VICTORIA JUNIOR COLLEGE

JC 2 PRELIMINARY EXAMINATION 2017

H2 ECONOMICS
9757/01

Paper 1 **September 2017**
2 hours 15 minutes

Additional Materials: Answer Paper

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 an HB pencil for any diagram or graphs.
Do not use staples, paper clips, highlighters, glue or correction fluid.
DO **NOT** WRITE IN ANY BAR CODES.

Answer **all** questions.

Start each question on a FRESH piece of paper.

At the end of the examination, fasten your work securely, by question, using the strings provided.

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

This document consists of **7** printed pages

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Answer **all** questions.

Question 1

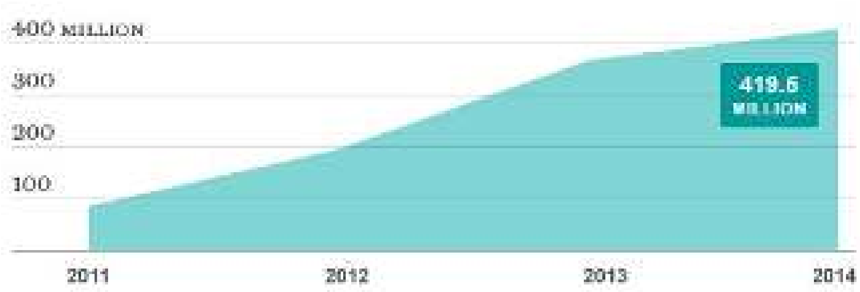
The Rise of the Mobile Economy

Extract 1: The value of mobile phones

Mobile technology has had a huge impact on the world economy and society. A report by the Boston Consulting Group has sought to quantify that impact. The research group examined mobile technology and its benefits in the U.S., Germany, South Korea, Brazil, China, and India. In developing economies such as China and India, the average consumer is willing to pay more than 40 percent of their income for mobile technology. In China and Korea, a majority of users would give up a subscription to home broadband Internet access rather than go without a mobile phone. The report says that the aggregate annual consumer surplus amounts to $6.4 trillion.

Source: venturebeat.com, 15 Jan 2015

Figure 1: China Smart Phone Market (annual number of units sold)



Source: Fortune, 1 March 2015

Extract 2: Growing domination of China's phone makers

Low-priced, high-tech mobile phones have become objects of desire for many of the 1.36 billion people in China, even though income per capita—after adjusting for purchasing power—is less than a fourth that of the U.S. In 2012, China passed the U.S. as the world's largest smartphone market.

Samsung and Apple, the global leaders in mobile phones, have made no secret of their desire to command the world's largest smartphone market. But as demand exploded in China, local companies sprang up to meet it. In 2011 just two of the top ten smartphone makers in China were Chinese: Huawei and Lenovo. Today six of the top ten smartphone brands worldwide are Chinese, even though many of them sell only in China—proof of the enormousness of that market relative to the rest of the world.

China's newcomers are now looking to expand beyond its borders. For years Chinese phone makers served in the shadows as manufacturers for Nokia and others. Everything changed after Google introduced Android in 2008. The inexpensive and customisable mobile operating system, an answer to Apple's status-quo–shattering iPhone, made it possible for any electronics company with some savvy to develop a worthy alternative. In no time, Chinese companies shifted from manufacturing phones for brands of other firms to building brands for themselves.

Take the case of Meizu. Four days after Apple introduced its iPhone in 2007, the founder of Meizu, Jack Wong, boasted that the firm would build an iPhone killer called the M8. The phone turned out to be too much like Apple's distinctive device, and Meizu, under pressure from Apple, pulled it from stores. Today Meizu is trying to expand within China to better position itself for entry into other Asian markets. Though the company builds some of the best-reviewed smartphones in China, it remains outside the country's top 10 brands. "The problem is, our phones are great, but no one knows about us," a Meizu marketing consultant said. Meizu's strategy now is to shift focus from profits to market share.

