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91222



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Mana Tohu Mātauranga o Aotearoa
New Zealand Qualifications Authority

Level 2 Economics 2025

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 2–12 in the correct order and that none of these pages is blank.

Do not write in the margins (//////). This area will be cut off when the booklet is marked.

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

Excellence

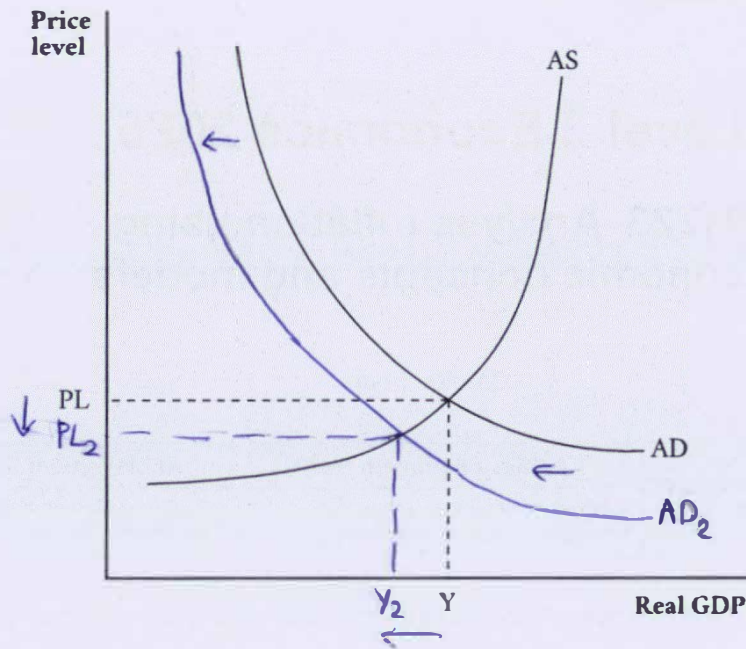
TOTAL 23

QUESTION ONE: Causes of inflation

In 2024, there were large-scale job losses and redundancies in New Zealand. These job losses had a flow-on effect on businesses such as cafes and restaurants in city centres.

- (a) On Graph One below, show the impact of job losses in New Zealand on aggregate demand. Fully label all changes.

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



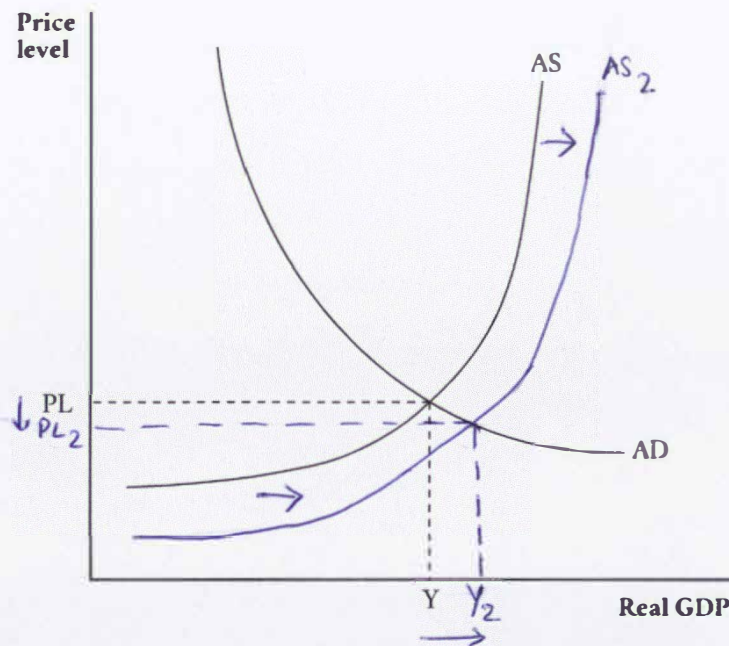
- (b) Explain the impact of job losses in New Zealand on the price level. Refer to Graph One in your answer.

