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## TOP SCHOLAR



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# Scholarship 2022 Economics

Time allowed: Three hours  
Total score: 24

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

You should answer ALL the questions in this booklet.

Pull out Resource Booklet 93402R from the centre of this booklet.

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–28 in the correct order and that none of these pages is blank.

Do not write in any cross-hatched area (☒). This area may be cut off when the booklet is marked.

**YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF  
THE EXAMINATION.**

**INSTRUCTIONS:** Write an essay in response to EACH of the THREE questions in this paper. Question Two is on page 10, and Question Three is on page 18.

### QUESTION ONE: Protectionist trade policies and allocative efficiency

Use information from **Resources A to D**, and your knowledge of micro-economic theory, to answer this question.

Cheap imports have some domestic producers asking the government for protection from the unfair competition of subsidised overseas-produced goods. Anti-dumping duties (tariffs) have been imposed on a range of imported goods, including canned peaches from South Africa and galvanised wire from Malaysia.

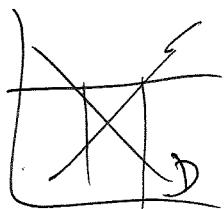
Explain the changes in the European market that lead to surplus goods that could be dumped on other markets. Analyse the impact of dumping these cheaper surplus goods on the New Zealand market. Evaluate the extent to which protectionist policies would impact participants and allocative efficiency in the New Zealand market.

In your answer:

- use appropriate economic models throughout
- illustrate and explain the changes in the European market for EITHER potato fries OR specialty cheese that have resulted in dumped goods
- analyse New Zealand's position as a price taker for imported goods, and the impact of lower-priced imports on producer revenue and allocative efficiency in EITHER the potato fries OR specialty cheese market
- analyse the impact of the TWO protectionist policies suggested in **Resource D** on producer surplus, consumer surplus, the government, and allocative efficiency in the New Zealand market
- evaluate which policy would be most effective in protecting New Zealand producers from unfair competition, whilst minimising the impact on consumers and allocative efficiency.

Use this space for planning your essay. This plan will NOT be marked.

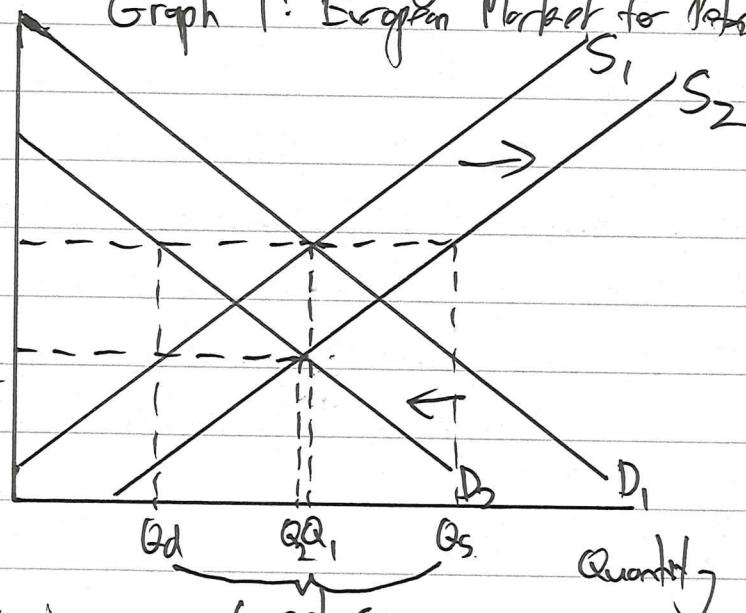
#### PLANNING



In the European market, demand for potato fries has decreased because "fewer people [are] eating out" (Resource B). This represents a change in ~~consumers~~ European consumers' tastes and preferences and has led to a decrease in demand in the European market for potato fries. Moreover, Europe has ~~also~~ increased its potato plantings to ~~set record levels~~, (Resource G). This increase in the raw material of potatoes that go into potato fries is likely to also have an ~~increase~~ in supply of potato fries. These changes are shown in the graph below.

Price (\$)

Graph 1: European Market for Potato Fries



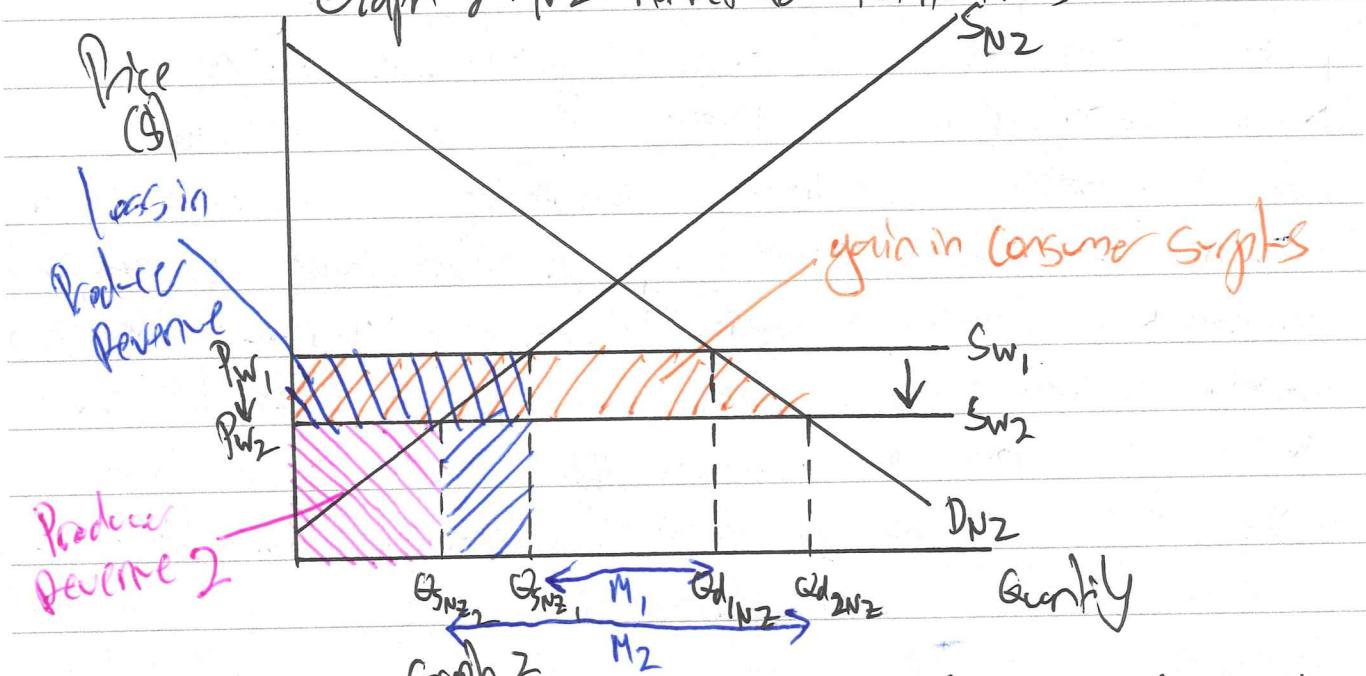
As is shown in graph, supply has moved from  $S_1$  to  $S_2$ , while demand decreased from  $D_1$  to  $D_2$ . At the original equilibrium price,  $P_1$ , the change in supply

