ECONOMICS

ATAR course examination 2019

Marking key

Marking keys are an explicit statement about what the examining panel expect of candidates when they respond to particular examination items. They help ensure a consistent interpretation of the criteria that guide the awarding of marks.

2019/62881

Section One: Multiple-choice **24% (24 Marks)**

Question	Answer
1	c
2	a
3	d
4	b
5	d
6	c
7	d
8	d
9	b
10	b
11	a
12	a
13	c
14	a
15	c
16	c
17	a
18	c
19	d
20	d
21	b
22	b
23	a
24	b

Section Two: Data interpretation/Short answer **36% (36 Marks)**

Question 25 **(12 marks)**

(a) (i) Identify the year that had the largest monthly trade deficit. (1 mark)

Description	Marks
2015	1
Total	**1**

(ii) Identify the value of the trade balance in September 2018. (1 mark)

Description	Marks
$3 billion	1
Total	**1**

(iii) Identify the value of Australian exports in September 2015. (1 mark)

Description	Marks
Accept answers in the range $27–$28.1 billion	1
Total	**1**

(b) Identify the trend in the trade balance over the three years up to September 2018 and state **two** possible reasons for this trend. (3 marks)

Description	Marks
Identification	
The trade balance has moved from deficit to surplus	1
Subtotal	**1**
For each of **two** reasons	
States a possible reason for the trend	1
Subtotal	**2**
Total	**3**
Answer(s) could include: Possible reasons for the trend: • rising commodity prices increasing value of exports • production phase resulting from mining investment has increased volume of exports • production of LNG for exports begins reaching large volumes • increasing diversification of export base as services such as tourism and education become more important • depreciation of the currency has made Australian exports more attractive to foreigners.	
Accept other relevant answers.	

Question 25 (continued)

(c) Discuss the likely effect of the trade balance in 2018 on the following:
- current account balance
- economic growth
- Federal Government budget outcome. (6 marks)

Description	Marks
Current account balance	
The balance on goods and services is a large positive	1
The deficit balance on the current account should get smaller	1
Subtotal	**2**
Economic growth	
Contribution of net exports will increase the economic growth rate	1
Exporting firms will increase profits and employment contributing to economic growth (reward, multiplier effects)	1
Subtotal	**2**
Federal Government budget outcome	
The budget should move to a smaller deficit and possibly a surplus in 2019–20	1
Higher exporting firm profits will mean greater company tax receipts and/or higher employment will mean more income tax receipts	1
Subtotal	**2**
Total	**6**

Question 26 **(12 marks)**

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

Description	Marks
RBA's announcement that a rate cut was likely	1
Total	**1**

(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)

Description	Marks
Strong commodity prices	1
Total	**1**

(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)

Description	Marks
AUD $309.73	1
Total	**1**

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

Description	Marks
Houses are key household assets and falling prices reduce the stock of wealth of households	1
Households will respond to the loss of wealth by reducing consumption and increasing saving and this will reduce aggregate expenditure	1
Falling household and business confidence will lead to decrease in investment	1
Decreased aggregate expenditure leads to a fall in economic activity (i.e. multiplier effects)	1
Total	**4**

Question 26 (continued)

(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)

Description	Marks
Explanation	
A reduction in Australian interest rates would reduce capital inflow into Australia decreasing demand for the Australian dollar	1
An increase in the United States' interest rates would increase capital outflow from Australia and therefore an increase in supply of the Australian dollar	1
Reference to shifts in the diagram and conclusion of significant depreciation of the Australian dollar	1
Subtotal	**3**
Model	
Correctly labelled diagram (i.e. vertical scale: Australian dollar in United States' dollars, horizontal scale: quantity, demand and supply curves labelled)	1
Demand curve shift to the left, supply curve shifts to the right and new lower equilibrium identified	1
Subtotal	**2**
Total	**5**

