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 a rise in real terms of the cost of goods & services over time.

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

A devaluing of the Australian Dollar will increase the price of imports leading to Inflation. The centralised wage fixing system & Industrial Relation commission rising wages cause an increase in Aggregate demand increasing inflation.

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Marks

Question 24 (continued)

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

Inflation causes a widening of the gap between rich & poor with higher prices making it harder for lower-income earners to purchase goods & services. Makes Australia less internationally competitive with our exports costing more to produce.

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

Monetary Policy could be used by rising interest rates it dampens aggregate demand therefore lowering prices and the rate of inflation. The encouragement of enterprise bargaining with less gov't interevention in setting minimum wages this will encourage highly skilled workers and firms may be encouraged to employ more workers. With the wage-rate remaining low it will prevent excessive consumption of high-incomes leading to an increase in inflation.

End of Question 24