

INNOVA JUNIOR COLLEGE  
JC 2 PRELIMINARY EXAMINATION  
in preparation for General Certificate of Education Advanced Level  
**Higher 2**

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**ECONOMICS**

**9732/01**

Paper 1

**19 August 2016**

**2 hours 15 minutes**

Additional Materials: Writing Paper and Cover page

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**READ THESE INSTRUCTIONS FIRST**

Write your name and class on all the work you hand in.  
Write in dark blue or black pen on both sides of the paper.  
You may use a soft pencil for any diagrams, graphs or rough working.  
Do not use staples, paper clips, highlighters, glue or correction fluid/tape.

Answer **all** questions.

Begin each question on a fresh sheet of paper.

At the end of the examination, attach cover pages provided to **Case Study Q1 and Q2**.  
Fasten all questions **separately** and securely.

At the end of the examination, fasten all your work securely together.  
The number of marks is given in brackets [ ] at the end of each question or part question.

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This document consists of **7** printed pages and **1** blank page.



Answer **all** questions

### Question 1

#### Global Steel Woes

**Table 1: Global Steel Production Geographical Distribution**

	<b>2004</b>	<b>2014</b>
<b>China</b>	25.6%	49.4%
<b>Japan</b>	10.6%	6.6%
<b>Other Asia</b>	11.1%	12.2%
<b>EU</b>	19.0%	10.2%
<b>NAFTA*</b>	12.5%	7.2%
<b>Other</b>	21.1%	14.4%

\* NAFTA refers the FTA signed between Canada, North America and Mexico to form a free trade region.

Source: *World Steels in Figures 2015*

#### Extract 1: Why the world has too much steel

The two giant furnaces at Port Talbot steelworks, Britain's biggest, were still hard at work this week, pouring out vast quantities of molten iron. But production of steel from iron ore here may soon come to an end. At the end of March, the plant's owner, Tata Steel, said that the operation was losing more than £1m (\$1.45m) a day due to the low price of steel on global markets, and that it planned to sell off or close down its British operations as it could no longer shoulder the losses; bidders were given until May 3rd to state whether they were interested in buying it. Britain's steel industry is not the only one in the West feeling the pinch from the collapse of global steel price. Both Belgium and Italy are spending public money to keep their steel mills open and the American industry there has been announcing a steady flow of job losses.

Between 2000 and 2014, global production doubled from around 800m tonnes to around 1.6 billion tonnes a year. Until 2014, Chinese demand rose at approximately the same rate as its steel mills could produce, meaning that the impact on the rest of the world was limited. But as its construction boom came to an end, demand sagged, prompting the country's state-owned steelmakers to sell their growing surpluses on foreign markets. Exports of steel from China increased from 45m tonnes in 2014 to 97m tonnes last year—marking a bigger rise than Germany's entire output of the past year: 43m tonnes. This has triggered demands from rival firms for protection.

Many economists argue that government subsidies are responsible for the overcapacity in the industry lasting so long. The flood of Chinese steel around the world should have caused high-cost producers elsewhere to extinguish their blast furnaces, eventually allowing supply and demand to reach a new equilibrium. But because steel is often seen as a strategic industry, providing lots of jobs in areas where there are few other employers, governments are usually keen on propping them up, either through subsidies or nationalisation.

Rising steel prices in America and Europe since January have raised hopes that plants such as Port Talbot may soon be able to break even without any government assistance. But many commodities and metals analysts predict this will simply encourage Chinese plants to increase

production again, causing more overcapacity and lowering prices again later this year. Last month the OECD, a club of rich countries, convened a bunch of ministers in Belgium to discuss measures to deal with the crisis. But until countries stop subsidising their plants, or imposing tariffs to artificially raise prices, progress towards ending the steel glut will be slow.

Source: The Economist, 4<sup>th</sup> May 2016

### **Extract 2: Tata's Effort to seek a way out of UK Steel Woes**

Tata Steel is in talks with its rival ThyssenKrupp about merging their European operations in a deal that appears to give a stay of execution to the stricken Port Talbot steelworks. The Indian conglomerate said on Friday evening that it was exploring a joint venture with its German competitor that would include a large part of its troubled UK arm.