created a ~~surplus~~ market. At  $P_1$ , the quantity supplied is  $Q_s$  and the quantity demanded is  $Q_d$ . The difference between  $Q_s$  and  $Q_d$  is  $Q_s - Q_d$ , which is labeled as  $Q_{\text{surplus}}$ . At the new equilibrium price,  $P_2$ , the quantity supplied is  $Q_s$  and the quantity demanded is  $Q_d$ . The difference between  $Q_s$  and  $Q_d$  is  $Q_s - Q_d$ , which is labeled as  $Q_{\text{shortage}}$ .

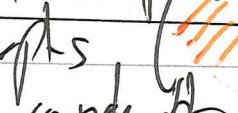
initial price,  $P_1$ . Thus, European producers are able to dump the surplus that is created into overseas markets at relatively low prices.

For meat goods, New Zealand produce a relatively small proportion of the global world's supply of the good. So, NZ domestic producers have very little influence on the world market price or supply of meat goods. This results in NZ being price takers for imported goods - NZ domestic producers simply have to accept the world price for the good because, otherwise they, at a higher price, risk losing significant market share to the firms that are pricing at the world price. Indeed, NZ is certainly a price taker for potato fries. The impact of the decrease in price of imports via dumping into the NZ market is shown in the graph below.

Graph 2: NZ Market for Potato Fries



As can be seen in Graph 2, the world price of potato fries has fallen from  $P_{W1}$  to  $P_{W2}$ , as a result of the changes

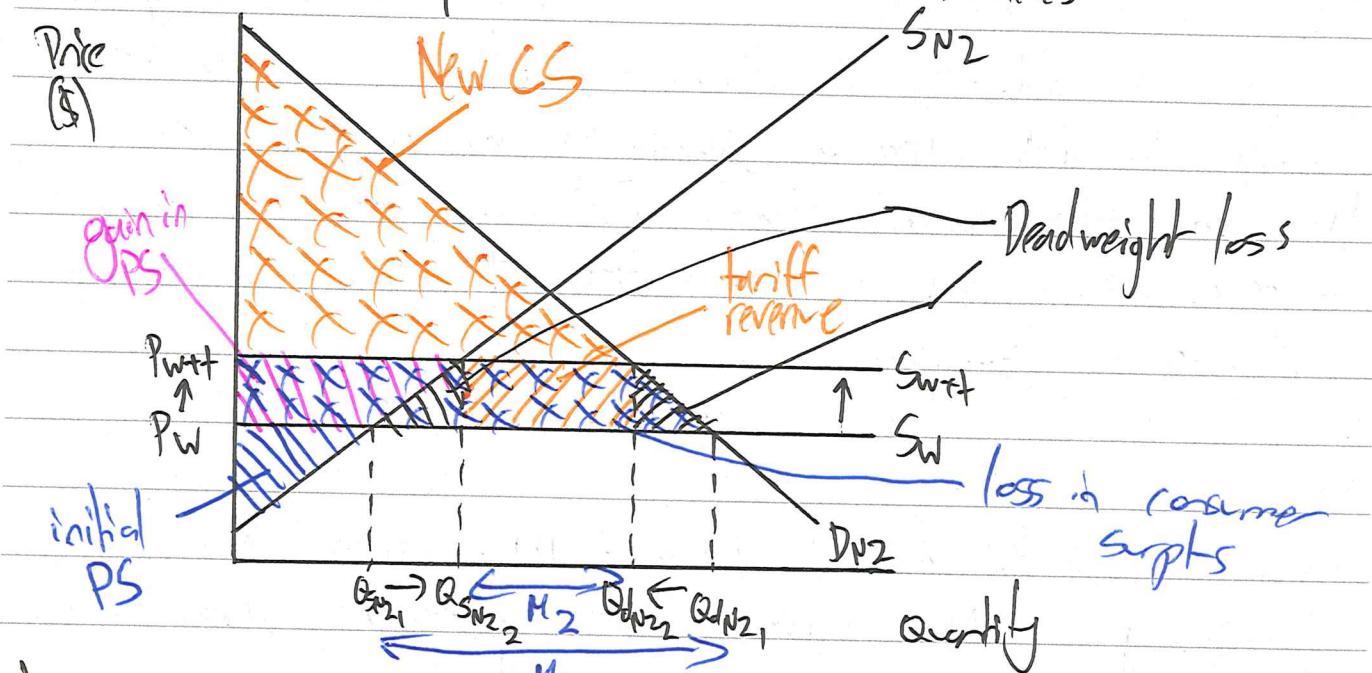
In the European market ~~M<sub>1</sub>~~ offered ~~domestic~~ supply & ~~car~~. Initially this means the last ~~import~~ ~~for M<sub>1</sub> to M<sub>2</sub>~~ to fill the gap of excess demand within the domestic economy. This is denoted by the low price. The quantity demanded of domestic resources decreases from  $Q_{d1}$  to  $Q_{d2}$ , but ~~domestic~~ supply too  $Q_{s1}$  to  $Q_{s2}$  as it is less profitable for ~~the~~ producer to supply potato from  $P_{w1}$  low price. And they are forced to sell. Thus, low-priced imports means that the quantity sold by the domestic producers fall from  $S_{N1}$  (from  $Q_{S1N1}$  to  $Q_{S2N2}$ ), while the price they sell is also ~~fall~~ (from  $P_{w1}$  to  $P_{w2}$ ). As a result, domestic producer revenue falls from  $(Q_{S1N1} \times P_{w1})$  to  $(Q_{S2N2} \times P_{w2})$ , a reduction by ~~area~~  area. The revenue of the exporting producer  $M_2$  ~~is~~ this likely to rise if the price elasticity of demand for their potato is relatively elastic. ~~This is because~~ It will change from  $(M_1 \times P_{w1})$  to  $(M_2 \times P_{w2})$ . Indeed, domestic potato producer could struggle surviving if they thought however, the low-priced import has created a gain in domestic consumer surplus . This gain in ~~producer~~ consumers' have to compete with more ~~foreign~~ imported goods, (Resource B), and this highlights the fact that the ~~own~~ own price may fall when firms' average total cost goes variable cost and force  $M_2$  to shutdown or exit the industry.

