

**Year 12 Economics Exam Semester 2 2021**

**Marking Guide**

**Section 1 (24 marks)**

1 B

2 A

3 B

4 C

5 A

6 B

7 C

8 D

9 D

10 A

11 C

12 D

13 B

14 A

15 C

16 C

17 D

18 C

19 B

20 D

21 A

22 B

23 C

24 D

**Question 25 (12 marks)**

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| a. i Terms of trade = export price index/import price index x 100  ii Dec qtr. 2019  iii Between 114 and 115 (110/96 x 100 = 114.6) | 1 mark  1 mark  1 mark |
| b. A rise in the terms of trade means that a country can purchase a greater quantity of imports with a given volume of exports | 1-2 marks |
| c. The ToT increased from around 100 in March 2020 to around 115 in March 2021.  The reasons were  (1) a sharp rise in the export price index due to a rise in commodity prices (e.g. iron ore prices)  (2) a fall in import prices due to falling prices for manufactured goods | 1 mark  1 mark  1 mark |
| d. Any FOUR effects (1 mark each):  1. An increase in the trade balance  2. An increase in aggregate demand  3. An increase in national income (living std)  4. An increase in the AUD exchange rate  5. An increase in investment in resources sector  6. A fall in the unemployment rate | 1 mark  1 mark  1 mark  1 mark |

**Question 26 (12 marks)**

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| a. i. 2020-21 (Deficit = $161 billion)  ii. Due to the large stimulus spending by the government | 1 mark  1 mark |
| b. The main method the govt finances its budget deficit is through borrowing - by selling govt bonds to either domestic residents or non-residents. | 1-2 marks |
| c. It is expected to fall mainly due to the operation of automatic stabilisers due to the economy recovering. The falling unemployment rate is evidence of the recovery.  Govt spending (payments) falls due to less welfare spending & less stimulus spending  Govt receipts (tax revenue) also recovers (esp. in 2022-23) due to a stronger economy. | 1 mark  1 mark  1 mark |
| d. Infrastructure – the basic facilities needed for an economy to operate such as roads, electricity & water supply, bridges, ports  Spending on infrastructure will increase investment, shifting the AD curve to the right increasing real GDP and employment & decreasing the unemployment rate  Spending on infrastructure will add to the capital stock which will shift the AS curve to the right, also increasing real GDP and employment helping to reduce the unemployment rate  AD/AS model showing both curves shifting to the right | 1 mark  1 mark  1 mark  1-2 marks |

**Question 27 (12 marks)**

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| a. i. Around $35,000 million ($495,000m - $460,000m)  ii. 1.8 or 1.9%  iii. In the March & June qtrs. of 2020 | 1 mark  1 mark  1 mark |
| b. Two economic indicators that would decrease: share prices; labour force participation rate; employment; retail sales; business & consumer confidence; the CPI  Two economic indicators that would increase: unemployment rate; inventories; business closures; budget deficit | 1-2 marks  1-2 marks |
| c. The economy recovers strongly with quarterly real GDP growing by over 3% in both the Sept & Dec qtrs. (i.e. the economy enters an an expansion after the recession)  There was a strong recovery in both consumption & investment which increased real GDP aided by the stimulus package of the government.  Use of either the AE model or the AD/AS model to show the economy expanding due to a rise in either AE or AD – correct labelling showing an increase in real GDP (& an increase in the price level in the AD/AS model)) | 1-2 marks  1 mark  1-2 marks |

**Question 28** **(20 marks)**

(a) Distinguish between the two main balances in the current account and describe the trends in these balances since 2019. (10 marks)

(b) Discuss the cyclical and structural factors that have contributed to Australia’s record current account surplus. (10 marks)

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| (a) Discussion of trade balance – 5 marks  The trade section in the current account records transactions in goods and services. Exports are credits and imports are debits. Aust’s main goods exports are resources such as iron ore coal, natural gas as well as rural commodities. Aust’s main service exports are education & personal travel. Aust’s main goods imports are manufactured goods such as motor vehicles & telecom equipment. Aust’s main service imports are personal travel & freight.  Trend – Australia has recorded record trade surpluses since 2019 due to exports increasing relative to imports.  Discussion of income balance – 5 marks  The income section in the current account records transactions in primary & secondary income. Primary income is the main component & consists of transactions involving interest, dividends & profits. Australia traditionally records an income deficit since income payments exceed income receipts.  Trend – the income balance has increased since 2019 – that is, the income deficit has fallen over time. | 1-3 marks  1-2 marks  1-3 marks  1-2 marks |