Source: Fortune, 1 March, 2015

Figure 2: Smartphone Global Market Share

Brand	Market Share (percent)
Samsung	28.0
Apple	16.4
Lenovo/Motorola *	7.9
LG	6.0
Huawei*	5.9
Xiaomi*	5.2
Coolpad*	4.2
Sony	3.9
ZTE*	3.1
TCL*	2.7
Others (including Meizu and OnePlus)	16.7

* Top Chinese Companies Source: Fortune, 1 March 2015

Extract 3: China's dramatic shift to a digital economy

Chinese consumers have adapted to the digital world with lightning speed. The penetration rate has reached nearly 50 per cent, with some 667 million internet users as of June 2015. These consumers are highly connected, mobile, digitally savvy and globally minded. The country is now the world's largest e-commerce market.

Private-sector companies have also embraced the digital age. Companies like Alibaba, Tencent, Baidu and travel websites Ctrip and Qunar have given rise to thriving social networks and transformed the way Chinese buy movie tickets and book hotels, exchange shopping tips and compare prices. They have also enabled Chinese shoppers to spend — be they in Beijing, Shanghai or rural Inner Mongolia.

Crucially, this eager embrace of the internet has injected more market forces, transparency and competition into the mainland Chinese economy. The real impact will

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come if these market forces take root across all parts of the economy — in particular, the massive state-owned sector that contributes nearly a third of China's GDP. Chinese authorities have seen the successes in the private sector and are now actively encouraging change in the state-owned sector. In March 2015, Premier Li Keqiang announced the "internet Plus" initiative. China spent 430bn yuan in 2015 to beef up the nationwide internet system.

Source: Business Spectator, 25 March 2016

Extract 4: Disruptive technologies bring massive economic boost to Asia

According to Dominic Barton, Global Managing Director of Mckinsey & Co, due to Mobile Internet, the Internet of Things (such as smart identity cards and Internet-connected TVs), cloud technology, 3D printing, renewable energy and advanced robotics, forty per cent of businesses will not be able to survive the next 10 years. This is because businesses are now cheaper to set up and run than ever before and easier to scale up than ever before, because of ecommerce, and there are lower barriers to entry, he said. "Very small industries now have access to markets which is correcting the economy and financial services are reaching remote areas meaning that more people can participate in the economy," he added. The digital revolution is also creating new markets for new products and services and improving productivity within organisations, he said.

Barton admitted whilst disruptive technologies would improve the quality of life for millions of ordinary people and deliver tremendous GDP growth for Asia, as well as create millions of jobs, they would at the same time disrupt the labour force and reduce jobs for migrant workers.

Source: Asia House, 30 Jan 2015

Questions

(a) **i)** What is the opportunity cost of buying a phone mobile phone to a Chinese consumer? [1]

ii) Explain how consumers are rational even when they spend 40 percent of their annual income on mobile technology. [2]

(b) **i)** Describe the trend in the number of smart phones sold in the China market. [1]

ii) Using demand and supply analysis and the data, account for this trend. [4]

(c) **i)** Explain how pricing strategy differs when a firm switches its aim from profit maximisation to market share expansion. [4]

ii) Discuss the factors that determine a Chinese phone maker's ability to dominate the global smart phone market. [8]

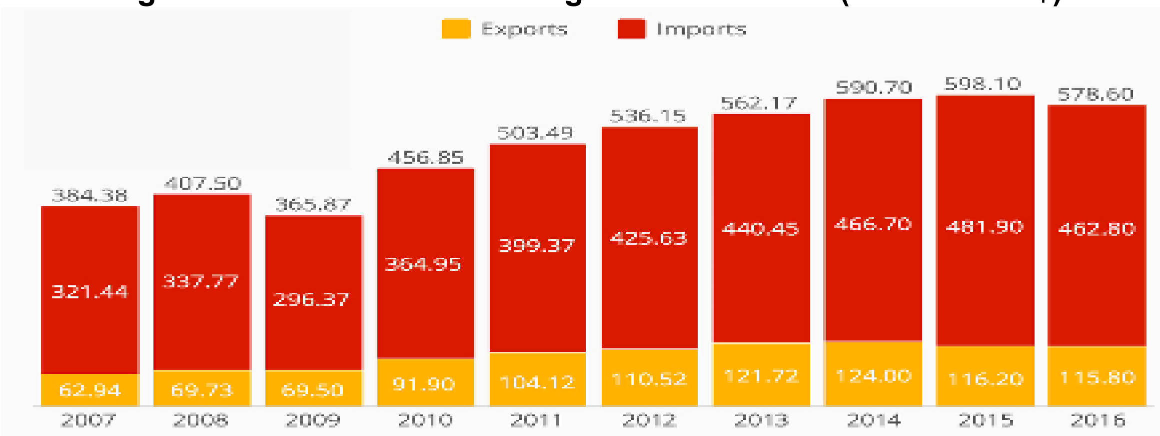
(d) Assess whether China's shift towards a digital economy will have a positive impact on the living standards of China's residents. [10]