Hence, the low-priced imports does create an increase in consumer surplus , but excepts the loss in domestic producer surplus. thus, it could be argued that

Surplus is maintained to aggregate output by the cheaper imports, moving the economy to a more allocatively efficient position. Indeed, these cheaper imports do ~~not~~ improve allocative efficiency in this. What this fails to consider is the impact on the potentially negatively impacted <sup>strictly</sup> domestic producers, and the unemployment that could result from this.

One of the protectionist policies suggested in Passage D is a tariff or anti-dumping duty on imports, and specially cheap. Indeed, NZ would be allowed to introduce such a policy under WTO agreements, as "WTO members can impose anti-dumping measures if the domestic industry produces like product in the importing country is suffering material injury" (Pearce A). Indeed, Passage B emphasized that domestic producers, may struggle to survive due to the dumping, while "Kiwidex makes out compare with cheap European products freely in the market" (Pearce C). The A duty would essentially add ~~a cost~~ an extra cost to import of that particular good to come into NZ, and as a result its price would be phased. NZ is still a price taker, but it would ~~be~~ pay a higher price for buying a higher price due to the tariff. The effect of the imposition of this tariff is shown on the graph on the next page.

Graph 3: NZ Market for Potato Fries

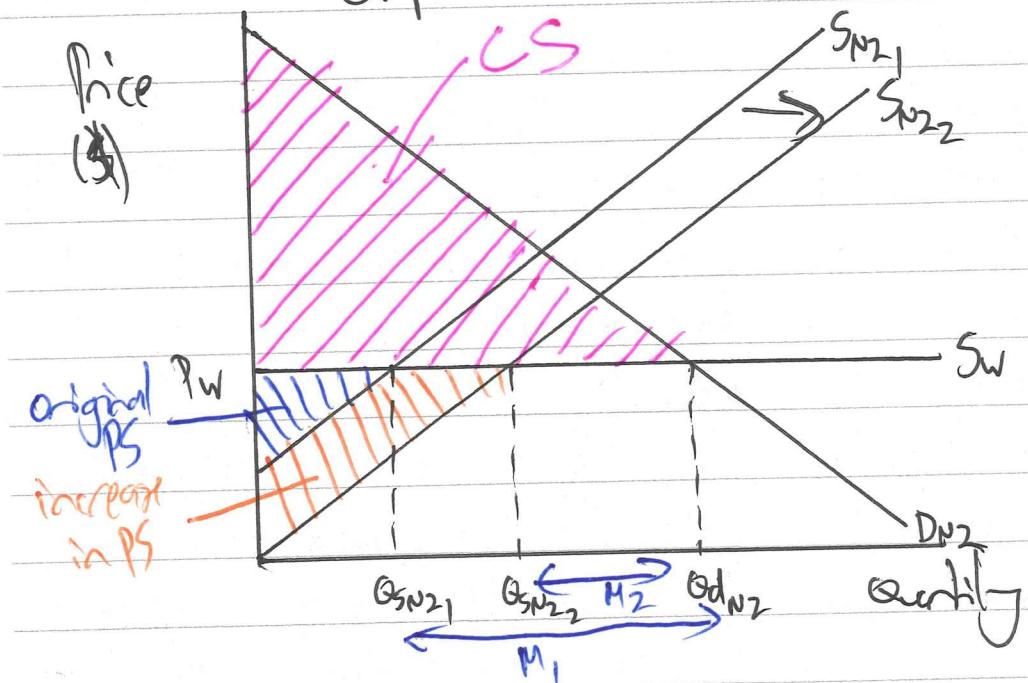


The tariff imposed causes the world price to increase from  $P_N$  to  $P_W$ . This gives the ability to cause producers to dump imports at cheap prices. However, at this relatively high price, domestic producers are shielded or harm their export markets, and they are able to sell more of the domestic product. As a result, this tariff causes an increase in producer surplus ~~III~~ (III). However, there is also a significant decrease in consumer surplus (XX). This is because the price that consumers have to pay for this good has increased, and they are less likely to buy less choice and variety to choose from. The import quota into New Zealand, while it will not go prohibitively high in imposing the tariff, the government will gain tariff revenue from this equal to  $(P_W - P_N) \times$  the size of the tariff ~~III~~ (III). This is not the primary effects of the tariff, but it does create more for the government to inject elixirs into the economy. Both become part tariff revenue is not as large as the difference between the ~~III~~

↑ PS at the origin in P5, there is a deadweight loss, and so a reduction in allocative efficiency on the N2 market for potato flour or specialty cheeses. So, while the R&D grant indeed protect domestic producers, this reduction in free trade causes a trade-off of allocative efficiency and consumer surplus.

The offe policy proposed was in Figure D, was a research and development (R and D) grant to encourage productivity in N2 potato and specialty cheese markets. If this grant was indeed successful at increasing productivity, then it would cause these producers to increase domestic supply as their costs of production are essentially lowered when they can produce with greater productivity. The effect of this is shown in the graph below.

Graph H: N2 market for potato flour (R & D grant)



The R and D grant caused N2 supply to increase from  $S_{N21}$  to  $S_{N22}$ . As a result, the level of domestic quantity supplied at the world price increased from  $Q_{S_{N21}}$ .

↳ Qs NZ. Because of the greater productivity of these firms, there is an increase in product supply (~~↑~~). More, in his case, there is no determination upon a consumer surplus. Furthermore, ~~partly~~ demand stays at Qd<sub>1</sub> and CS at ~~CS~~ because there is no change in price. Domestic producers are simply able to supply ~~at~~ a greater proportion of domestic demand at the existing world price. Moreover, there is no reduction in allocative efficiency because of this policy. Free trade is still encouraged and producer and consumer surplus is maximized, and indeed total welfare in the NZ market has increased. However, the Research & Development grant for these firms will require some government expenditure. This creates an opportunity cost as this money could have been channeled into other areas of the economy. But, there is also a degree of risk. There is no certainty that the R&D grant will be successful in increasing productivity - they may not be breakthroughs.