The proposal offers a glimmer of hope to the 11,000 workers at the collection of British factories, which had experienced years of losses, but the announcement does not dispel the cloud of uncertainty that has been hanging over the business. Koushik Chatterjee, group executive director at Tata Steel, said the discussions could lead to the creation of a "premium, world-class strip steel business" and it is too early to give any assurances about the success of these talks. Any deal could lead to massive restructuring to streamline the production lines and management offices as part of an attempt to find further cost savings in the business.

Although the possible joint venture was "encouraging" and the government will continue to work closely with Tata to find a long-term solution for sustainable blast furnace steel manufacturing in Port Talbot. However, there are also calls for the UK government to nationalise the entire business temporarily.

Source: The Financial Times, 8<sup>th</sup> July 2016

Source: The Financial Times, 7<sup>th</sup> July 2016

### **Extract 3: China's increased effort to curb pollution**

Steel producers in top market China may face more shutdowns next year as the government steps up its fight against air pollution, although recent closures in the Hebei province have been restricted to the key producing region for now, sources said. Hebei produces about a quarter of China's crude steel output, which hit a record 716.5 million tonnes last year and is forecast to rise to 780 million this year. But output may suffer next year as China aggressively enforces more pollution control measures and focuses on industries like steel where there is an estimated overcapacity of around 200 million tonnes.

Last week's order to shut some facilities in Wu'an city in southern Hebei to curb power use had stoked steel output worries, pushing Shanghai rebar futures to 11-week highs. But prices have come off almost 2 percent since then on expectations the closures will last for only about 15 days.

"This temporary shutdown should not have any significant impact on steel output this month but we are afraid that Beijing might take more measures targeting steel mills next year to ease air pollution," said an official with a steel mill in Wu'an.

"The government can't just shut down everything as this will cause social instability and high unemployment rate, but they will do it step by step, and it's a gradual, long-term process."

China's large steel mills had only seen an average profit margin at 2.99 percent for the first three quarters of this year, far lower than the average 6-7 percent margin for the whole manufacturing industry, according to state-owned media Xinhua, citing the China Iron and Steel Association.

If China follows through in closing mills that fail to meet pollution control standards and regularly inspects the approved ones, it could mark a "turning point" in both the enforcement of environmental standards as well as management of overcapacity, Citigroup analyst Ivan Szpakowski said. So far closures have mostly been in Wu'an, which has an annual capacity of around 40-50 million tonnes, where mills have started shutting down rolling lines and brought forward annual maintenance on blast furnaces since last week.

