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NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

SUPERVISOR'S USE ONLY

Level 3 Economics, 2014

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

9.30 am Tuesday 25 November 2014
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 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: APPRECIATION IN THE EXCHANGE RATE

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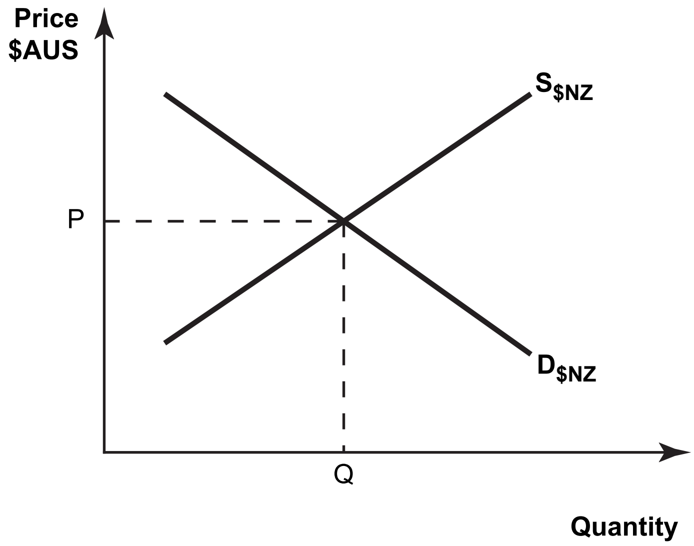
High-flying NZ dollar causes jitters

The NZ / AUS exchange rate is becoming a headache for exporters and Australia-originated inbound tourism … well over 40 per cent of visitors to this country are from Australia.

Westpac expects the currency to continue to appreciate on the cross rate, driven by interest rate differentials, especially since the Reserve Bank is expected to start its tightening cycle by increasing the Official Cash Rate (OCR).

Source (adapted): http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11193320

Graph One: The Market for the New Zealand dollar



(a) (i) The Reserve Bank increasing the Official Cash Rate (OCR) will increase the interest rate 'differentials' between New Zealand and Australia. On Graph One above, shift **both curves** to illustrate the impact on the NZ exchange rate of the Reserve Bank increasing the OCR. Label curve shifts, and identify the new exchange rate as $\mathbf{P_1}$.

(ii) Explain in detail the change in exchange rate from **P** to $\mathbf{P_1}$.

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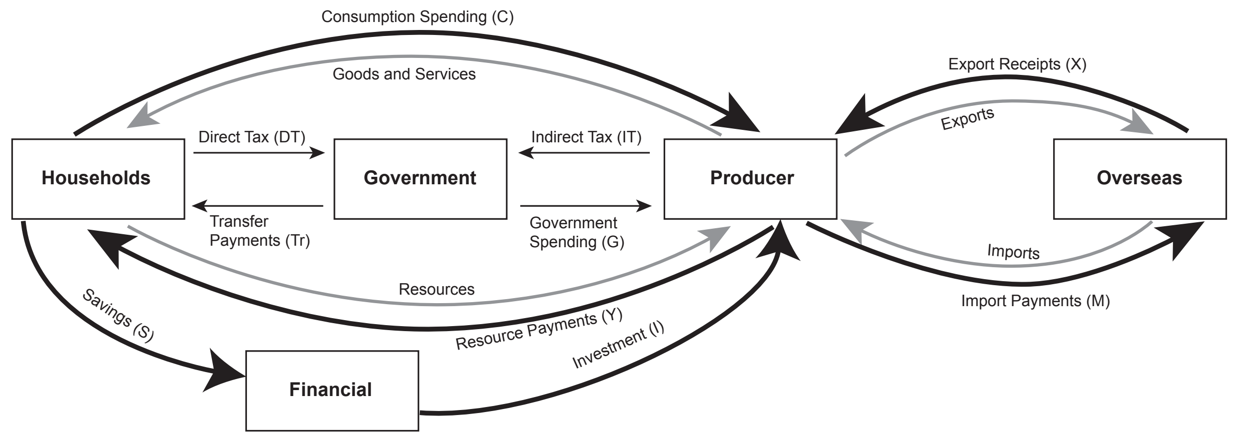
The circular flow diagram below illustrates the relationship between different sectors of the economy. The exchange rate has an influence on different sectors of the economy.



(b) Use the circular flow diagram to compare and contrast the impact that an appreciation in the NZ exchange rate has on the macro-economic goals of economic growth and balanced current account. In your answer, use money flows and real flows, to explain in detail:

- the impact an appreciation in the NZ exchange rate has on New Zealand tourism firms
- how an appreciation in the NZ exchange rate will impact on the current account, by referring to flows between the producer and overseas sectors
- how an appreciation in the NZ exchange rate will impact on economic growth, by referring to the flows between the sectors of the economy
- how an appreciation in the NZ exchange rate may have a greater impact on the macro-economic goal of a balanced current account than on economic growth.

More answer space for this question is available on the next page.

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QUESTION TWO: GOVERNMENT POLICIES

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New Zealand Real Gross Domestic Product (GDP) growth for the year ending Sept 2013 was 2.6%.

Source: http://www.rbnz.govt.nz/statistics/key_graphs/real_gdp/

As a way to increase GDP, the Government can increase government spending, which has multiplied effects through the economy. For example, an increase in government spending of $5 billion can increase GDP by $20 billion.

The spending multiplier formula used to calculate the increase in GDP is $\frac{1}{1 - \text{MPC}}$.

(a) Use the spending multiplier formula to explain in detail how an increase in government spending of $5 billion can increase GDP by $20 billion.

