Work Sample

Performance associated with Grade A, representing excellent achievement

Assessment type

Data interpretation/short answer

Task title

Monetary policy decision

Summary of task

The following is an extract of an assessment.

Students were required to complete the assessment under test conditions allowing approximately 20 minutes to complete the section contained in this sample.

A grade is based on the student's **overall performance for the pair of units** as judged by the teacher with reference to a set of pre-determined standards. These standards are defined by grade descriptions.
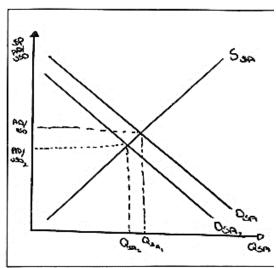
Statement by Glenn Stevens, Governor: Monetary Policy Decision (May 3, 2016)

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(from beginning to ' … an appreciating exchange rate could complicate this')

Source: Media Release, Reserve Bank of Australia

a.   i. What is the main reason the Reserve Bank lowered the cash rate?   (1 mark)

Inflationary pressures lower than expected

ii. Explain why there have been substantial falls in commodity prices over recent years.   (1 mark)

China's growth rate slowed

– extracts the relevant information from the stimulus material

b.   Prior to the announcement the AUD was trading at US77.07c but after the decision it fell to US75.67c. Use an exchange rate model to explain why the dollar depreciated.   (3 marks)

The dollar depreciated as a result of a fall in interest rates (cash rate fell to 1.75%). When interest rates fell, the interest rate differential decreased, thus Australia attracts less foreign investment.

As a result the demand for the Australian dollar decreased, causing depreciation to occur.

– constructs an exchange rate model to demonstrate the reason for the depreciation

c. Explain how a lower exchange rate helps the traded sector? (3 marks)

A lower exchange rate helps the traded sector, because the exchange rate acts as a shock absorber. A depreciation in the currency, means exports become cheaper, while imports become more expensive. As a result of exports becoming cheaper, this will increase exports, thus stimulating the traded sector, causing an expansion in the economy, especially in exporting sectors.

– identifies and explains the links between most factors that impact on exchange rates

– communicates in a coherent manner

d.   Discuss the effectiveness of using monetary policy in the current economic climate.

(4 marks)

The economy is currently in a trough phase, thus confidence levels are low, as well as levels of consumption and investment. Therefore using the monetary policy in this current economic climate is ineffective. Even though interest rates are low, and hence the cost of borrowing has decreased and opportunity cost of saving has increased, you can't forced people to spend, and since confidence levels are low it is unlikely to be effective. However since there is a contractionary fiscal policy, as the government wants to decrease the current account deficit, the monetary policy is being forced to take all burden, and as a result interest rates are at an historical low.

– communicates using appropriate economic terminology