

Suggested answers

SECTION A: MULTIPLE-CHOICE QUESTIONS

Question	Answer	Question	Answer
1	A	9	D
2	B	10	A
3	D	11	C
4	A	12	C
5	B	13	B
6	B	14	D
7	C	15	C
8	D		

SECTION B: WRITTEN RESPONSES

Note: When making judgements about the quality of student answers to questions, teachers could be guided by some or all of the following factors (depending on the question): accuracy, relevance, completeness, breadth/depth of treatment, logic of connections, clarity, substantiation of claims, level of coherence.

Note: The following are suggested answers only.

Question 1 (13 marks)

a. Outline two aims of aggregate supply policies.

4 marks

One aim of aggregate supply (AS) policies is to improve the international competitiveness of the Australian economy. International competitiveness refers to the ability of Australian businesses to successfully compete for market share in a global economy on both price and non-price factors. Therefore, if AS policies are successful in increasing Australia's productive capacity, then this should increase the international competitiveness of Australian businesses as downward pressure is placed on costs. This in the long run will allow these businesses to lower prices or improve quality in order to attract a larger market share.

Another aim of AS policies is to assist the economy to avoid capacity constraints, whereby the nation's productive capacity is reached and output cannot keep pace with aggregate demand. For example, problems such as traffic congestion, electricity brown-outs and container ships queuing at ports, all point to problems with Australia's productive capacity. AS policies, such as the creation of infrastructure including new and more efficient transport systems that allow businesses to transport goods more quickly, and therefore more cheaply, help to reduce cost-push inflationary pressures and increase the nation's productive capacity in the long run.

Marking guide:

2 marks for indicating the main features of a relevant aim (**x two = 4 marks**)

- b. Explain how the Australian Government's 10-year infrastructure program might contribute to an improvement in productivity, aggregate supply and assist in achieving the domestic macroeconomic goal of low inflation. 5 marks**

Infrastructure acts as the arteries via which households, businesses and governments interact to deliver and receive goods and services. In recent times, the Australian Government has committed to investing significant resources in many long-term infrastructure projects as part of the 10-year infrastructure program. These include major transport infrastructure projects, such as the Western Sydney Airport and the Melbourne to Brisbane Inland Rail.

Using transport infrastructure as an example, upgrades to existing infrastructure (e.g. widening of the Monash Freeway) will help to speed up the delivery of goods and provision of services produced in the Australian economy. This can help to place downward pressure on transport costs and improve both the productivity and profitability of businesses. This is because faster transport times allow businesses to get goods more quickly from A to B, and this has the benefit of increasing output per unit of input (labour and capital), as measured by labour and multifactor productivity. Ultimately, this results in lower transport costs for businesses, improved profitability, and therefore increased willingness of businesses to produce, which equates to an increase in aggregate supply.

Improvements in aggregate supply also place downward pressure on cost inflation, which can assist to achieve the government's macroeconomic goal of low inflation, being consumer price index rising between 2% to 3% on average over time. This is because businesses will be facing improved supply side conditions and will be more able and willing to lower prices to attract market share.

Marking guide:

1 mark for demonstrating an understanding of the term productivity

2 marks for making valid links between the policy and improvements in productivity and aggregate supply

2 marks for demonstrating an understanding of the goal and how the policy can assist in achieving the goal through improving AS

- c. Discuss how the Australian Government's decision to restrict migration to Australia could impact on Australia's labour market. 4 marks**

The government's decision to restrict entry to Australia for new migrants on working visas has dramatically slowed growth in supply to Australia's labour market. This slowdown in supply has created shortages in many occupations reliant on overseas labour, and therefore has created a 'tightening' of labour market conditions. This can place upward pressure on wages and make it difficult for businesses to source labour resources required to facilitate production.

This upward pressure on wages, due to the shortages of suitable labour, can significantly add to businesses' cost of production and reduce their willingness to supply. This in turn negatively affects the amount of goods and services available for sale in the economy as measured by aggregate supply.

