: Changes in a government policy

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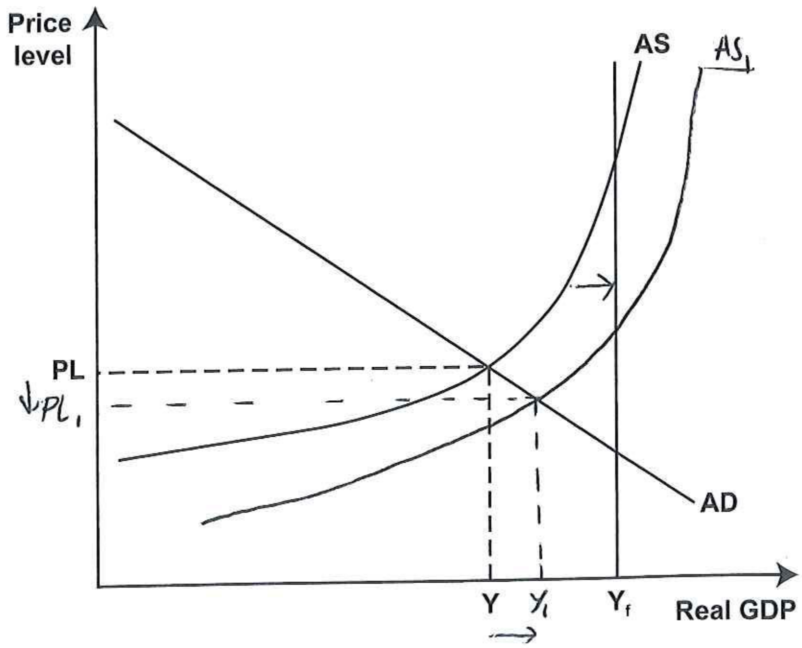
Source (adapted): http://www.nzherald.co.nz/property/news/article.cfm?c_id=8&objectid=11389827

Changes to the Resource Management Act is an example of a supply-side policy.

(a) On Graph One, shift ONE curve to illustrate the impact that a supply-side policy such as the reform of the Resource Management Act may have on the macroeconomy.
In your answer:
- label the curve shift
- label the new equilibrium.

Graph One: The New Zealand economy



(1)

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"The high-level reforms were designed to reduce building costs and reverse the skyrocketing price of housing in New Zealand."

"Environment Minister Nick Smith said overhauling the Resource Management Act was critical to addressing housing supply and affordability."

Source: quotes from resource material on page 2.

Residential and commercial property activity contributes a significant amount to economic growth and employment.

Along with economic growth, the Government has the goal of full employment.

(b) Compare and contrast the effectiveness of the reform of the Resource Management Act on both economic growth and full employment.

In your answer:

- explain in detail the impact that a supply-side policy such as the reform of the Resource Management Act could have on Real GDP
- explain in detail how a supply-side policy such as the reform of the Resource Management Act could create jobs
- explain the effectiveness of the policy in achieving BOTH economic growth and full employment
- refer to changes made to Graph One, and to the resource material.

• A supply side policy such as the reform of the Resource Management Act will increase Real GDP. This is because it will reduce building costs and therefore firms will be willing to supply more housing in New Zealand as it is relatively more profitable so aggregate supply will increase causing the AS curve to shift to the right from AS to AS_1 and real GDP will increase from Y to Y_1 as output has increased and more houses are being produced and supplied. //

(2)

• The reform of the Resource Management results in an increase in aggregate supply and for aggregate supply to increase production must increase so as a result more workers are needed in order to increase production of houses as the demand for labour is derived from the demand of goods and services so employment will increase from Y to Y_1 as more jobs will be created in order to increase production of houses. //

(3)

(4)

The policy is very effective in ~~econo~~ achieving both economic

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growth and full employment. This is because real GDP increases from Y to Y_1 ~~without~~ therefore allowing economic growth to occur with no inflationary pressure as the increase in AS leads to disinflation so the RBNZ will not step in, in order to control the inflation and will not increase rates which will lead to an economic growth as firms are certain about their financial future. Since firms are also having lower costs of production and therefore higher profitability, they will be willing to supply more output at every price causing real GDP to increase and therefore economic growth. Since ~~p~~ house prices ~~&~~ have stabilized and have decreased from PL to PL_1, households will save more and borrow less and firms will invest more on capital goods than speculative investment which will further lead to an economic growth.
The government is also closer to its goal of full employment as more households are employed due to the increase in production of houses so ~~employment~~ unemployment has decreased from $Y_f - Y$ to $Y_f - Y_1$ and the inflationary gap has decreased. //
Since more households are being employed, they earn more income ~~so~~ which can ~~lead~~ lead to an increase in consumption spending and investment since firms will want to expand so this can lead to ~~an~~ a further increase in economic growth. //