Overall though, the Research and development grant is likely to be the most effective in protecting NZ producers from unfair competition, whilst minimizing the impact on consumers and allocative efficiency. The tariff may increase the price and do a better job than fish or poultry producers. However, it's dependent on trade relations with the NZ economy, greatly it might loss all consumers or not. In the long run, when the R&D grant is able to make an impact in productivity, this is of most benefit to the NZ economy. (page 26) //

**QUESTION TWO: Reducing smoking incidence and inequities in New Zealand**

Use information from **Resources E to H**, and your knowledge of micro-economic theory, to answer this question.

In 2011, the Government set a target for a Smokefree Aotearoa – that by 2025 fewer than 5% of the population would be smokers. The goals include eliminating inequities in smoking rates and smoking-related illnesses. Policy options identified have been categorised into three themes – affordability, availability, and addictiveness of tobacco.

Analyse the market failure in the New Zealand cigarette market. With reference to allocative efficiency and equity, evaluate the effectiveness of three policies suggested by the government on different groups in society.

In your answer:

- use appropriate economic models throughout
- explain and illustrate the externalities associated with smoking cigarettes, and why market failure occurs
- explain and analyse THREE government policies from **Resource H** and their impact on allocative efficiency and equity for different groups in society
- evaluate which policy or policies would be most effective, and allocatively efficient, for the government to pursue to achieve its goals in the short-and long-term.

Use this space for planning your essay. This plan will NOT be marked.

**PLANNING**

Smoking cigarettes has significant negative externalities of ~~costs~~ consumption. They cause health issues including lung cancer, respiratory disease, and cardiovascular disease. (Source F) Crucially, the negative externalities of that impact the ~~are spillover effect that impact third parties in society at the cost~~ and impacts on health and welfare system. Indeed, the "Ministry of Health announced that the total cost of smoking to New Zealand's health and welfare system was \$2.5 billion." (Source F). This is unnecessary expenditure if cigarettes were not smoked at all. The existence of negative externalities of consumption mean that the marginal social benefit is less than the marginal private benefit. This is shown in the graph below.

Graph 1: Cigarettes Cost and Benefit

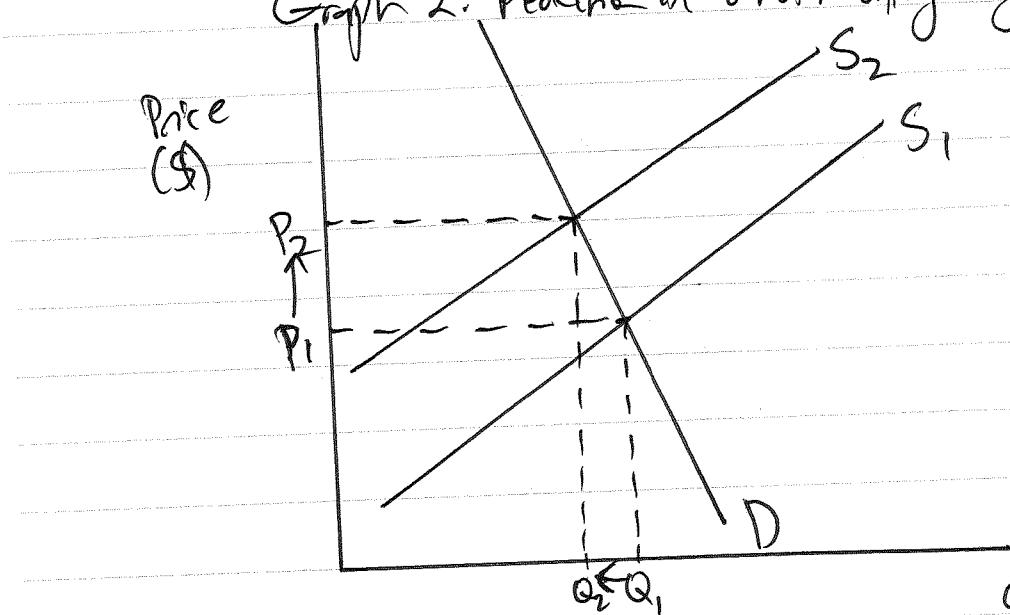


In the free market, only the private costs and benefits are considered - the externalities are disregarded as they do not impose a direct cost on the individual consumer of a cigarette. However, the socially desirable or efficient output occurs when the marginal social benefit is equal

to the marginal social cost where the externalities are accounted for. As can be seen in graph 1, in the free market cigarettes are over-produced and under-priced compared to the socially desirable or allocatively efficient output and price. As a result, there is a deadweight loss in the cigarette market and thus market failure occurs because individuals do not take into account externalities when making consumer decisions in the free market. The failure at the market fails and deadweight loss justifies the government intervention.

One government policy option could be utilised to is to reduce outlets selling cigarettes from 3000 to 300. This would likely work to reduce the availability and supply of cigarettes, particularly if they focus on removing them from low-income areas and close to schools.

Graph 2: Reduction in outlets selling cigarettes



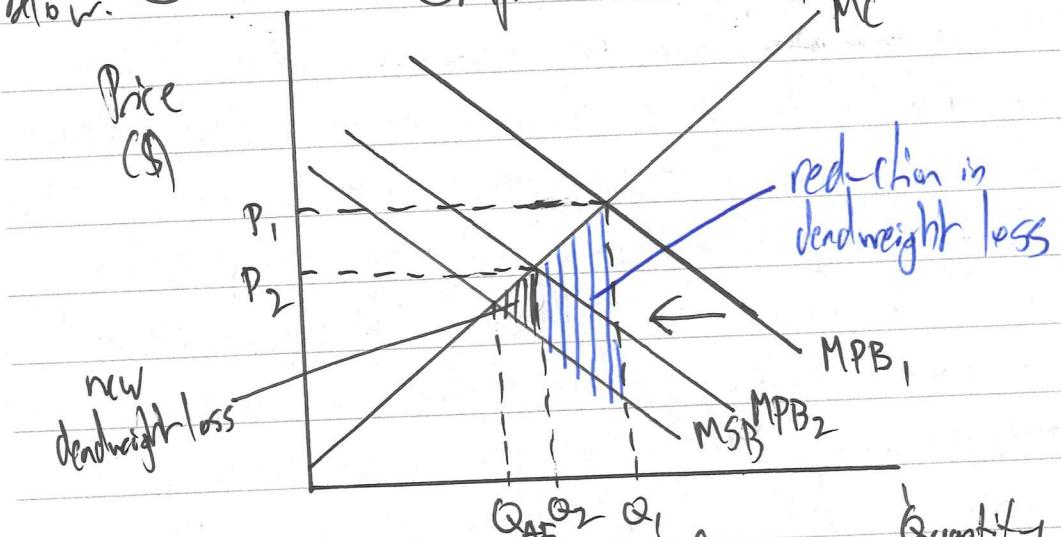
The reduction of outlets would reduce the availability of cigarettes, and hence reduce its supply from  $S_1$  to  $S_2$ . This has the chance to prevent some people from smoking cigarettes.

