

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*.

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Inflation is a sustained rise in the general level of prices in an economy.

(b) Outline TWO causes of inflation.

2

• Demand-Pull inflation is caused when aggregate demand increases past the productive capacity in an economy causing prices to rise.  
• Cost-Push inflation is caused <sup>when</sup> increases in the costs of production are passed onto consumers (usually caused by increases in wages)

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## Question 24 (continued)

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

- Inflation could have a negative effect on economic growth as prices rise causing a decrease in consumer consumption.
- Inflation also increases the inequality in an economy as the poorer people cannot buy as much, whereas the rich still maintain their lifestyles.

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

By the RBA using monetary policy to ~~decrease~~ increase interest rates in an economy this should cause aggregate demand to decrease causing a decrease in demand-related inflation as a result of decreased spending & investment.

By also using micro-economic reform policies to increase the efficiency and competitiveness of industries the govt will hopefully decrease their costs and therefore decrease cost-related inflation.

**End of Question 24**