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NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

# Level 2 Economics, 2014

## 91222 Analyse inflation using economic concepts and models

2.00 pm Wednesday 12 November 2014
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 parts of ALL 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: THE BUSINESS CYCLE AND INFLATION

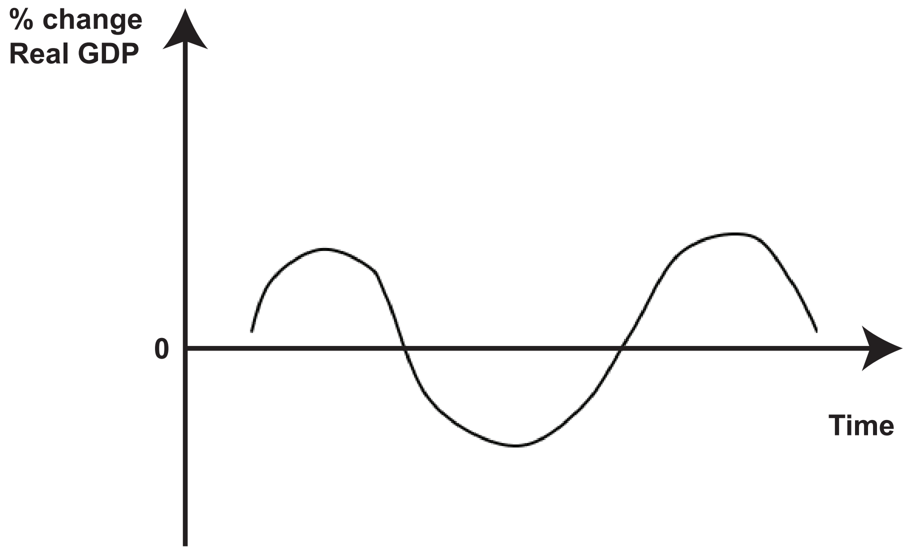


According to the Household Labour Force Survey, employment increased from 2 208 100 to 2 261 800 between September 2012 and September 2013, which indicates New Zealand was in the recovery stage of the business cycle for this time period.

Source of statistics: http://www.stats.govt.nz/infoshare

(a) On Graph One below, clearly label an example of a recovery. Label this point **X**.

**Graph One: The Business Cycle**



(b) Use Graph Two below to analyse in depth the effects of the recovery stage of the business cycle on inflation. In your answer:

- show the effect of increasing employment on the AS and / or AD curve
- explain in detail how increasing employment would affect inflation.

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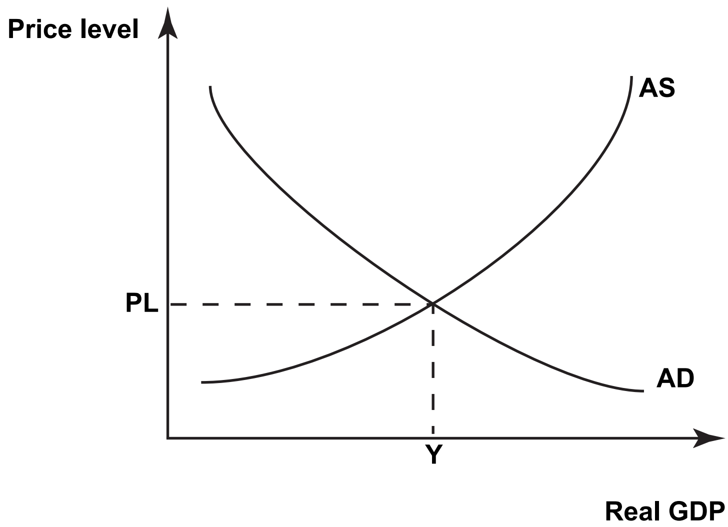
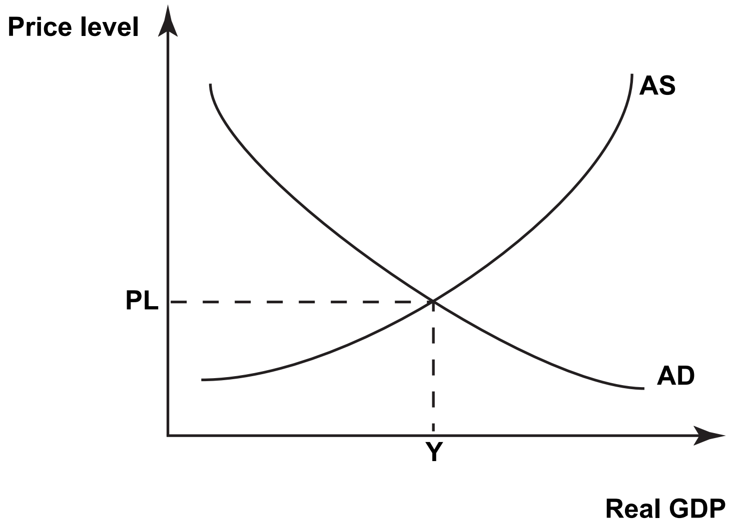
**Graph Two: AS / AD model of the New Zealand economy**



When the economy enters the boom stage of the business cycle, output and employment are increasing at high rates and shortages of resources may occur, as the economy is approaching full capacity.

