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3

91403



914030



NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

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SUPERVISOR'S USE ONLY

Level 3 Economics, 2016

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

2.00 p.m. Friday 25 November 2016
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 2–8 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

ASSESSOR'S USE ONLY

QUESTION ONE: Impact of monetary policy on growth and inflation

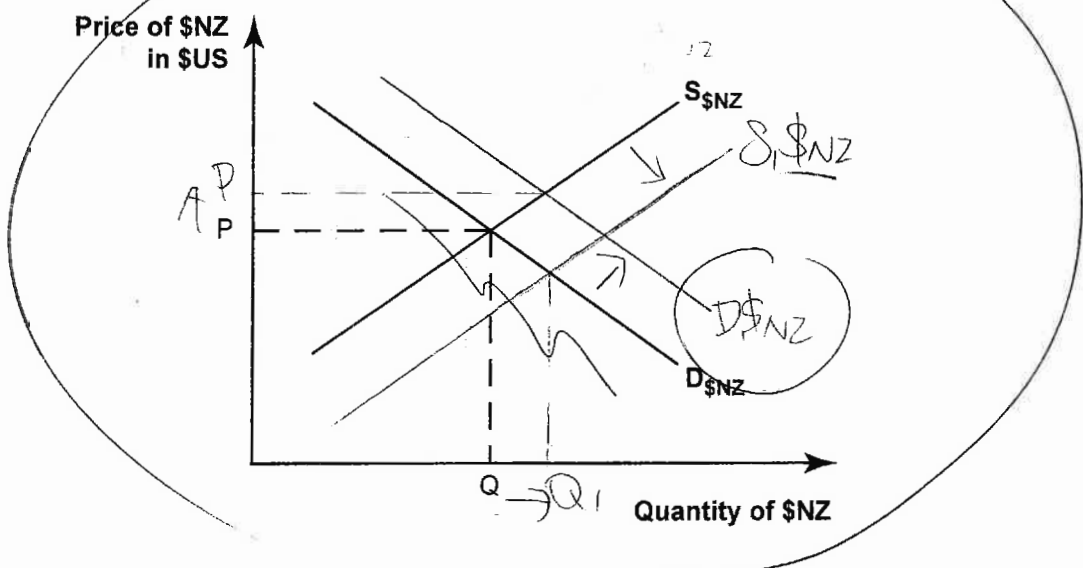
On 10 September 2015, the Reserve Bank reduced the Official Cash Rate (OCR) by 25 basis points to 2.75 per cent.

Inflation remains below the price stability target of 1 to 3 per cent due to the previous strength in the New Zealand dollar.

A reduction in the OCR is warranted by the softening in the economy and the need to keep future average CPI inflation near the 2 per cent target midpoint.

Source (adapted): <http://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement/mps2015-09>

Graph One: The Market for the New Zealand dollar (1)

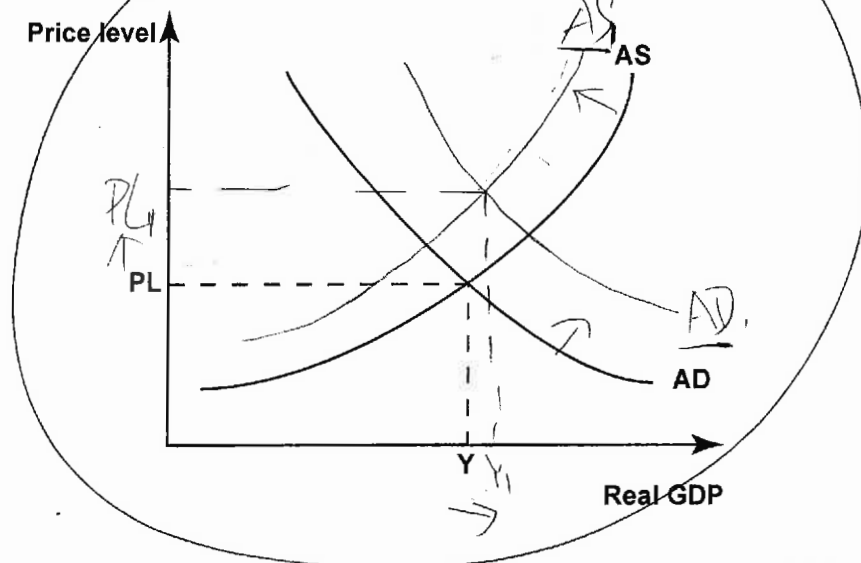


(1)

- (a) On Graph One above, shift both curves to illustrate how a reduction in the OCR could affect the value of the New Zealand dollar. Clearly label any changes you make.