Question 27 **(12 marks)**

(a) (i) Calculate the real economic growth rate in Year 3. (1 mark)

Description	Marks
3.56% or 3.6%	1
Total	**1**

(ii) Identify the indicator in the table that is lagging. (1 mark)

Description	Marks
Unemployment rate	1
Total	**1**

(iii) Identify the year which had the highest rate of inflation. (1 mark)

Description	Marks
Year 3	1
Total	**1**

(b) With reference to Year 3 in the table on page 15, explain how **one** economic objective conflicts with the objective of economic growth and how **one** other economic objective complements the objective of economic growth. (4 marks)

Description	Marks
Conflicting economic objective	
In Year 3 the economy is growing at over 3% but the inflation rate is over 4% so the objective of price stability is undermined	1
Strong growth leads to demand pull inflation as the economy approaches capacity	1
Subtotal	**2**
Complementary economic objective	
In Year 3 the economy is growing at over 3% and this has led to a fall in the unemployment rate from 6.3% to 6.0% moving the economy closer to full employment	1
Economic growth increases the demand for labour, reducing cyclical unemployment	1
Subtotal	**2**
Total	**4**

Question 27 (continued)

(c) Describe and demonstrate, using the aggregate demand and aggregate supply (AD/AS) model, the performance of the economy from Year 4 to Year 5 in the table on page 15. (5 marks)

Description	Marks
Description	
Identifies the business cycle stage	1
Describes the change in the indicators	1
Links the change in the indicators to the changes in the economy	1
Subtotal	**3**
Model	
AD/AS model showing AD intersecting the SRAS to the left of the LRAS and a resulting contractionary gap or AD/AS model showing AD intersecting the curved AS line in the Keynesian range below the full employment level of output	1
Correctly labelled diagram (i.e. vertical scale: price, horizontal scale: Real GDP, AD and AS labelled, level of Y below potential Y)	1
Subtotal	**2**
Total	**5**

Answer(s) could include:

- the economy is in a contraction/recession as Real GDP has declined from \$562 billion to \$560 billion (negative growth)
- unemployment (5.5%) has stopped falling as the demand for labour begins to slow
- deflation is being experienced as prices have fallen due to a lack of demand
- the CAD has dramatically decreased (5.4% to 2.5%) because there is less spending on imports/reduced inflow of foreign investment
- the weakening demand conditions have caused firms to slash their investment spending (15.2% to 7.5%).

Section Three: Extended answer **40% (40 Marks)**

Question 28 **(20 marks)**

(a) Explain and demonstrate, using an economic model, how a nation can gain from specialisation and trade. (12 marks)

Description	Marks
Explanation	
Explains an economic model (i.e. absolute and comparative advantage and the PPF, demand and supply model). Includes gains from both exports and imports	5–6
Describes an economic model, showing how a nation can gain from specialisation and trade	3–4
Outlines some features of an economic model, showing how a nation can gain from trade	1–2
Subtotal	**6**
Model	
Detailed model clearly demonstrating gains from specialisation and trade	5–6
Mostly correct model showing how a nation can gain from trade	3–4
Some features of an appropriate model	1–2
Subtotal	**6**
Total	**12**

Answer(s) could include:

Model and explanation:

- theory of comparative advantage and calculation of opportunity costs to determine production possibilities before trade, after specialisation and after trade. Graphical representation to show consumption outside the initial PPF

or

- the demand and supply model demonstrating a country with a comparative advantage and domestic price below world price and gain in total welfare when opening up to trade at higher price. Demonstration of a comparative disadvantage with domestic price above world price and gain in total welfare when opening up to world trade at the lower price.