(2)

M6

QUESTION TWO: The impact of falling oil prices and slowdown in world economy on the current account

IMF World Economic Outlook pessimistic

Source (adapted): http://www.stuff.co.nz/business/world/65250567/imf-global-outlook-more-pessimistic

Deflation looms as oil prices fall

Source (adapted): http://www.stuff.co.nz/business/industries/64765449/deflation-looms-as-oil-price-falls

Definition: **Deflation** is a persistent decrease in the general price level.

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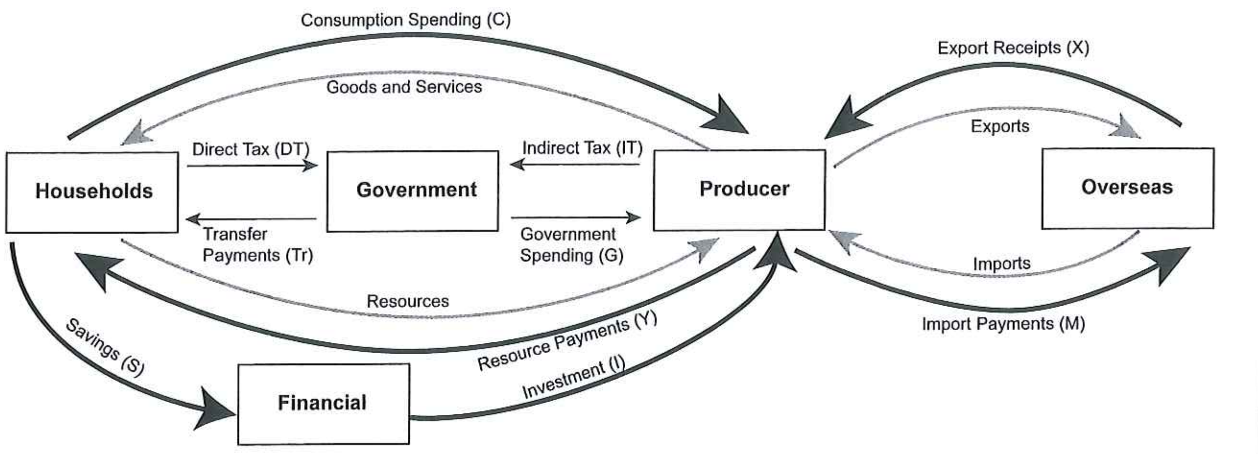
The circular flow diagram below illustrates the relationship between different sectors of the economy.



(a) Explain in detail how falling oil prices could lead to deflation.
In your answer, refer to the relevant real and money flows from the circular flow diagram to explain:

- the impact of falling oil prices on the producer sector
- how the impact on the producer sector could result in deflation.

The impact of falling oil prices on the producer sector is that the producer sector will earn less revenue from exports due to ~~the~~ low prices so the flow of the export receipts (X) from the overseas sector to the producer sector will decrease. At the same time producers will pay less on imported oil so will purchase more imports so the flow of import payments (M) ~~to~~ from the producer sector to the overseas sector will increase. As a result of export receipts (X) falling and import payments (M) increasing, there will be a decrease in economic growth as producers earn less from exports and are spending more on imports. Producers earn less revenue from export receipts (X). Because producers are earning less from exports and therefore a decrease in export receipts, they will decrease production as they are earning less revenue and profit so as a result, resource payments to households will decrease as some might lose their jobs so as a result consumption spending will decrease. The falling export receipts, increase in import payments and falling consumption spending will decrease economic activity and therefore economic growth which will lead to deflation as there is less inflationary pressure. Falling oil prices also mean that costs of production of ~~[illegible]~~ producers will decrease so they will lower ~~the~~ prices of their goods and services leading to further deflation. //

(5)

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New Zealand both imports and exports oil, but it imports far more than it exports.

