

# 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

A general increase in the level of prices in an economy at a given point in time.

(b) Outline TWO causes of inflation.

2

1. Substantial increase in economic growth - causes inflation to rise - due to higher demand for goods/services.  
2. When economic activity increases, ~~the market~~ businesses produce more goods/services to satisfy aggregate demand which can cause inflation.

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## Question 24 (continued)

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

2

Increases prices of goods & services in the economy  $\Rightarrow$  which slows economic growth and makes the economy come to a stand-still.  
 Increases unemployment in the economy which further halts the economy.

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

4

Both macro-economic policies - Fiscal & Monetary Policy could reduce the rate of inflation. Fiscal Policy uses the federal budget to influence a reduction in inflation - by slowing the economy down ~~and down~~ via the fiscal stance of the budget. Monetary Policy is used via the Reserve Bank's inflationary targeting of 2-3% and also influencing inflationary expectations, ~~which~~ which has been successful since the early 1990s.

End of Question 24