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Level 2 Economics 2021

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 2–11 in the correct order and that none of these pages is blank.

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

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

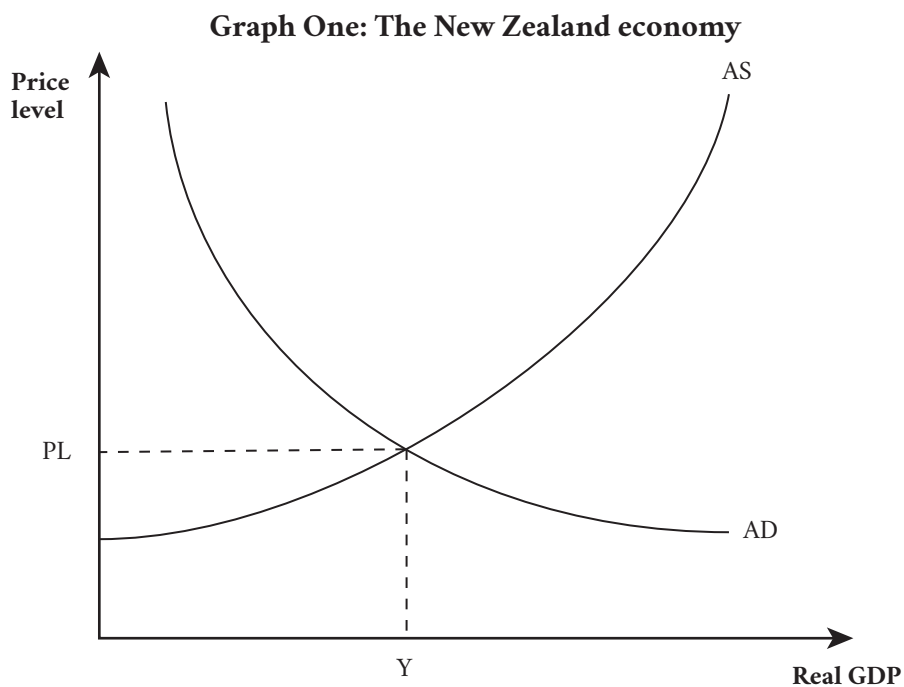
QUESTION ONE: The AD/AS model

Disruption to the global supply chain from the ongoing effects of COVID-19, and congestion at New Zealand's major ports, have meant that the cost of imported raw materials increased for many businesses in the early months of 2021.

Steel and Tube Holdings Ltd. said its costs of both imported raw materials and transport had risen significantly.

Source (adapted): www.stuff.co.nz/business/124156787/price-hikes-in-wings-as-businesses-fend-off-cost-pressures

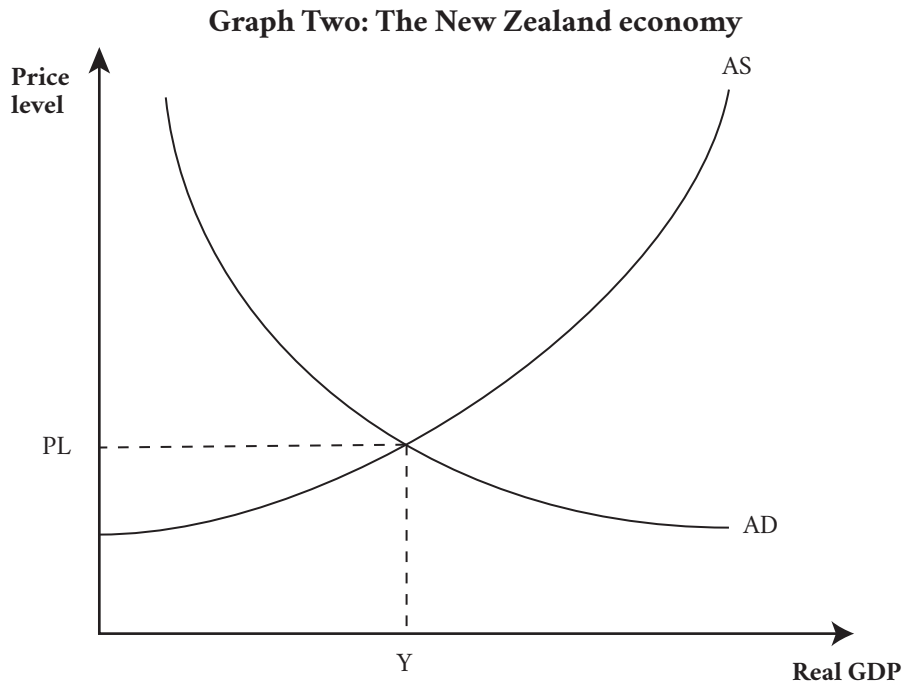
- (a) (i) On Graph One, show the impact of an increase in the cost of imported raw materials.



