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Level 3 Economics 2021

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

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 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 2–16 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.

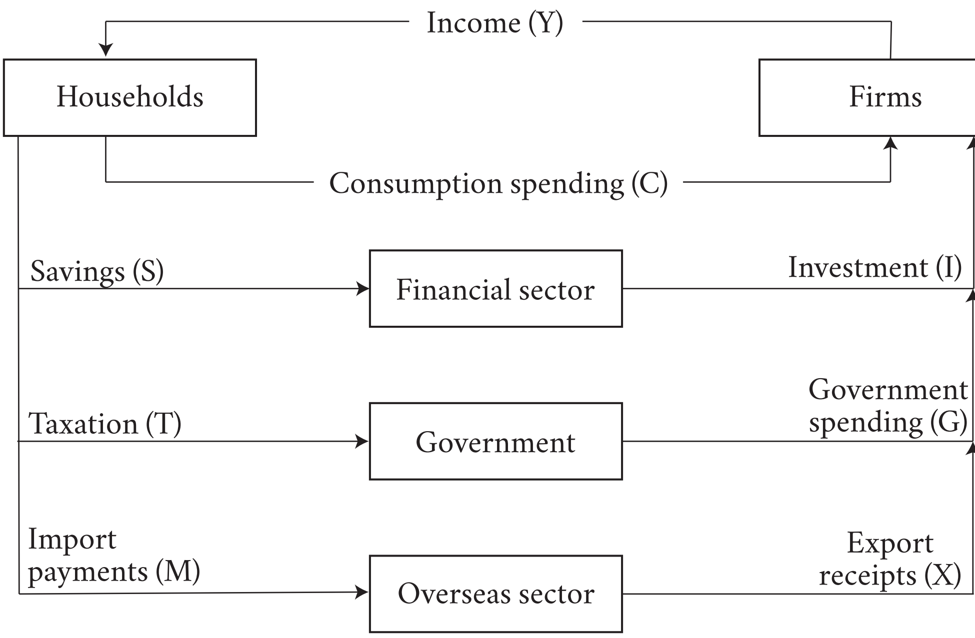
YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

QUESTION ONE: Border restrictions and lowering the Official Cash Rate

Border restrictions remain in place. These are significantly affecting industries such as international tourism and education, which together would normally account for a fifth of New Zealand's exports. Many firms are reducing costs because of the weaker economy. New investment projects are being put on hold or cancelled.

Border restrictions due to COVID-19 have much wider implications on the New Zealand economy than the initial decrease in export receipts.

Model One: Circular flow model showing money flows



(a) Referring to the resource material and Model One, explain in detail the initial impact on export receipts of continued border restrictions, and the flow-on effects on all five sectors of the economy.

