



ABBOTSLEIGH

2016

Assessment Task 2

HALF-YEARLY

# Economics

## General Instructions

- Write your Student Number at the top of this page, on the multiple choice answer sheet and on each of the writing booklets used
- Write using a black pen
- Board approved calculators can be used.

**TOTAL MARKS – 80**  
**WEIGHTING - 25%**  
**TIME ALLOWED - 2 hours and 15 minutes**

### SECTION I

20 marks

- Use the multiple choice answer sheet provided
- Allow about 30 minutes for this section

### SECTION II

40 marks

- Respond in the spaces provided in the examination paper
- Allow about 1 hour for this section

### SECTION III

20 marks

- Attempt Question 25 **OR** 26
- Write your answer in separate writing booklets
- Allow about 45 minutes for this section

## Section I

20 marks

### Attempt Questions 1-20

Allow about 30 minutes for this section

Use the multiple choice answer sheet provided.

Select the alternative A, B, C, or D that best answers the question. Fill in the response oval completely.

**Sample**     $2 + 4 =$     (A) 2                      (B) 6                      (C) 8                      (D) 9

A                       B                       C                       D

If you think you have made a mistake, put a cross through the incorrect answer and fill in the new answer.

A                       B                       C                       D

If you have changed your mind and have crossed out what you consider to be the correct answer, then indicate this by writing the word *correct* and drawing an arrow as follows:

A                       B  <sup>correct</sup>                      C                       D

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1. The following table shows selected information for the balance of payments of a country with a floating exchange rate.

<i>Category</i>	<i>Amount (\$millions)</i>
Goods balance	10
Net services	2
Net primary income	?
Net secondary income	-2
Capital and financial account	30

What is the *net primary income balance* on the current account?

- a) -\$20 million
- b) -\$30 million
- c) -\$40 million
- d) \$30 million

2. The table below shows selected data for the Australian economy.

<i>Year</i>	<i>Exchange rate (\$A/\$US)</i>	<i>Export Price Index</i>	<i>Import Price Index</i>
Year 1	0.98	185	116
Year 2	1.04	187	119

According to the data, which statement is correct between Year 1 and Year 2?

- a) International competitiveness has improved and the terms of trade have improved
  - b) International competitiveness has improved and the terms of trade have deteriorated
  - c) International competitiveness has deteriorated and the terms of trade have improved
  - d) International competitiveness has deteriorated and the terms of trade have deteriorated
3. The Reserve Bank decides to alter the setting of monetary policy by adopting an expansionary stance. What is the likely *impact* on the Australian economy?
- a) The \$A will appreciate and there will be an increase in the level of imports
  - b) The \$A will depreciate and there will be an increase in the level of exports
  - c) The \$A will appreciate and there will be an increase in the level of exports
  - d) The \$A will depreciate and there will be an increase in the level of imports
4. How would a sale of Australian shares by United States investors and a return of the money to the US be recorded in Australia's Balance of payments?
- a) As a debit in the Australian current account
  - b) As a credit in the Australian current account
  - c) As a debit in the Australian capital and financial account
  - d) As a credit in the Australian capital and financial account

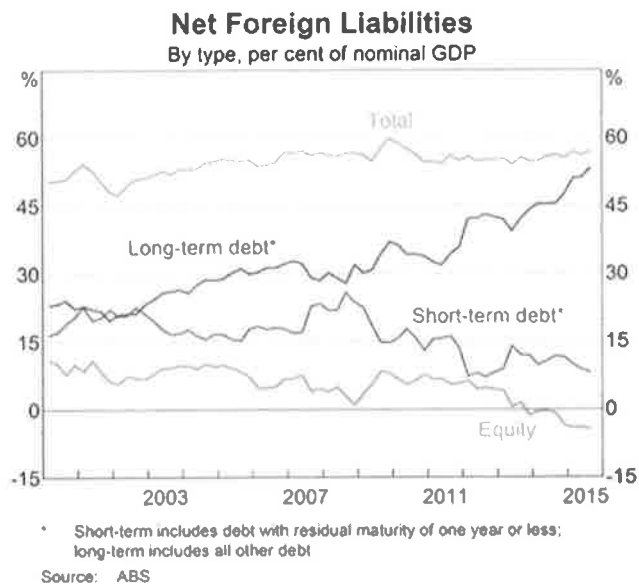
5. In an economy that has a policy of fixing its exchange rate below the equilibrium which of the following statements is correct.
- The central bank needs to sell the domestic currency and buy foreign currency to maintain the exchange rate at this level
  - The central bank needs to buy domestic currency and sell foreign currency to maintain the exchange rate at this level
  - Monetary policy becomes much more effective than under a floating exchange rate
  - Importers have an advantage because imports become cheaper
6. Which of the following might be an *impact* on Australia if global interest rates started to increase while Australia's interest rates remained unchanged?
- A decrease in capital outflows from Australia
  - There would be a bigger deficit in Australia's net primary income account in the Balance of Payments
  - The Australian dollar would appreciate
  - There could be an unfavourable movement in Australia's Terms of Trade
7. Refer to the following table to answer the question below.

