2019 VCE Economics examination report

General comments

Students performed well in Section A with data indicating that most students demonstrated the necessary knowledge and skills to respond accurately to the multiple-choice questions.

Most students attempted all questions in Section B, thereby positioning themselves to achieve the greatest number of marks. This showed that most students managed their time effectively.

There were some questions that related to specific knowledge and skills in the study design which were answered well by most students. These included:

- describing trends presented in graphs
- accurately drawing demand and supply diagrams to illustrate changes in a market
- explaining how monetary policy transmission mechanisms operate to influence economic goals
- identifying factors currently influencing the performance of the Australian economy
- understanding trade liberalisation
- explaining how a decline in the rate of economic growth of one of Australia's major trading partners potentially impacts Australia's balance of payments or the value of the Australian dollar.

The main key knowledge and skills requiring clearer and deeper understanding by students were identified as follows:

- the concept of elasticity of demand
- the nature and causes of the business cycle
- the role of the Reserve Bank of Australia in monetary policy, as outlined in its charter
- aggregate demand policies including both budgetary and monetary policies
- the relationship between the budget outcome and the level of government (public) debt
- the role of automatic stabilisers (the cyclical component of the budget)
- what is meant by the 'stance' of budgetary policy
- the strengths and weaknesses of using aggregate supply policies to achieve the Australian Government's domestic macroeconomic goals
- the terms of trade.

Another area of potential improvement was the need for students to read questions carefully and answer precisely and explicitly. For example, in Section B, Question 3c., students often began by citing specific examples of budgetary policy changes rather than discussing the budgetary policy stance, thereby not meeting the specific question requirements and not maximising their possible marks.

Specific information

The statistics in this report may be subject to rounding resulting in a total of more or less than 100 per cent.

Section A – Multiple-choice questions

The table below indicates the percentage of students who chose each option. The correct answer is indicated by shading.

Question	% A	% B	% C	% D
1	5	91	1	3
2	10	2	87	2
3	90	2	4	4
4	18	80	1	2
5	2	2	6	90
6	14	29	21	35
7	94	2	2	1
8	5	5	4	86
9	4	2	1	94
10	74	19	3	4
11	1	79	13	7
12	18	8	55	18
13	41	18	37	3
14	8	75	9	9
15	2	5	1	91

Section B – Written responses

This report provides sample answers or an indication of what the answers may have included. Unless otherwise stated, these are not intended to be exemplary or complete responses.

Question 1a.

Marks	0	1	2	Average
%	2	26	72	**1.7**

For students to score full marks on this question, they needed to describe the trend in the growth of Australia's housing prices over the specified period (the past two years) and refer to some of the data in the graph to provide evidence to support their description.

While most students were able to be awarded the full two marks, some students had difficulty demonstrating the distinction between changes in the rate of **growth** in housing prices as shown on the graph and a change in house prices.

Many students were able to identify the trend in growth, but offered contradictory or confusing statements, such as:

- Housing prices have dropped by 17% over the period.
- House prices declined to – 5%.
- House prices have begun to decline in 2018.

A high-scoring response needed to demonstrate that while the trend in housing price **growth** was declining overall, housing prices were not necessarily falling. In fact, over much of the period, housing prices were actually still increasing, but at a slower rate. Many students simply described the changes in housing prices rather than changes in the **growth** of housing prices.

Question 1b.

Marks	0	1	2	3	Average
%	8	12	33	47	**2.2**

Students generally handled this well. They were expected to describe one likely effect of the trend (indicated in Question 1a.) in the growth in housing prices on Australian living standards. Students were able to choose whether they described the likely effect on material or non-material living standards. They were not required to describe the effect on both material and non-material living standards to score full marks, although many students did write about the likely effect on both.

Students described a wide number of likely effects in response to this question.

The following are examples of possible responses.

The slower growth in housing prices might have a 'wealth effect' on homeowners; that is, home owners feel 'less wealthy' as the slowing of the growth in house prices creates less confidence in homeowners due to a possible decline in their expectations related to the increase in the value of their largest asset, their home. This is likely to affect their consumer confidence and possibly lead to a reduction in their spending, which lowers material living standards.