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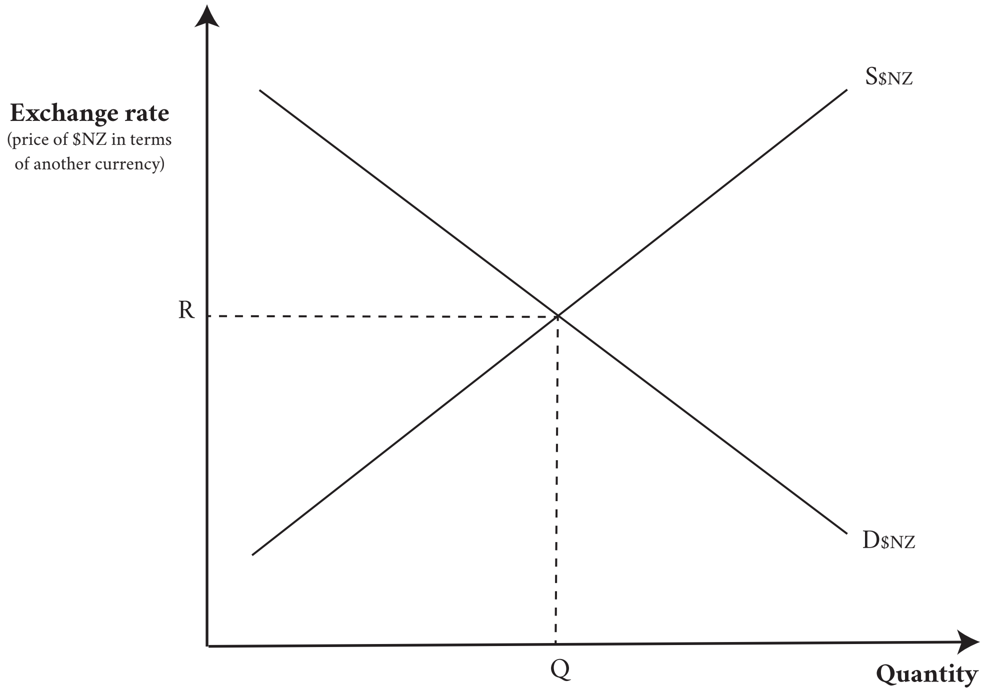
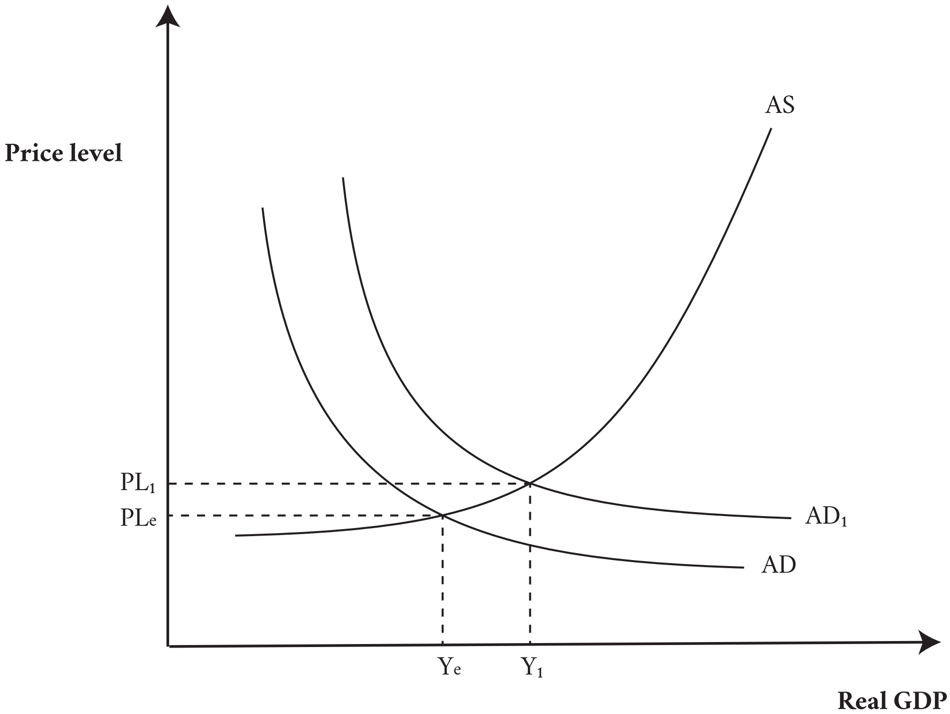
The Reserve Bank reduced the Official Cash Rate (OCR) to an all-time low of 0.25%. This can have an effect on the value of the New Zealand Dollar.

(b) On Graph One, below, show the impact of reducing the OCR on the value of the New Zealand dollar. Label any changes made.

Graph One: The market for the New Zealand dollar



Graph Two: The New Zealand economy after reducing border restrictions



Although reducing border restrictions is one way to promote economic growth, many argue that lowering the OCR is a more effective way.

Graph Two, on the previous page, shows the current level of output at Y_e. The level of output moves to Y_1 if the Government reduces border restrictions.

(c) (i) On Graph Two, show the impact on the level of output (label Y_2) of the Reserve Bank lowering the OCR.

(ii) Compare and contrast the impact on economic growth of the New Zealand Government reducing border restrictions and of the Reserve Bank lowering the OCR. Refer to Graph One and Graph Two and explain why lowering the OCR might be more effective for the Government to achieve its goal of economic growth.