(b) Compare and contrast the impact falling oil prices and a slowdown in the world economy will have on the macroeconomic goal of a balanced current account.
In your answer, use money flows and real flows from the circular flow diagram to explain in detail:

- the impact falling oil prices will have on the balance on goods, the balance on services, and the current account
- the impact the slowdown in the world economy will have on the balance on goods, the balance on services, and the current account
- why the slowdown in the world economy will have a bigger impact on the current account than falling oil prices.

The impact falling oil prices will have on the balance on goods, ~~balance~~ balance on services ~~on services~~ and the current account is that it will worsen it while balance on services is unaffected. This is because as New Zealand imports far more than it exports, it means that ~~there will be~~ an increase in imports as oil is cheaper ~~and therefore~~ import payments (M). There will also be a decrease in export competitiveness, exporter incomes and therefore a fall in export receipts (X). As more money ~~is~~ flowing out of the ~~circle~~ circular flow than the money flowing in, ~~both~~ balance on goods worsens and therefore the current account worsens. Balance on services is unaffected as ~~oil~~ oil is a good not a service.

The impact the slowdown in the world economy will have on the balance on goods, balance on services and the current account is that they will worsen. This is because a slowdown in the world economy means that economic growth from other countries are decreasing. Production, output, employment and household incomes are also decreasing so as a result there will be a decrease in the demand for New Zealand exports from overseas particularly in China. Since China is one of New Zealand's largest trading partner where it exports most of its dairy products, a slowdown in the world economy means that New Zealand will earn less revenue from exports and therefore there will be a large decrease in export receipts (X) causing the Balance

(6)

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on goods to worsen as ~~most~~ there is a large decrease in the flow of money from the export receipts (X). At the same time, export receipts (X) from tourism will also fall because households from China ~~are~~ have lower or no household income so as a result they will travel less to New Zealand So as a result, Balance on services will also worsen as less money is flowing into the circular flow from export receipt(X). Since both balance on goods and balance on services worsened, the current account will worsen. //

(7)

The slowdown in the world economy will have a bigger impact on the current account than falling oil prices because a slowdown in the world economy ~~aa~~ affects both balance on goods and balance on services and both worsened and therefore have a larger impact on the current account. In contrast, falling oil prices have only affected the balance on goods as ~~this~~ oil is a good while balance on services remained the same therefore resulting in a smaller impact on the current account. China is also one of New Zealand's largest trading partners so a slowdown in its economy means that New Zealand will sell less exports ~~as~~ there will be a large decrease in export receipts (X). //

E7

QUESTION THREE: Consumer spending and the business cycle

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Retail card spending shows slight rise

New Zealanders increased their spending on debit and credit cards in December, with gains in apparel, consumables, and hospitality …

Source (adapted): http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11386314

Levels of credit card spending are an indicator of consumer confidence.

(a) Calculate, using the spending multiplier formula $\frac{1}{1-\text{MPC}}$, the change in Gross Domestic Product if consumer spending increased by \$200 million and New Zealand households save 6 per cent of their income. (Round your answer to the nearest \$ million.)

MPS = 0.06 so MPC = 0.94 $K = \frac{1}{1-0.94} = 16.7 = 17$

17 x 200 million = \$3400 million //

GDP has increased by from \$200 million to \$3900 million which a total increase of \$3200 million. //

(8)

(b) Explain in detail how an increase in consumer spending of \$200 million can lead to the change in GDP you have calculated. In your answer, refer to the spending multiplier.

Using the information provided, spending multiplier formula is $\frac{1}{1-MPC}$. MPC or Marginal Propensity to Consume is the proportion of income households choose to spend. MPS or Marginal Propensity to save is the proportion of income that households choose to save. Since 6% of income is saved then 94% is the amount that is spent as income. So for every \$1 of income 94 cents is spent by households and will become someone else's income. e.g. households spend their income and pay it to firms where they buy their goods and services from so employees of that firm will be paid with wages. This ~~situation~~ cycle will continue having multiplied effects on the economy. The multiplier is $\frac{1}{1-0.94} = 16.7 = 17$ so \$200 million x 17 times = \$3900 million. So GDP has increased from \$200 million to \$3900 million which is a total increase of \$3200 million. //

(9)

(c) Compare and contrast the impact an increase in consumer spending will have on the macroeconomic goal of price stability during BOTH a recession phase AND a recovery phase of the business cycle.

