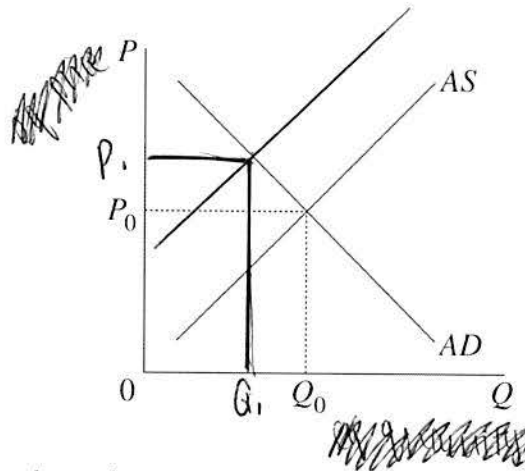


Question 24 (10 marks)

- (a) The following diagram shows aggregate demand and aggregate supply curves for a hypothetical economy. 2



On the diagram, draw the new curve that results if there is a fall in labour productivity. Label the new equilibrium price P_1 and the new equilibrium quantity Q_1 .

- (b) Outline an effect of product market deregulation on inflation. 2

Product market deregulation can put downward pressure on inflation as it allows for foreign competitors, who may have cheaper labour and productivity costs than domestic producers, to enter the market. The ensuing competition between producers ~~can~~ subsequently leads to lower prices, as they seek to ~~attract~~ satisfy consumers.

- (c) Outline a feature of a centralised labour market policy. 2

A centralised labour market has less flexible wage negotiation policies as they are fixed through a central system, with less room for individual negotiation between employers and employees.

Question 24 continues on page 17

Question 24 (continued)

- (d) Outline an advantage and a disadvantage of moving from a fixed exchange rate to a floating exchange rate system. 4

An advantage of the fixed exchange rate system is that it reduces the impact of foreign activity on the economy as it is pegged by the RBA to maintain a satisfactory

A disadvantage

An advantage of moving to a floating exchange rate is that it allows the economy to penetrate and interact with global markets leading to greater international competitiveness of the currency. This can lead to higher investment and demand for the country's products which improves economic growth.

End of Question 24

A disadvantage is that the exchange rate becomes susceptible to market forces, which can become volatile due to "speculative investors." These investors seek to gain short-term profits from short-term currency movements on the FOREX market and operate typically in "herd" movements which can rapidly appreciate or depreciate the value of a currency.