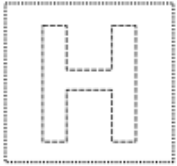


Name: _____

Centre No. / Index No.: _____ / _____

Class: _____



PIONEER JUNIOR COLLEGE, SINGAPORE
JC2 PRELIMINARY EXAMINATION 2016
Higher 2

ECONOMICS

9732/01

Paper 1

15 September 2016

2 hours 15 minutes

Additional Materials: Answer Paper

READ THESE INSTRUCTIONS FIRST

Write your Centre number, index number and name 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.

Answer **all** questions.

At the end of the examination, fasten all your work securely together.

Fasten your answers to each question **SEPARATELY**.

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



Pioneer Junior College

This document consists of **7** printed pages and **3** blank pages.



Ministry of Education

Answer **all** questions.

Question 1**Supermarket Shake Up****Extract 1: How Aldi's price plan shook up Tesco, Morrisons, Asda and Sainsbury's**

The message that Aldi is getting cheaper and bigger will be welcomed by British shoppers battered by years of austerity. But for Aldi's rivals, this is bad news. A steely focus on price and simplicity, against a backdrop of falling living standards that has sharpened customers' eye for a bargain, has seen Aldi grab market share from its rivals. With a 15% basket discount to the UK's major chains, Aldi is a serious player in the cut-throat world of British retail. Sales at Aldi's rose 36% last year to £5.3bn, and pre-tax profits soared 65% to £260.9m. The success is driving Aldi to plan a £600m expansion to add 120 stores over the next two years.

Tesco, Morrisons, Asda and Sainsbury's have been forced to cut prices in a bid to stop shoppers leaking away. Yet Aldi has only echoed those price drops to maintain its lead on price. Competing on price is difficult for the large supermarkets, which can stock more than 40,000 different products in their largest stores, but are up against the limited range of goods of budget stores like Aldi. By sourcing large amounts of only 2,500 products, Aldi is able to keep costs low and pass on the benefit to shoppers. In addition, more than 90% of its goods are own-label, thus packaging can be designed to fit the maximum amount onto shelves so no space is wasted. Efficiency, simplicity and cost savings help deliver prices that tempt a growing number of shoppers to buy grocery from Aldi.

Price may be an important factor in Aldi's recent success, but it is not the whole story. Aldi had widened their product range to include more fresh fruit, vegetables and meat and worked more closely with British suppliers. Sales of fresh meat has risen 60% a year in the last three years. And its Specially Selected range of premium foods, from brioche buns to specialty coffees, increased sales by 90% last year. Aldi increased its product range from about 900 to more than 2,500 regular lines to broaden its appeal. Shoppers' tastes have also swung their way, with more cynicism about the major grocer's promotions and discounts compared to Aldi's tactic of permanently low prices.

The economic downturn has helped Aldi and its fellow discounter, Lidl. With shoppers short of spare cash, they have been more willing to seek alternatives to save money. Aldi has attracted upper and middle-class shoppers in Britain with deals on treats like champagne and fine wines. Now that the economy is improving, Aldi wants to hold on to those big spenders. Aldi's growth has slowed down and it remains to be seen whether Aldi can hold shoppers' attention once they have more spare cash in their pockets.

Source: Adapted from www.theguardian.com, 29 September 2014

Extract 2: Online shopping changing the economics of supermarkets

Online shopping is changing the economics of supermarkets in a fundamental way that does not bode well for conventional stores. The costs of a store are relatively fixed, in the form of wages and rent, so additional sales will generate progressively bigger profits. On the flipside, when store sales fall, profits will fall faster than sales as many of the costs are set in stone. Yet, investing to sell online may undermine profits of stores by cannibalising sales. This revolution in food retailing may benefit shoppers by offering lower prices and more choices in what and how to purchase, but the large supermarkets still seem to be struggling.

Morrisons' profits have crumbled from £901m two years ago to about £350m this year due to the squeeze on customers' incomes, consumers migrating to cheaper rivals (like Aldi), and consumers shifting to online shopping. Now Morrisons is trying to develop an online sales presence. Tesco has also lost more than 1 million customer visits a week, worth £25m in sales revenue. Tesco's and Morrisons' falling sales and market share despite huge investment, contrasts with the rise of discount grocers Aldi and Lidl, whose sales revenue surged by 36% and 23% respectively.