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Increased government spending can be used to stimulate economic growth. Decreased interest rates could also stimulate economic growth, as it will impact on the spending multiplier.

(b) Compare and contrast the effectiveness of increased government spending with decreased interest rates to stimulate economic growth. In your answer:

- use the ideas of **savings** and **consumption** to explain in detail how decreased interest rates can have multiplied effects on the economy
- refer to your answer in (a)
- use the spending multiplier formula to explain in detail the idea that decreased interest rates may be more effective in achieving economic growth than increased government spending.

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QUESTION THREE: ECONOMIC BOOM

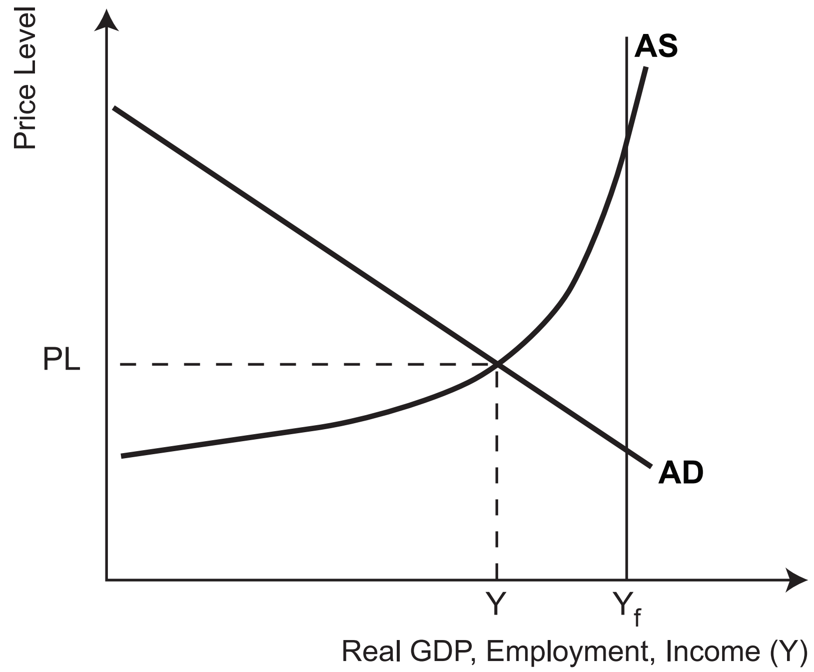
Welcome to the boom of 2014

Financial experts are united – 2014 could be a golden one for the New Zealand economy, with all signs pointing to a prosperous year.

Commodity prices are booming, businesses are at their most confident in 20 years, the economy is among the world's fastest growing, jobs and wages are predicted to rise and that confidence is filtering through to consumers, who are starting to open their wallets.

Source (adapted): http://www.stuff.co.nz/business/industries/9560760/Welcome-to-the-boom-of-2014

Graph Two: The New Zealand economy



(a) (i) On Graph Two above, illustrate the impact of the news that "businesses are at their most confident in 20 years", by shifting the correct curve. Label the curve shift, and identify the new equilibrium as $\mathbf{PL_1}$ and $\mathbf{Y_1}$.

(ii) Explain in detail the changes you made to Graph Two, and the impact of the changes on the macro-economic goal of price stability (targeting inflation between 1 per cent and 3 per cent, with a focus on 2 per cent).

Question Three continues on the following page.

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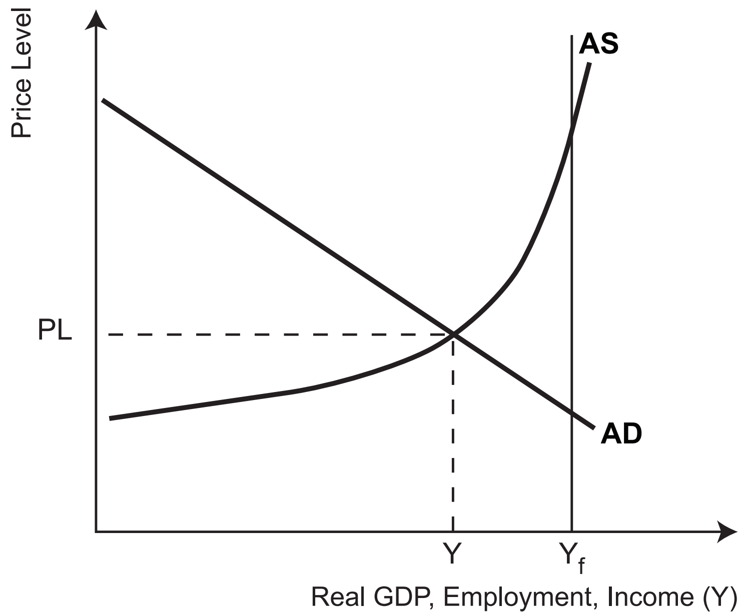
Economists also expect wage growth, as well as falling unemployment in 2014 and beyond. As wages grow, consumers feel wealthier and begin to "open their wallets".

Source (adapted): http://www.stuff.co.nz/business/industries/9560760/Welcome-to-the-boom-of-2014

(b) Compare and contrast the impact that **wage growth** and **falling unemployment** have on the macro-economic goals of **economic growth** and **price stability**. In your answer:

- illustrate the impact that wage growth and falling unemployment will have on **both curves** in Graph Three below. Label curve shifts, and identify the new equilibrium point as **PL_2** and **Y_2**
- explain in detail the impact that wage growth and falling unemployment have on economic growth **and** on price stability
- refer to Graph Three.

Graph Three: The New Zealand economy



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