

Economics

Section II (continued)

Marks

Question 24 (10 marks)

The following information refers to inflation.

The Consumer Price Index (CPI) increased by 0.9 per cent in the December quarter, after rising by 0.3% in the September quarter, to be 3.1% higher over 2001. . . .

However, the outlook for the medium term determinants of inflation has not changed substantially in the light of recent data. Wage and labour cost growth remain contained and are likely to continue to be so given the prevailing weakness in the labour market. The stability of the exchange rate over the past year, combined with downward pressure on world prices from the subdued global economy, suggests that there will be little inflationary pressure from import prices in the medium term.

Adapted from Reserve Bank, *Statement on Monetary Policy*,  
February 2002

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(a) Define the term *inflation*.

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Inflation is the percentage increase in prices from the first period to the second period. It helps to show the stability within an economy.

(b) Outline TWO causes of inflation.

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- One cause of inflation is the demand for a particular good or service increasing and thus the price rising.
- Another cause is levels of uncertainty in an economy increasing, which would lead to price volatility and an increase in supply of the currency.

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## Question 24 (continued)

(c) Outline TWO negative effects of inflation on an economy.

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- One negative effect of inflation would be that it leads to a de-valuation of the dollar in the economy, causing price rises
- Another negative effect would be that exports would become more expensive and less affordable

(d) Explain TWO government economic policies that could reduce the rate of inflation in an economy.

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- Prices and Incomes policy and the deregulation of certain goods would allow fluctuations to occur and increase competitiveness between goods
- Fiscal policy could also be used by altering the levels of government expenditure in certain sectors which would lead to a decrease in inflationary pressures

End of Question 24