ERUVIO MENTORING · EXTERNAL-STYLE EXAMINATION

Economics

Unit 4 · Contemporary macroeconomics

Stimulus book

SOURCES 1 TO 8

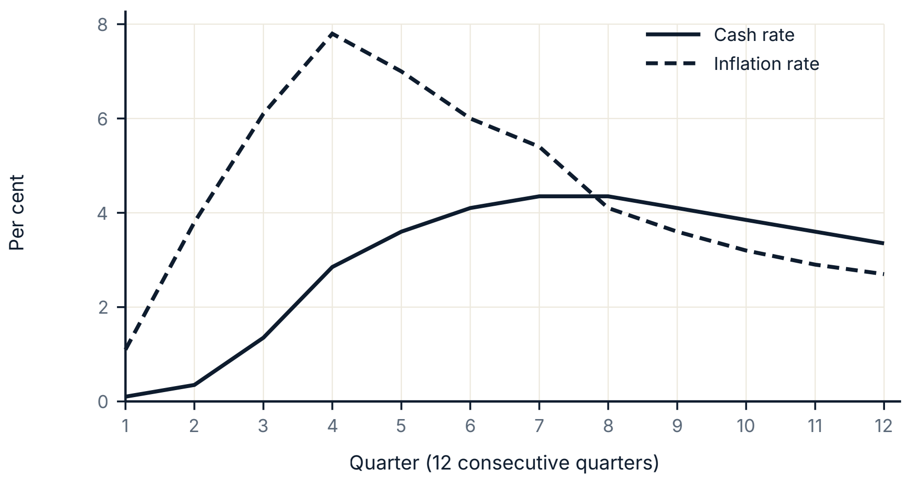
DO NOT WRITE ON THIS PAGE

Instructions

- **This book contains eight sources.** Questions in Section 2 and Section 3 direct you to particular sources, but you may refer to any source that supports your response.
- The data in this book describe a hypothetical economy unless a source states otherwise. Figures are illustrative and are provided so that you can practise interpreting economic data, not as a record of any actual economy.
- You may annotate this book during perusal time.

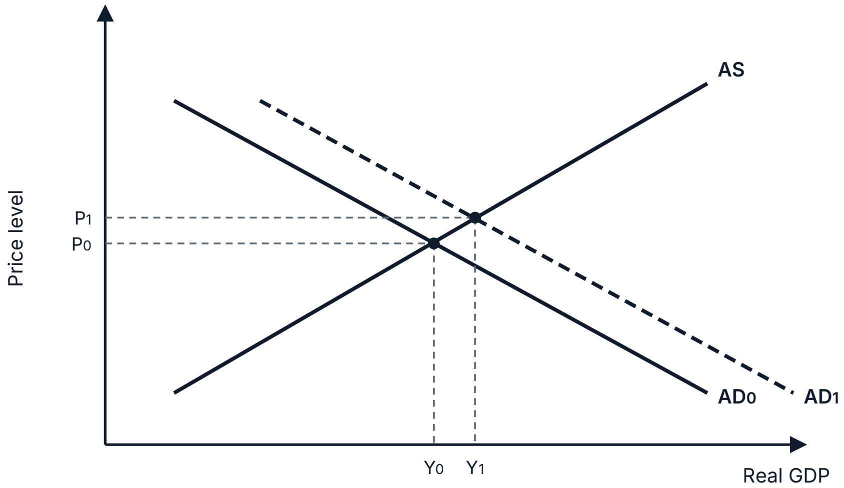
This book is for reference only. Do not write your responses in this book. All sources may be used in Section 2 and Section 3.

Source 1 Cash rate and inflation rate



The cash rate is the policy interest rate set by the central bank. The inflation rate is the annual percentage change in the consumer price index. The central bank has an inflation target of 2% to 3% on average over the cycle. The twelve quarters shown correspond to Years 1, 2 and 3 in Source 3 and Source 4.

Source 2 Aggregate demand and aggregate supply



The diagram shows aggregate demand shifting from AD_0 to AD_1, with aggregate supply AS unchanged. The equilibrium moves from P_0, Y_0 to P_1, Y_1.

Source 3 Key macroeconomic indicators

	Year 1	Year 2	Year 3
Real GDP growth (%)	4.2	2.1	1.4
Unemployment rate (%)	3.9	4.1	4.6
Inflation rate (%)	6.1	5.4	2.9
Wage growth (%)	3.1	4.0	3.6
Household saving ratio (%)	9.4	5.1	3.8

Illustrative figures for a hypothetical economy.