(c) Compare and contrast the impact on inflation of the recovery stage of the business cycle with the impact of the boom stage of the business cycle. In your answer:
- use Graph Three below to show the effects of a boom on the AS and / or AD curve
- explain in detail how a boom would affect inflation
- explain in detail whether a recovery or a boom would have the greater impact on inflation
- refer to Graphs Two and Three in your answer.

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



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## QUESTION TWO: EFFECTS OF DISINFLATION

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New Zealand's annual percentage increase in the CPI declined from 5.3% to 0.7% between the March quarter in 2011 and the March quarter in 2013.

Source: RBNZ

(a) Explain in detail why the change in the CPI identified in the stimulus above is an example of disinflation rather than an example of deflation. Refer to data from the resource material in your answer.

(b) Compare and contrast the impact of disinflation on various groups in New Zealand society, such as households, producers, borrowers, savers, exporters, and importers.
In your answer:

- identify TWO groups in New Zealand society who could be better off because of disinflation
- explain in detail why these groups could be better off
- identify TWO groups in New Zealand who could be worse off because of disinflation
- explain in detail why these two groups could be worse off.

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## QUESTION THREE: INFLATIONARY EXPECTATIONS AND DEPRECIATION

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Changes in inflationary expectations and the value of the New Zealand dollar are two factors that can significantly affect inflation.

(a) Use the Quantity Theory of Money to explain in detail how increasing inflationary expectations could affect inflation. In your answer:

- explain in detail how increasing inflationary expectations would affect the velocity of circulation and the general price level
- refer to all the variables in the Quantity Theory of Money.

(b) Compare and contrast the impact on inflation of increasing inflationary expectations with the impact of a depreciation of the New Zealand dollar. In your answer:

- use Graph Four on page 9 to show the effects of increasing inflationary expectations on inflation
- use Graph Five on page 9 to show the effects of a depreciation of the New Zealand dollar on inflation
- explain in detail how a depreciation of the New Zealand dollar would affect inflation
- explain in detail why a depreciation of the New Zealand dollar would have a greater impact on inflation than increasing inflationary expectations
- refer to Graphs Four and Five in your answer.

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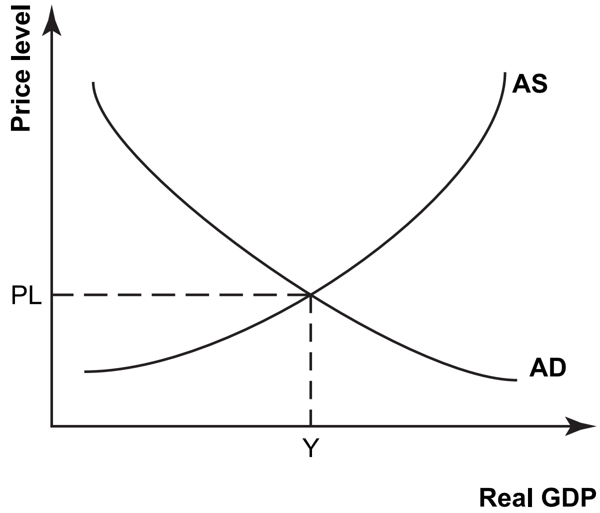
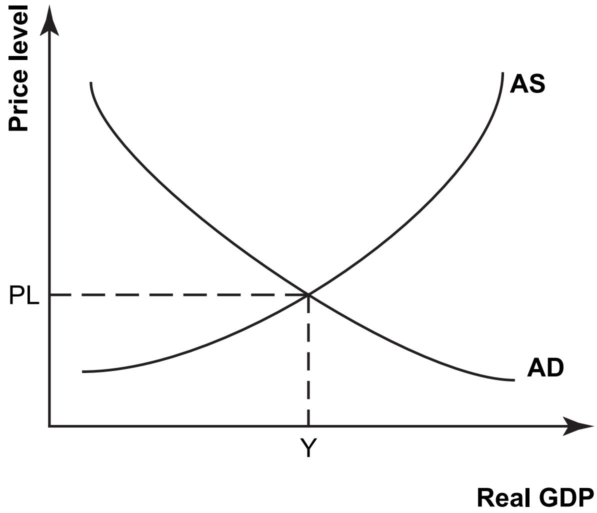
**Graph Four: The New Zealand economy with increasing inflationary expectations**




**Graph Five: The New Zealand economy with depreciation of the New Zealand dollar**




**Question Three continues on the following page.**

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