Source: Adapted from www.bbc.com, 13 March 2014

Extract 3: Asda announces £1bn price-cutting plan

Asda has declared a new price war in the UK supermarket industry where they will effectively cut prices by £1bn over the next five years. Price remains a fierce battleground among the leading supermarkets, with Tesco and Sainsbury's battling over the validity of their price-matching schemes, which pledge to match the price of products at rival retailers or refund customers with a voucher. Asda pledged to be 10 percent cheaper on everyday food items.

In addition to reducing prices, Asda will spend £250m on improving the quality of its own-brand food and will revamp its supermarkets. Asda also intends to tap into the growth in online food sales by opening 1,000 click and collect points around the UK, meaning that customers may be able to collect their shopping from train stations and petrol stations.

Source: www.telegraph.co.uk, 14 Nov 2013

Extract 4: The Impact of the Supermarket Price War

The first food price deflation since 2006 will come as a relief to hard-pressed shoppers in the runup to Christmas. But it puts more pressure on retailers' profits. Falling prices of many agricultural commodities such as sugar and wheat had fed through to shops, while competition between supermarkets looks set to remain intense. In addition, the fall in oil prices was also having a knock-on effect on food prices due to its impact on the costs of producing food from the cost of feed to transport. The strong pound has also helped keep prices low as UK imports roughly a quarter of its food. Given the intensity of competition in the food sector, these savings have been passed on to consumers in the form of lower prices.

Food producers have become cannon fodder in the bitter supermarket price war with 28% more specialist manufacturers shutting down this year than last. The 146 food producers that shut down affect employment in industry and they include wholesale bakeries, pasta makers, fish processors and ready meal manufacturers. In one of the larger cases, 170 jobs were lost when fresh pasta maker Pasta Reale had to shut down in August after it lost three major supermarket contracts.

UK supermarkets are trying to compete on price with Aldi and Lidl but to maintain profit margins, the big supermarkets are putting food producers under so much pressure that we have seen a sharp rise in the number of food producers failing. The rise in bankruptcies among food suppliers is in stark contrast to the reduction in bankruptcies among all firms in the economy as a whole over the same period. The rising popularity of discounters such as Aldi and Lidl are forcing major supermarkets to find ways to reduce the cost of goods through greater efficiencies and that means relying on fewer larger food suppliers, pushing smaller and less efficient firms out of business.

In a bid to protect suppliers from bullying by supermarkets, the government last year appointed a grocery code adjudicator, Christine Tacon, with the power to fine the UK's biggest retailers millions of pounds if they are found to have abused their power. But the adjudicator's remit is limited to examining whether retailers have broken the terms of contracts. She cannot interfere in the original price negotiation that forms the basis of a contract and that leaves suppliers vulnerable.

Given the transformation in the UK grocery industry, analysts believe that major supermarkets have to close down one in five stores in order to reduce their cost base, compete on price with discounters Aldi and Lidl, and grow profits. Current trends suggest that sales in large supermarkets will fall 18 percent over the next six years and store closure is the only viable option. As supermarkets close their stores, one possibility is to redevelop the land into residential property.

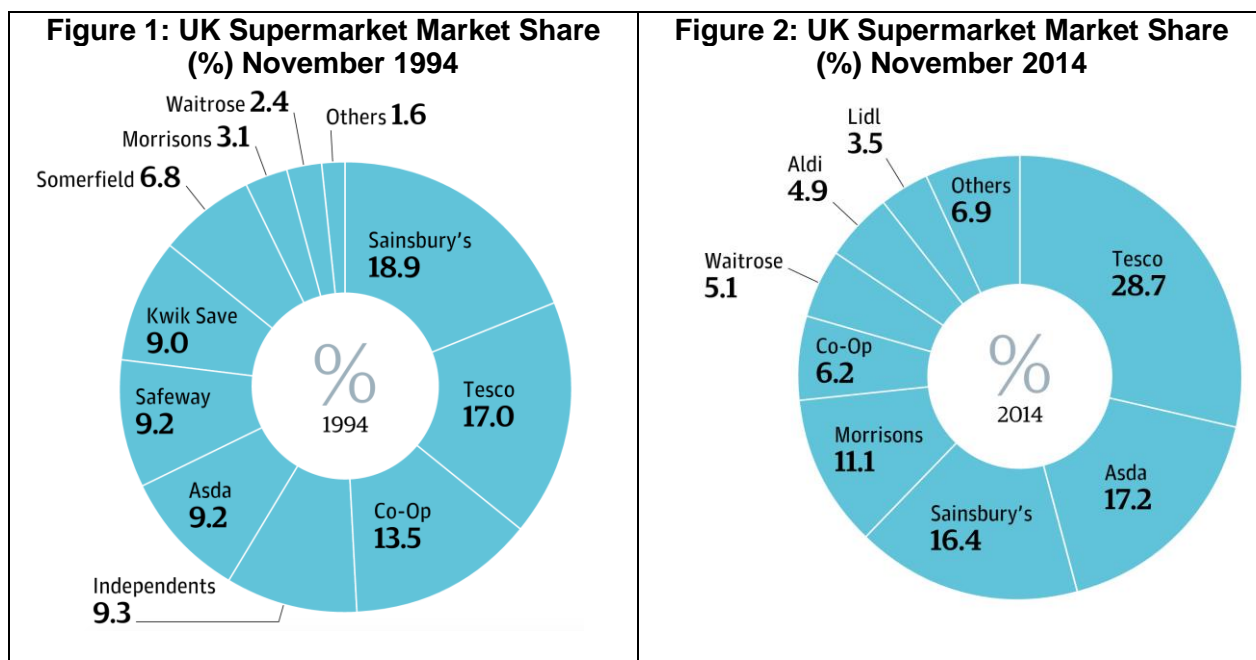
Source: Adapted from www.theguardian.com, 24 November 2014