Penalty

Graph Two: The New Zealand economy



(2)

- (b) On Graph Two above, shift both curves to illustrate how a reduction in the OCR could affect the New Zealand economy. Clearly label any changes you make.

- (c) Referring to the resource material on page 2 and to Graphs One and Two, compare and contrast the impact that a reduction in the OCR would have on the Government's goals of economic growth and price stability.

In your answer, fully explain:

- the impact of a reduction in the OCR on the value of the New Zealand dollar
- the impact of a reduction in the OCR on aggregate demand and aggregate supply
- the effectiveness of a reduction in the OCR in achieving the goals of economic growth AND price stability.

A reduction in the OCR decreases interest rates in short term. As a result, it ~~will~~ encourages spending and increases money flow between sectors. Therefore, the ~~the~~ New Zealand dollar depreciates due to an increase in supply (and demand) of NZ dollars. //

(3)

~~A reduction in the OCR //~~

A reduction in the OCR will shift AS to the left as cost of production increases due to a depreciation of NZ\$. Also AD curve will shift outwards due to an increase in consumption spending (C) and investment spending (I). This is because a fall in interest rate causes the value of savings to decrease. Savings is ~~discouraged~~ discouraged as the return will be lower. However, cost of borrowing will decrease as the repayment decreases, households will then borrow and spend on other areas e.g. investment. Therefore, producers

(4)

~~can increase the investment spending to~~ can see a great future of business and increase investment spending to improve the conditions e.g. hire more employees or pay more for existing workers, invest in new technology. As C+I are components of AD, C+I results in AD. (extra)

(5)

A4

QUESTION TWO: Impact on the Current Account of an increase in the Terms of Trade and a depreciation of the New Zealand dollar

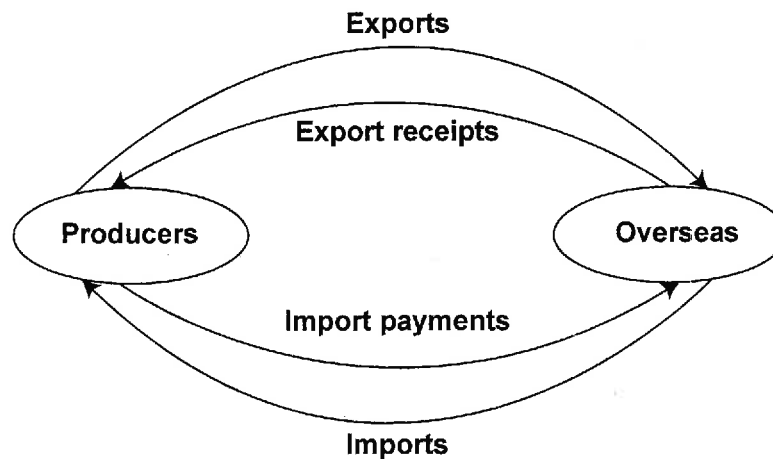
New Zealand's Terms of Trade index increased from 1 319 to 1 353 between January 2015 and July 2015. In New Zealand, the Terms of Trade (ToT) is the ratio of the price of exportable goods to the price of importable goods.

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

During the same time period, the value of the New Zealand dollar depreciated as New Zealand's Trade Weighted Index (TWI) decreased from 75.44 (30 January 2015) to 70.14 (31 July 2015).

Source: Reserve Bank of New Zealand.

Model One: Simple circular model showing New Zealand producers and the overseas sector



- (a) Referring to Model One, fully explain how an increase in the Terms of Trade could improve New Zealand's Current Account balance.

An increase in Terms of trade means the export receipts is greater than import payments. It is desirable as producers' revenue will increase. As exports are greater than imports, it will show a surplus in NZ's Current Account ~~balance~~, therefore it would improve the balance. 1

- (b) Referring to Model One, fully explain how a depreciation of the New Zealand dollar could improve New Zealand's Current Account balance.