<i>Year</i>	<i>Import Price Index</i>	<i>Export Price Index</i>
1	100	109
2	112	118
3	115	122
4	120	125

In which year were less exports required to pay for the same volume of imports?

- Year 1
- Year 2
- Year 3
- Year 4

8. Which of the following would be consistent with an attempt to reduce the size of the *current account deficit* in Australia?
- Increase the level of economic growth in Australia
  - Reduce government spending and aim for a surplus budget
  - Encourage Australian companies to borrow offshore where interest rates are cheaper
  - Allow people to take money out of their superannuation accounts to purchase property
9. The following graph shows Australia's net foreign liabilities.



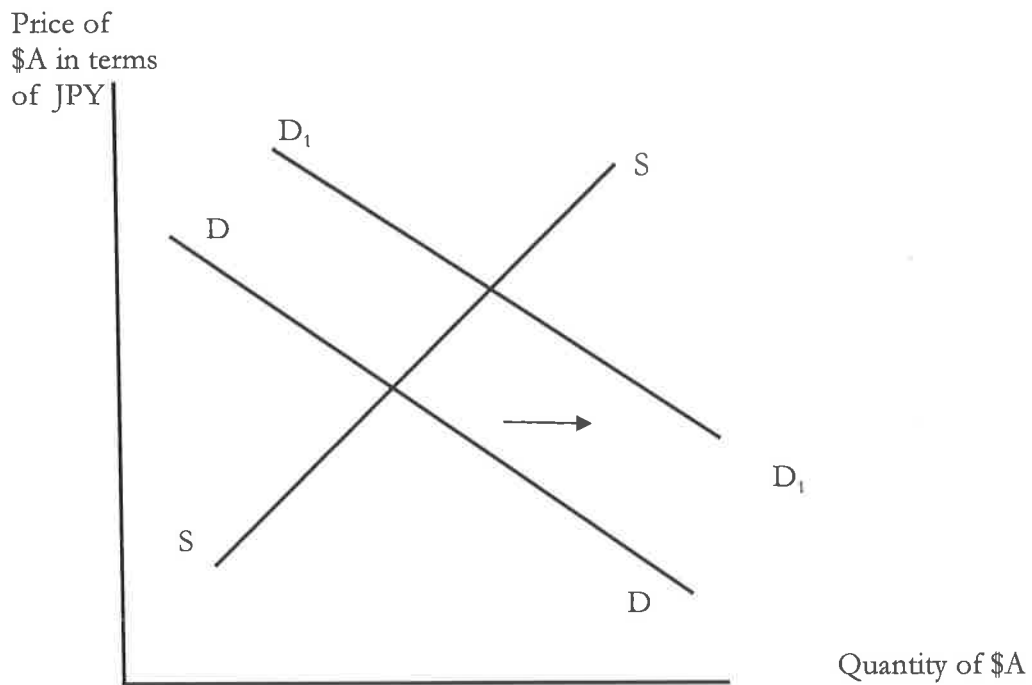
From your knowledge and the information presented above, which of the following statements is CORRECT?

- Australia's net foreign liabilities have become much greater as a percentage of GDP since the GFC.
- Australia's net foreign debt as a percentage of GDP has been steadily falling since the resources boom began in the early 2000s
- Australians now have more equity investments abroad than foreigners have equity investments in Australia
- Net foreign equity has become much more important than net foreign debt to finance Australia's liabilities

10. Which of the following could lead to an increase in an economy's net primary income deficit?

- a) An appreciation of the currency
- b) A fall in global interest rates
- c) A decrease in the profitability of domestic producers with foreign shareholders
- d) An increase in the profitability of domestic producers with foreign shareholders

11. The following graph shows a movement in the supply and demand of Australian dollars against the Japanese yen on the foreign exchange market.