2 marks for making valid links between a restriction in migration to Australia and possible wage pressures and skill shortages in particular labour markets

2 marks for explaining how a tightening of the labour market conditions can have negative consequences for aggregate supply

Question 2 (9 marks)

- a. Referring to Figure 1, explain how the trend in the unemployment rate and underemployment rate in 2021 might influence non-material living standards.

3 marks

As represented in Figure 1, Australia's unemployment rate has demonstrated a marked downward trend, indicating an improvement, as the unemployment rate has fallen from 6.4% at the start of 2021 to a low of 5.1% in May 2021.

Any improvement in the unemployment rate can have many positive non-material impacts on living standards. As unemployment typically carries with it the trauma of loss of identity, social connections and increased stress on family relationships, resulting from financial hardship, any reduction in the number of people affected will result in an improvement in the average quality of life across the community.

Marking guide:

1 mark for highlighting an improvement or downward trend in the unemployment rate

1 mark for supporting the description of the trend with relevant data from the figure

1 mark for linking lower levels of unemployment with an improvement in non-material living standards.

- b. Referring to Figure 2, explain how an aggregate demand (AD) factor may have influenced the Consumption component of AD in 2020.

2 marks

Aggregate demand factor: _____ **impacting Consumption**

Consumer confidence (sentiment) measures the general level of optimism about the future state of the economy, from a consumer's perspective. With the onset of the COVID-19 pandemic in March 2020, the general state of optimism collapsed, as the consumer sentiment index suffered its largest monthly fall in April 2020. Consumers became worried about income and employment prospects, which contributed to a steep increase in the marginal propensity to save and a downward pressure on Consumption, particularly of non-essential items. This is evident in the fall in the Consumption component of AD by around 1.5% across 2020.

Marking guide:

1 mark for identifying a relevant AD factor

1 mark for making a valid link between the factor and an impact on consumption in 2020, as per the direction shown in the chart

- c. With reference to Figures 1 and 2, assess whether the Australian Government has achieved its domestic macroeconomic goals of strong and sustainable economic growth, and full employment in 2020.

4 marks

The goal of strong and sustainable economic growth is the strongest growth rate possible, consistent with strong employment growth, without leading to inflationary, external or environmental pressures, which is currently suggested to be an annual growth rate of between 3.0% and 3.5% in real GDP. As shown in Figure 2, real GDP fell by -1.5% in 2020, highlighting that the economy experienced a recession in 2020, as total output decreased for the period.

The goal of full employment is a level of employment that is consistent with the goal of strong and sustainable economic growth, where cyclical unemployment is minimised. Currently, it is generally viewed that an annual unemployment rate of approximately 4.5% would mean that the Australian Government's full employment goal was achieved. As shown in Figure 1, the unemployment rate reached a peak of 7.4% in July 2020, and as the economy improved it

fell to 6.6% by December 2020, which is still well above the government's goal of full employment. Following the same trend, underemployment peaked at 13.6% in April 2020, indicating a significant number of workers would have liked to be working more hours. However, due to the significant restrictions on migration to Australia and an improving economy in the second half of 2020, the labour market quickly tightened, such that the underemployment rate fell back to 8.5% by December 2020.

Overall, the government failed to achieve either of these goals in 2020; however, signs of improvement were evident as 2021 commenced.

Marking guide:

2 marks for accurately using data from the diagram to conclude that the goal of strong and sustainable economic growth had not been achieved in 2020

2 marks for accurately using data from the diagram to conclude that the goal of full employment had not been achieved in 2020

Question 3 (20 marks)

- a. Explain how low wage growth might have influenced the stance on monetary policy in 2021. 3 marks**

In determining monetary policy, the Reserve Bank of Australia's (RBA) objectives have been to maintain price stability, full employment and economic prosperity for all Australians. The central focus has been the RBA's price stability goal, which has been to keep inflation (as measured by the consumer price index) at between 2%–3%, on average, over time. In 2020 and 2021, inflation collapsed to 0.9% for the year ended 31 December 2020. This was in line with consumption and investment expenditure collapsing, due to the impact of COVID-19. In response, the RBA's monetary policy stance has been highly expansionary, since the emergency COVID-19 response resulted in the target cash rate being reduced to 0.10% in March 2020 (and retained into 2021) to support expenditure in the Australian economy.