- (ii) How does an increase in the cost of imported raw materials impact inflation? Refer to Graph One in your detailed explanation.

Due to border closures, most New Zealanders were unable to travel overseas in the summer holidays of 2020–2021, and some took the opportunity to take a local holiday, travelling within New Zealand instead. Many campgrounds were full, although luxury hotels and resorts did not experience the same increase in demand.

- (b) (i) On Graph Two, show the impact of increased spending on local holidays by New Zealanders.



- (ii) How does increased spending on local holidays impact inflation? Refer to Graph Two in your detailed explanation.

- (c) Discuss whether the increased spending by New Zealanders on local holidays would have a smaller or larger effect on inflation than the increase in the cost of imported raw materials.

Refer to Graph One and Graph Two, and the resource material from part (a) and part (b) in your answer.

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The examination continues on the following page.**

QUESTION TWO: Impact of inflation and deflation

In 2020, New Zealand's inflation rate was 1.4%.

Despite this relatively low inflation rate, the price of some goods and services increased significantly. For example, the overall price of fresh fruit and vegetables increased by 8.9%.

Source: www.stats.govt.nz/news/more-expensive-fruit-and-vegetables-boost-food-prices-in-2020

- (a) (i) Explain why not all households will be equally affected by an 8.9% increase in the overall price of fresh fruit and vegetables.

- (ii) Explain one reason why the 2020 inflation rate of 1.4% was less than the 8.9% increase in the overall price of fresh fruit and vegetables.

- (b) (i) If disinflation occurs in 2021 and deflation in 2022, fill out the table below with appropriate values.

2020	Inflation	1.4%
2021	Disinflation	_____ %
2022	Deflation	_____ %

- (ii) Savers who put their money in the bank found that nominal interest rate income fell to less than 1%.

Why might a saver prefer a period of deflation when nominal interest rates are very low? Explain in detail.

- (c) Inflationary expectations are an important component of consumer behaviour and business confidence.

Using the economic concept of inflationary expectations, provide a detailed explanation of why businesses would prefer a low and stable rate of inflation, rather than deflation.

QUESTION THREE: The quantity theory of money

Due to the ongoing effects of COVID-19, many governments have borrowed money to increase spending in order to stimulate their economies. Some have suggested that instead of increasing debt, governments should print more money. This will increase the money supply.

- (a) Use the quantity theory of money ($MV = PQ$) and the resource material, above, to explain how an increase in the money supply could increase inflation (assuming real output stays constant).

- (b) What is meant by the velocity of circulation? Why might it decrease during a recession?

- (c) Compare and contrast how an increase in the money supply impacts the rate of inflation when the velocity of circulation and the level of output decrease due to a recession.

In your answer, use the quantity theory of money to provide a detailed explanation of:

- how a decrease in the velocity of circulation impacts the rate of inflation when money supply increases (assuming real output stays constant)
- the overall impact on the rate of inflation of real output decreasing and the velocity of circulation decreasing due to a recession.

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