	<h1>PRELIMINARY EXAM 2017</h1>
	<h2>Economics JC2 H1 (8819/01)</h2>

PAPER 1

Tuesday
12 September 2017
08:00 – 11:00

TIME : 3 hours

INSTRUCTIONS TO CANDIDATES

Do not open this paper until you are told to do so.

Write your name, class and name of economics tutor in the space provided on the writing paper.

Do not use staples, paper clips, glue or correction fluid/tape.

Section A

Answer **all** questions.

Section B

Answer **one** question.

The number of marks is given in the brackets [] at the end of each question or part question.

Write your answers on the writing papers provided. If you use more than one sheet of paper, fasten the sheets together.

You are advised to spend several minutes per question reading through the data and questions before you begin writing your answers.

There are 8 printed pages including this cover page

SECTION A

Answer **all** questions.

Question 1

Trade Slump and Deflation

Extract 1: UK slips into deflation as prices fall 0.1%

The UK has officially slipped into deflation for the first time in more than half a century, but economists and policy makers are not concerned, saying that a brief period of gently falling prices is more likely to help growth than harm it.

The UK has been teetering on the brink of deflation for several months because of the slide in global oil prices, falling household incomes and the strength of sterling, which has reduced UK's export competitiveness.

Suneil Mahindru, chief investment officer international equity at Goldman Sachs Asset Management, reacted by saying: "We are not concerned about the UK". Falling prices are "freeing disposable income and many industries, such as retail, are benefiting", he added. UK households have suffered from falling real wages over the past few years. Now that prices of consumer essentials like food and energy are stagnant or falling, many households are finally getting a boost in living standards.

Chancellor George Osborne said the data were good news for family budgets and should not be mistaken for "damaging deflation" — a vicious cycle of falling prices and wages which shrinks an economy. He added that once deflation sets in consumers would expect prices to fall and they would delay spending for as long as possible in order to save money. This would perpetuate the problem and is known as a deflation trap. The deflation trap would lead to falling economic growth.

Source: Adopted from The Financial Times, 19 May 2015

Extract 2: Deflation risk and trade slump cast chill over global economy

The world economy is at risk of slipping into a deflation trap and faces a historic slump in global trade that should serve as a wake-up call for governments around the world. The International Monetary Fund warned on Tuesday that a "broad-based phenomenon" of low inflation, fed by a collapse in commodity prices and faltering demand, risked deteriorating into a full-blown deflation trap, particularly in advanced economies.

The fund's warning, came as the World Trade Organisation forecast global trade volumes would rise only 1.7 per cent this year. This would be the slowest increase since the 2008 financial crisis, and a big reduction from the 2.8 per cent growth it forecast in April. "The dramatic slowing of trade growth is serious and should serve as a wake-up call," said Roberto Azevêdo, the WTO's director-general.

The trend was particularly worrying in the context of an increase in protectionism and anti-globalisation rhetoric seen in the US and around the world, he said, adding: "This is a moment to heed the lessons of history and recommit to openness in trade, which can help to spur economic growth."

The twin warnings highlight mounting concerns over the world economy's slow recovery from the 2008 crisis and the tepid response by policymakers. They also point to two key areas of

concern. International institutions are increasingly worried about the potential impact on a fragile global economy of the rise of populist politicians, such as US presidential candidate Donald Trump, and the protectionist policies they put forward.

They are equally frustrated by what they see as the failure of many governments to take tough decisions and their continuing overreliance on central banks and monetary policy to respond to slow growth. The IMF has for years urged governments to adopt more growth-friendly fiscal policies and to push structural reforms to stimulate consumption and investment. Alongside the warning of a deflation trap, the IMF called for governments to target stagnant wages and adopt policies such as raising the minimum wage to boost incomes. Such a response, IMF economists wrote, was particularly necessary in advanced economies, where “the scope of monetary policy to further stimulate demand is perceived to be increasingly constrained” and “policy rates are not far from their effective lower bounds”.

