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 measured by the Consumer Price Index which shows a general increase or decrease in the prices of a variety of goods and services such as recreation, food and alcohol.

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

Demand pull may cause inflation to rise, there is a higher demand for goods and services causing the prices of these goods and services to rise creating inflation.

Inflation may be imported from other countries through the imports of goods and services that have higher prices

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Marks

Question 24 (continued)

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

Inflation rising causing prices to rise creates concern for minimum wage earners as the increases in prices is not automaticly seen in an increase in wages. Employers may see prices rising bad for their business and terminate jobs to lower costs causing higher unemployment for the economy.

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

The Reserve Bank of Australia may tighten monetary policy by increasing interest rates to decrease business and consumer spending levels and hopefully decrease the demand of goods and services. Increasing interest rates has large time lags and ~~ma~~ is not effective imediately in decreasing inflation.
The government could use micro economic policies to decrease economic growth such as removing funding or assistance to for example first home buyers to decrease growth levels leading to a decrease in inflation.

End of Question 24