In an effort to remain afloat as the pandemic hit, many businesses have implemented wage freezes or even wage cuts in order to protect profitability. This has resulted in a significant reduction in wage growth to below 2% per annum, as measured by the wage price index. Soft wage growth has meant much lower demand and cost pressures in the Australian economy, supporting a very low inflationary environment. This has meant the RBA has been able to focus on being as expansionary as possible to stimulate employment and economic growth.

Marking guide:

1 mark for accurately describing macroeconomic goal of low inflation

2 marks for making a valid link between low wage growth, low inflation and a highly expansionary monetary policy

- b. Explain how the exchange rate transmission mechanism channel of monetary policy can operate to affect the level of aggregate demand and the rate of economic growth, following the cuts to the target cash rate in 2020. 3 marks**

When interest rates decrease, this causes the return on savings in Australian institutions to fall for international investors. As such, foreign investors are discouraged to purchase Australian debt securities as the rate of return on investment is relatively lower. This will reduce demand for the Australian dollar (AUD). It will also encourage existing foreign investors to liquidate their Australian debt securities in order to obtain a higher yield overseas, causing an increased supply of the AUD. These changes in capital flows will work together to cause the AUD to depreciate. The depreciation in the AUD relative to the currencies of Australia's trading partners, will make Australian exports more price

competitive and imports more expensive, leading to an increase in (X-M) and therefore aggregate demand in the economy. Given all things are equal or constant, businesses should notice inventory levels starting to fall, leading to increased orders and demand for factors of production, which ultimately leads to an increase in economic growth that will be measured by an increase in real Gross Domestic Product (GDP).

Marking guide:

1 mark for demonstrating an understanding of how the channel works

1 mark for making a valid link between the operation of the channel and an increase in the level of AD

1 mark for making a valid link between the increase in AD and the rate of economic growth

- c. Referring to Table 1, identify the outcome of the 2021–22 Budget and outline its stance. 2 marks**

The budget outcome for the 2021–22 Budget is a deficit of \$106.6 billion or 5% of GDP, as measured by the underlying cash balance. This compares to a much larger deficit in the previous year (2020–21) of \$161 billion.

Generally, a deficit budget, where the value of government outlays exceeds its receipts, is considered an expansionary stance. However, it can be noted that the considerably smaller budget deficit for 2021–22 can be described as contractionary (or less expansionary) as the net injection by the Budget into the economy is less than the previous year.

Marking guide:

1 mark for accurately identifying the budget outcome for 2021–22

1 mark for providing a key reason for the budget stance for 2021–22

- d. Explain the importance of the major economic parameters (forecasts) in determining estimated budget outcomes. Refer to the data contained in Table 1 in your response. 2 marks**

The Australian Government's macroeconomic forecasts of levels of output (nominal and real GDP), inflation (CPI), unemployment (unemployment rate), wage price index and other macroeconomic measures are critical in preparing the budget. For example, estimates of unemployment rate in 2021 and 2022 of 5% and 4.75%, allow the government to predict expected outlays of unemployment benefits and planned tax collections, ultimately influencing the budget outcome. The macroeconomic predictions can help determine whether changes to discretionary stabilisers are required to moderate the overall level of Australian economic activity and/or whether the government requires or has surplus funds to finance planned expenditure.

Marking guide:

1 mark for making a valid link between economic parameters and their influence on revenue and expenditure forecasts

1 mark for selecting relevant data to support explanation

- e. Describe how the outcome of the 2021–22 Budget would impact on the level of government (public) debt. 2 marks**

The 2021–22 Budget outcome is estimated to be a significant deficit of \$106.6 billion. As outlays exceed receipts, the Australian Government will be required to obtain funding to meet the shortfall. To do this the government will need to issue government bonds, which when purchased by investors, will increase the level of public debt.