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| (b) Aust has recorded consecutive current account surpluses from June 2019 to March 2021. This has been due to a combination of an increasing trade surplus and a declining income deficit.  The main **cyclical** factors are associated with the trade surplus:  1. Increasing commodity prices (export price index) – these have increased the value of Aust’s’ exports, increasing the trade surplus  2. Increased demand from China for our resources – increasing the trade surplus  3. A relatively low AUD – this has helped to increase the competitiveness of our exports & increase the trade surplus  4. A weak economy – this has reduced spending on imports helping to increase the trade surplus. The Covid crisis has played a role in reducing Aust tourists from travelling overseas – Aust’s largest import.  The main **structural** factors are associated with the rising income balance:  1. Record low global interest rates have reduced interest payments on foreign debt helping to reduce the income deficit  2. Aust has been recording financial account deficits which means that the level of foreign investment in Aust is falling reducing income payments & reducing the income deficit  3. Aust’s S – I gap is now positive reducing the need for foreign investment | 1-2 marks  1-5 marks  1-3 marks |

**Question 29** **(20 marks)**

(a) Explain the meaning and importance of the trade weighted index and discuss the impacts of a rise in the trade weighted index on the Australian economy. (10 marks)

(b) Use a model to explain the effect of each of the following on Australia’s exchange rate:

i. A fall in commodity prices

ii. A rise in Australia’s interest rate differential (10 marks)

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| a) Importance of the trade weighted index (TWI) – 4 marks  The Australian trade-weighted index (TWI) is the price of the Australian dollar in terms of a group (or ‘basket’) of foreign currencies based on their share of trade with Australia. The most important currencies in the basket are the Chinese renminbi, the US dollar, the Japanese Yen and the European euro – reflecting Aust’s most important trading partners.  The importance of the TWI is that it provides a broader measure of whether the Australian dollar is appreciating or depreciating against the currencies of its trading partners compared to a single currency. This means it provides a better measure of Australia’s relative competitiveness against other countries.  Impacts of a rise in the TWI – discuss any 3 effects for 6 marks (3 x 2 marks)  Note there are both negative & positive effects of a rise in the TWI   * It will reduce the competitiveness of Aust’s exports causing exports to fall & imports to increase * It can have a contractionary effect on the economy by reducing net exports & reducing aggregate demand * Lower import prices will lead to a fall in the price level reducing the rate of inflation * Lower import prices can reduce input costs (raw materials & capital goods) for businesses which can increase aggregate supply | 1-2 marks  1-2 marks  1-6 marks |
| b) i. A fall in commodity prices – 5 marks  Commodity prices are the prices of resources such as iron ore, coal, natural gas & rural goods which make up most of Aust’s exports. A rise in commodity prices will reduce the value of Aust’s resource exports causing a decrease in the demand for AUD.  Correctly labelled model of AUD: show the D($A) shifting to the left leading to a currency depreciation.  ii. A rise in Aust’s i/r differential – 5 marks  This means that i/rs in Aust have risen relative to other countries.  This will attract foreign investment (portfolio) into Aust increasing the D($A).  At the same time it will cause a decrease in Aust capital outflow causing the S ($A) to decrease.  Correctly labelled model of AUD: show the D($A) shifting to the right AND the S($A) shifting to the left resulting in a strong currency appreciation. | 1-3 marks  1-2 marks  1-3 marks  1-2 marks |

**Question 30** **(20 marks)**

(a) Use the aggregate expenditure model to explain how macroeconomic equilibrium is determined if spending does not equal output. (8 marks)

(b) Define the multiplier and explain what determines its value. Demonstrate and explain how each of the following would affect the equilibrium level of income:

i. a decrease in the marginal propensity to save and

ii. a decrease in household wealth. (12 marks)