Source: Adopted from The Financial Times, 28 September 2015

Extract 3: MAS 'must remain alert' to signs of slow growth

Singapore's central bank should "remain vigilant" to signs of slow growth in the country and make policy adjustments if needed, the International Monetary Fund (IMF) said. In a statement released yesterday, after a visit here, fund representatives noted that Singapore's growth prospects remain subdued, given a lacklustre global outlook.

The IMF also said the Monetary Authority of Singapore's (MAS) latest move to stop the local currency from rising further against a basket of key currencies was "appropriate", given slowing growth, a weakening labour market as well as low oil prices worldwide. The fund noted that Singapore's economic growth has slowed markedly in recent years owing to both domestic and external factors.

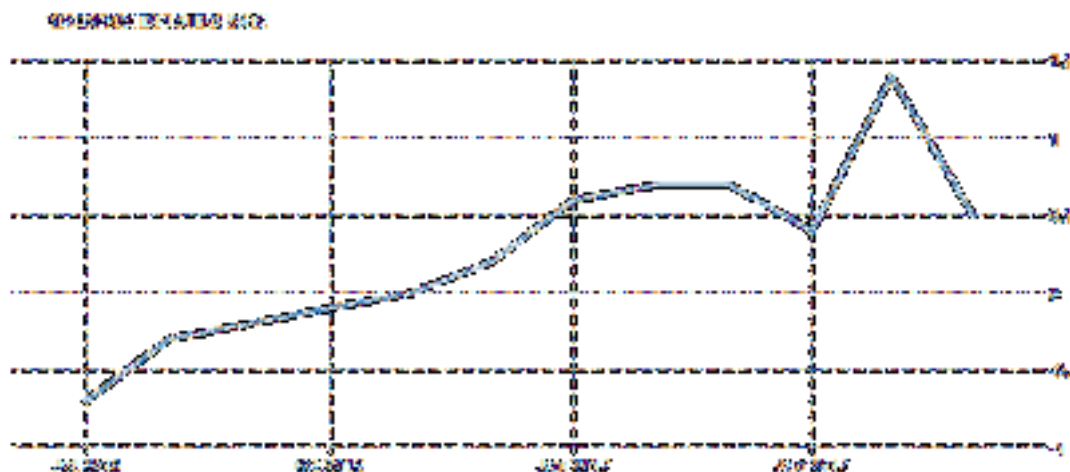
At home, growth is constrained by an ageing labour force, tighter limits on foreign workers and the transition costs of the shift to an innovation-based growth model. On the external front, the outlook for global growth and trade remains subdued, the IMF said. The fund also said Singapore's growth is likely to slow further this year, as the full impact of the slowdown in global trade and capital outflows is felt and companies continue to hold back on hiring and investment. The most important short-term external risk is a sharper-than-expected global slowdown, which could result from weak growth in China, other emerging economies as well as key advanced economies.

Still, the Singapore Government has enough in its coffers to ramp up spending and provide a short-term lift if the economic outlook worsens further, said the IMF. "The authorities are prepared to implement fiscal stimulus through targeted measures, for example providing more income transfers to poor families and seniors and accelerating infrastructure spending," added the fund in its statement.

In the longer run, raising productivity will be essential to Singapore's growth, given slower labour force expansion, the IMF said.

Source: The Straits Times on 11 May 2016

Figure 1: Inflation Rate in Singapore



Source: SingStats

Questions

- (a) Describe the trend in the consumer prices in Singapore between July 2016 and April 2017. [2]
- (b) Using extract 1, comment on whether economies should fear deflation. [4]
- (c) Using aggregate demand and supply analysis, explain the causes of deflation in the UK in 2015 as identified in extract 1. [6]
- (d) In extract 2, the IMF claimed that “the scope of monetary policy to further stimulate demand is perceived to be increasingly constrained”

Explain a possible factor that would determine the effectiveness of monetary policy to stimulate demand. [2]
- (e) Using both the case study and your own relevant knowledge, discuss whether “an increase in protectionism and anti-globalisation rhetoric” seen in the US and around the world can be justified in terms of economic theory. [8]
- (f) Discuss whether depreciation of the Singapore dollar would be most appropriate way of responding to slow growth in Singapore. [8]

[Total: 30 marks]

Question 2

Are low oil prices here to stay?

