

This question refers to the edited extract below, taken from an article by James Hall that appeared online on 8 February 2019.

Interest rate cut will see Aussie dollar fall well below 70 US cents, economists say

The local dollar has been slammed following the Reserve Bank of Australia's (RBA) announcement a rate cut was likely.

The Australian dollar is on track for its worst one-day fall in nearly two years following Reserve Bank boss Philip Lowe's comments a rate cut was likely with growing concerns over the local economy.

The Aussie dollar fell 1.35 US cents in the 24 hours between midday yesterday and today. It was buying 71.03 US cents at noon today and economists say it will crash well below 70 US cents if the rate is cut.

Macro Business Fund chief strategist David Llewellyn-Smith said the Aussie dollar would be worth 65 US cents by the end of the year.

'The likelihood is that they will have to cut because house prices nearly always draw the broader economy into weakness, and they're falling very fast in Sydney and in Melbourne and are now falling in all major capitals. We think they'll have to cut twice and that's going to put a lot of downwards pressure on the Aussie dollar.'

AMP Capital chief economist Shane Oliver agrees the RBA will have to cut rates twice this year, but he says strong commodity prices will ensure a slide isn't as dramatic as Mr Llewellyn-Smith predicts.

Dr Oliver told news.com.au the expected US rate hike would compound the weakness of the Australian currency.

'If our interest rates have been falling below those in the US, then that just makes it less attractive to park your money in Australian dollars versus US dollars', he said.

'And that will put more downwards pressure on the Aussie, pushing it into the 60s.'

- (a) (i) Identify the reason given in the extract for the fall in the value of the Australian dollar. (1 mark)

- (ii) Identify the factor mentioned in the extract that may limit the extent of any fall in the value of the Australian dollar. (1 mark)

- (b) Using the exchange rate at noon on 8 February 2019, calculate how many Australian dollars would be required to purchase an American product valued at US \$220. (1 mark)

- (c) Discuss, with reference to aggregate expenditure, why falling house prices 'nearly always draw the broader economy into weakness'. (4 marks)

[illegible]

- (d) Use an appropriate model to demonstrate and explain how a simultaneous reduction in Australian interest rates and an increase in interest rates in the United States would affect the value of the Australian dollar. (5 marks)

Model