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| (a) Explanation of how equilibrium is determined – 5 marks  Macro equilibrium occurs when aggregate expenditure (C + I + G + NX) equals total output (GDP). This occurs where the AE line intersects the 45 degree line.  Students need to explain the process to reach equilibrium when spending (AE) does not equal output.  When GDP is below the equilibrium level, AE is greater than output which will cause inventories to decrease. Firms will respond by increasing production and the economy will move up the AE line towards the equilibrium point.  When GDP is above the equilibrium level, AE is less than output which will cause inventories to increase. Firms will respond by decreasing production and the economy will move up the AE line towards the equilibrium point.  Correctly labelled AE model showing movement up or down the AE line to achieve equilibrium – 3 marks | 1-2 marks  1-2 marks  1-2 marks  1-2 marks |
| (b) Explanation of the multiplier – 4 marks  The multiplier refers to the effect of how a change in new spending will cause a larger change in GDP or national income.  The formula for the multiplier is 1/(1 – mpc) or 1/mps. So the value of the multiplier is determined by the marginal propensity to consume (or marginal propensity to save).  The mpc measures the proportion of any extra income that is spent. As the mpc increases, so does the multiplier: if the mpc = 0.75, the multiplier = 4; if the mpc = 0.8, the multiplier = 5.  i. A decrease in the mps – 4 marks  This will increase the slope of the consumption function or AE line (become steeper) since the slope of the C function is determined by the mpc. This will increase the equilibrium level of income – 2 marks  Diagram showing the AE or C line increasing in slope increasing Ye – 2 marks  ii. A decrease in household wealth – 4 marks  This will shift the consumption function or AE line down wards since wealth is one of the main factors affecting household consumption. This will decrease the equilibrium level of income – 2 marks  Diagram showing the AE or C line shifting downwards decreasing Ye – 2 marks | 1 mark  1 mark  1-2 marks  1-2 marks  1-2 marks  1-2 marks  1-2 marks |

**Question 31 (20 marks)**

(a) Outline the economic policy objectives of the Reserve Bank of Australia with reference to the current state of the economy. (8 marks)

(b) Explain how monetary policy works to affect the level of economic activity and discuss its current effectiveness. (12 marks)

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| (a) Economic policy objectives – (4 marks)  Three specific objectives in the Reserve Bank Act:  1. Price stability – to keep consumer price inflation between 2 and 3 per cent, on average, over the business cycle  2. Full employment – keep unemployment close to the natural rate which is believed to be around 4-4.5%  3. The economic prosperity and welfare of the people of Australia – general objective related to rising living stds over time  State of the economy – (4 marks)  The annual inflation rate as of the March qtr. 2021 was 1.1% which is well below the target range. This is due to the economy being in recession in 2020, but as the economy recovers the inflation rate is expected to increase to above 2%.  The unemployment rate has been falling since the peak of the recession in July 2020 where it reached a high of 7.4%. In May 2021, the unemployment rate had fallen to around 5% which is above the target but should continue to fall as long as recovery stays on track. However Covid uncertainty remains.  In the March qtr. 2021, real GDP was growing at an annual rate of around 1%. which is well below the target rate of around 3%. However, a positive sign is that the qrtly. rates have been very strong (Mar qtr. = 1.8%) | 1-4 marks  1-4 marks  Should refer to 3 different indicators for full marks |
| (b) How monetary policy works – 8 marks  Basically a discussion of the monetary transmission mechanism – how a change in interest rates affects the level of economic activity. There are 4 channels through which a cut in i/rs will increase either C, I and/or NX which will increase agg demand & lead to an increase in economic activity.  1. Cost of borrowing – a cut in i/rs will reduce the cost of borrowing and encourage households & firms to increase borrowing which will increase consumption & investment spending  2. Cash flow – a cut in i/rs will reduce the repayments for existing borrowers which increases their net income and enables increased spending  3. Asset prices – a cut in i/rs will increase asset prices such as shares & property. This increases wealth which should lead to an increase in consumption.  4. Exchange rate – a cut in i/rs will depreciate the AUD which will increase net exports and increase aggregate demand.  Effectiveness – 4 marks  Need to relate answer to current state of the economy, not simply list strengths/weaknesses  The current cash rate is at a record low of just 0.1%. The Reserve Bank has stated that it will not increase the cash rate for several years which helps to boost confidence to the private sector.  Given that the economy is now recovering, record low i/rs are proving effective in increasing spending, both C & I. This is esp. evident in the housing market where construction is increasing & house prices are rising boosting household wealth & spending. Investment spending is also on the rise. So three of the main channels of monetary policy are working – cost of borrowing, cash flow & asset prices. | 1-2 marks  1-2 marks  1-2 marks  1-2 marks  1 mark  1-3 marks |