In your answer:

- clearly identify a recession AND a recovery on Graph Two
- explain in detail the impact of a recession on price levels
- explain in detail the impact of a recovery on price levels
- explain in detail whether an increase in consumer spending is more likely to have a bigger impact on price levels in a recession or a recovery.

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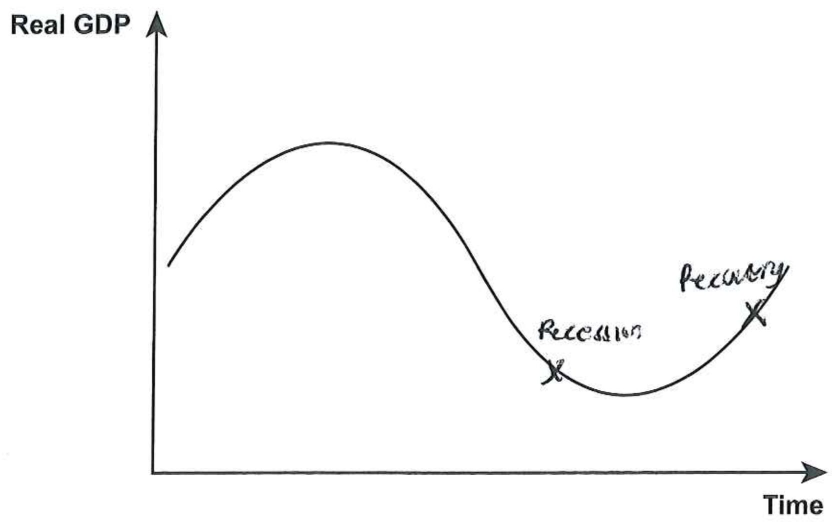
Graph Two: The business cycle of economic activity



(10)

The impact of a recession on price levels is that ~~there~~ they are decreasing and slowing down as economic growth, production, employment, household incomes and business sales are all decreasing so as a result there is little pressure on the price levels. // (11)

The impact of a recovery on price levels is that price levels will slightly increase as economic growth, production, employment, household incomes and business sales are increasing so there is more pressure on price levels. // (12)

An increase in consumer ~~confidence~~ spending is more likely to have a bigger impact on price levels in a recovery than recession. This is because in ~~although the economy is approaching full capacity~~ a recovery, more resources are employed and utilised so and the economy is closer towards full capacity. //

Excellence exemplar for 91403 2015			**Total score**	**20**
Q	**Grade score**	**Annotation**		
1	M6	This candidate has received M6 for this question because they: a) shifted and labelled the AS curve correctly on Graph One. **(1)** b) provided detailed explanations on how the reform of the RMA will reduce costs of production and improve productivity, increasing Real GDP **(2)** and how this will create more jobs **(3)** which is a derived demand **(4)** and improve Employment. More in-depth explanations would have included details such as the impact of reduced time delays, the components that make up AS, the significance of the changes to Eco Growth and/or Employment. These would have allowed a more comprehensive comparison.		
2	E7	This candidate has received E7 for this question because they: a) were unable to use the producer sector and the circular flow model to provide a relevant explanation of how falling oil prices could lead to deflation **(5).** b) provided detailed explanations of the impact of falling oil prices on the export of goods, the import of goods and NZ's current account **(6)**. This is compared to the impact of a world economic slowdown with detailed explanations with regard to the export of goods, the export of services and consequently, NZ's current account **(7).** A better answer would have recognised the impact of falling oil prices on the export or import of services rather than stating they were unaffected, and used a more relevant contrast.		
3	E7	This candidate has received E7 for this question because they: a) calculated the spending multiplier and the change in GDP. **(8)** b) have not used the spending multiplier to explain how the change in GDP occurs. A better answer would have made it clear that income is **re-spent (9)**. c) correctly identified a recession and a recovery on Graph Two **(10)** and identified that in a recession inflation is low and production and sales are decreasing **(11)** and that in a recovery, production and sales are increasing**,** and there is increasing pressure on prices **(12)**. The differing impact of increasing consumer spending in a recovery compared to a recession is explained in detail, using the idea of differing resource utilisation and capacity constraints impacting the price level to make a relevant contrast **(13).**		