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

(a) Define the term *inflation*. **2**

the term inflation refers to the general increase in the prices of goods and services over time

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

inflation is caused by a surplus in the supply of the Australian dollar. another cause of inflation will be due to inflationary expectations. workers may try to potect themselves by asking for wage rises and businesses will compensate these wage rises by putting their products for higher price.

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Marks

Question 24 (continued)

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

inflation can ~~se~~ cause the Australian dollar to depreciate as a surplus of AUD will be a result, therefore reducing Australia's international competitiveness. high inflation can also cause unemployment levels to rise as demands for goods & services decrease, leading to ~~a~~ surplus in stock which causes ~~and~~ businesses to retrench some workers as they may not have the capacity to pay the wages which then leads to greater government expenditure in unemployment benefits.

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

by tightening monetary policy, the government will be increasing interest rates and increasing tax rates to slow the economy down, thus resulting to a reduction in the rate of inflation.

another government economic policy that could reduce the rate of inflation in an economy is the use of counter-cyclical policies to ammend extreme fluctuations in the business cycle. Such counter cyclical policies ~~tradable~~ include 'progressive' taxation system.

End of Question 24

· progressive tax