WESLEY COLLEGE

By daring & by doing

ATAR ECONOMICS YEAR 12

UNIT 3 ASSESMENT 9

MARKING GUIDE

TYPE: SHORT ANSWERS MM: /34

WEIGHTAGE: /15% DURATION : 60 MINIUTES

MULTIPLE CHOICE	/10
SHORT ANSWER 1	/12
SHORT ANSWER 2	/12
TOTAL	/34

NAME: ____________________

Section 1: Multiple Choice (10 marks)

1. This question refers to the table below.

Year	Export price index	Import price index
1	100	100
2	110	120
3	120	125

For this economy in Year 3

a) The current account has improved.
b) There has been an increase in the volume of exports.
c) The terms of trade have deteriorated.
d) The terms of trade have improved.

2. If Australia experienced a favourable movement in its terms of trade, which of the following (other things being equal) would be **most** likely to occur?

(i) A rise in the capital and financial account surplus
(ii) A fall in the current account deficit
(iii) A depreciation of the Australian dollar
(iv) A rise in Australia living standards

a) (ii) and (iii)
b) (i), (iii) and (iv)
c) (i) and (iv)
d) (ii) and (iv)

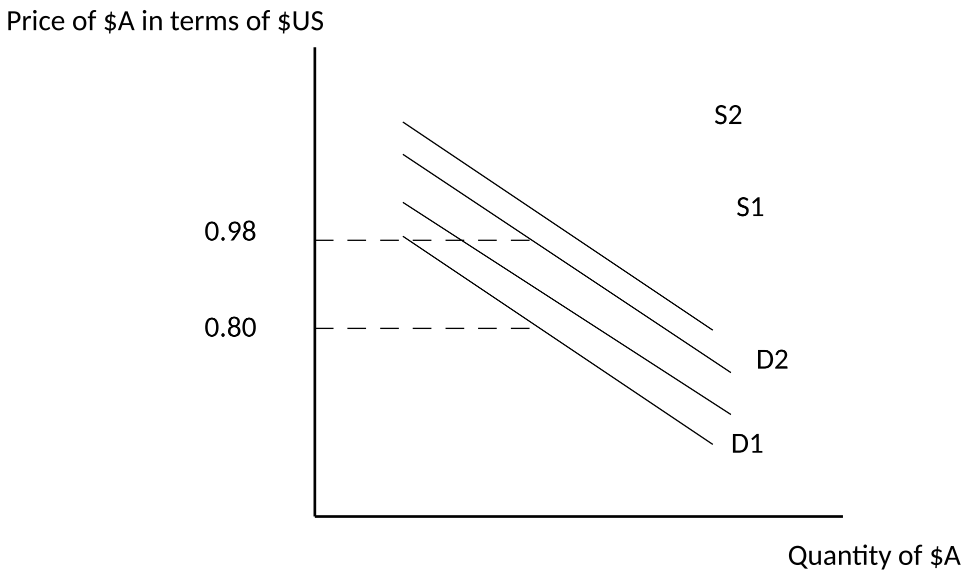
3. When the value of the Australian dollar increases this benefits

a) Exporters of Australian made cars.
b) Australians investing overseas.
c) Farmers and rural regions that rely on export markets.
d) Foreign investors wanting to buy Australian assets.

4. The Trade Weighted Index measures the

a) Value of the Australian dollar compared with a basket of currencies of our major trading partners.
b) Ratio of the total value of exports to the total value of imports for Australia.
c) Value of the Australian dollar by comparison with the value of all other countries' currencies.
d) Prices of Australian exports compared with the prices of Australian imports.

5. This question refers to the diagram below.



Assuming a floating exchange rate, which of the following may have caused the value of the Australian dollar to change from $US0.80 to $US0.98?

a) An increase in Australian interest rates and a decrease in imports into Australia.
b) An increase in Australian interest rates and an increase in imports into Australia.
c) A decrease in the interest rate differential between Australian and the United States
d) A decrease in Australian interest rates and an increase in the prices of Australian exports.