Extract 4: Predicting the oil price is challenging

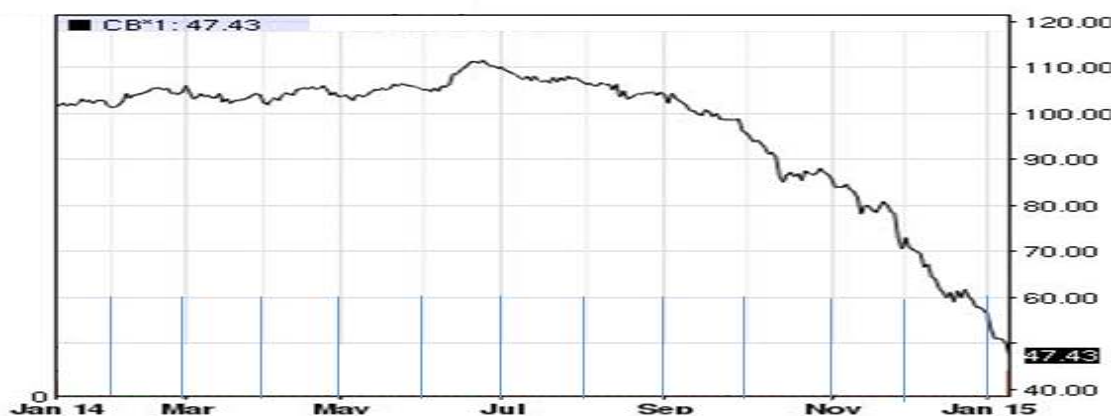
What we do know is that, despite a recent upturn, the price of oil has slumped almost 50% since last summer following the longest-running decline for 20 years.

And we know why - US shale oil, and to a lesser extent Libyan oil returning to the market, has pushed up supply together with a slowdown in the Chinese and EU economies.

With the booming US shale industry showing little signs of slowing, and growing concerns about the strength of the global economy, there are good reasons to suspect that the current slump in the oil price will continue for some time.

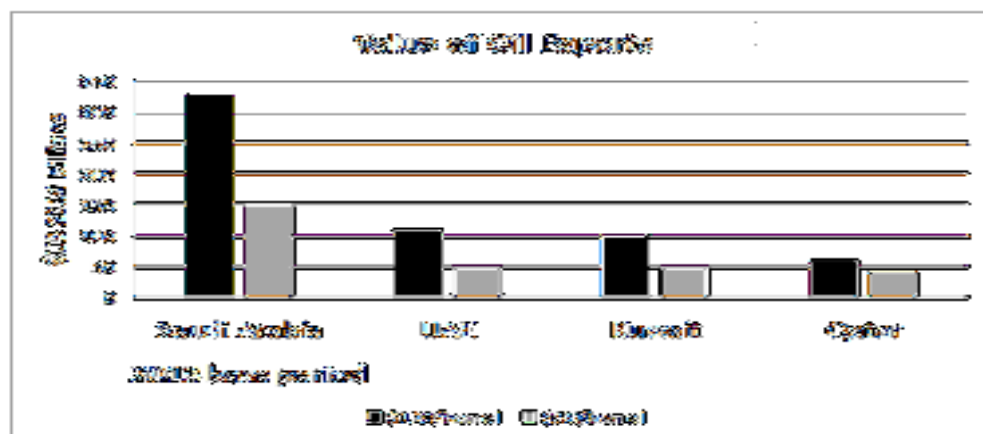
Source: BBC News, 24 February 2015

Figure 2: Latest Price for Crude Oil



Source: Nasdaq.com Jan 14th 2015

Figure 3: The value of oil exports based on different oil prices per barrel for selected countries



Source: Energy Matters, 18 Nov 2015

Extract 5: What are the effects of fracking on the environment?

