

91222



NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

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SUPERVISOR'S USE ONLY

Level 2 Economics, 2019

91222 Analyse inflation using economic concepts and models

2.00 p.m. Friday 22 November 2019
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 2–11 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 QUANTITY THEORY OF MONEY

The Quantity Theory of Money states that the quantity of money circulating in the economy is equal to the monetary value of the goods and services available within the economy.

Complete parts (a) and (b) to comprehensively analyse the effects of changes in the money supply and velocity of circulation on inflation.

- (a) (i) Identify each of the four variables used in the Quantity Theory of Money equation.

M: _____

V: _____

P: _____

Q: _____

- (ii) State the Quantity Theory of Money equation, and use it to fully explain how a 5% increase in the money supply could affect the price level, assuming other variables are constant.

Historically, home owners experience a 'wealth effect' when house prices increase. They feel they can increase consumer spending, often borrowing against the increased value of their house.

Source (adapted): <https://www.stuff.co.nz/business/money/99373238/dont-be-fooled-by-the-wealth-effect-of-a-rising-house-value>.

However, lower immigration, tighter lending conditions from banks and falling house prices in Australia are leading to the possibility that house prices in New Zealand will either weaken or decrease in 2019. This is expected to reduce consumer confidence and the velocity of circulation.

(b) Compare and contrast the effect on the price level of:

- (i) an increase in the money supply, while other variables remain constant
- (ii) an increase in the money supply, accompanied by a fall in house prices, causing a decrease in consumer confidence.

In your answer, you should:

- refer to the Quantity Theory of Money
- fully explain how a decrease in consumer confidence will affect the change in the price level that results from a 5% increase in the money supply
- fully explain which of the two changes out of (b)(i) and (b)(ii), above, will cause a greater increase in inflation.

There is more space to answer part (b) on page 4 ►

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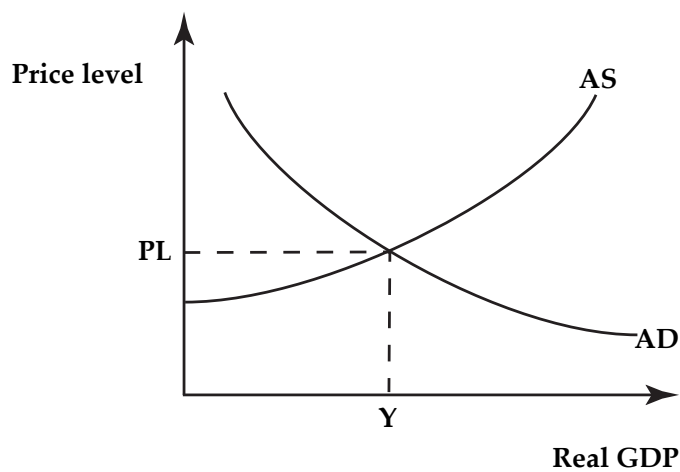
QUESTION TWO: THE AD/AS MODEL

New Zealand will host rounds of the Track Cycling World Cup in the 2018 / 2019 and 2019 / 2020 seasons, which will have 550 competitors, staff, officials and media from more than 40 countries travelling to New Zealand. The sold-out events will benefit the local regions with significant spending from international and domestic supporters.

Source (adapted): <http://www.sportzhub.com/article/uci-track-cycling-world-cup-returns-to-new-zealand-in-2019.html>.

- (a) (i) On Graph One, below, show the impact of an international sports event, such as the Track Cycling World Cup rounds in New Zealand, on Aggregate Demand.

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



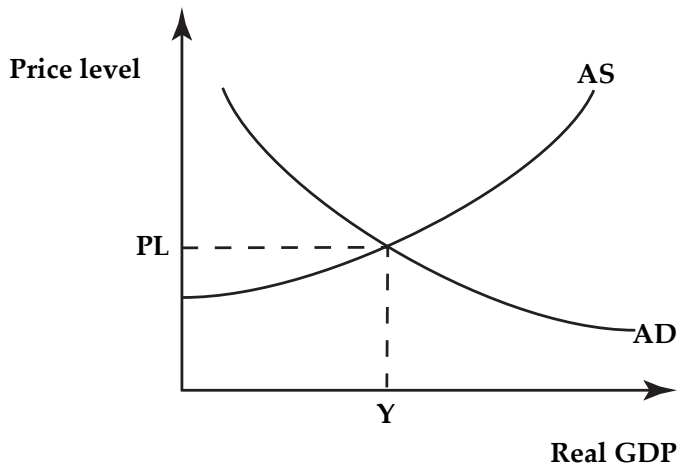
- (ii) Referring to Graph One, fully explain the impact on inflation of an event, such as the Track Cycling World Cup, being held in New Zealand.

Reserve Bank of New Zealand has projected that import prices (in New Zealand-dollar terms) will increase by 5.1% during 2019. Many New Zealand businesses depend on imported capital goods (e.g. fuel, machinery, farm equipment, vehicles and electronics) in their production.

Source: <https://rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Monetary%20policy%20statements/2018/mpsnov2018.pdf>.

- (b) (i) On Graph Two, below, show the impact of increasing import prices on Aggregate Supply.

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



- (ii) Referring to Graph Two, fully explain the impact on inflation of increasing import prices in New Zealand.

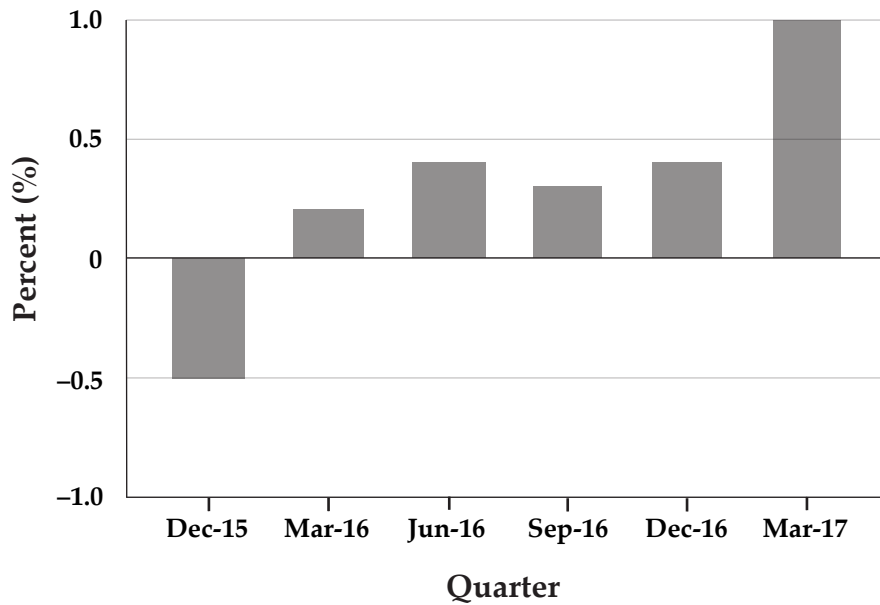
- (iii) Fully explain why the impact on inflation of increased import prices may be greater than the impact of an international sports event, such as the Track Cycling World Cup.

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QUESTION THREE: IMPACT OF INFLATION AND DEFLATION

Graph Three: Consumers' Price Index, quarterly change,
December 2015–March 2017



Source (adapted): <https://www.stats.govt.nz/information-releases/consumers-price-index-september-2018-quarter>.

(a) Fully explain the difference between inflation and deflation, by:

(i) Using Graph Three, above, identify and explain a period of **inflation**.

(ii) Referring to Graph Three, identify and explain a period of **deflation**.

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