6. Assume the following exchange rate: $1 AUD = $0.92 USD. What will be the cost in AUD of an imported American car valued at $20 000 USD?

a) $18 400
b) $21 739
c) $21 600
d) $20 000

7. The floating of the $A means that the value of Australia's currency is mainly determined by
(a) a weighted average of a basket of international currencies
(b) the free market forces of demand and supply
(c) the Reserve Bank in consultation with the Treasurer

(d) the current level of interest rates

8. Which of the following will **not** affect the demand for the Australian dollar?
   (a) foreigners purchasing assets such as land and shares in Australia
   (b) Australian's receiving dividend payments on investments made overseas
   (c) Australian investors purchasing domestic bonds and other securities
   (d) increased numbers of tourists in Queensland and Western Australia

9. If imports are relatively inelastic, a deterioration in Australia's terms of trade may cause

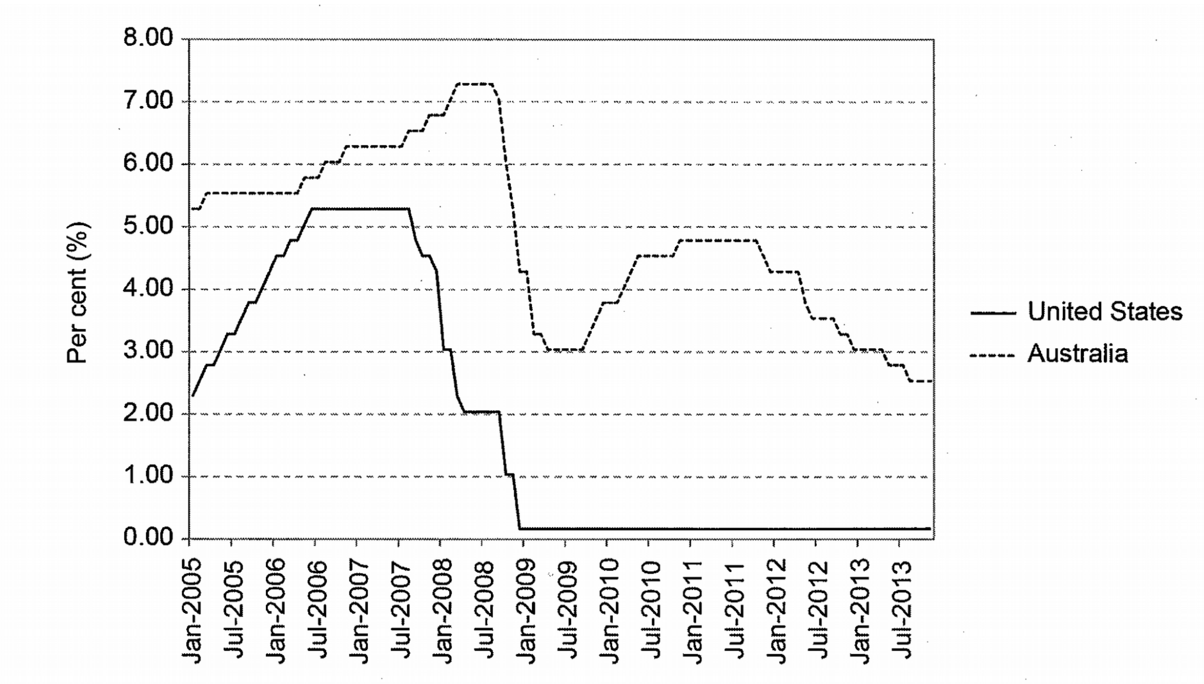
   (a) fewer imports of capital equipment
   (b) net capital outflow to rise
   (c) a worsening of the merchandise trade balance
   (d) the current account deficit to improve

10. The terms of trade will deteriorate if
   (a) export prices rise more rapidly than import prices
   (b) export prices fall more rapidly than import prices
   (c) export prices fall more slowly than import prices
   (d) export prices rise faster than import prices fall

Section 2: Short Answer (24 marks)

1. (12 marks)

Official interest rates for Australia and the United States



a) (i) What was the interest rate differential between Australia and the United States in January 2007? (1 mark)

- Approx. 1%

(ii) State the size of the fall in Australian official interest rate from January 2012 to July 2013. (1 mark)

- 4.25 – 2.5% = 1.75%

b) Explain how the fall in Australian interest rates from January 2012 should have effected the AUD?. (4 marks)

