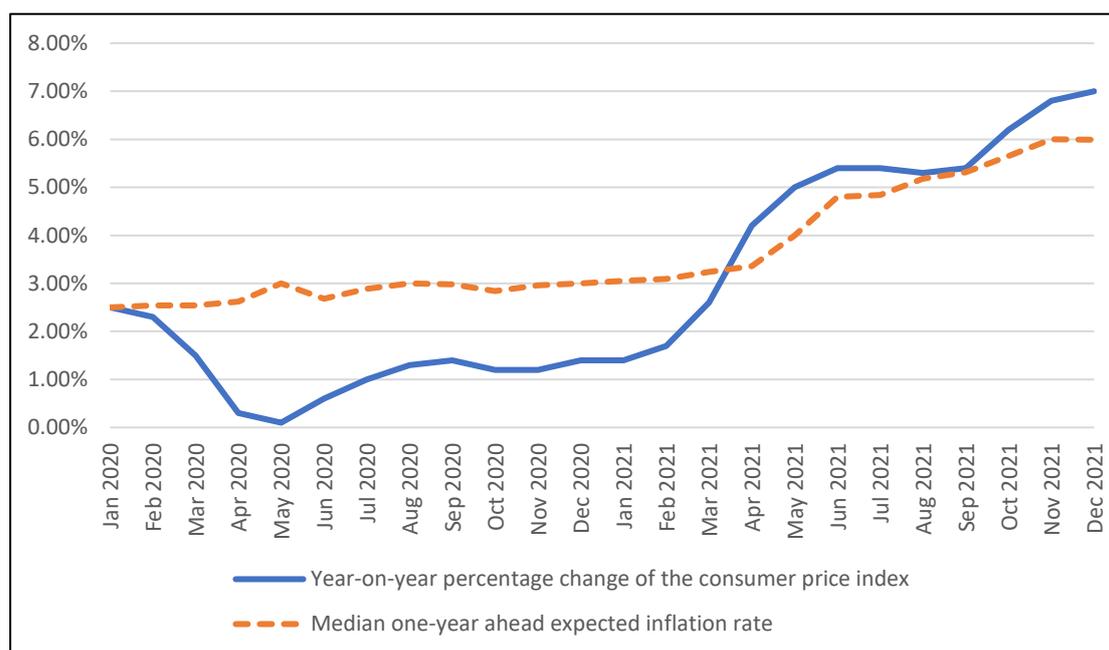


**Q.31**

US recorded a year-on-year increase in the consumer price index of 7% in December 2021, a record high since June 1982. The US Federal Reserve hopes to stabilise the price level through monetary policies.

**Source A:** Year-on-year percentage change of the consumer price index and the median one-year ahead expected inflation rate in the US between January 2020 and December 2021



*(Source: Federal Reserve Bank of St. Louis, Federal Reserve Bank of New York)*

**Source B:** A news excerpt about the supply chain issues in the US

COVID-19 worsened the US's supply chain issues. As a huge number of workers were infected by COVID-19, there was a shortage of workers at ports in the US, leading to delay in the supply of goods.

*(Source: various newspapers)*

**Source C:** A news excerpt about a possible increase in the interest rate by the US Federal Reserve

Inflation in the US has been increasing during the COVID-19 pandemic. The market expects the US Federal Reserve to start raising the interest rate in March to fight against inflation.

*(Source: various newspapers)*

**Source D:** Some opinions on US's monetary policy

|  |   |
|--|---|
|  <p>An official of the US Federal Reserve</p> | <p>The current inflation rate remains above our long-term target of 2%. There is room to raise the interest rate without threatening the labour market, as there are more job openings than unemployed workers.</p> |
|  <p>A journalist</p>                         | <p>If the supply chain issues continue, a contractionary monetary policy will not help lower the price level.</p>   |
|  <p>An entrepreneur</p>                     | <p>An increase in the US's interest rate will cause an appreciation of the US dollar against other currencies, affecting the US's external trade.</p>   |

**Questions**

- (a) (i) Refer to Source A. Compare the median one-year ahead expected inflation rate in the second half of 2020 and the year-on-year percentage change of the consumer price index in the second half of 2021, and state whether there was unexpected inflation or deflation in the second half of 2021. (2 marks)
- (ii) Explain whether an employee who received a fixed wage would gain or lose when the change in the price level in Source A occurred. (2 marks)
- (b) Refer to Source B. With the aid of a diagram, explain how the COVID-19 pandemic affected the price of US imported goods. (4 marks)
- (c) Refer to Sources B to D. **WITHOUT** using a diagram, explain the viewpoint of the journalist in Source D using the AS-AD model. (3 marks)

For part (d), candidates are required to present their answer in essay form. Criteria for marking will include the use of sources and economic theories, relevant content, logical presentation and clarity of expression.

- (d) With reference to the above sources and your own knowledge in Economics, discuss the effects of the US Federal Reserve raising the interest rate on the US, including:
- employment level
  - tax revenue
  - trade balance
- (11 marks)
- (e) Other than raising the interest rate, suggest **ONE** measure to the government to lower the price level. Briefly explain how your proposal works. (2 marks)