A depreciation of the \$NZ will encourage exports. This is because foreign consumers ~~are~~ can ~~swap~~ ^{exchange} ~~forex of currencies~~ for more \$NZ at the same price. They are more affordable to buy NZ made products. NZ exports become more price competitive to foreign goods. It results in an increase in export receipts. Therefore a depreciation of the NZ dollar could improve NZ's Current ~~Account~~ Account balance. (2)

- (c) Explain which of these two events is more likely to have a greater impact on New Zealand's Current Account balance.

An increase in the Terms of Trade could have a greater impact on NZ's Current Account balance than a depreciation of \$NZ. This is because a depreciation will harm ~~the~~ importers as ^{the value of} cost of production increases due to a fall in \$NZ compared to foreign currencies. Therefore, importers receive lower profits could lead to the company close down. (3)

QUESTION THREE: Impact of fiscal policy on growth and employment

ASSESSOR'S
USE ONLY

Government spending on the recovery of Christchurch includes spending on key building projects in the CBD, fixing of roads and sewers, the repairs of schools and hospitals, and insurance pay-outs. The Christchurch City Council has estimated that this spending will generate additional spending by consumers and businesses.

Source (adapted): <http://www.stuff.co.nz/the-press/business/the-rebuild/70084887/How-much-is-the-Government-really-spending-to-fix-Christchurch>

The contribution of the Canterbury region (which includes Christchurch) to national GDP rose 0.9 percentage points to 13.1 per cent between March 2009 and March 2014.

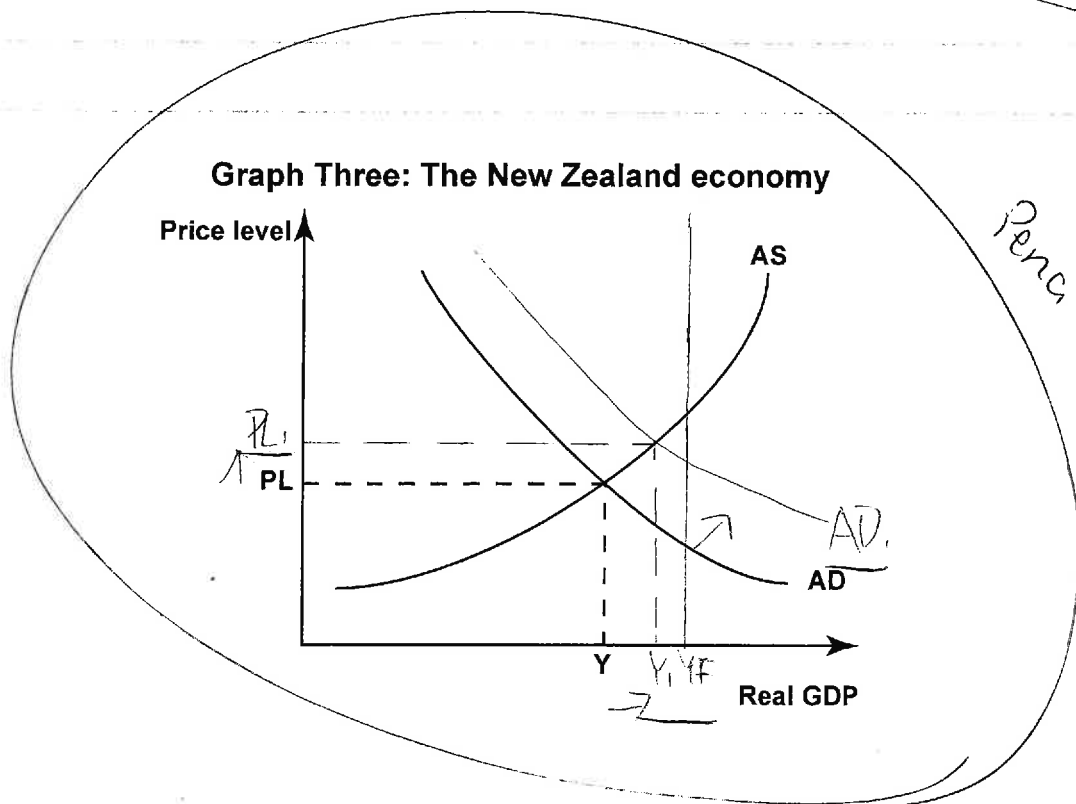
Source (adapted): http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/RegionalGDP_HOTPYeMar14.aspx