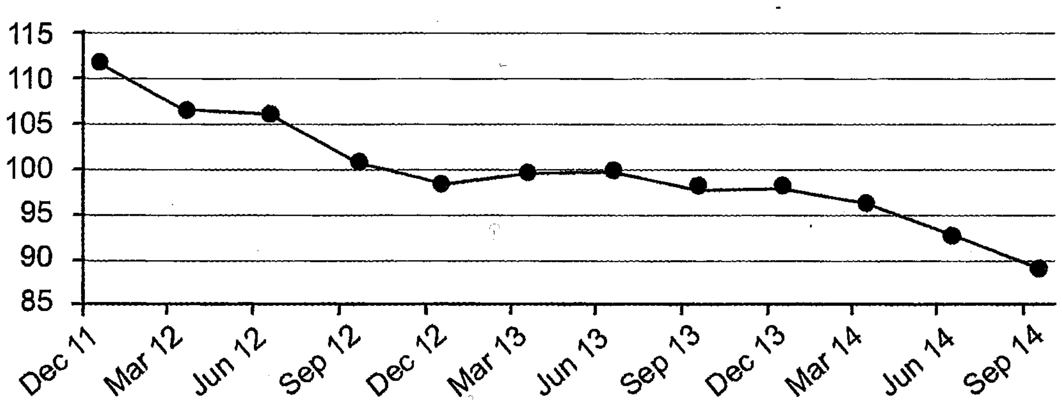
- AUD should have fallen as IR differential is lower so less returns on deposited funds from os investors hence less demand for AUD so appreciation. This should encourage exporting firms leading to more Egrowth

c) Discuss the likely effects on consumption and investment of the Depreciation of AUD? (6 marks)

- Consumption: Lower IR reduces cost of borrowing domestically so hholds have more income leading to more spending on imports and hence a rise in supply of AUD so depreciation
- Lower IR leads to more EGrowth so more investment by local firms including purchasing imported capital machinery by firms leading to rise in supply of AUD and a depreciation
- If lower AUD encourages export industries so foreign investment may rise if its attracted by higher potential profits

2. (12 Marks)

Australia's terms of trade December 2011-September 2014



Estimated impact on the budget balance of a 1% decrease in nominal GDP due to a change in the terms of trade

	2014-15 $b	**2015-16 $b**
Receipts		
Individuals' and other taxes (income)	-0.6	-1.6
Company tax	-1.8	-3.1
Goods and Services tax	-0.1	-0.3
Excise and customs duty	0.0	-0.1
Other taxes	-0.1	-0.1
Total receipts	**-2.6**	**-5.2**
Payments		
Income support	-0.1	-0.2
Other payments	0.0	0.1
Goods and services tax	0.1	0.3
Total payments	**0.0**	**0.2**
Public debt interest	0.0	-0.2
Underlying cash balance impact	**-2.6**	**-5.4**

a) (i) State the size of the movement in Australia's terms of trade between December 2011 and September 2014. (1 mark)

- fallen from 112 to 89

(ii) Identify which source of government revenue was **most** affected by a fall in the terms of trade in 2015-2016? (1 mark)

Company tax revenue fell by 3.1%

b) Explain how terms of trade movement should effect the balance of trade. (4 marks)

Unfavourable movement in TOT should lead to

- lower credits if due to fall in export prices as receipts from exports are lower if their prices are cheaper hence trade balance worsens
- higher debits if due to import prices rising as imports more expensive so trade balance worsens

c) Explain **three** likely effects of the terms of trade movement on the domestic economy. (6 marks)

Fall in terms of trade

- If due to lower export prices exporting firms may cut output if profits are lower, so **unemployment** rises, this would be more of a short term effect
- If due to lower export prices, and demand for exports rises as internationally competitiveness rises (CAD lower), then firms may expand and employ more labour leading to fall in un, more of a longer term effect
- If due to higher import prices **inflation** will be higher reducing hhold/consumer spending if they demand less (CAD lower), but if demand does not fall then prices being higher increases cost of living
- Exporting firms may suffer if due to lower export prices so economic **growth** falls: as mentioned above this would tend to be more of a short term impact
- Leads to cheaper exports so less demand for AUD and a depreciation: supporting export firms
- Leads to more expensive imports so more supply of AUD and depreciation: supports export firms