Those who are not addicted to tobacco will care no longer about cigarettes. In their local dairy or nearby ~~nearby~~ <sup>are</sup> are likely to quit and reduce their cigarettes' consumption. Thus, the quantity does decrease from  $Q_1$  to  $Q_2$ , moving closer to the allocatively efficient level of output. However, those cigarettes, and in particular the ones at night with them, are an addictive substance. This means that the price elasticity of demand for cigarettes is likely to be relatively inelastic. Indeed, according to [Borjas](#), the World Bank estimated that a 10% rise in the cigarette price results in a decrease in smokers of 7% among young people and 4% among adults. This shows that young people's demand for cigarettes has a price elasticity of 0.7, while it is 0.4 for adults - both being relatively inelastic (adults more so). So, while the decrease in supply will cause an increase in price from  $P_1$  to  $P_2$ , this is likely to only cause a 10% proportional change in the quantity from  $Q_1$  to  $Q_2$ . This is because those who are addicted to smoking will simply travel further to continue purchasing cigarettes. This will mean that they suffer from higher travel costs and the high prices of cigarettes. So the policy can potentially be equitable in that it targets the removal of cigarettes from low-income areas. But, the fact that many will be addicted and continue to consume cigarettes will mean that those living in socioeconomically deprived areas will have a greater burden, as they are the ones facing likely to face the higher costs of cigarette consumption. Thus, in the short term, this policy will increase allocative efficiency slightly as cigarette consumption will move towards the allocatively efficient level. But, in the long run

long-term it does not reduce the need of smokers for cigarettes, so it is likely that this reduction will not be that significant. Those addicted, we are over-represented in lower socio-economic groups, will continue to travel by cigarettes, and so it lacks significant effectiveness in the long-term.

Another government policy option is to reduce the level of nicotine in cigarettes. Because "the effects of nicotine" cause smoking to be "highly addictive" (Resource F), reducing the level of nicotine in them would reduce the addictions of cigarettes. This would be likely to reduce the demand and so cigarettes and the marginal price benefit that consumers perceive that they gain from smoking. The effect of this is shown in the graph below.

Graph 3: Reduction in level of nicotine



The decrease in marginal benefit (from  $MPB_1$  to  $MPB_2$ ) causes the quantity to fall from  $Q_1$  to  $Q_2$ . This moves us further away from allocative efficiency level. Indeed, if the nicotine levels reduced enough it could even cause production to occur at allocative inefficiency. An increase in allocative efficiency can

be seen with the reduction in deadweight loss (III). All groups in society with who smoke cigarettes will be faced with this reduction in the level of nicotine equally. In this way, the policy could be viewed as equitable as it affects all groups in the same way.

Especially ~~some~~<sup>smokers</sup> "smokers" who state they do not wish to quit, but in reality, find they cannot" (Reserve F), this policy may reduce the addiction to tobacco and allow many of them to quit.

In the short-term though, the effectiveness of this policy is uncertain. Reserve H points out that this reduction in nicotine will be hard to implement and monitor. "The government would need to ensure that all cigarettes are contaminated with nicotine limit otherwise this would undermine the policy. There would be a significant ~~loss~~<sup>cost</sup> of enforcement and monitoring cost for the government to keep this policy in place. This creates an opportunity cost as this money could have been invested in other areas of the economy.

Moreover, consumers may not realize that nicotine levels have been reduced and still place ~~the some~~<sup>some</sup> cost of margin to ~~buy~~<sup>buy</sup> cigarettes, particularly in the short-term. In the long-term, as consumers' addictions start to dissipate the policy is likely to be more effective in reducing the consumption of cigarettes to a more allocatively efficient level. It would appear to be a workable policy to undertake if the ~~equity~~<sup>cost</sup> of enforcement and monitoring is less than the ~~equity~~<sup>cost</sup> external costs saved by ~~by~~ ~~addictive~~ consumption of cigarettes. ~~especially~~ as the decrease in addictions will cause demand for cigarettes to decrease relatively more price elastic.

A third government policy option would be a minimum ~~price~~<sup>price</sup>. An effective minimum price would need to be imposed above the equilibrium price. This would increase the price of cigarettes and cause a contraction in quantity demanded.

The effect of a minimum price on the cigarettes market is shown in the graph below

Graph H: Minimum Price on Cigarettes



As can be seen the minimum price discourages consumers from buying cigarettes so quantity demanded decreases to  $Q_d$ . This does more harm than good as it allocates efficiently less. But again, because at the fact that demand for cigarettes is relatively price inelastic the change in quantity demanded will be less than proportional to the change in price. Moreover, efficiency is due to the fact that supply is actually maximised by the higher price to produce more cigarettes. This results in surplus equal to  $(Q_s - Q_d)$ . In this way resources are being used wastefully because goods and labour produced are not demanded and are not being consumed - it is wasted.

The impact of a minimum price is likely to be heterogeneous. Before I highlight how £8.79 a pack of Marlboro and £8.71 for Pacific people are daily smokers in comparison to 11.6% of N2 adults in 2019/20. This means that the poorer and Pacific people are going to be disproportionately affected by the increase in price.

d cigarettes). Also, ~~Hence in sooo~~ "there is still significant  
negotiating for ~~the~~ ... ~~Hence in socioeconomically depressed~~  
~~areas, and (Passage E) add with~~ "the rate of tobacco  
smokes ... has been linked to low-income communities" (Passage  
E). It shows that cigarettes will still be readily available for  
the poor at low prices. Rather than a significant  
reduction in the amount of cigarettes they smoke, because  
they believe relatively reliable demand it's more likely that  
they simply spend a greater proportion of their income on  
cigarettes, potentially reducing their ability to purchase  
necessities. Thus, in the short term, it's more likely that  
the minimum price will be largely ineffective. It  
encourages production of cigarettes, and will only cause a  
slight reduction in the quantity demanded to them.