Question 28 (continued)

(b) Explain the main determinants of Australia's international competitiveness and describe **two** ways in which competitiveness can be improved over the long term. (8 marks)

Description	Marks
Main determinants	
Explains the main determinants with a clear link to international competitiveness	4
Describes the main determinants of international competitiveness	3
Outlines some determinants of international competitiveness	2
Identifies one or more determinants	1
Subtotal	**4**
For each of **two** ways of improving competitiveness over the long term	
Describes a way that competitiveness can be improved over the long term	2
Outlines a way that competitiveness can be improved over the long term	1
Subtotal	**4**
Total	**8**

Answer(s) could include:

Main determinants:
- real unit labour costs reduced (measures wages relative to productivity)
- lower inflation level keeping prices low relative to trading partners
- exchange rate changes – affects prices paid for imports and exports
- changes to labour productivity.

Long term improvements:
- infrastructure investments reducing production costs
- investment in technology, education and training improving efficiency of labour
- efficient labour markets that can respond to changes
- efficient financial markets that can make capital available
- government efficiency – regulatory framework is not onerous on businesses.

Question 29 **(20 marks)**

(a) Explain the relationship between Australia's current account outcome and its foreign liabilities. (8 marks)

Description	Marks
Explains the relationship between Australia's current account outcome and its foreign liabilities	7–8
Describes the main features of the relationship between Australia's current account outcome and its foreign liabilities	5–6
Outlines the links between Australia's current account outcome and its foreign liabilities	3–4
Identifies some relationship between Australia's current account outcome and its foreign liabilities	1–2
Total	**8**

Answer(s) could include:

Current account:
- definition of the current account and identifies the deficit outcome for Australia
- identifies the income section as the structural reason for the current account deficit
- describes the transactions involving interest, profit and dividends that are recorded in the incomes section of the current account
- explains the income transactions as a consequence of foreign investment flows.

Foreign liabilities:
- Australia's foreign liabilities are greater than its foreign assets which means that foreign investment into Australia is greater than foreign investment out of Australia
- Australia, as a consequence, has a net foreign liability
- most of the inflow of foreign investment is in the form of borrowing
- the servicing cost of foreign liabilities is recorded in the income section of the current account.

Question 29 (continued)

(b) Describe and account for the recent trends in Australia's level of foreign debt and discuss the impact this has had on the Australian economy. (12 marks)

Description	Marks
Recent trends	
Describes recent trends in Australia's level of foreign debt	2
Identifies a recent trend in Australia's level of foreign debt	1
Subtotal	**2**
Account for the recent trends	
Accounts for recent trends	2
Identifies a reason for recent trends	1
Subtotal	**2**
Impact on the economy	
Detailed discussion of the impact of private and public foreign debt with references to relevant recent features of the Australian economy	7–8
Discusses the impact of private and public foreign debt and some links to the Australian economy	5–6
Explains a range of impacts of foreign debt on an economy	3–4
Identifies some impacts of foreign debt	1–2
Subtotal	**8**
Total	**12**

Answer(s) could include:

Recent trends:
- foreign debt has increased over the last 10 years from approximately 50% of GDP to 64% of GDP
- net foreign debt is equivalent to just over $1000 billion dollars
- approximately 75% of foreign debt is private; the rest is owed by the government.

Account for recent trends:
- when Australia records a CAD, foreign debt or foreign equity increases. Currently all of Australia's foreign liabilities are in the form of foreign debt because recently Australia has had a net equity asset position
- as a consequence of the GFC and the end of the mining boom, government budget deficits have occurred for the last 10 years. This has increased public debt as the government has to borrow to fund the deficit.

Impact on the economy:
- when Australia records a CAD, foreign debt or foreign equity increases. Currently all of Australia's foreign liabilities are in the form of foreign debt because Australia now owns more assets overseas than foreigners own in Australia
- interest burden from the debt has actually been declining due to low global interest rates and increased Australian export income
- the foreign debt build-up was used mostly to fund massive expansion of Australian capital-intensive mining industry
- this increase in investment has led to an increase in the value of exports
- Australia's net worth measured by its assets (i.e. capital, resources, financial assets owned overseas) has increased much faster than the level of foreign debt. Per capita wealth has also increased in the last 10 years
- the build-up of public debt has led to increased interest payments and this money has been diverted away from expenditure on government services. However, the size of the budget deficit has been reducing in the last few years and government net public debt is due to peak in the next few years
- other negative effects of foreign debt (i.e. credit rating)
- overall, the foreign debt has successfully been used to produce higher rates of economic growth and a higher level of investment.