Which of the following may have caused a shift in the demand for the Australian dollar from  $D$  to  $D_1$ ?

- a) An increase in the net primary income deficit in the Balance of Payments
- b) An increase in the number of Australian tourists travelling to Japan
- c) An appreciation in Australia's exchange rate
- d) An increase in investors borrowing cheaply in Yen and investing in Australian dollars

12. Which is the most likely method the Reserve Bank would use to try and curb a rapid appreciation in the Australian dollar?
- a) They would intervene by selling Australian dollars and then buying bonds to sterilize the effect on the money supply
  - b) They would intervene by buying Australian dollars and then buying bonds to sterilize the effect on the money supply
  - c) They would intervene by selling Australian dollars and then selling bonds to sterilize the effect on the money supply
  - d) They would intervene by buying Australian dollars and then selling bonds to sterilize the effect on the money supply
13. Which of the following may cause Australia's international competitiveness to deteriorate?
- a) A depreciation of the Australian dollar
  - b) A decrease in the level of subsidies paid to farmers in the European Union
  - c) An increase in the inflation rates in countries with which Australia competes
  - d) An increase in company tax rates in Australia
14. Which of the following would be regarded as direct foreign investment?
- a) The purchase of Australian agricultural land by Chinese investors to improve their food security
  - b) A foreign company placing funds in an interest bearing account in an Australian bank
  - c) An Australian mining company signing a contract to sell more uranium to India
  - d) An Australian company signing a long term contract to supply goods to an overseas buyer
15. If an Australian company buys the rights to set up a franchise in Australia from an American company how would this be recorded in Australia's Balance of Payments?
- a) As a debit in the primary income account
  - b) As a debit in the secondary income account
  - c) As a debit in the financial account
  - d) As a debit in the capital account

16. Which of the following would be regarded as portfolio investment?
- A Brazilian mining company purchases 20% of the shares in an Australian mining company
  - A transnational corporation sets up a new branch office in Indonesia
  - China and India decide to invest in a joint venture in agriculture in a developing economy
  - An Australian speculator buys several small parcels of shares in different companies on the New York Stock Exchange
17. If Australia's terms of trade improved which of the following is likely to occur?
- The capital and financial account balance will move to a bigger surplus
  - More imports can be financed with the same level of exports
  - The net income component of the current account will become a larger deficit
  - Australia will need to sell more exports to finance the same level of imports
18. Under a floating exchange rate system, what would be the likely effect of a rise in Australian interest rates?
- An increase in the supply of foreign currencies in Forex markets
  - An increase in capital outflow from Australia
  - A decrease in the demand for the Australian dollar
  - There would be no impact on the exchange rate

19. The table shows selected data for an economy.

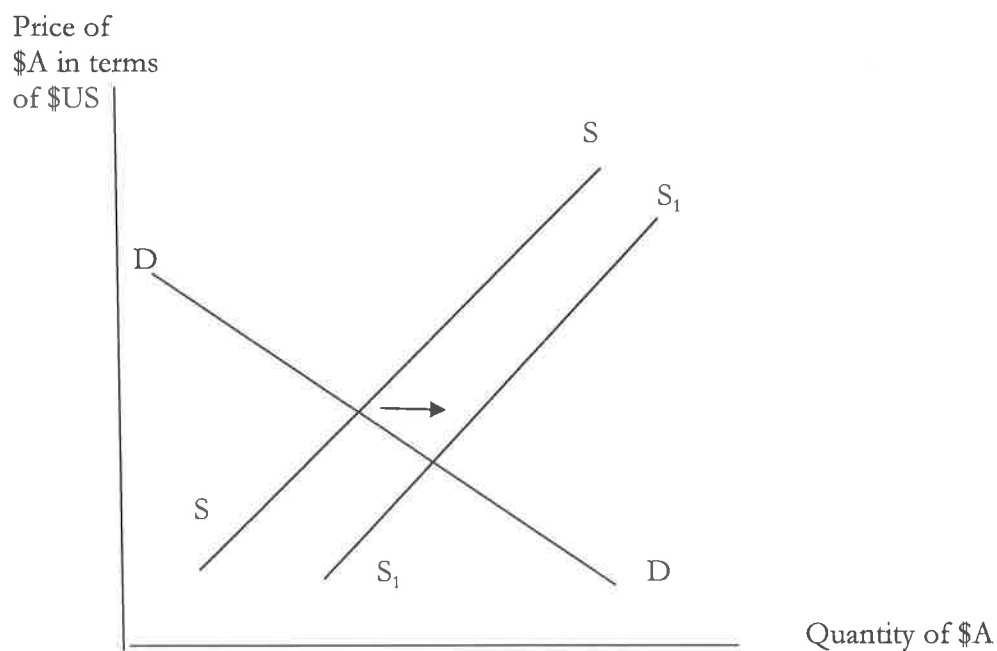
Real GDP (\$bn)	Net Foreign Liabilities (\$bn)	Net Foreign Debt (\$bn)
1450	830	570