Source 4 Government budget position

($ billion)	Year 1	Year 2	Year 3
Revenue	640	698	712
Expenditure	672	690	726
Budget balance	**−32**	**+8**	**−14**
Net debt as a share of GDP (%)	28.1	26.4	26.9

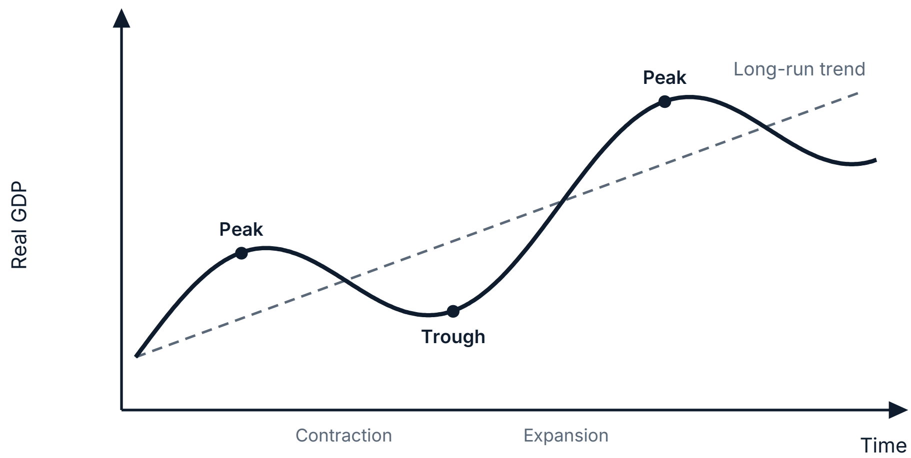
Illustrative figures for a hypothetical economy.

Source 5 Central bank commentary

> Inflation has passed its peak but remains above the target band. The board judged that the level of the cash rate is now restrictive, and that the full effect of the increases already made has not yet been felt by households, because many borrowers are still moving from fixed to variable rates.
>
> The board noted that the disinflation achieved so far has come at a cost. Growth has slowed markedly and the unemployment rate has risen, although it remains low by historical standards. Real wages fell in each of the first two years and have only recently begun to recover.
>
> Members observed that monetary policy is a blunt instrument. It works largely through the household sector, and its burden falls most heavily on recent borrowers, who are concentrated among younger households. Other arms of policy, including fiscal policy and measures to lift productive capacity, would spread the adjustment more evenly.

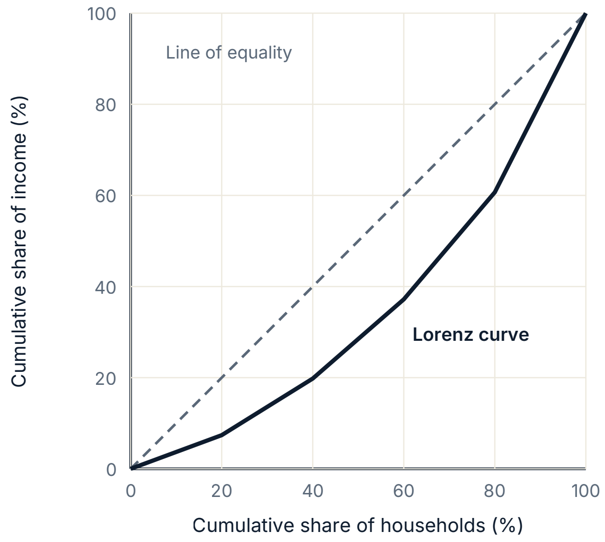
Adapted commentary written for this examination. It does not quote any real central bank or official.

Source 6 The business cycle



The solid line shows real GDP over time and the dashed line shows the long-run trend rate of growth. Turning points and phases are labelled.

Source 7 Distribution of household income, Year 3



Quintile of households	Lowest	Second	Third	Fourth	Highest
Share of total income (%)	7.4	12.4	17.4	23.5	39.3

The Gini coefficient for this distribution is 0.30. A Gini coefficient of 0 represents perfect equality and 1 represents perfect inequality.

Illustrative figures for a hypothetical economy.

Source 8 Labour force indicators, Year 3

Indicator	Value
Labour force	12.0 million
Number unemployed	456 000
Number underemployed	780 000
Participation rate	66.8%
Long-term unemployed as a share of all unemployed	21%
Unemployment rate, 15 to 24 year olds	9.2%

Illustrative figures for a hypothetical economy. Underemployed workers have a job but want and are available for more hours.

END OF STIMULUS BOOK