When large scale job losses and redundancies take place in New Zealand, households loose income. When households are low on money, they become very careful of how they spend money. This reduces consumer spending in the economy. As consumer spending is a component of aggregate demand, given that $AD = C + I + G + (X - M)$, aggregate demand decreases from AD to AD₂. As businesses are not making profits at current price levels, they lower the price levels to more affordable prices. This causes PL to decrease from PL to PL₂. This results in a decrease in inflation

Decreasing petrol prices, including the removal of the 10c per litre Auckland Regional Fuel Tax, have benefitted businesses across the country.

- (c) On Graph Two below, show the impact of decreasing petrol prices in New Zealand on aggregate supply. Fully label all changes.

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



- (d) Explain the impact of decreasing petrol prices in New Zealand on the price level. Refer to Graph Two in your answer.

The removal of the Auckland Regional Fuel Tax reduce costs of production significantly for businesses across the country, as transportation of goods and services and powering machines and such become cheaper. This allows them to produce more goods and services and improves efficiency. This causes aggregate supply to increase from AS to AS₂. This results in price levels dropping from PL to PL₂. This shows a decrease in inflation.

Question One continues on the next page ➤

- (e) Explain whether job losses or decreasing petrol prices will have a bigger effect on the price level in New Zealand. Refer to Graphs One and Two in your answer.

The decreasing petrol prices is likely to have a bigger impact on the price levels in New Zealand because it affects a bigger portion of almost all businesses across the country. This is because petrol is a resources that helps businesses with cheaper transportation and providing energy for machines etc... This can also be beneficial for consumers who can satisfy their consumer needs with more affordable prices for goods and services. With the job losses, eventhough ^{can be assumed} it was a significant amount of people that lost their jobs, these people may have the opportunity of finding another job with the increased job opportunities a decrease in petrol prices will bring. This could mean becoming truck drivers and people who ~~take~~ could get other roles in the transportation side of business. The decreasing petrol prices even aides in economic growth as ~~more people~~ with the graph two shows Y increasing to Y_2 . This goes to show that the ~~decrease~~ increase in Aggregate supply in graph two is bigger than than the decrease in Aggregate demand in graph one. This means that the price change ~~in graph two is bigger~~ ^{in graph two,} and counteracts the price from PL to PL_2 is bigger and has more impact on the price level in New Zealand than the price change from PL to PL_2 in graph one.

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The assessment continues on the following page.**

QUESTION TWO: Inflation and the quantity theory of money

- (a) Use the figures above to explain the difference between disinflation and deflation.

~~Inflation~~ ~~deflation~~ disinflation is a decrease in the rate of inflation, ^{at a} which means inflation is still rising just a slower rate.

Deflation is the decrease in the general price levels, which we can see in inflation rate dropping to 2.2% ~~from~~ in 2024, from 7.3% in 2022.

- (b) Explain one reason why the change in inflation rate from 2022 to 2024 is positive for the New Zealand economy.

When the inflation rate is as high as 7.3% in 2022, consumers will not be willing and able to spend money freely, only focusing on necessities. This reduces consumption in the economy, however, when inflation rate drops to 2.2%, which is a significant drop, consumers are now more willing and able to spend, boosting consumption, which is good for the economy.

In response to the slowing of inflation rates and slowing economic activity, the Reserve Bank of New Zealand has been decreasing the Official Cash Rate, resulting in decreasing interest rates.

- (c) Explain why decreasing interest rates may increase the velocity of circulation in New Zealand.

A decrease in interest rates caused by decreasing official cash rate will increase velocity of circulation by making borrowing and spending money more advantages, as less interest rates are to be paid, ~~making~~ making loans cheap and discouraging saving money, therefore encouraging borrowing money and spending it.

- (d) Using the quantity theory of money, explain how an increasing velocity of circulation will impact inflation in New Zealand.

In your answer:

- state the quantity theory of money
- explain how inflation will be impacted if the velocity of circulation increases but other variables remain constant
- explain how inflation will be impacted if the velocity of circulation increases and the level of real GDP increases.

$$1. \overset{-\uparrow}{M}V = \overset{\uparrow}{P}\overset{-}{Q} \quad 2. \overset{100}{M}\overset{\uparrow}{V} = \overset{90}{P}\overset{\uparrow}{Q}$$