Question 30 **(20 marks)**

(a) Discuss the importance of investment to the Australian economy and explain the factors that can influence the total amount of investment spending in Australia. (10 marks)

Description	Marks
Discussion of the importance of investment	
Definition of investment; percentage of aggregate expenditure	1
Reference to volatility, major factor driving the business cycle, nature of Australian industry and capital requirements	1
Subtotal	**2**
Explanation of factors	
Detailed explanation of the main factors that can influence the total amount of investment spending and how they can affect the level of investment as a component of aggregate expenditure	7–8
Explains the main factors that can influence the total amount of investment spending and a clear link made to variation in investment level	5–6
Describes the main factors that can influence the total amount of investment spending	4–5
Limited description of some factors influencing investment	2–3
Identification of a few factors that can affect investment	1
Subtotal	**8**
Total	**10**

Answer(s) could include:

Discussion of the importance of investment:
- investment is expenditure on capital goods that will be used to produce final goods and services in the future
- investment in national accounts includes business investment, private housing investment, inventories
- 16–26% of aggregate expenditure
- essential in driving turning points at top and bottom of business cycle
- Australia has a large investment savings gap because of the nature of capital-intensive export industries.

Explanation of the factors that can influence the total amount of investment spending in Australia:
- business expectations – a poor outlook may result in firms 'running down' their capital equipment and investment level decreases. An increase would occur if there is an improvement in confidence
- interest rates – the inverse relationship between lower real rates of interest and higher investment spending: investment demand curve
- profitability – high expectations of profit encourages the purchase of new capital and higher profits will result in more being retained by firms for investment
- government policy incentives (i.e. subsidies, tax allowances), infrastructure investments (i.e. roads, communications)
- macro and microeconomic environment – stability means confidence in regulatory environment and encourages long-term, large-scale investment and microeconomic reform. This assists with business confidence and lowers regulation freeing funds for investment
- other factors – changes in the level of output (e.g. technological changes) and cost of inputs (e.g. wages growth) can induce firm and industry level investment changes.

Question 30 (continued)

(b) Use the aggregate expenditure model and the multiplier process to demonstrate and explain the likely effect of the increased mining and energy investment on the Australian economy. (10 marks)

Description	Marks
Explanation	
Detailed explanation of effect of increased investment on the economy with the multiplier concept used to explain outcome	6–7
Explains the effect of increased investment on the economy with some use of the multiplier concept	4–5
Describes the changes in the economy due to increased investment	2–3
Identifies some changes in the economy	1
Subtotal	**7**
Model	
Fully labelled aggregate expenditure model correctly showing more than proportional increase in Real GDP/income compared to increase in investment	3
Mostly correct aggregate expenditure model showing changes in aggregate expenditure and increase in real GDP/income	2
Outlines aggregate expenditure model with change in aggregate expenditure curve and effect on real GDP/income	1
Subtotal	**3**
Total	**10**

Answer(s) could include:

Explanation:
- use of example showing mathematical change to income using MPC and MPS and the multiplier (k) as a result of increased investment
- explanation of a change in the equilibrium level of income/real GDP due to the increase in investment spending using the multiplier effect – where one person's spending generates another person's income
- autonomous investment creates additional income for individuals who supply goods, services and labour to the company responsible for the initial investment. This income is spent on other goods and services – consumables and durables
- firms will increase demand for resources (including labour) as they increase aggregate output
- output will rise along with aggregate expenditure (at a pace in keeping with the consumption function and the slope of aggregate expenditure line)
- the initial mining and energy investment are reinforced and multiplied in subsequent periods in the circular flow of income
- a new equilibrium at a higher level of income/real GDP is established with a more than proportional increase in real GDP/income compared to increase in investment.