Thus, overall, the government should seek to both  
reduce outlets selling cigarettes from 5000 to 300 while  
also reducing the yield of nicotine in it. In the short  
term, this does reduce total demand and supply of  
cigarettes which brings the market closer to its allocative  
efficiency position. Most significantly, the reduction in nicotine  
content will encourage people to reduce their demand of additional  
cigarettes in the long-term. Thus, in turn, will make demand  
for cigarettes more price elastic and allow the government  
to supply to cause a large decrease in quantity of sales to  
reduce the negative impacts of those have less to buy  
cigarettes. This would in effect be what the government  
for use to goal of Smokers Action 2025.

### QUESTION THREE: Inflationary pressures and the New Zealand economy

Use information from Resources I to M, and your knowledge of the New Zealand economy and macroeconomic theory, to answer this question.

The consumers price index (CPI) increased [redacted] % annual inflation

[redacted] year to the June 1998 quarter, many other OECD countries experiencing higher inflation than in recent decades.

Analyse the factors causing inflation that were impacting the New Zealand economy in early 2022.  
 Evaluate the impact of implementing a contractionary monetary policy on the New Zealand economy and macro-economic goals.

In your answer:

- use appropriate economic models throughout
- analyse the aggregate demand and aggregate supply factors that led to increasing inflation in New Zealand in early 2022
- explain why price stability is an important macroeconomic goal
- evaluate the effect of an increasing Official Cash Rate on the New Zealand economy and key macroeconomic goals, given the position of the New Zealand economy in early 2022.

Use this space for planning your essay. This plan will NOT be marked.

#### PLANNING

$$AD \rightarrow D - p^e$$

$$AS \rightarrow c^e - p^e$$

note that near capacity (Yf)



$$P\text{AD} \rightarrow \text{is inflat rate}$$

then T%

$$\downarrow \text{AD (LC, LF)}$$

(app)  $\rightarrow$  effect on AS (less sig)

M2 eco.  $\rightarrow$  all caps

down

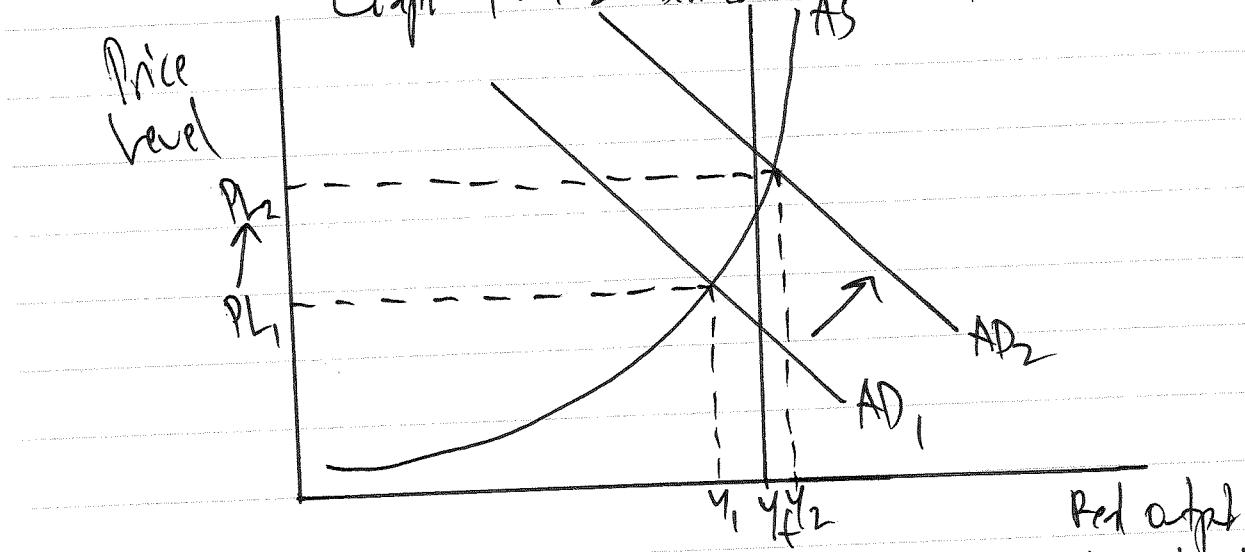
gdp  $\rightarrow$  per stat, eco. of, more. st. employ.

In NZ in early 2022 CPI inflation reached relatively high levels reaching 6.9% year-over-year data in March 2022, and it has continued to remain at this high level for the rest of 2022. Both demand-pull and cost-push inflation have occurred which explains why the inflation has been so significant.

Firstly, there have been aggregate demand factors that have led to increasing inflation in NZ. In response to Covid-19, NZ adopted both expansionary monetary and fiscal policy. The Reserve Bank lowered the OCR to 0.25% from March 2020 to August 2021. This lowers all interest rates in the NZ economy, which in turn reduces the cost of borrowing for firms and consumers. It also increases the real interest rates of savings, encouraging the expenditure instead. As a result this causes a rise in consumption spending and investment spending - both components of aggregate demand (AD) - which leads to a rise in AD. Moreover, government spending has increased through the form of "expansionary fiscal policy support" (Reserve Bank). This shows that the government made significant injections into the economy during the Covid-19 pandemic, in particular with its spending on wage subsidies. It is another component of aggregate demand. The positive contribution to the demand-pull inflation. Moreover, the rapid global economic activity coming to life in 2021, and so this will have increased AD demand to New Zealand exports. Today, despite NZ had a strong term of trade in January, still on an export-year high, as NZ's net exports were

also increased. This, with all components of aggregate demand appearing to increase from a significant increase in aggregate demand occurred. This would have been surprising, because while it was clear that expansionary measures were being taken, many economists did not expect economic activity and demand to recover as quickly as it did following the end of Covid-19 health restrictions. The effect of this increase in aggregate demand is shown in the graph below.

