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Mana Tohu Mātauranga o Aotearoa
New Zealand Qualifications Authority

# Level 2 Economics 2023

## 91222 Analyse inflation using economic concepts and models

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.

Do not write in any cross-hatched area (DO NOT WRITE). This area will be cut off when the booklet is marked.

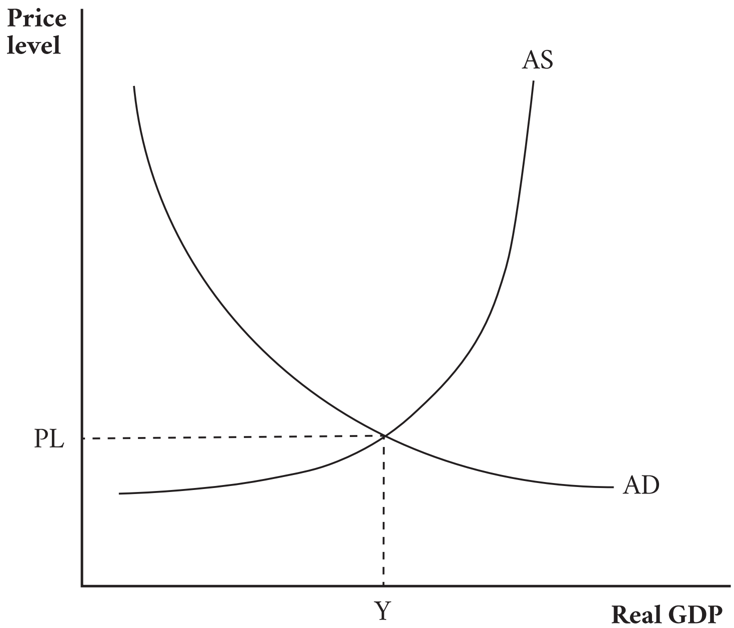
**YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.**

## QUESTION ONE: The aggregate supply / aggregate demand model

A shortage of migrant workers and the increasing cost of living has led to increasing wage expectations among the workforce. This has come at a time when successive increases to the minimum wage in New Zealand have led to a large increase in wage costs for businesses across all sectors of the economy.

(a) On Graph One below, show the impact on aggregate supply of the increase in wage costs for businesses in New Zealand.

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

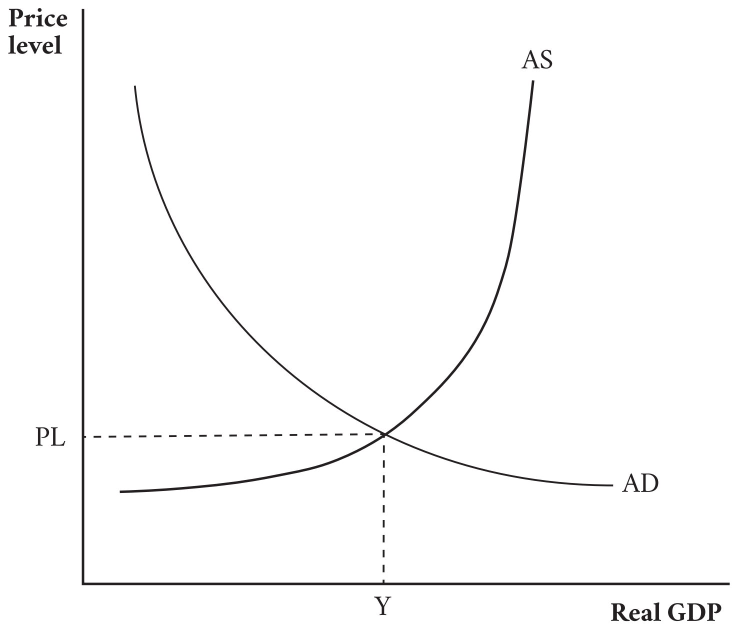



(b) Explain the impact on inflation of an increase in wage costs to businesses in New Zealand. Refer to Graph One in your answer.

In 2022, the cost of living payment was paid to all eligible New Zealanders to help with the rising costs created by increasing inflation rates. People received $350, which was split across three separate payments.

(c) On Graph Two below, show the impact on aggregate demand of the cost of living payments made to New Zealanders.

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




(d) Explain the impact on inflation of the cost of living payment. Refer to Graph Two in your answer.

(e) Discuss whether increasing wage costs or the cost of living payment is likely to have had the larger impact on New Zealand's current inflation rate. Refer to Graphs One and Two on pages 2 and 3 in your answer.

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The assessment continues on the following page.

## QUESTION TWO: Quantity theory of money

New Zealand's annual inflation rate was 7.2% in the December 2022 quarter. This is considered to be a high level of inflation.

(a) Explain one reason why a high inflation rate would have a negative impact on the New Zealand economy.

One option for the Reserve Bank of New Zealand to manage the inflation rate is to reduce the money supply, which has been at a record high as a result of the COVID-19 recovery.

(b) Identify the variables in the quantity theory of money.

M:

V:

P:

Q:

(c) Use the quantity theory of money formula to explain how a 2% decrease in the money supply would impact the inflation rate in New Zealand, assuming the other variables remain constant.

The Reserve Bank of New Zealand predicted that New Zealand will experience a recession in 2023. This means a decrease in real GDP as production and economic activity slows.

(d) Compare and contrast the impact on inflation of decreasing the money supply by 2% under the following conditions:

- when the other variables remain constant
- during a recession, when output has decreased by 3%.

## QUESTION THREE: Measurement and impacts of inflation

(a) Explain how inflation is measured in New Zealand.

(b) Explain why New Zealand is likely to experience disinflation, rather than deflation, as the Reserve Bank takes measures to control the inflation rate.

It was announced in February that the minimum wage would increase to $22.70 per hour from 1 April 2023. This increase of 7.1% aligns with the 7.2% inflation rate, to ensure that workers do not lose purchasing power as a result of increasing levels of inflation.

The Labour Cost Index (LCI) is one measure of the increase in wages across the entire economy. The LCI showed that, on average, wages and salaries in New Zealand rose only 3.7% in the year ended September 2022.

Source (adapted): Ministry of Business, Innovation & Employment. (2023, February 8). *Minimum wage rising to $22.70 per hour from 1 April 2023.* https://www.mbie.govt.nz/about/news/minimum-wage-rising-from-1-april-2023/. (CC-BY-4.0)

Source (adapted): Public Service Commission. (2022, September). *Labour cost index September 2022.* https://www.publicservice.govt.nz/assets/Labour-Cost-Index-September-2022-quarter.pdf. (CC-BY-4.0)

(c) Using the resource material above, explain the change in real wages for workers earning the minimum wage, compared to other workers in the economy.

(d) Compare and contrast the impact of high inflation on low-income households and high-income households.

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