



Worksheet 4: Chains of analysis answers

Economic Event 3 – Imports becoming expensive

(a) The impact of expensive imports on demand pull inflation:

Imports becoming expensive	<i>may be because of import tariffs or weaker currency</i>	<i>locally made goods seem cheaper</i>	<i>imports fall</i>	<i>Aggregate Demand (AD) rises</i>	<i>may trigger demand pull inflation</i>
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(b) The impact of expensive imports on exchange rates:

Imports becoming expensive	<i>imports fall</i>	<i>supply of currency falls</i>	<i>exchange rate rises</i>
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(c) The impact of expensive imports on cost push inflation:

Imports becoming expensive	<i>cost of imported raw material rises</i>	<i>Aggregate Supply (AS) decreases</i>	<i>cost push inflation</i>
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(d) The impact of expensive imports on trade deficit:

Imports becoming expensive	<i>imports fall</i>	<i>trade deficit falls</i>	<i>however, cost of production may go up</i>	<i>exports become less price competitive</i>	<i>exports fall</i>	<i>impact on trade deficit is uncertain</i>
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Economic Event 4 – Fall in interest rates

(a) The impact of a fall in interest rates on Aggregate Demand (AD):

Lower interest rates	<i>reward for saving falls</i>	<i>cost of borrowing falls</i>	<i>savings fall</i>	<i>consumption rises</i>	<i>opportunity cost of investment falls</i>	<i>investments rise</i>	<i>AD rises</i>	<i>demand pull inflation or real output rises</i>
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(b) The impact of a fall in interest rates on the exchange rate

Lower interest rates	<i>financial capital inflows fall</i>	<i>demand for currency falls</i>	<i>financial capital outflows rise</i>	<i>supply of currency rises</i>	<i>exchange rates fall</i>
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(c) The impact of a fall in interest rates on net exports:

Lower interest rates	exchange rates fall	exports become cheaper	imports become expensive	net exports rise
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(d) The impact of a fall in interest rates on Aggregate Supply (AS):

Lower interest rates	investment in capital and technology rises	production potential rises	AS shifts to the right
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Economic Event 13 – Fall in exchange rates

(a) The impact of a fall in exchange rates on demand pull inflation:

Fall in exchange rate	exports become cheaper	imports become expensive	exports rise	imports fall	AD rises	may trigger demand pull inflation
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(b) The impact of a fall in exchange rates on cost push inflation:

Fall in exchange rate	imported raw materials become expensive	cost of production rises	AS falls	cost push inflation
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Economic Event 14 – Higher inflation rate

(a) The impact of inflation on exchange rates:

Higher inflation rate	exports become relatively expensive	imports seem cheaper	exports fall	imports rise	demand for currency falls	supply of currency rises	exchange rates fall
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Economic Event 18 – Government raising its spending on education/infrastructure

(a) The impact of higher government spending on education/infrastructure on demand pull inflation:

Government raising its spending	G rises	AD rises	price level and real output rise
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(b) The impact of higher government spending on education/infrastructure on cost push inflation:

Government raising its spending	increased spending on education improves workers' skills and productivity and increased spending on infrastructure reduces cost of businesses	production potential rises	AS increases	price level falls but real output rises
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(c) Combined effect of increased government spending on inflation:

Government raising its spending	G rises	AD rises	price level and real output rise	production potential rises	AS rises	price level falls but real output rises	combined impact on price level is uncertain	real output certainly rises
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