What is the value of net foreign equity as a percentage of real GDP?

- 57.2%
- 17.9%
- 39.3%
- 96.6%



20. The following graph shows a movement in the supply and demand of Australian dollars against US dollars on the foreign exchange market.



Which of the following may cause a shift in the supply of the Australian dollar from  $S$  to  $S_1$ ?

- a) An increase in the number of Australians travelling overseas
- b) A depreciation in Australia's exchange rate
- c) Tighter monetary policy by the Reserve Bank of Australia
- d) A decrease in the net primary income deficit in the Balance of Payments

**END OF SECTION I**

**Section II**

**40 marks**

**Attempt Questions 21–24**

**Allow about 1 hour for this section**

Answer the questions in the spaces provided. These spaces provide guidance for the expected length of response.

Extra writing space is provided on pages 18 and 19. If you use this space, clearly indicate what question you are answering.

**Question 21** (10 marks)

- a) Define the Trade Weighted Index (TWI). (2 marks)

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- b) Explain how the value of the \$A can appreciate against the Euro and yet depreciate against the TWI. (2 marks)

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**Question 22 (10 marks)**

a) Distinguish between fixed and floating exchange rates. (2 marks)

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b) Describe ONE advantage and ONE disadvantage of floating exchange rates. (2 marks)

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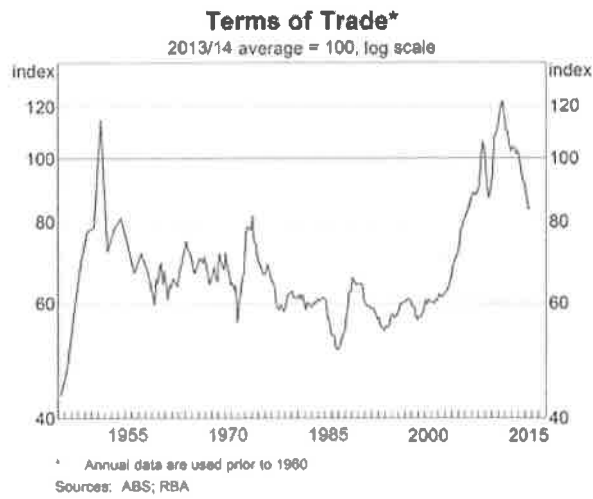
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**Question 23 (10 marks)**



a) Define the Terms of Trade. (2 marks)

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b) Outline the expected impact of the decline in Australia's terms of trade on the current account. (2 marks)

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**Question 24 (10 marks)**

a) Distinguish between debt and equity flows. (2 marks)

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b) Distinguish between foreign direct investment and portfolio investment. (2 marks)

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## Section III

20 marks

Attempt EITHER Question 25 OR Question 26

Allow about 45 minutes for this section

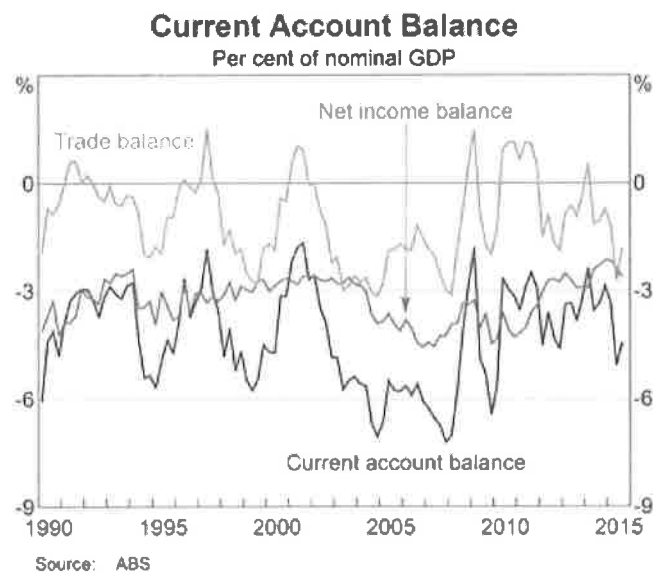
Answer the question in a SEPARATE writing booklet. Extra writing booklets are available.

