

90794



NEW ZEALAND QUALIFICATIONS AUTHORITY  
 MANA TOHU MĀTAURANGA O AOTEAROA

*For Supervisor's use only*

## Level 2 Economics, 2008

### 90794 Describe inflation and its causes and effects using economic models

Credits: Four

9.30 am Tuesday 18 November 2008

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 answer ALL the questions in this booklet.

If you need more space for any answer, use the page(s) provided at the back of this booklet and clearly number the question.

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.**

<i>For Assessor's use only</i>		<b>Achievement Criteria</b>	
<b>Achievement</b>		<b>Achievement with Merit</b>	<b>Achievement with Excellence</b>
Describe inflation and its causes and effects using economic models.	<input type="checkbox"/>	Explain inflation and its causes and effects using economic models.	Fully explain inflation and its causes and effects using economic models.
		<input type="checkbox"/>	<input type="checkbox"/>
<b>Overall Level of Performance</b>			<input type="checkbox"/>

You are advised to spend 40 minutes answering the questions in this booklet.

### QUESTION ONE

- (a) Identify each **component** of the equation  $MV = PQ$ .

M \_\_\_\_\_

V \_\_\_\_\_

P \_\_\_\_\_

Q \_\_\_\_\_

- (b) Use the Quantity Theory of Money to explain how an **increase** in the money supply can affect **inflation**.

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- (c) Complete the table below by stating the most appropriate term for each **inflation situation**.

Period	Quarterly Inflation Rate	Term to describe each situation
Dec. 2006	-0.2%	
Mar. 2007	0.5%	
Jun. 2007	1.0%	
Sep. 2007	0.5%	

- (d) State the meaning of the term **deflation**.

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**Recent newspaper headlines**

Oil prices skyrocket to new high  
 Price of butter up a healthy 37 per cent

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- (e) Explain why inflation is **more likely** to be caused by an **increase in the price of oil** than by an **increase in the price of butter**. Refer to the headlines above in your answer.

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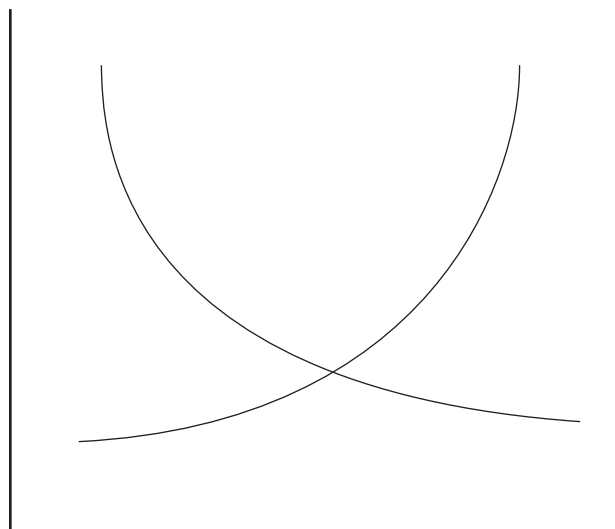
**QUESTION TWO**

- (a) For each situation below, tick the appropriate box to identify the type of inflation involved.

Situation	Cost-push	Demand-pull
Cheap credit		
Increase in wages		
Rise in disposable incomes		
Drop in productivity		

- (b) Fully label the model below AND show the effect of an **increase in the cost of raw materials**.

**Model One: Aggregate Supply and Aggregate Demand of an Economy**



### QUESTION THREE

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#### Butter, cheese, milk powder set export record

Record dairy exports have contributed to the biggest December trade surplus in a decade. Statistics New Zealand numbers for exports and imports in December showed a 25 per cent increase to a record monthly \$3.7 billion in exports. Milk powder, butter, and cheese exports exceeded \$1 billion for the first time, having increased 77 per cent from December 2006.

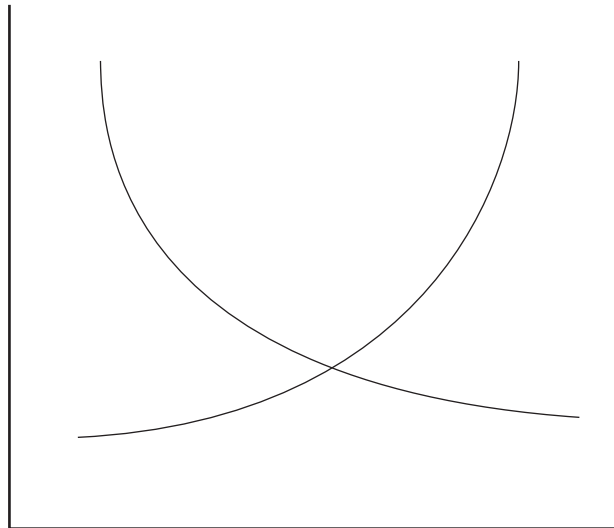
Source: *The Dominion Post*, 1 February 2008.

- (a) Fully label the model below, including the equilibrium.

Show the effect of **high prices** for **exported dairy products**.

Fully label the changes.

#### Model Two: Aggregate Supply and Demand of the New Zealand Economy



- (b) Explain the changes you made for (a).

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Refer to the graph on the previous page to answer (c) and (d).

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(c) Explain the impact on **growth** of the **high prices** for exported dairy products.

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(d) Explain the impact on **inflation** of the **high prices** for exported dairy products.

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**QUESTION FOUR**Assessor's  
use only**Wages up, but consumer prices rise as well**

Current wages were up by 3.2 per cent in the last year and consumer prices were up by 2.5 per cent, the Council of Trade Unions said today.

Source: Adapted from Council of Trade Unions Press Release, 7 May 2007.

- (a) Calculate the percentage increase in the **real wage**.

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- (b) Explain the difference between **nominal wages** and **real wages**.

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**House prices down, but no crash**

The national median price [of houses] also fell, down from \$345 000 in December to \$340 000 in January. That compares with the peak price of \$352 000 in November 2007.

Source: Adapted from *New Zealand Herald*, 23 February 2008.

- (c) Fully explain the effect of **the decreasing value of houses** on **future consumer spending**. Refer to the resource above. Your explanation should include the **wealth effect** and the impact on **inflation**.

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**QUESTION FIVE**

Fully explain the link between the **rate of inflation** and the **phases of the business cycle**.

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