The quantity theory of money, which states that $MV = PQ$. (M) stands for money supply and (V) stands for velocity of circulation. (P) stands for price level and (Q) stands for real output. When velocity of circulation increases, but (M) and (Q) remain constant, price levels will also proportionately increase. This is because (V) velocity of circulation and price levels are on opposite sides of the equation. Therefore for the equation to remain in equal state, price levels must drop proportionately. Because when more money is spent, prices are able to increase. When velocity of circulation increases, and the level of real GDP increases, the price level will remain neutral if the velocity and real GDP increase proportionately. However, this is because equal increases counteract and nullify any changes. However, if velocity increases more than output where velocity increases by 5% and output increases by 3%, prices will need to increase by 2% more, increasing inflation. If output was to increase more than velocity, where output increased by 4%, but velocity only increased by 3%, price levels will have to decrease by 1% to keep the equation in equal state, therefore, decreasing inflation.

QUESTION THREE: The CPI and its effects on inflation

(a) What does CPI stand for?

The CPI stands for Consumer Price Index, which is used to calculate the rate of inflation in New Zealand.

(b) Explain how the CPI is used to calculate the rate of inflation in New Zealand.

The CPI is a basket of weighted goods and services purchased by New Zealand households. This is then used to measure the price changes of these goods and services, which helps calculate the rate of inflation in New Zealand.

(c) Explain why the rate of inflation, as calculated by the CPI, does not affect all households equally.

This is because not all households spend the same proportions of their income on the same goods and services as other households. Some people may be spending less on rent than others and some ^{households} might be spending more on groceries / food than other households. So the rate of inflation calculated by CPI ~~was~~ does not affect all households equally.

(d) Explain one reason why government revenue might increase during a time of high inflation.

government revenue might increase during a time of high inflation because the government receives more tax revenue from ~~for example~~ increased GST, as prices of goods and services increase during high inflation, which leads to a higher GST.

- (e) Compare and contrast the impact of high inflation on low-income and on high-income households.

Low-income ~~workers~~ ^{households} will be worse off during a period of high inflation because these ~~workers~~ ^{households} are already at low incomes, meaning their spending on food and rent is tight. When inflation causes the prices to increase, this will make it even harder for low-income workers to afford basic necessities, therefore their ~~consumption~~ ^{consumer} spending will be lower than before. Low-income workers also are ~~more~~ ^{less} likely to have an opportunity to ~~negotiate~~ negotiate wage increases in line with the increasing inflation. This can lower their standard of living as well. High-income ~~workers~~ ^{households} on the other hand are probably more likely to have opportunities to negotiate wage increases as they have more of an impact and influence in their workplace. Even if high-income workers are unable to negotiate wage increases, they will probably not be as disadvantaged than low-income workers because they already have high-income. These high income households also tend to invest and own **assets** like properties. When inflation rises, so will the value of these properties, so the high-income workers have a back-up income option that will be advantageous to them. Low-income ~~workers~~ ^{households} are ~~worse~~ ^{worse} off, but high-income households will have little to no impact by high inflation.

Acknowledgements

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

Question Two (a)

Reserve Bank of New Zealand. (2025). *Inflation*. www.rbnz.govt.nz/monetary-policy/about-monetary-policy/inflation

Question Two (d)

Westpac. (2025). *Economic overview: Turning the corner*. www.westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2025/Other/Economic-Overview_120225-QEO_report_12Feb25.pdf

Excellence

Subject: Economics

Standard: 91222

Total score: 23

Q	Grade score	Marker commentary
One	E7	<p>The AD and AS explanations referred to components of AD and AS with detailed reference to the graph. The candidate gave a detailed explanation of why the increase in the price of petrol has a larger effect on the decrease in PL, specifically referring to relative changes in both graphs.</p> <p>E8 would have been awarded if the graphs showed a larger shift of AS.</p>
Two	E8	<p>The candidate explained:</p> <ul style="list-style-type: none"> • disinflation and deflation with reference to the data • the effect of decreased interest rates on V with reference to saving, borrowing, and increased spending • the proportional increase in PL from an increase in V • the effect on PL from changes in V and Q depending on the relative changes of V and Q.
Three	E8	<p>The candidate explained:</p> <ul style="list-style-type: none"> • that not all households are affected by the rate of inflation given, using examples • why GST will increase with a reference to high prices • in detail, the relative impact of inflation on low- and high-income earners, including the ability to negotiate pay increases and asset ownership.