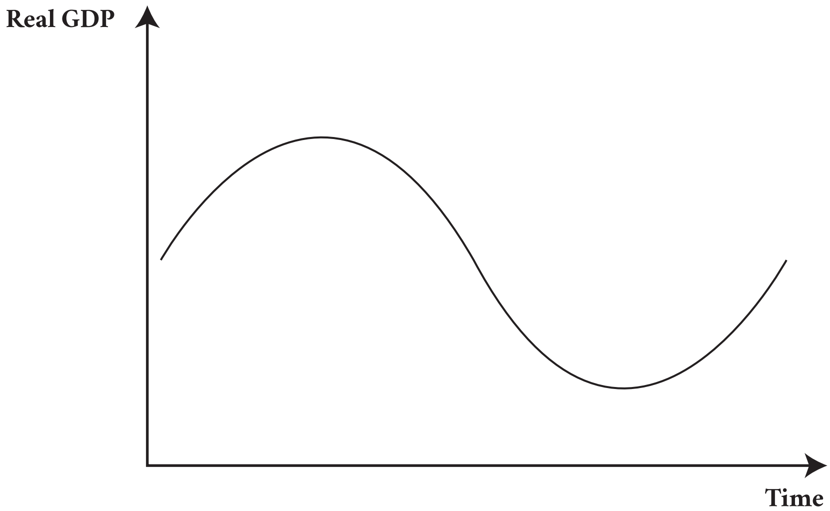
QUESTION TWO: Business confidence and the business cycle

A snapshot of the March 2020 ANZ Business Outlook Survey

- Profit expectations fell, with many firms expecting lower profitability.
- Employment intentions fell, with a significant number of firms intending to reduce employment.
- Capacity utilisation, one of the best GDP indicators in the survey, fell heavily.

(a) (i) Based on the snapshot in the resource material, identify the likely position, in March 2020, of the New Zealand economy by marking an **X** on Model Two, below.

Model Two: The business cycle



(ii) State the four stages of the business cycle and explain why you have chosen the above position on Model Two for the New Zealand economy. Refer to the snapshot above.

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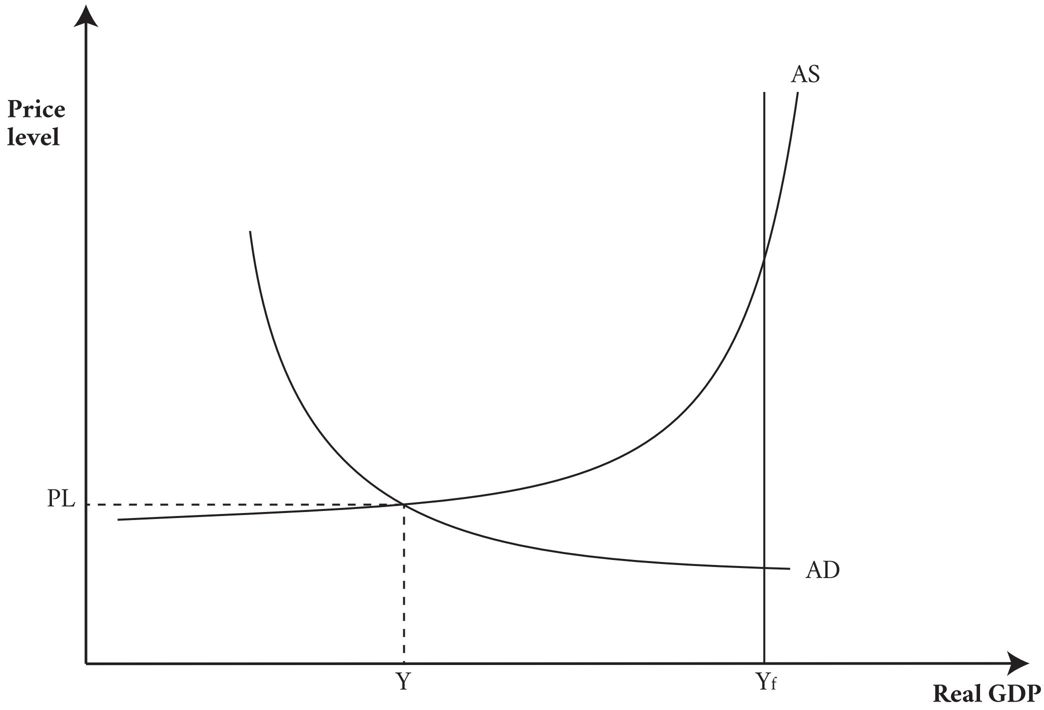
The March 2020 ANZ Business Outlook Survey also reported the following:

Business confidence plunged 45 points, with a majority of firms reporting that they expect general business conditions to deteriorate. Firms' expectations for their own activity fell, expecting lower activity over the year ahead. Investment intentions fell 21 points to net –14%.