Marking guide:

1 mark for linking a budget deficit budget to an increase in public debt

1 mark for describing how the funding shortfall will be filled through the issuing of government bonds

- f. Evaluate the effectiveness of using budgetary policy to support economic growth during 2020. Refer to the data contained in Table 1 in your response.**

8 marks

Australia faced a recession in 2020, as the economy shrank by 7% in the June quarter after falling by 0.3% in March 2020. The COVID-19 crisis caused a dramatic reduction in consumer and business confidence, in part as a response to widespread government-imposed lockdowns, as well as uncertainty surrounding the pandemic. This led to significant falls in consumption and investment expenditure, causing the government to rapidly respond to falling economic growth and rising unemployment by using its budgetary policy, in conjunction with monetary policy.

A key strength of using budgetary policy to support economic growth in 2020 was its ability to target particular sectors of the economy. This contrasts with monetary policy, which has a 'blunt' approach, whereby it is unable to assist particular sectors of the Australian economy. For example, the household sector was initially hit hard by the public health measures to lockdown the community, leading to a significant fall in incomes for many households and the risk of skyrocketing unemployment. The Australian Government was able to quickly provide additional income support to the unemployed via JobSeeker and the Coronavirus Supplement, which quickly helped to support consumption expenditure, aggregate demand and economic growth.

Another strength of budgetary policy is its ability to have a relatively short 'impact lag' in comparison to monetary policy. For example, through the government's ability to alter taxation policy (e.g. expanding the instant asset write-off for business) and payments (e.g. JobKeeper), the government was able to quickly stimulate expenditure and therefore economic growth within a period of weeks or months from its announcement. This is in contrast to monetary policy, where changes to the cash rate and other measures might take up to 18 months to have their full effect on the economy.

The ability of the budget's cyclical stabilisers to automatically support economic growth during a significant decline in expenditure is another advantage budgetary policy. For example, as unemployment steeply increased and business revenue fell, the government's welfare payments (e.g. unemployment benefits) moved to cushion the blow to household income, while leakages from the economy, due to taxation, also rapidly reduced via smaller income tax, company tax and GST collections.

A weakness of budgetary policy in attempting to support economic growth is that it will lead to substantial levels of public debt, which will impact on future budgets in the medium- to long- run. For example, the 2021–22 Budget estimates that net government debt will reach over \$980 billion by 2024–25. This significant increase in public debt will likely require future generations to finance interest and principal repayments through a combination of higher taxes or reduced government services.

As noted earlier, Australia did experience a recession during 2020; however, there are clear signs during 2021 that the economy has begun to grow again. Overall, the strengths of the budgetary policy measures implemented outweighed their weaknesses, and they have been effective in supporting economic growth relative to the levels that would have been possible without the extensive and effective measures.

Marking guide:

6 marks for judging the strengths and weaknesses of budgetary policy in attempting to support economic growth in the specific context of 2020, considering depth/breadth of treatment, accuracy and relevance

1 mark for selecting relevant data to support the response

1 mark for drawing a conclusion that is consistent with the judgements

Note: The response should address the strengths and limitations of using budgetary policy; however, there does not need to be an equal number of strengths and weaknesses.

Question 4 (9 marks)

- a. With reference to Figure 3, describe the trend in the terms of trade from June 2018 to March 2021. 2 marks**

As represented in Figure 1, Australia's terms of trade index has demonstrated a marked upward trend, indicating an improvement, as it has moved from 95.5 in the June quarter 2018 to 114.7 in the March quarter of 2021.

