2002 HIGHER SCHOOL CERTIFICATE EXAMINATION

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*. **2**

Inflation is the fluctuations in price of goods and services. The government aims to keep inflation between 2-3% over the business cycle

(b) Outline TWO causes of inflation. **2**

Increased Economic Growth usually causes inflation to rise, as more people are purchasing goods and services, spending in economy. Decreased interest rates also cause inflation, as people borrow more money, and spend it, due to low levels of interest repayment. This results in increased ~~unemployment~~ economic growth. Increase in employment usually brings about ↑ inflation as more people are spending money

Question 24 continues on page 16

Marks

Question 24 (continued)

(c) Outline TWO negative effects of inflation on an economy. **2**

If inflation increases over the target band, it may discourage investers overseas from buying ~~or~~ assets or shares in the country.
If Inflation increases, the RBA may up interest rates to reduce spending. This is a negative effect as it increases repayments for individuals in society

(d) Explain TWO government economic policies that could reduce the rate of inflation in an economy. **4**

The Monetary and Fiscal Policies can reduce the rate of inflation in an economy. the monetary policy has 5 objectives, and one is price stability. The monetary policy can increase ~~decrease~~ interest rates which will in turn result in a reduction ~~of~~ in inflation
The fiscal policys can reduce inflation by the RBA

End of Question 24