(b) (i) On Graph Three, below, show the likely impact of decreased business confidence. Show the changes by labelling the new curve, the new price level (PL_1), and real GDP (Y_1).

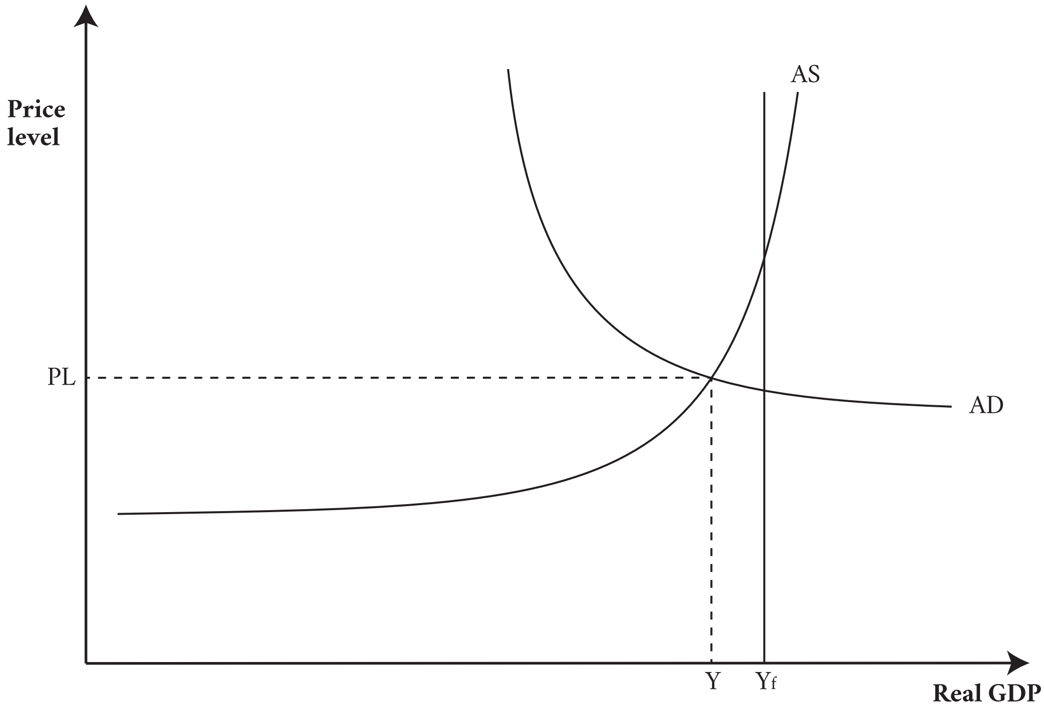
Graph Three: The New Zealand economy operating at low levels of output



(ii) How would a decrease in business confidence affect employment? Refer to the changes you made to Graph Three in your detailed explanation.

(c) (i) On Graph Four, below, show the likely impact of decreased business confidence. Show the changes by labelling the new curve, the new price level (PL_2), and real GDP (Y_2).

Graph Four: The New Zealand economy operating at high levels of output



(ii) Compare and contrast the impact of a decrease in business confidence on the Government goals of price stability and full employment, when the economy is operating at different levels of the business cycle. In your answer, explain:

- the difference in the size of the impact on the **price level** in Graph Three to that in Graph Four
- the difference in the size of the impact on **employment** in Graph Three to that in Graph Four.