State governments may receive less tax revenue (stamp duty from housing sales) since the slower growth in housing prices may cause homeowners to delay the sale of their properties, which will mean fewer sales, less stamp duty. Therefore the state government may have less funds to spend on education, health, etc., contributing to a decline in living standards.

Slower growth in housing prices may encourage buyers as they feel property is more affordable. This may therefore increase material living standards, as more consumers are able to afford to buy a home.

Question 1c.

Marks	0	1	2	3	Average
%	17	23	32	27	**1.7**

Some students had difficulty demonstrating an understanding of elasticity of demand in their explanations. While many students were able to select a factor that likely determined the elasticity of the housing market (either elastic or inelastic), such as the proportion of income or whether a house is a necessity, many neglected to define elasticity (the responsiveness of the quantity of a product demanded given a change in its price) or show an understanding of the concept in their explanations.

The following is an example of a possible high-scoring response.

Price elasticity of demand (PED) measures the responsiveness of changes in quantity demanded to changes in prices. PED for buying a house is affected by the percentage of income needed to purchase it. For most people buying a house is the most expensive purchase of a lifetime.

Therefore, it takes a large percentage of income so consumers will be very responsive/sensitive to price changes, that is the PED for housing is likely to be high (elastic – where PED > 1). For example, if the price of a house increased by 10 percent one might expect the quantity demanded to fall by greater than 10 percent because houses take up a large proportion of household income so a small percentage increase in price makes it less affordable for more people. For this reason the PED is high that is price elastic.

Question 1d.

Marks	0	1	2	3	4	Average
%	4	8	10	30	49	3.1

Generally, this question was answered well, with many students achieving full marks. To score full marks students were only required to explain how the selected policy change was likely to influence **either** demand or supply in the housing market and show this scenario on a correctly labelled demand and supply diagram. They were not required to explain both changes in demand and supply.

Most students recognised that both policy changes had a similar effect on the housing market; both were likely to result in an increase in the demand for housing, and therefore an increase in the price and quantity. Students' explanations should have included reference to the changes on the demand and supply graph used to illustrate the response.

The following are examples of possible high-scoring responses. Please note that the graph shows the shift in demand to the right, which is the same in both cases.

1di The Reserve Bank of Australia (RBA) reduces the cash rate

If the RBA reduces the cash rate the cost of borrowing is likely to fall as interest rates on home loans are likely to be cut as banks pass through some or all of the lower cash rate. Given that the cost of borrowing is reduced, this may be an incentive for consumers to buy a house. This is likely to increase the demand for housing which means a shift in the demand curve for housing to the right (from D1 to D2), and the price (from p1 to p2) and quantity (q1 to q2) of houses increases. (See diagram).