The oil and gas industry has been expanding consistently for decades due, in part, to the advances in technology in the processes of extracting, transporting and delivering the resource to consumers. One of the most-discussed technological advances is hydraulic fracturing, also known as fracking. This extraction process combines often dangerous chemicals with large amounts of water and sand at high rates of pressure into rock formations to fracture surrounding material for the purpose of extracting oil and gas. Fracking is controversial because of the amount of natural resources needed to complete its process, and more notably because of the negative effects like air pollution and water contamination. In addition to air and water pollution, fracking also increases the potential for oil spills, which can harm the soil and surrounding vegetation. Fracking may cause earthquakes due to the high pressure used to extract oil and gas from rock and the storage of excess wastewater on site.

Source: Investopedia, 19 January 2015

Extract 6: Can Indonesia phase out energy subsidies without hurting the poor?

Indonesia enacted a major reform recently. On 1 January, President Joko Widodo followed through with his electoral promise to cut decades-long subsidies for energy products. Many leaders had tried before him, but retreated in the face of fierce resistance from the people. Thanks in part to low oil prices, the newly-elected President got the reform through without much trouble. The true challenge will be how to support poor households when prices start rising again.

Source: OECD Insight 28 April 2015

Extract 7: Little cheer for Singapore's economy despite lower oil prices

Singapore: Lower global oil prices should stimulate global economic growth, according to the International Monetary Fund, which estimates that every US\$10 fall in per-barrel oil price can lift global GDP by 0.2 per cent. In particular, countries which are net importers of oil, such as Singapore, should benefit more from lower global oil prices. For example, electricity bills and petrol costs have fell about 15% and 5.5% respectively. Crude oil prices have slumped by 48% on average from 2014 to last year.

But now that oil has dipped below US\$30 a barrel, and is hovering its lowest price levels in over a decade, initial cheer from energy cost savings appears to be turning into fear over a global economic slowdown. The current slump in oil prices has done little to prop up consumer spending and spur growth, according to CIMB Private Banking economist Song Seng Wun, "because the slump in global trade has overtaken the benefits of cheaper oil", he said. Hit by slowing global demand, Singapore's trade-dependent economy grew 2.1 per cent in 2015, clocking its weakest pace of growth since 2009.

"Last year for example, was one of the worst years for the petrochemical industry, even though the industry had the benefit of lower input prices. Due to low global demand, the firms over-invested and could not run at capacity," said Mr Song. Singapore-based Keppel Corp announced that it had cut around 8,000 jobs as weak energy prices hammered profits at the world's largest oil rig builder. Further, the global economic slump that has resulted from low oil

price has also had a chain effect on Singapore's economy. These effects extend beyond just the oil and gas industry.

Overall, some clear winners from lower oil prices could be consumers, and businesses in energy-intensive industries, such as aviation and shipping, which stand to gain from lower utility bills. Meanwhile, the losers include oil-related firms, like rig builders and offshore and marine companies, which have seen orders thin out in line with lower oil exploration activity.

Source: CNA online 22 Jan 2016

Questions

- (a) (i) Using Figure 2, describe the trend of oil prices between January 2014 and January 2015? [2]
- (ii) With the help of a diagram, explain the demand and supply factors that are responsible for the trend in oil prices identified in (i). [4]
- (b) Using the evidence from Figure 3, what can you conclude about the price elasticity of demand for oil in Saudi Arabia? [3]
- (c) With reference to Extract 6, explain how a complete removal of energy subsidies will affect households' expenditure on electricity. [3]
- (d) (i) Explain one possible reason why the price of crude oil has fallen by 48% whereas price of petrol has fallen only by 5.5%. [2]
- (ii) With reference to Extract 7, discuss the impact of changes in oil prices on the economic growth of Singapore. [8]
- (e) Explain and evaluate one market-based policy to deal with economic inefficiency in resource allocation due to fracking. [8]

[Total: 30 marks]

SECTION B

Answer **one** question from this section

- (1) (a) Explain how the existence of merit goods such as art galleries represent market failure. [10]
- (b) Discuss the view that subsidies to provide free entry to art galleries is the best way to achieve efficient allocation of resources. [15]
- (2) (a) Explain how standard of living is measured in an economy. [10]
- (b) Discuss whether an improvement in trade balance will help to achieve a higher standard of living in an economy. [15]

******* The End *******