- (a) Using the multiplier, fully explain the increase in real GDP that would occur if there were an additional \$40 billion of spending and the marginal propensity to consume (mpc) in Christchurch is 0.70.

$$\frac{1}{1-MPC} = \frac{1}{1-0.7} = 3.33$$

$$3.33 \times \$40 = \$133.2$$

(1)



- (b) Use Graph Three on page 6 to illustrate how the government spending on the Christchurch earthquake recovery would affect the New Zealand economy. Clearly label any changes you make.
- (c) Referring to Graph Three, the multiplier, and the resource material, compare the effectiveness of government spending on the Christchurch earthquake recovery on the goals of economic growth and full employment for the New Zealand economy.

An increase in government spending causes AD to shift outwards. This is because government spending (G) is a component of AD, ~~so~~ since G↑, AD increases. As AD increases, ~~Y~~^{REAL GDP} increases to Y_1 which is economic growth. It is close to Y_F which is full employment. Price level rises from PL to PL, which inflation occurs. //

As government spends more on recovery, it means that transfer payment ~~is~~ also increases. More people would be employed due to ~~a~~ businesses gain high revenue and wants to improve conditions. Therefore unemployment will decrease.

A4

Extra space if required.

Write the question number(s) if applicable.

ASSESSOR:
USE ONLY

QUESTION
NUMBER

1.0) AS shifts to the left due to an increase in cost of production. This is because producers will have to spend more on purchasing the same amount of raw materials, it results in a decrease in profit also a decrease in productivity as some employees may be redundant. //

Overall, a decrease in AS and an increase in AD will cause real GDP ~~falls~~ ^{increases} from Y_1 to Y_2 which leads to ~~economic~~ growth, price level ~~falls~~ ^{also increases} from PL to PL₁ which is inflation. //

(6)

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Achievement exemplar 2016

Subject: Economics		Standard: 91403	Total score: 11
Q	Grade score	Annotation	
1	A4	<p>This candidate has received A4 for this question because they:</p> <p>a) Shifted and labelled the S\$NZ shift correctly but shifted the D\$NZ incorrectly on Graph One. (1)</p> <p>b) Shifted and labelled the AS and AD curves correctly on Graph Two. (2)</p> <p>c) Failed to provide an explanation for why the S\$NZ and D\$NZ curves have shifted. (3) Provided a partial explanation on why the AS curve decreases when the OCR decreases (4). A more in-depth explanation would have linked the decrease in OCR to increasing cost for imported raw materials which increase firms' costs of production. Provided a detailed explanation on why the AD curve increased using two variables, Consumer Spending and Investment. (5) Failed to provide a detailed explanation to explain the effectiveness of a reduction in the OCR in achieving the goals of economic growth and price stability. (6)</p>	
2	A3	<p>This candidate has received A3 for this question because they:</p> <p>a) Provided a partial explanation on how an increase in the Terms of Trade will improve NZ's Current Account. (1) A more detailed answer would have explained how an increase in export prices relative to import prices (or vice versa) had improved NZ Terms of Trade and how this will improve NZ's Current Account.</p> <p>b) Explained in detail how a depreciation of the NZ dollar will make NZ's exports more competitive and lead to an increase in Export Receipts and improve NZ's Current Account. (2) A more complete answer would have included an explanation of the impact of the NZ dollar depreciating on NZ's Import Payments.</p> <p>c) Failed to provide an explanation of which event (increase in Terms of Trade or Depreciation of the NZ dollar) will have the bigger impact on the Current Account. (3)</p>	
3	A4	<p>This candidate has received A4 for this question because they:</p> <p>a) Used the multiplier to correctly calculate the increase in real GDP but did not explain how this would occur. (1)</p> <p>b) Shifted and labelled the AD curve correctly on Graph Three. (2)</p> <p>c) Provided partial explanations of the impact of government spending on the Christchurch earthquake recovery on the goals of economic growth (3) and full employment. (4) More complete explanations would have explained in detail how the government spending would lead to increased consumer spending and/or investment and that firms need to employ more workers due to the need to increase output to meet the increased demand for goods and services.</p>	