1dii. The Australian Government offers loan guarantees for first home buyers

The Australian Government's First Home Loan Deposit scheme will commence on the first of January 2020. It provides assistance to first home buyers to get over the deposit hurdle when first home buyers struggle to accumulate a sizeable deposit. It will provide eligible Australians the opportunity to buy their first home with a deposit of at least 5% of the home's value and will guarantee mortgages for first home buyers who have saved a 5% deposit, effectively helping them buy sooner. The Government will guarantee the remaining 15% of the deposit. A number of rules will apply such as home buyers earning up to a certain income level will only be allowed to apply and it will be available for up to 10,000 first home buyers. The aim is to support first home buyers to get into the housing market earlier than they would have if they had to save a 20% deposit. Therefore, this policy is likely to increase demand for housing as first home buyers will be able to get into the housing market sooner and therefore the demand for housing will shift to the right (from D1 to D2) resulting in an increase in the price of houses (from p1 to p2) and the quantity sold (from q1 to q2).
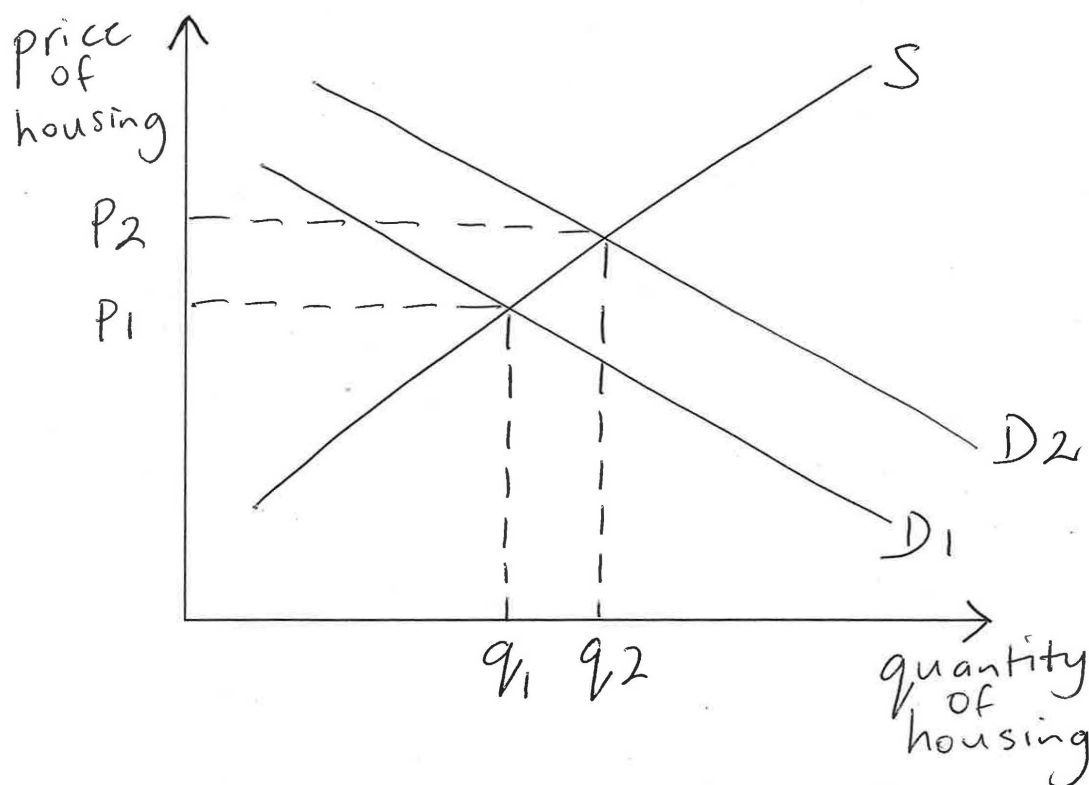
Question 2a.

Marks	0	1	2	Average
%	18	29	53	**1.4**

Many students had difficulty expressing a full understanding of the term 'business cycle'. A number of students incorrectly applied the business cycle to product life cycles and stages of business development rather than discussing the macroeconomic meaning as it applies in economics.

The following is an example of a possible high-scoring response.

The business cycle is a recognition that over relatively long periods of time, levels of output and economic growth fluctuate. There tends to be a cyclical nature in the movement of output and economic growth, with periods of above average rates of economic growth (an expansionary phase or boom) and periods of negative or low rates of economic growth (a contractionary phase or trough or recession).

Question 2b.

Marks	0	1	2	3	Average
%	16	11	26	47	**2.1**

Despite the apparent confusion when answering Question 2a., this question was generally handled successfully. Most students were able to explain the notion of a contraction in the business cycle and then explain how an appropriate aggregate demand factor may cause a business cycle contraction.

Some students were unable to score high marks because they explained how a component of aggregate demand such as private consumption expenditure (C) caused a contraction in the

business cycle rather than using a specific aggregate demand factor such as consumer confidence or interest rates.

A wide number of aggregate demand factors were correctly used in response to this question, including:

- decline in consumer or business confidence
- lower disposable incomes as a result of increased income tax rates
- higher interest rates
- decline in overseas demand for exports / weaker growth overseas
- appreciation in exchange rate.

The following is an example of a possible high-scoring response.

A contraction of the business cycle is associated with a slow-down in economic activity and economic growth and usually follows a peak or boom in economic activity. The rate of economic growth slows to below trend or may even decline (be negative). Unemployment may rise and inflation rates slow.

A decline in consumer confidence (aggregate demand factor) occurs when households feel less secure about the state of the economy and/or their future employment prospects. Households may delay spending and/or 'tighten their belts' and/or increase their savings, all of which leads to a reduction in consumption spending (C), thus reducing aggregate demand. As aggregate demand falls, producers will notice a fall in sales and may cut back production. This decline in production is likely to increase cyclical unemployment, and lead to a contraction in the business cycle.