Graph 1: NZ Demand-Pull Inflation

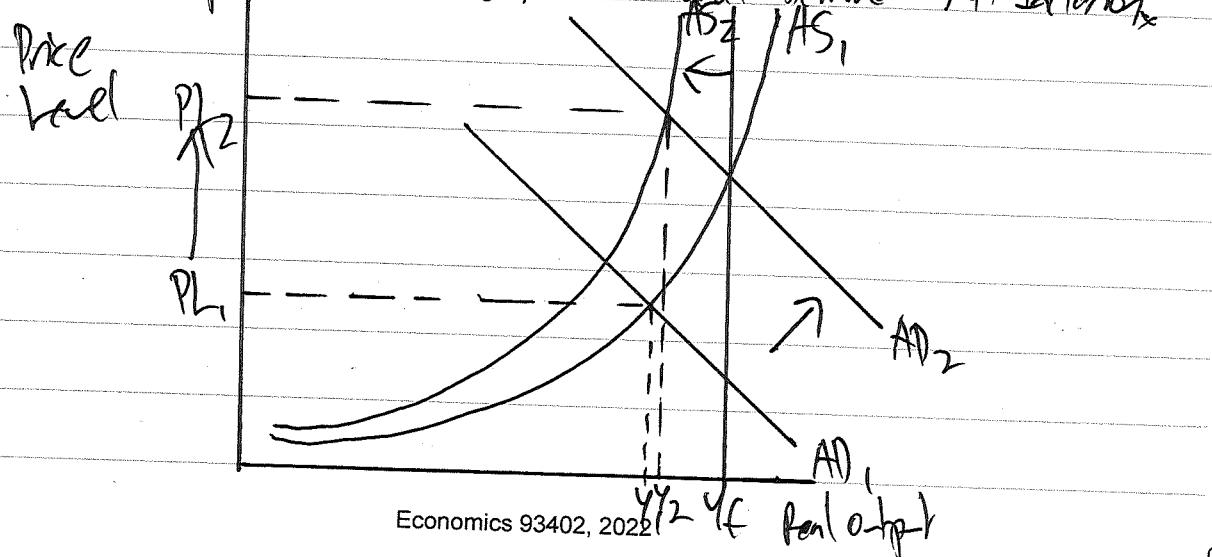


As shown in graph 1, the increase in AD from  $AD_1$  to  $AD_2$  causes a significant rise in the price level from  $P_1$  to  $P_2$ . This explains how aggregate demand factors contributed to the increasing inflation in NZ.

Aggregate supply factors also contributed to continued inflation in the NZ economy, exacerbating the effects of demand-pull inflation and creating the inflationary conditions that the NZ economy is operating under in 2022. Covid-19 and other issues, internationally, such as the Russia-Ukraine war have created "global supply-chain disruptions" which causes both

"cost pressures and constraint on production" (Resource I). The impact of these increased costs and inability to produce due to supply chain issues & heat form, in NZ are reflected in unwillingness due to the cost-push on profitability to produce as much. This, has contributing to a decrease in aggregate supply (AS). Similarly, "pandemic disruption has driven manufacturing and transportable costs through the roof," (Resource M). The rise in costs of production means that producing output becomes less profitable. So, producers choose to decrease their supply and pass on some of these costs to consumers in the form of prices, causing inflation. Because this is widespread throughout the NZ economy, it contributes to the general inflation. The depreciation of the NZD against the USD, will have caused the NZD price of imports into NZ to increase. This has also caused domestic oil prices to have risen globally" (Resource M). The increase in prices of raw materials, again causes the cost of producing for NZ firms using imported oil or other raw materials and its feeds through to prices. The impact of this change in aggregate supply, alongside the increase in aggregate demand, shown in the graph below.

Graph 2: NZ Cost-Push and Demand-Pull Inflation



As shown in graph 2, the decrease in aggregate supply reinforces the increase in price level caused by the increase in aggregate demand. This creates the rather dramatic increasing inflation in NZ at 6.9% in the March 2022 quarter (and at 7.2% late in the year).

This is of concern to the NZ government because price stability is an important macroeconomic goal. The NZ Policy Target Agreement setting that the RBNZ's goal is to maintain CPI inflation between 1 and 3% on average over the medium term. Essentially, a high rate of inflation reduces the purchasing power of firms' consumers. That is,  $P_{real} = \frac{P_{nominal}}{1 + \text{inflation}}$ . This means that consumers cannot buy as many goods and services as previously and their material standard of living falls. Moreover, high rates of inflation reduce both business and consumer confidence. The reduction in business confidence is significant because they are likely to reduce their investment when they face greater certainty of the future in the economic future of NZ.

In NZ, the high rate of inflation has created "beyond the bread basket" a "cost of living crisis." lower and middle-income consumers in NZ have suffered in particular from the rising cost of living due to inflation. Many are struggling to even afford basic necessities and have been going more reliant on food packages. Indeed, if inflation gets significantly out of hand, resulting in hyperinflation, then confidence in the monetary system may

completely despite. This is very unlikely to be the case in New Zealand though. ~~Price~~ It is also important to avoid deflation and a decreasing price level. This is because this encourages consumers to delay consumption in anticipation of further decreases in prices. This can lead to a fall in AD and ~~cause a recessionary gap~~ cause a recession. In 2022, deflation is not the threat to price stability in NZ, and indeed ~~deflation~~ ~~it is~~ the high and rising inflation rate that is eroding real incomes and the value of savings (it is the actual rate of increase in the inflation rate), and so the government is seeking to control this and re-achieve its macroeconomic goal of price stability.

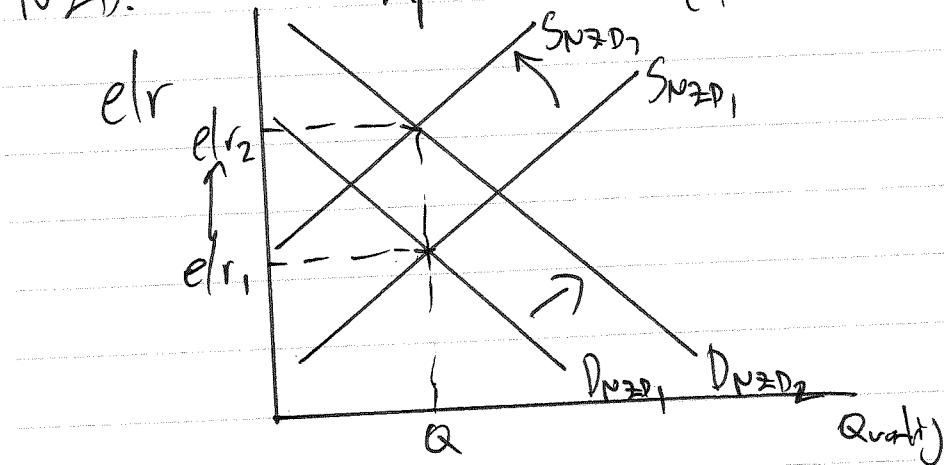
<sup>(OCR)</sup>  
Increasing the official cash rate is a contractionary monetary policy that seeks to decrease aggregate demand. An increase in the OCR will lead to increases in bank wholesale interest rates on settlement accounts and then to an increase in retail interest rates via the transmission mechanism. The increase in interest rates raises the cost of borrowing as well as existing debt servicing costs, including mortgages. This reduces consumers' desire to borrow money to consume, and also reduces their deposit income that they can then spend on consumption. Moreover, it increases the return on savings encouraging consumers to save rather than spend their money. This creates a feedback in consumption spending. Marginal efficiency of capital may also decline as investment will decrease. As interest rates increase, there are less projects or investments that will have an expected rate of return that equals the interest rate.