Table 1: Selected Economic Indicators, UK

Indicator	2011	2012	2013	2014
Nominal GDP growth (annual %)	2.0	1.2	2.2	2.9
Inflation Rate (annual %)	2.1	1.6	2.0	1.8
Employment in services (% of total)	79.0	79.0	79.3	79.1
Employment in industry* & agriculture (% of total)	20.3	12.0	19.7	20.0
Unemployment Rate (% of total labor force)	8.0	7.9	7.5	6.1
Youth Unemployment Rate (% of total labor force ages 15-24)	21.3	21.2	20.7	16.9

*industry: includes food producers

Source: www.worldbank.org, accessed 30 August 2016



Source: Kantar Worldpanel, November 1994 and November 2014

Questions

- 1 (a) (i) Explain how real GDP growth can be calculated from the data in Table 1. [1]
- (ii) State how the level of real GDP has changed from 2011 to 2013. [1]
- (b) Account for the surge in Aldi's sales revenue using the concepts of price and income elasticity of demand. [4]
- (c) Comment on whether the pricing behavior of firms in the supermarket price war is in alignment to traditional economic theory. [6]
- (d) Discuss the factors that supermarkets should consider in deciding whether to develop their online sales presence. [8]
- (e) Discuss whether the UK government should be concerned about the supermarket price war. [10]

[Total: 30 Marks]

Extract 5: End of Quantitative Easing

The Federal Reserve announced the end of its Quantitative Easing (QE) Program on Wednesday, marking the close of a six-year effort to stimulate the economy. The decision reflects how much the economy has improved since the recession. The Federal Reserve has also given indications that with the end of QE, it will likely raise the interest rate in 2015.

The Fed's relatively optimistic language about inflation and the labor market was a "hawkish," or positive, move. Many economists and traders expect the Federal Reserve to begin raising rates in the summer of 2015.

Source: CNN Money, Patrick Gillespie, 29 October 2014

Extract 6: Wake up call for emerging economies

The OECD Friday said the end of US Quantitative Easing Program should be a "wake-up call" for emerging economies to accelerate reforms. Emerging economies have suffered sharp capital outflows and losses to their currencies as a by-product of Federal Reserve ending its mammoth Quantitative Easing program.

Yellen said in the Feb 12 testimony that the Fed was keeping a close eye on market volatility, but offered little sympathy for the plight of emerging economies. On Thursday, IMF chief Christine Lagarde cautioned the US to be "mindful" of the impact of ending its QE on emerging economies, although she also said that emerging economies should "mind the shop at home".

Source: The Straits Times, 21 February 2014

Extract 7: Hard times ahead of Brazil and Russia

Nearly 20 years on, two members of the "BRICs" (Brazil, Russia, India and China) responsible for propping up global growth in 2010, are now close to recession. The mixture Brazil and Russia face—falling currencies, high inflation and slow growth—could make 2015 a very bad year.

The largest emerging economies after China, together Brazil and Russia have the heft of Germany. In both countries the currency is sliding. The Brazilian Real hit new lows in November after data revealed the budget deficit reached a record in September. The Russian Rouble is dropping faster, down 27% in a year and 10% in the past month. Both face stagflation: bubbly prices coupled with growth rates likely to be below 1% this year.