In your answer you will be assessed on how well you;

- demonstrate knowledge and understanding relevant to the question
- use the information provided
- apply relevant economic terms, concepts, relationships and theory
- present a sustained, logical and cohesive response

### Question 25 (20 marks)

Analyse the main causes of Australia's current account deficits (CAD), and discuss the advantages and disadvantages for Australia in running a CAD.

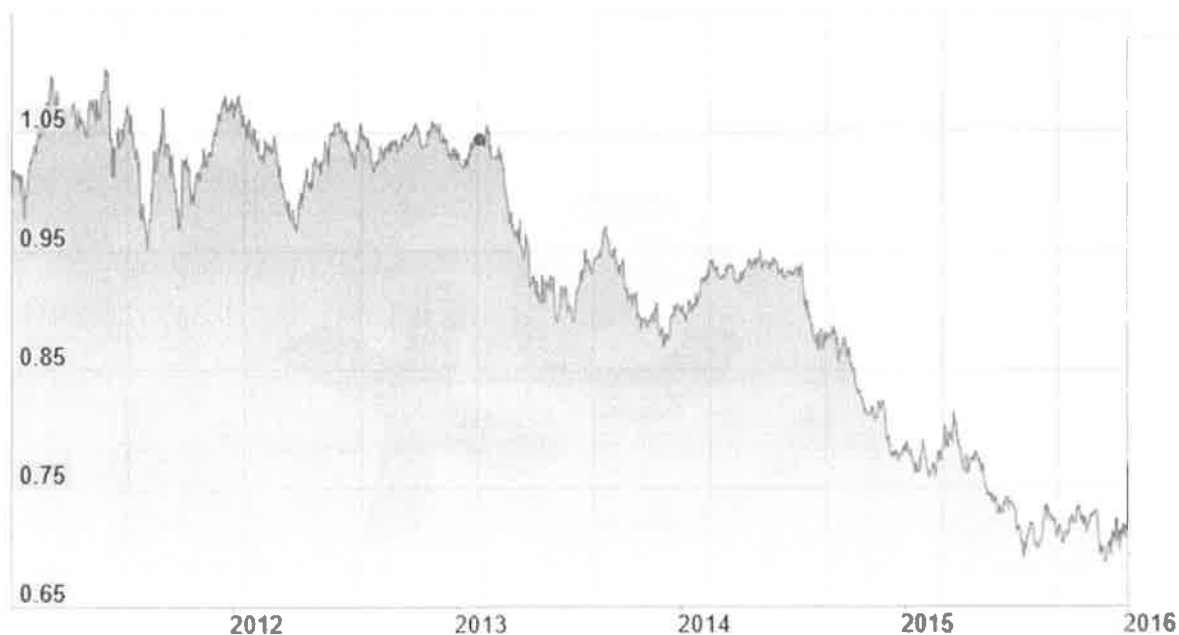


When a country has a current account surplus, national saving is greater than national investment, which means it does not need to attract foreign capital and there are plenty of local savings to fund investment and consumption. With less need to attract offshore money, the interest rates in these countries tend to be lower than those with current account deficits (such as Australia). *Sydney Morning Herald (11 Feb 2016), Central banks firing blanks in global currency wars*

OR

### Question 26 (20 marks)

Analyse the factors causing the depreciation in the value of the Australian dollar, and explain the impact of this depreciation on the Australian economy.



Australia's terms of trade have declined substantially from their peak of around four years ago and, over the course of the past year or so, the Australian dollar has been adjusting to lower commodity prices. As a result of the decline in bulk commodity prices from late last year, the forecast for Australia's terms of trade has been revised down a little further, although the exchange rate has been little changed since then. - *Reserve Bank of Australia (February 2016), Statement on monetary policy.*

**END OF EXAMINATION**