Question 2c.

Marks	0	1	2	3	4	Average
%	8	12	23	32	25	**2.5**

Responses to this question indicated that students need to be reminded to answer all parts of a question. In this case most students spent time explaining the likely effect on economic growth of a business cycle expansion, but neglected to explain the likely effect on inflation or had time for only a short explanation of the likely effect on inflation.

Generally, most students were able to explain the likely effect on economic growth of a business cycle expansion; however, many found it difficult to explain a likely effect on inflation. Many students simply said higher aggregate demand in an expansionary phase means more inflation, but offered no explanation about why this may be so.

The following is an example of a possible high-scoring response.

When there is an expansionary phase of the business cycle, the rate of economic growth (that is the percentage change in the volume of goods and services) tends to be increasing. This means that the economy is growing faster than it was before. Injections in the circular flow model will be rising relative to leakages and therefore more goods and services will be produced.

The rate of inflation refers to the percentage increase in general level of prices. The higher rates of economic growth associated with the business cycle expansion might mean that the inflation rate starts to increase. The expansion in economic activity and the higher rates of aggregate demand might mean that the spare capacity in the economy is gradually being used up and so shortages might develop in some markets and prices will be bid up. This means that on average prices will increase and therefore so will the rate of inflation.

Question 2d.

Marks	0	1	2	3	4	5	6	Average
%	16	9	11	10	18	26	10	**3.3**

A number of students did not demonstrate an understanding of what countering a slowdown in rates of economic growth actually means, limiting the opportunity to score marks for this question. Countering a slowdown in rates of economic growth when inflation rates are under control means that the RBA will be likely to lower interest rates in order to create the conditions to support increased rates of economic growth via a range of transmission mechanisms.

Generally, the transmission mechanisms were well explained and understood although sometimes students failed to use the correct label for the particular transmission mechanism they were dealing with.

Students were expected to make a comment about the role of monetary policy in the economy. Students should have referred to the fact that the role of monetary policy is to maintain the targeted inflation rate and that when inflation is under control the RBA can use monetary policy to achieve its other objectives related to economic prosperity and therefore economic growth.

The following is an example of a possible high-scoring response.

Monetary Policy is the use of the cash interest rate in a countercyclical manner by the RBA to help stabilise spending and aggregate demand (AD) to achieve the goal of low inflation. However, if the inflation rate is under control then the RBA's attention turns to supporting its other objectives such as economic prosperity which when the economy is experiencing a slowdown is likely to mean raising the economic growth rate and lowering unemployment.

Therefore, to counter the slowdown in rates of economic growth the RBA is likely to decrease the cash rate (like it has done in 2019) to bring about an increase in AD and economic activity by stimulating spending. Monetary policy transmission mechanisms work to achieve these outcomes, examples being

The cost of credit transmission mechanism – lowering the cash rates leads to lower interest rates. Lower interest rates increase the demand for credit because it makes it cheaper for consumers and businesses to borrow and repay debt. Increased borrowing can stimulate private consumption expenditure (C) and private business expenditure (I) which increases AD and rates of economic growth.

The cash flow effect transmission mechanism – lowering the cash rates leads to lower interest rates. Lower interest rates can increase levels of discretionary income available to households who have mortgages as their interest rate is reduced and it costs them less to service their home loans. This increase in available income can stimulate consumption C, AD and rates of economic growth.

Question 2e.

Marks	0	1	2	3	4	5	6	Average
%	22	17	17	17	14	8	6	**2.3**

Many students did not read this question properly and spent time explaining how the scenario might influence aggregate demand itself, rather than how it influenced aggregate demand policies, which is what the question required.

Another issue related to students accurately referencing aggregate demand policies. To score well, students were expected to explain how the scenario might influence both budgetary and monetary policies, which are the aggregate demand policies specified in the study design.

A further confusion noted was that some students incorrectly believed that the government can use aggregate demand policies to directly increase wages. This is not the case. Rather, students could have said that in order to stimulate wages growth, the use of expansionary aggregate demand policies (budgetary and monetary policies) is required to stimulate economic activity so that the demand for labour might increase, and this may increase wages.

The highest-scoring responses were able to link the two events, recognising that normally a fall in unemployment means that the demand for employment is growing and wages are likely to increase, and explaining how this scenario might occur.