Marking guide:

1 mark for highlighting an improvement or upward trend in the terms of trade index

1 mark for supporting the description of the trend with relevant data from Figure 3

- b. Predict how the trend in Australia's terms of trade might impact on the Australian dollar, rate of economic growth and material living standards. 5 marks**

A higher terms of trade (TOT) indicates that the price Australia receives for its exports rose relative to the price Australia has paid for its imports over the period. Assuming the rise in the TOT is a result of rising export prices, this should place upward pressure on the Australian dollar (AUD), rate of employment growth and material living standards. For example, higher export prices for Australia's commodity exports, including iron ore and coal, are likely to be reflected in a rising TOT. As a consequence, incomes from commodity exports will increase and this will be reflected in increased demand for AUD as the proceeds are eventually repatriated to Australia.

A rising TOT caused by rising commodity prices should translate into an increase in export incomes and profits for Australian exporting businesses. These profits can then be distributed to shareholders and workers in the form of higher dividends and wages, which in turn should encourage increased consumption and investment as exporting businesses seek out new profit opportunities through exploration or expansion of existing operations. Businesses seeking to expand their operations will likely increase their derived demand for labour and this should result in upward pressure on employment growth.

Other things being equal or held constant, rising income levels, driven by higher export prices, will therefore cause aggregate demand (AD) to rise, which will be demonstrated by a shift to the right in the AD curve, and this in turn will encourage the Australian economy to increase production (expansion along the supply curve) and therefore increase derived demand for factors of production, including labour.

At the same time, increasing levels of production to meet increasing demand will result in increased levels of output, as measured by Gross Domestic Product (GDP). If the increase in GDP leads to an increase in GDP per capita, material living standards of Australians should rise as Australians can access more goods and services on average.

Marking guide:

2 marks for proposing a valid impact on the Australian dollar, using evidence to support the prediction

2 marks for proposing a valid impact on employment growth, using evidence to support the prediction

1 mark for proposing a valid impact on material living standards

c. Distinguish between the terms trade liberalisation and barriers to trade. 3 marks

Trade liberalisation refers to the government policy of removing or reducing barriers to trade, such as tariffs, quotas and subsidies, in order to encourage the free trade of goods and services across economies. Whereas barriers to trade refer to government policies that aim to restrict international trade, such as tariffs on imports, subsidies for local producers and quotas on imports. A point of difference between the two policies is their purpose – trade liberalisation seeks to encourage competition and international trade, while barriers to trade aim to protect local producers from competition.

Marking guide:

1 mark for providing the meaning of the term trade liberalisation and barrier to trade

1 mark for providing the meaning of the term barrier to trade

1 mark for highlighting a point of difference between the two terms

Question 5 (13 marks)

a. Describe one demand factor and one supply factor that could have led to an increase in the price of housing in late 2020 and early 2021. 4 marks

Note: There are other relevant factors in addition to the suggested answers.

Demand factor: Interest rates

In response to the COVID-19 crisis in 2020, the Reserve Bank of Australia (RBA) announced its lowest ever target cash rate. This was to encourage borrowing, in order to finance expenditure, including the purchase of assets such as housing. As the RBA cut rates in March 2020, this was followed by the commercial lenders cutting their fixed and variable lending rates to record low levels, which improved the affordability of housing loans. Consequently, this increased the number of buyers in the market, which put upward pressure on prices

Supply factor: Government restrictions on public gatherings

In response to the COVID-19 outbreak, governments across Australia have implemented a range of restrictions on social gatherings in an effort to limit the spread of the virus. For the property market this has meant that activities, such as home inspections and traditional auctions, have been restricted in order to comply with government mandates. This has impacted on the willingness of some existing homeowners to offer their property for sale, which has restricted the stock of housing for sale and therefore contributed to upwards pressure on price.