Model:
- vertical axis: aggregate expenditure, horizontal axis: real GDP/income
- 45-degree line represents macroeconomic equilibrium
- rise in aggregate expenditure line increasing equilibrium from Y1 to Y2
- horizontal increase in Y greater than vertical increase in aggregate expenditure.

Question 31 **(20 marks)**

Discuss the contemporary monetary policy setting of the Reserve Bank of Australia with reference to the business cycle, the intended effects on key economic sectors and its effectiveness in influencing aggregate demand.

Description	Marks
Contemporary monetary policy	
Discusses the contemporary monetary policy setting and the current state of the economy using a variety of indicators/evidence	5–6
Describes contemporary monetary policy setting with reference to the state of the economy	3–4
Outlines monetary policy setting with some link to the state of the economy	2
Identifies the contemporary cash rate	1
Subtotal	**6**
Intended effects	
Discusses intended impact of contemporary monetary policy setting on households, firms and net exports via borrowing costs, cash flow, asset prices and the exchange rate. Clear link to intended change in aggregate demand/real GDP	7–8
Describes how the contemporary monetary policy setting influences consumption, investment and net exports via several features of the transmission mechanism	5–6
Outlines the impact on economy's major sectors and resulting change in aggregate demand from monetary policy setting	3–4
Identifies some changes in economic sectors due to monetary policy setting	1–2
Subtotal	**8**
Effectiveness	
Discusses effectiveness of monetary policy in influencing aggregate demand and clear assessment of its contemporary effectiveness	5–6
Describes several strengths and weaknesses of monetary policy and some link to contemporary impact	3–4
Outlines several strengths and weaknesses of monetary policy	2
Identifies a strength and/or weakness of monetary policy	1
Subtotal	**6**
Total	**20**

Answer(s) could include:

Contemporary monetary policy setting:
- identification of contemporary cash rate settings
- below trend economic growth (i.e. less than 3%)
- weak consumer and business sentiment/confidence
- supporting structural change from mining to housing sector
- falling house prices
- stimulate employment opportunities
- overseas economic uncertainty (e.g. China's economic growth, Brexit, United States trade policy)
- monetary policy setting compensating for fiscal policy focus on medium-term structural balance.

Intended influence on economic sectors (transmission mechanism):
Households:
- lower interest rate results in increased consumption
- reduced incentive to save
- reduction in servicing costs for existing loans
- reduced opportunity cost of borrowing
- lower rates should promote rising asset prices over time.

Firms:
- reduction in cost of borrowing so firms encouraged to invest
- improvement in firm's cash flow because most firms are net borrowers
- investment demand curve.

Net exports:
- reduction in interest rate differential makes Australia a less attractive destination for foreign investment
- reduction in capital inflow decreases demand for the Australian dollar – Australian dollar falls
- increased international competitiveness of Australian producers.

Overall impact of loose monetary policy setting is to support aggregate demand and economic growth.

Effectiveness (of monetary policy):
- stabilising housing prices
- stimulate economic activity by promoting consumption
- reducing debt exposure for consumers and firms
- depreciating the Australian dollar and improving competitiveness
- monetary policy has short decision and implementation lag but long effect lag
- monetary policy is politically neutral and affects most sectors of the economy
- monetary policy is weak in periods of low growth as low interest rates may be outweighed by negative sentiment and expectations – 'you can lead a horse to water, but you can't make it drink'
- contemporary settings have seen historically low cash rates to support transition from mining boom
- monetary policy is a blunt instrument so applied to all States and industries regardless of individual economic performance
- low cash rate has encouraged excessive borrowing and rapid rise in housing prices in Eastern State capitals.

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