The following is an example of a possible high-scoring response.

This scenario is unusual because ordinarily if unemployment rates are falling there is strong demand for labour and this would normally mean wages would be increasing!

Normally a decrease in the unemployment rate might be seen as a positive economic outcome but in this scenario it is associated with slow wages growth, so it would be reasonable to conclude that there is still plenty of spare capacity and/or underemployment in the labour market.

Also, while the unemployment rate may have fallen, it could still be well above the rate that is deemed to occur at full employment (around 4 – 4.5% in Australia).

Monetary and Budgetary policies are both aggregate demand policies that could be implemented in response to this scenario. To promote stronger growth in wages because the relatively slower rate of economic growth is reducing growth in purchasing power and confidence, the RBA may seek to lower the cash rate, that is implement expansionary monetary policy. When the cash rate is reduced, indebted households with variable loans such as home loans, may feel somewhat more comfortable as they are charged less to service their loan(s) because interest rates have been reduced. Having more discretionary income may mean they can afford more goods and services that they could not previously afford because of slow wages growth. This possible increase in consumption spending will increase aggregate demand so the derived demand for labour increases and the unemployment rate moves closer to full employment. This tightening of the labour market would help put upward pressure on wages.

To support the RBA, the government might run an expansionary budgetary policy. The government could increase spending on infrastructure projects (creating job opportunities in the process) and/or offer income tax cuts which could be directed to low and middle income earners who may be suffering the most from the slow wages growth. Either way these expansionary budgetary policies will increase aggregate demand – increasing infrastructure spending will increase government spending, a component of aggregate demand and reduced income tax will increase disposable income and increase consumption spending, another component of AD. Both policies will increase the demand for labour given the increase in AD, lowering the unemployment rate, moving it closer to full employment, which might increase the bargaining power of workers in their quest to generate faster wages growth.

Question 3a.

Marks	0	1	2	3	4	Average
%	17	16	20	23	23	**2.2**

While a number of high-scoring responses were seen, there was still evidence of confusion about the concepts of government debt, foreign debt and the current account deficit, and what the relationship is between the budget outcome and government debt.

The highest-scoring responses were well planned and began with explicit definitions of budget outcome and government debt, and then proceeded to explain the relationship between these.

The following is an example of a possible high-scoring response.

The budget outcome is the difference between government revenues (receipts) and outlays (expenses). If outlays are higher than revenues (budget deficit), there is a shortfall of funds and the government will need to finance the budget deficit by borrowing such as through the issuing of new government bonds (debt financing instrument). Therefore, government budget deficits add to the level of government or public debt.

If on the other hand revenues are greater than outlays a budget surplus is achieved. When revenues are greater than outlays the government can use these funds to pay back some of their debt and therefore the level of government (public) debt may fall in net terms.

Question 3b.

Marks	0	1	2	3	4	Average
%	35	13	13	20	20	**1.8**

This question was generally not well handled. Many students evidently did not understand what an automatic stabiliser was; nor could they accurately identify an example. Even those who appeared to know the definition of an automatic stabiliser and could identify an example, had difficulty explaining how the stabiliser operates to influence aggregate demand and the rate of economic growth.

The following is an example of a possible high-scoring response.

Automatic stabilisers in relation to budgetary policy are the changes to the budget that occur automatically with changes in the level of economic activity. They work counter cyclically to boost or slow AD without deliberate, discretionary or structural intervention by the government. An example of an automatic stabiliser are income taxes. For example, during a downturn, personal income tax revenues tend to decrease as due to rising unemployment, the government collects less revenue. Lower tax revenues tend to push the budget outcome into a reduced surplus or increased deficit. This budget outcome therefore automatically has an expansionary effect on the level of economic activity resulting in increased consumption spending, which increases aggregate demand. This helps to stimulate production resulting in increased rates of economic and employment growth.

Question 3c.

Marks	0	1	2	3	4	5	6	Average
%	14	12	16	17	17	13	11	**2.9**

Some students did not address the requirements of this question and were therefore unable to score high marks. Students were required to refer to the 2019–2020 budget policy stance but many only looked at one or two budgetary policy discretionary measures without reference to the stance.

