

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

Material used with permission of the Reserve Bank of Australia

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

..... Inflation is a gradual, sustained increase  
..... in price levels over time.....  
.....  
.....

- (b) Outline TWO causes of inflation. 2

..... ~~The~~ ~~best~~ ~~cause~~ of inflation may be <sup>due to</sup> ~~caused by~~  
..... ~~best~~ ~~push~~ inflation, ~~for~~ ~~ex~~ which involves the <sup>and thus</sup> ~~price~~ ~~increased~~  
..... supply of goods and services being decreased <sup>due to</sup>  
..... for example an increase in the cost of labour.  
..... demand pull inflation which involves <sup>an increase in</sup> ~~the~~ ~~supply~~ of  
the demand of goods and services, for example if income  
world incomes <sup>rose</sup>. Therefore if there is higher demand  
the prices would  
increase.

Question 24 continues on page 16

## Question 24 (continued)

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

2

• An increase in income inequality as set wage and income earners are negatively affected by <sup>their</sup> decreasing value of income & salaries, but investors and people who receive income from shares, profits and so on benefit.

• There is a decrease in the value of money thus the same amount of money has less purchasing power. This places an upward pressure of wages and may result in a wage/price spiral.

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

- Inflation could be reduced through the use of monetary policy. The RBA could sell G.S. and thus decrease the <sup>supply</sup> of funds compared to demand thus increase interest rates and the cash rate, discouraging spending and thus reducing inflation.

- Fiscal policy could be used through the government using a fiscal ~~deficit~~ surplus. This would ~~to~~ place a contractionary stance on the economy, reducing economic activity and therefore reducing the inflation rate due to decreased demand in the economy.

End of Question 24