Source: Reuter, 13 Dec 2013

### Questions

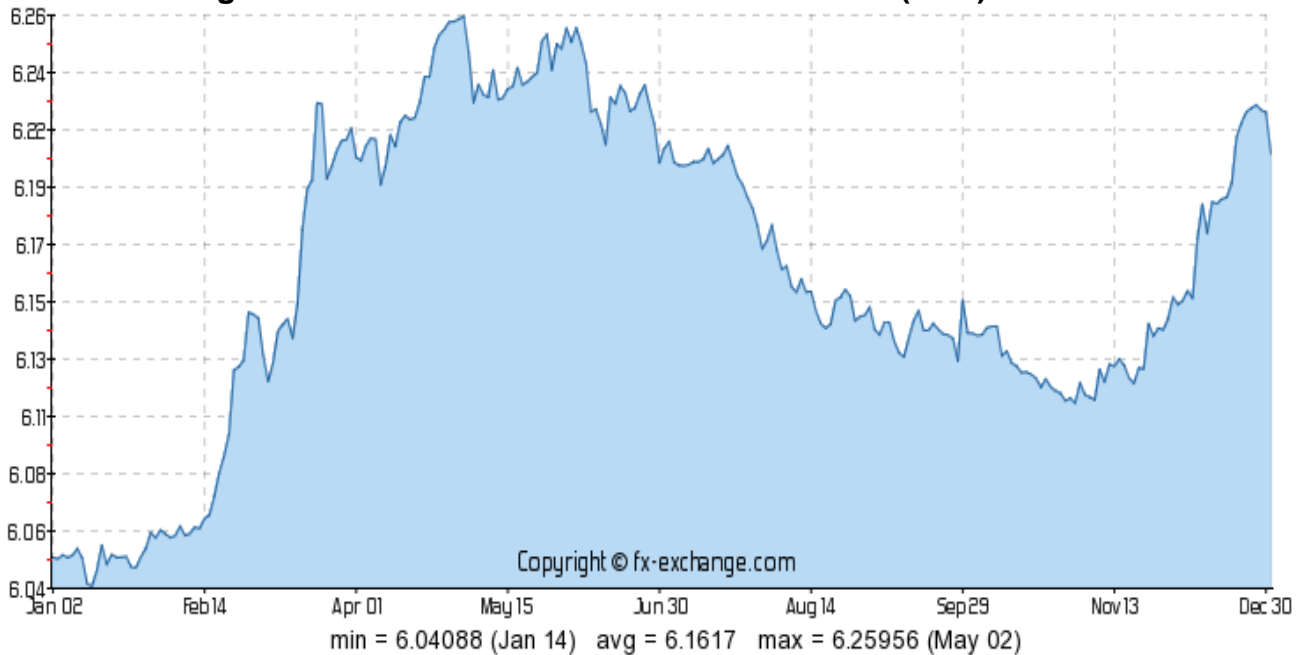
- a) Suggest one possible reason for the change in geographical distribution of crude steel production between 2004 and 2014. [2]
- b) Account for "the collapse of global steel prices". [6]
- c) Explain why that the rise in China steel export "triggered demands from rival firms for protection" as mentioned in extract 1. [2]
- d) (i) Explain how the merger between Tata and ThyssenKrupp brings about "further cost-saving" to the firms. [2]
- (ii) Assess whether nationalisation will be effective in aiding the UK steel firms in surviving the steel crisis. [8]
- e) Discuss the factors that will determine whether China should extend the mandatory "shut-down" beyond Wu' an, Hebei Province. [10]

**[Total: 30 marks]**

## Question 2

## Currency War

Figure 1: US Dollar to Chinese Renminbi Yuan (CNY) in 2014



Source: fx Currency Exchange

**Extract 4: Yuan depreciation poses risk to Chinese economy**

A weaker yuan was once one of the magic pills for China's economic boom. It was considered such an effective stimulus to Chinese exports. Some still argue that the Yuan, after years of appreciation, is still undervalued. The central bank, People's Bank of China (PBOC) initiated its campaign to tighten liquidity and raise interest rates last year, hot money flowed into China, which built up the market's one-way yuan appreciation sentiment. By sending the speculators a message that the yuan can depreciate, as well as the recent lowering of short-term interest rates, PBOC has tried to stem the inflow of hot money.

Adapted from *Globalrisk Insights*, 6 March 2014**Extract 5: US warns China after Yuan depreciation**

The US has warned Beijing not to go back to manipulating its currency, following a sharp depreciation of the Yuan since the start of 2014. The US comments highlight concern in Washington that China will be tempted to respond to a slowing economy by holding down its currency in order to boost exports. Such moves could lead China to reduce global demand at a time when several other regions of the world, such as the eurozone, are weak. That in turn could hamper US growth. The Obama administration thinks that moving away from exports, via a more fairly valued currency, is in China's own interests and has generally sought to avoid pushing too hard. "To secure its own long-term growth and contribute more to global growth, China needs to shift to a growth model that relies more on consumption and less on investment and exports," said the Treasury official.

Adapted from *Financial Times*, 8 April 2014

### **Extract 6: Chinese targets to boost foreign trade**

In response to a recent slump in foreign trade, China's State Council has announced a swath of new export tax measures, including plans to improve the country's export tax rebate system and simplify the application process for claiming rebates. In a similar move, export VAT refunds were recently extended to foreign trade comprehensive service providers—defined as foreign trade enterprises who provide export-related services for domestic SMEs in the manufacturing industry. Both measures show the Chinese government's concern with maintaining strong growth in foreign trade (especially as a means to maintain the employment rate).