Marking guide:

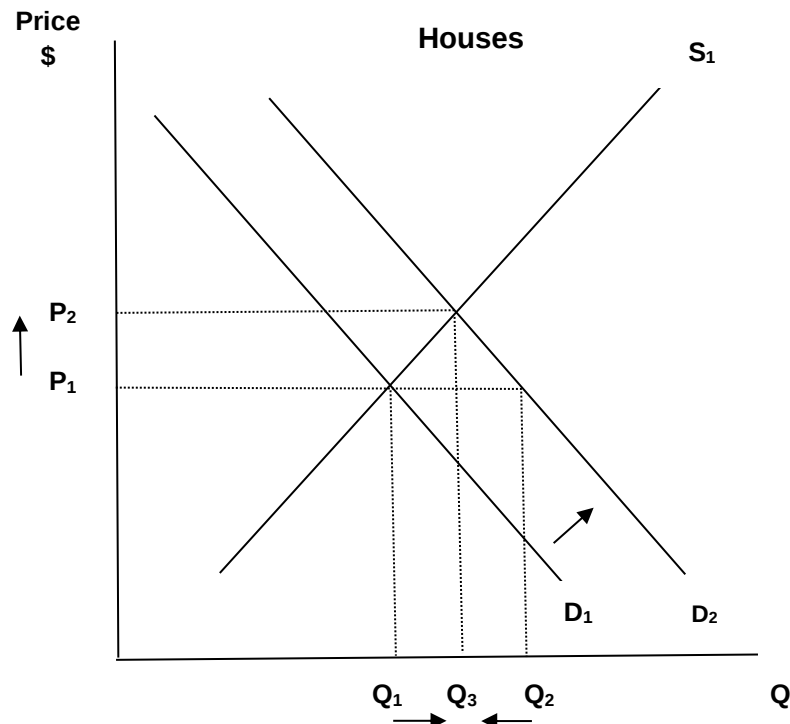
1 mark for stating a relevant demand factor

1 mark for providing details of the factor that resulted in an increase in demand for housing

1 mark for stating a relevant supply factor

1 mark for providing details of the factor that resulted in a decrease in supply of housing

- b. On a fully labelled demand and supply diagram for the market for housing, illustrate how an increase in demand for housing since the second half of 2020 might influence the market for housing. **3 marks**



Marking guide:

1 mark for fully labelling the demand and supply diagram

1 mark for drawing D_1 as a shift in the demand curve to the right

1 mark for annotating an increase in both P and Q

- c. Referring to **one** factor influencing price elasticity of demand, explain why the demand for buying a house is likely to be price elastic. **3 marks**

The price elasticity of demand (PED) measures the responsiveness of buyers (demand) to a change in price. Demand for housing is described as price elastic if there is a proportionately larger increase in quantity demanded in response to a given fall in price of housing, and vice versa.

From a buyer's perspective, the purchase of a house is likely to be the most expensive purchase a household will make in their lifetime. Consequently, buyers are likely to be very sensitive to changes in price and therefore react accordingly when the price changes. For example, if house prices were to fall by 5%, there is likely to be an increase in quantity demanded for housing by greater than 5%, representing a PED value of greater than 1. The significance of the purchase price as a proportion of income (even in terms of interest and principal repayments on a mortgage) would likely result in a price elastic demand for housing.

Marking guide:

1 mark for accurately describing what is meant by price elastic demand

1 mark for stating a logical factor influencing PED for housing

1 mark for making a logical connection between the PED factor and the price elastic demand for housing

- d. Explain how a recent government intervention has led to, or could result in, an unintentional decrease in the efficiency in resource allocation. Your answer can relate to the NSW Government's first homebuyer grant or another example of government intervention. **3 marks**

The NSW Government's intention to increase grants by up to \$25 000 for first homeowners may be well intentioned; however, it is likely to only inflate prices in what has been described by some commentators as an already overheated property market. If this is the case, the grant will be wasted as the intended beneficiaries of the first homeowners grant will only be further priced out of the market. This represents an unintentional decrease in efficiency in resource allocation, as the government intervention into the property market has potentially only made it more difficult for first homebuyers. This has resulted in an opportunity cost for the taxpayer, as the funds could have been used for more efficient purposes, such as the construction of public housing. This redirection of funds could assist in easing the housing shortages that contributed to upward pressure on price in the first place.

Marking guide:

1 mark for providing the key features of a government intervention that led to an unintended decrease in the efficiency in resource allocation

2 marks for making a valid link between the example and an unintentional decrease in efficiency in resource allocation

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