So, businesses are ~~more~~ likely to decrease their investment spending. As consumption and investment spending are both components of AD, the increase in OCR ~~is likely~~ (from 0.73 in August 2021 to 1.50 in April 2022, <sup>as shown in</sup> October 2022), is likely to cause a fall in AD.

No increase, the demand for

Moreover, the increase in OCR ~~causes~~ <sup>1/22</sup> and interest rates  
encourages importers to oversupply imports to hold NZD  
as the returns on them are now increased. It is also  
likely to reduce the amount of money leaving NZ as  
the returns are greater in NZ, decreasing the supply of  
NZD.<sup>2</sup>

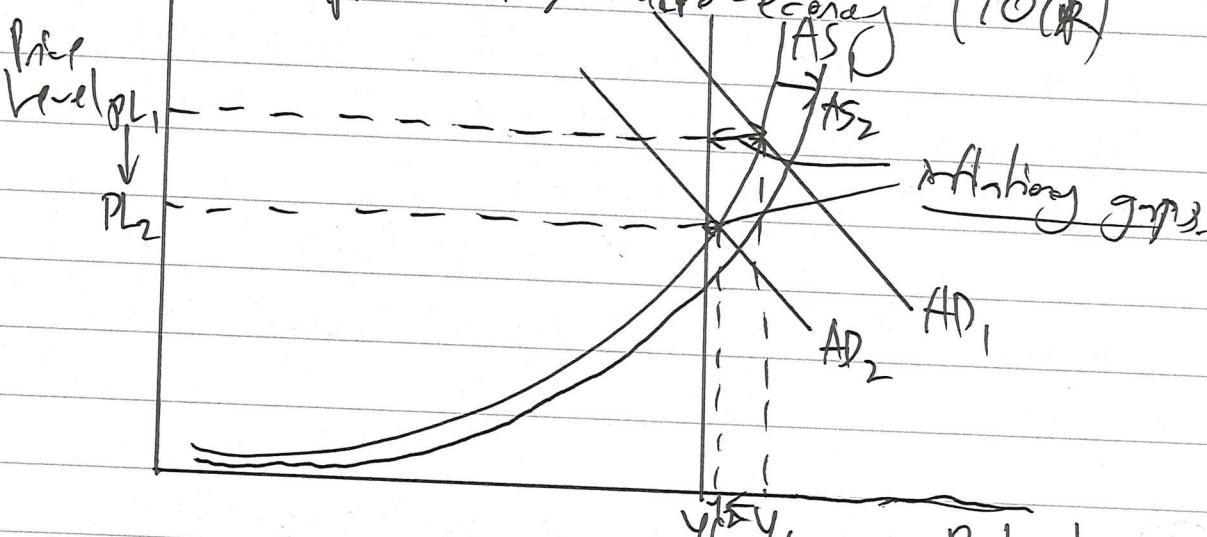
Graph 3: NZ elr



As shown this causes an increase in the exchange rate  
from elr<sub>1</sub> to elr<sub>2</sub>, or an appreciation of the  
NZD. This reduces the price of imports into NZ. The  
decrease in the price of imported raw materials reduces  
a cost of production for NZ firms and so can lead to  
a slight increase in AS, although it will be small due to  
other factors still affecting supply.

The effect of the OCR change on NZ economy → see  
on the graph below.

Graph H: NZ Macro-economy (10CR)



NZ economy is currently operating at above full employment ( $Y_F$ ), as Pescara highlights. Full employment is now at maximum sustainable level  $\frac{1}{2} \text{ of } 3.3\%$  inflation  $\rightarrow 3.3\%$  utilisation of 96.1% in September 2021. At this point, the decrease in AD (which is more significant than the decrease in AS), only; the economy has to clear to operate at the full employment, reducing the size of the inflationary gap. This need will result in NZ achieving its goal of price stability. It puts downward pressure on the price level ( $PL_1 \rightarrow PL_2$ ), although it should be noted that global energy supply issues may reduce the effectiveness of achieving this. The decrease in OCR is also likely to increase real output from  $Y_1$  to  $Y_2$ . Otherwise, this goes against the achievement of the macroeconomic goal of economic growth and maximum employment. Hence, the move to recession, because the economy is already at a full employment level (3.3%). The real output will not rise at all, instead it will be at 4.5%. Therefore,

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Write the question number(s) if applicable.

QUESTION NUMBER

- 1) It has forced domestic producer to enabled them to increase supply but it does so without sacrificing any significant level of government support and allocative efficiency. Thus, if the government can afford to do so, and does it in a timely manner, it can increase welfare in NZ by increasing a reward and a demand grant. //
- 2) be a greater number of workers available for firms so that they are able to increase supply. While economic growth may be hindered in the short run, it is necessary to bring the economy back to its full employment level of output and to reduce the inflation pressure. In the short run, some people may lose their jobs and real GDP may fall, but in the long run, the improved price stability and the slowing of the inflation rate will create greater confidence in the NZ economy. This will encourage greater industrial and economic growth to occur again as the economy bounces back. Indeed, Reserve Bank forecasts the annual GDP growth to fall from +1.2% in 2021 to +2.8% in 2023 in part due to the contractionary monetary policy. Indeed, these forecasts were made in October 2021, and already inflation has risen to a higher rate than forecast. Thus, the short-run outcome in the NZ economy may be

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Write the question number(s) if applicable.

be more positive in terms of employment and economic growth fully in order to get inflation under control.

**Acknowledgements**

Material from the following sources has been adapted for use in this assessment:

**Question One**

<https://www.customs.govt.nz/about-us/news/important-notices/update-imposition-of-provisional-anti-dumping-duties-on-galvanised-wire-from-china-and-goods-currently-subject-to-anti-dumping-duties>  
<https://www.newshub.co.nz/home/rural/2020/07/new-zealand-specialty-cheesemakers-call-for-tariffs-on-eu-imports.html>

**Question Two**

<https://www.health.govt.nz/our-work/preventative-health-wellness/tobacco-control/smokefree-aotearoa-2025>

**Question Three**

<https://www.stats.govt.nz/news/annual-inflation-reaches-30-year-high-of-6-9-percent>

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