Meanwhile, domestic companies received new incentives to import advanced technology and engage in outward investment for business development purposes. The announcement further called upon the Ministry of Commerce to speed up the implementation of China's free trade agreements and actively support domestic companies in anti-dumping and anti-subsidy trade suits.

Adapted from *China Briefing*, 21 May 2014

### **Extract 7: Why countries wage currency war**

The U.S. dollar has been on a tear this year, rising against the currencies of virtually all major developed economies. What we're seeing around the world is intense -- and in some cases, deliberate -- devaluations. One reason for the devaluations is that, when economic growth is weak -- as it has been globally for five years -- governments feel tremendous pressure to increase exports and reduce imports to restore growth.

The European Central Bank, for example, wants to depress the euro to keep deflation at bay. The euro's earlier strength drove down import prices, forcing domestic producers who compete with imports to slash their prices. As a result, consumer price inflation moved steadily toward zero. It was a mere 0.4 percent in October versus a year earlier. The euro-zone economy remains stagnant, with a third recession since 2007 a possibility. Unemployment is high. Youth unemployment tops 25 percent in many countries; it exceeds 50 percent in Spain and Greece. Meanwhile, consumer sentiment, which never recovered from the last recession, is again dropping.

On the other side of the globe, Japanese Prime Minister Shinzo Abe is curbing deflation and reviving the economy. The use of monetary easing and yen-cheapening is to spur exports, retard imports and reverse the growing foreign-trade deficit. Fiscal stimulus, is difficult to carry off in view of Japan's already high government deficit and debt. Still, the Abe government is discussing some less-disruptive structural reforms that could raise Japan's growth potential. A cut in the top corporate tax rate to below 30 percent from above 35 percent, in line with the 29 percent average among developed nations, is one possibility. Also under consideration are "special economic zones" that would give companies the freedom to cut the red tape that constrains everything from hiring and firing to land ownership and management.

Adapted from *The Bloomberg*, 23<sup>rd</sup> November 2014

### Extract 8: China is preparing for a currency war

The idea that central banks in China, Japan, the US and the eurozone have deliberately attempted to devalue their currencies to improve competitiveness has since taken hold. Many others, however, insist currency wars remain very much alive and thriving, to the detriment of investors and savers in emerging and developed markets. Investors are bracing for further surprising, unwanted monetary policy shifts in the belief that volatile markets since the start of the year are likely to encourage central bankers to employ protectionist tactics.

Some are sceptical about whether the ceasefire will last. David Riley, head of credit strategy at BlueBay Asset Management, the London-based hedge fund company, says: "Markets have decided that, by accident or design, there is a ceasefire in the global currency war. Currency wars leads to "protectionism and trade barriers which will be detrimental to global trade and economic activity", says Abi Oladimeji, head of investment at Thomas Miller Investment, the London-based wealth manager. "This in turn will undermine investor confidence and result in higher volatility. "So long as the global economy stays gloom, the temptation to adopt 'beggar-thy-neighbour' policies will persist."

Adapted from *The Financial Times*, 3<sup>rd</sup> April 2016

### Questions

- (a) (i) From Figure 1, describe the change in the external value of Chinese Yuan in 2014. [1]
- (ii) With the help of a diagram, explain a possible reason for the change in the external value of Chinese Yuan. [3]
- (b) Explain how People's Bank of China tried to stem the inflow of hot money. [2]
- (c) Using an elasticity of demand concept, explain how China reduces global demand as mentioned in extract 5. [3]
- (d) Using extract 6, discuss the effectiveness of measures adopted by China to improve export competitiveness. [8]
- (e) Explain why governments aim to curb deflation identified in extract 7. [3]
- (f) In view of the problems faced by different economies, assess whether, on balance, currency war can ever be justified. [10]

**[Total: 30 marks]**

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