Even when students referred to the 2019–2020 budget stance, there was a wide variety of interpretations about what exactly the stance was. Given the budget was estimated to move from a

deficit in 2018–2019 to a surplus in 2019–2020, it was expected students would identify this as a contractionary stance, as the government is increasing leakages relative to injections.

If students set up their introduction in this way, they were then able to say that it would be harder to achieve full employment because the net effect on aggregate demand could be negative, while it would also curtail any inflationary pressures due to the contractionary stance.

A number of students seemed to rush their discussion and very quickly stated how the outcome or measure would affect the goal, without detailing how and why.

On the other hand, some responses demonstrated thorough understanding about the current state of Australia's economic goals of full employment and low inflation / price stability. Many students successfully argued that a contractionary budgetary policy stance would likely increase unemployment, thus jeopardising the goal of full employment. Inflation levels were below the RBA target in 2019, which might cause inflation levels to be reduced further, meaning the goal of price stability was further away from being achieved. The ability to quote current data in support of arguments was also frequently demonstrated and this added to the quality of the discussion.

The following is an example of a possible high-scoring response.

When the budget was handed down in 2019 Australia was in the midst of the following economic conditions – low inflation (below target), gradually rising unemployment (to 5.2% in May from 4.9% in Feb), very low wages growth and slowing economic growth.

The focus of the 2019/20 budget was about returning the budget outcome to a surplus from a deficit in the previous year. The budget estimates show that the underlying cash outcome will increase from a deficit of - $4.2 b to a surplus of $7.1 b. Reducing the size of the deficit and turning it into a surplus would be seen as a contractionary budget stance because injections are falling relative to leakages. (However, there were some structural changes to aspects of budgetary policy that might have an expansionary effect such as income tax offsets and increased spending on infrastructure. These structural changes may create therefore some boost to household spending (income tax offsets) and support some increase in AD while spending on infrastructure directly creates jobs so these structural policies might create some generate some increased demand, production and employment).

A contractionary budget makes it more difficult for the government to achieve full employment i.e. the lowest rate of unemployment that can be achieved without causing excessive inflation, approx. 4.0% - 4.5% as discussed this year by the RBA. The current rate of unemployment is 5.3% with an underemployment rate around 8.6%. This indicates there is spare capacity in the labour market. This spare capacity is one reason why wages growth has remained subdued. Therefore with low wages growth and little stimulus from the budget surplus i.e. the contractionary budget stance, it is unlikely that inflationary pressures (from the cost or demand side) will build given that wages growth is very slow which means demand remains sluggish and costs are rising slowly.

Therefore the contractionary nature of the budget will likely cause AD to grow more slowly (ceteris paribus) and make it more difficult to achieve the goal of full employment. Also given that AD is growing more slowly and that wages growth is in part low due to the spare capacity in the labour market, it is likely that the goal of low inflation/price stability will remain in or below the RBA targeted level of 2–3% on average over time.

Question 3d.

Marks	0	1	2	3	4	Average
%	13	11	19	27	30	**2.5**

Students who chose a taxation reform policy appeared to find it easier to explain how the selected policy might influence aggregate supply and living standards than students who chose a welfare reform policy.

The following is an example of a possible high-scoring response.

Tax reform - Lower rates of personal income tax. The Morrison government recently passed legislation that sees the removal of the 37% marginal tax rate by 2024/25 to a 30% marginal tax rate which will apply to income levels between incomes of $40,000 and $200,000 per year. It is argued that the lower income tax rate might encourage greater participation or more work/effort by taxpayers given the lower marginal tax rate, thereby increasing productivity/worker. This boost to productivity may increase the ability and willingness of producers to produce thus expanding aggregate supply.

The boost to productivity might mean that that real unit labour costs (RULCs) might grow more slowly and prices might fall and/or grow more slowly so purchasing power is likely to increase. Therefore, material living standards are enhanced.

Question 3e.

Marks	0	1	2	3	4	Average
%	19	16	24	21	20	**2.1**

Many students were unable to describe a strength and a weakness of using aggregate supply policies to achieve the Australian Government's domestic macroeconomic goals. Low-scoring responses simply described how the policy works rather than identifying a strength and a weakness in the ability of the policy to achieve an economic goal. Other responses failed to link the policy to the achievement of full employment.