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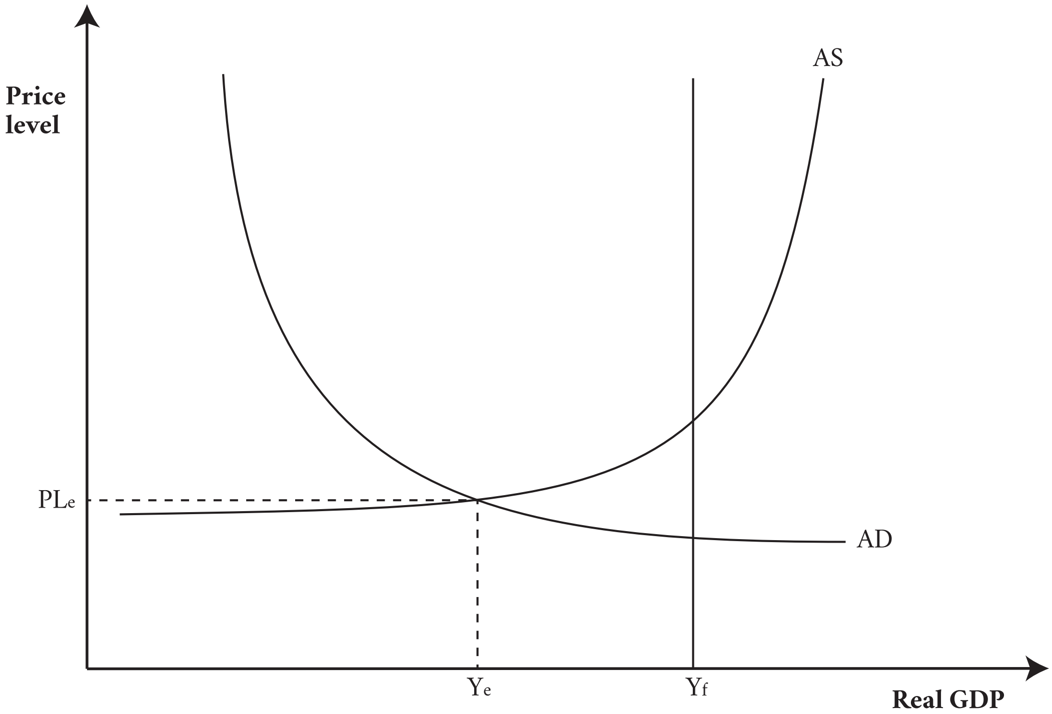
QUESTION THREE: Income tax cuts and free trade agreement

(a) (i) On Graph Five, below, clearly label the recessionary gap (RG) as a result of the economy operating below the full employment level of real GDP.

Graph Five: The New Zealand economy with a recessionary gap



One way to reduce the recessionary gap is by the Government boosting household income through an income tax cut that encourages households to increase consumption spending.

(ii) Assume that the size of the recessionary gap (RG) is $1.5 billion and the marginal propensity to consume is 90%. Using the formula for the spending multiplier, calculate the amount of initial increase in consumption spending that is required to increase real GDP by $1.5 billion and fully close the recessionary gap.

Amount of initial increase in consumption spending required = $ ____________________

Space for working (if required)

(iii) Refer to your calculation from part (ii) and the concept of the spending multiplier. How could the recessionary gap be removed with spending of less than $1.5 billion?

A free trade agreement that improves the current account could also reduce the recessionary gap.

(b) (i) On Graph Five, show the impact of a free trade agreement that reduces the recessionary gap. Label your changes.

(ii) How could a free trade agreement improve the current account and reduce the recessionary gap? Refer to the changes you made to Graph Five in part (b)(i), in your detailed explanation.

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(c) Which of these two policies (income tax cut or free trade agreement) will be more effective in increasing growth and fully removing the recessionary gap? Give a detailed explanation and refer to the changes you made to Graph Five.

Extra space if required.
Write the question number(s) if applicable.

QUESTION NUMBER

Acknowledgements
Material from the following sources has been adapted for use in this examination:

Question One
https://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement/mps-november-2020
https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Monetary%20policy%20statements/2020/Monetary-policy-statement-snapshots-nov-2020.pdf

Question Two
https://www.anz.co.nz/content/dam/anzconz/documents/economics-and-market-research/2020/ANZ-BusinessOutlook-20200331.pdf