Some of their pain comes from abroad. Brazil's main trading partners are slowing (China) and stagnant (the Euro area). Not only are export volumes down; the prices of things Brazil sells—iron ore, petroleum, sugar and soyabeans—are dropping as global demand falters. Russia is feeling the slowdown too, as energy prices fall. It is one of the world's biggest producers of oil and natural gas. Its big five energy firms employ close to 1m workers. Exports worth \$350 billion flowed through pipelines to Europe and Asia in 2013.

For Russia, her self-inflicted wounds are even more severe. Vladimir Putin's invasion of Ukraine led to American and European sanctions that have been gradually tightened since they were imposed in July. The rules ban American firms from selling kit or advice to Russia's energy giants. This prevents Western oil firms from helping Russian ones develop oil- and gasfields. Mr Putin's retaliation—import tariffs on Western goods—has pushed up domestic prices further.

There could be worse to come. The drop in commodity prices looks set to last. Meanwhile, in order to crimp inflation and stem the slide in their currencies the central banks in both countries raised their interest rates last month. At the same time, worried finance ministries are rushing to reduce burgeoning budget deficit. In Brazil, fuel-tax hikes are being put forward in discussion, and tax

breaks on car purchases may be scrapped. In Russia, a rule that caps the budget deficit at 1% of GDP may require tightening of the fiscal policy.

This frugality will hurt. Banks could prove vulnerable as public-sector spending cuts hit incomes and high interest rates make loans hard to service. In Russia things are particularly bad: non-performing loans are rising, and savers are draining the banks of Roubles.

Source: The Economist, 8 November 2014

Extract 8: Why Brazil needs to change

The troubled world economy and the end of the great commodity boom have hurt Brazil. But it has fared worse than its Latin American neighbours. President Rousseff's constant meddling in macroeconomic policies have resulted in falling investments and few efforts were made to tackle Brazil's structural problems: its poor infrastructure, high costs, high and burdensome tax systems, mountains of red tape and a rigid labour laws.

Moving forward, President Rousseff should strive to cut bureaucracy and implement sound macroeconomic policies such as simplifying the tax system, greater trade liberalisation to allow its domestic firms benefit from significant economies of scale with lower barriers to export. The Brazilian government should also work on boosting its productivity performance, curb rising wages to enhance its competitiveness and encourage private investment in infrastructure. It should also strive to trim government expenditure and hopefully to boost confidence by demonstrating a strong commitment to balance the government budget.

Source: The Economist, 14 October 2014

Table 2: GDP Growth Rates (Annual % change at constant prices in local currency)

	2010	2011	2012	2013	2014
Brazil	7.5	3.9	1.9	3.0	0.1
Russia Federation	4.5	4.3	3.5	1.3	0.7

Table 3: Inflation, consumer prices (annual %)

	2010	2011	2012	2013	2014
Brazil	5.0	6.6	5.4	6.2	6.3
Russia Federation	6.8	8.4	5.0	6.8	7.8

Table 4: Current Account Balance (in Billions US\$)

	2010	2011	2012	2013	2014
Brazil	-75.8	-77	-74.1	-74.8	-104.2
Russian Federation	67.5	97.3	71.3	33.4	58.3

Table 5: Exchange rates (National currency units/US dollar)

	2010	2011	2012	2013	2014
Brazil (Real)	1.76	1.67	1.95	2.16	2.35
Russia Federation (Rouble)	30.37	29.38	30.84	31.84	38.38

Source: World Bank and OECD

Questions

- 2 (a) (i) Compare the change in Brazil's current account balance with that of Russia Federation between 2010 and 2014. [2]
- (ii) Explain how the change in Brazil's current account balance might affect its growth rate as shown in Table 2. [2]
- (b) Explain how raising interest rates would 'crimp inflation'. [3]
- (c) (i) How does the value of the Russian Rouble in 2014 compare with its value in 2010? [1]
- (ii) With the help of a supply and demand diagram, explain how the end of Quantitative Easing in US would account for the change in the value of Russia Rouble. [4]
- (d) IMF chief Christine Lagarde cautioned the US to be "mindful" of the impact of ending its QE on emerging economies, although she also said that emerging economies should "mind the shop at home".
- To what extent is the end of QE accountable for the economic performance of Brazil and Russia? [8]
- (e) As an economic advisor to Brazil, what options would you recommend to the government as possible responses to achieve sustained economic growth? Justify your answer. [10]

[Total: 30 Marks]

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