High-scoring responses explained the meaning of aggregate supply policy and described a strength of the policy in achieving full employment, as well as a weakness of the policy that might limit the achievement of full employment. The following is an example of a possible high-scoring response.

- Aggregate supply policies, such as spending on education and training or taxation reforms, grow productive capacity or potential GDP through increasing efficiency in how resources are used and allocated. Generally, this can increase the ability and willingness of suppliers to produce goods and services and thus raise demand for labour, reducing unemployment.
- A strength of aggregate supply policies is that their operation might promote full employment in the long term. Aggregate supply policies, such as spending on education and training, welfare and tax reforms, can help reduce rates of unemployment by increasing the flexibility and efficiency in the use of labour resources, retraining labour resources, etc.
- A weakness of aggregate supply policies is that they can cause a rise in the level of structural unemployment in the short term in some industries as businesses adapt to be more competitive and profitable.

Question 4a.

Marks	0	1	2	3	Average
%	5	10	40	45	**2.3**

Generally students handled this question well and were able to explain the difference between trade liberalisation and barriers to trade.

The following is an example of a possible high-scoring response.

Trade liberalisation involves removing barriers to trade between different countries and encouraging free trade. For example, lowering or removing tariffs or setting up free trade agreements.

Barriers to trade are a form of government intervention in markets for imports (and sometimes exports) that distort the relative prices of domestic versus imported goods such that local industries will be protected from competing with cheaper imports. For example, tariffs on imports will raise their relative price compared to domestic goods protecting the local industry and jobs as consumers avoid paying the higher price for the imported good. Other examples include import quotas, export subsidies.

The terms can be distinguished by looking at their impact – trade liberalisation is about enabling free trade and promoting efficiency by exposing industries to relative prices in world markets. It assumes resources will be reallocated to areas where a country has a comparative advantage and overall consumers benefit because they are able to access the lower prices that follow on from the increased competitive pressures; while barriers to trade are designed to protect local producers from overseas competitors. This may mean local producers are not internationally competitive or efficient. It is seen as a way to protect local jobs and support domestic industry.

Question 4b.

Marks	0	1	2	3	Average
%	20	13	20	47	**2.0**

Most students handled this question well, although those who chose the value of the Australian dollar generally scored higher than those who chose Australia's balance of payments on current account.

It was expected that students would include the following points, or similar, in response to this question.

- When there is a decline in the rate of economic growth in Australia's major trading partners, it is likely that this will lead to less demand for Australia's exports of goods and services.
- Less demand for Australia's exports means that:
    - the balance of payments on current account may be negatively impacted with less income in from exports while maintaining the same level of income out as Australia pays for its imports. Therefore, it is likely that the balance of payments on current account will see an increase in the size of its deficit or a reduction in the size of its surplus.
    - the value of the Australian dollar will depreciate. Less demand for Australia's exports means less demand for Australian dollars in the foreign exchange market, which will likely see depreciation in the value of the Australian dollar.

Question 4c.

Marks	0	1	2	3	4	Average
%	20	20	20	22	19	**2.0**

Students seemed to have difficulty explaining the terms of trade; many were not able to define the meaning of the concept. They had difficulty accurately explaining what an unfavourable movement in the terms of trade might mean for Australia's goal of strong and sustainable economic growth and living standards.

The following is an example of a possible high-scoring response.

The terms of trade measures the average price of exports (measured as an index) divided by the average price of imports. The unfavourable movement in the terms of trade could mean that the average price received for Australia's exports has fallen and/or the average price of imports has increased over the two-year period. If export prices fall this might have a negative effect on real net disposable income. Lower export prices could also reflect a fall in world demand and so the revenue from exports might fall. This decreases export injections in the circular flow and the level of income that can be disseminated in the economy. Therefore dividends, wages and tax receipts might all fall resulting in less ability to increase spending. Therefore, with falling aggregate demand, the rate of growth in production might fall thus meaning the government's goal of achieving strong economic growth is jeopardised.

The fall in real net disposable income might also mean that purchasing power could decrease. For example, mining companies with decreased profits might have to cut dividends and shut down some projects which are not viable when prices are lower. This could lead to an increase in unemployment and therefore reduced purchasing power (leading to lower material living standards) and increased job insecurity/stress (leading to lower non-material living standards).