Total: 30 m

Question 2

Impact of Exchange and Interest Rates Changes

Figure 3: Value of US trade in goods with China (in billion US$)



Source: US census Bureau

Extract 5: Reasons why China's currency crisis matters to us all

Last week's devaluation by China represented the largest yuan depreciation for 20 years; and the ripples may be felt thousands of miles away. China's devaluation may be seen as a distress signal from Beijing policymakers – in which case the world's second-largest economy may be weaker than the 7 percent a year growth that official figures suggests.

A less costly Christmas

China has been trying to shift from being a vast factory producing cut-price consumer goods for the rest of the world to higher value added industries. Yet glance at the label on almost any T-shirt or toy – let alone consumer gadget – and it's still likely to read "Made in China". In addition, China's apparently insatiable demand for natural resources has been a key factor supporting the price of oil in recent years. So fears that China's economy is in trouble tend to undermine oil prices – and that probably means cheaper petrol in Britain. In coming months, weak Chinese demand could also force down the cost of many commodities, from oil to iron ore.

Delayed interest rate rises

Central bankers in the US and the UK have been issuing warnings for months that, with growth strengthening, they are preparing to start pushing up interest rates – reversing the emergency cuts made in the global credit crunch. However, if the cheaper yuan cuts the price of imports for UK, this will undermine inflation and could delay an interest rate rise. In the short term, lower-than-expected borrowing costs will benefit indebted consumers in the west. But some analysts believe China's decision to devalue the yuan is the latest evidence of a lack of demand in the global economy, which will unleash deflation. Brief periods of falling prices – particularly if concentrated among one or two commodities – can be good news; but economists fret about periods of persistently falling prices, which can undermine spending and investment and feed through to wages, as consumers and businesses delay spending, expecting goods to be even cheaper in future.

www.theguardian.com 20 Aug 2015

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Extract 6: How cheaper yuan could reverberate

The impact of China's move to lower the value of its currency on consumers and producers will take longer to play out but possible winners and losers are already emerging. A weaker currency is generally beneficial for China's exporters because it makes their goods more affordable for overseas buyers, but that could be offset if a factory uses a lot of imported raw materials, which it has to pay for in dollars or other foreign currency. There are also other factors at play as well. The yuan has weakened about 3 percent against the U.S. dollar since Tuesday, not big enough of a move to overcome sluggish global demand and rising labour costs in China that are hampering the country's manufacturing industry, economists say. In addition, the long term impact may be muted because yuan weakness adds pressure on Asian countries, for many of which China is their biggest trading partner, to devalue their own currencies to stay competitive. However, there's little sign yet of a "currency war" in the making, though some Asian currencies have already responded by weakening on their own.

Stephen Antig, executive director of the Pilipino Banana Growers and Exporters Association, said the yuan's devaluation definitely will have some impact for Chinese consumers and banana growers in the Philippines. The Philippines exports around 60 to 70 million boxes of bananas a year to China, with an average price of US$5-US$10 per box. "With the devaluation of the yuan, they have to pay more for every dollar that they buy and chances are some importers will reduce their purchases of bananas," he said.

Thailand, Malaysia, Hong Kong and Taiwan could be among the most vulnerable countries because they are both highly reliant on China's demand for their exports and services while also compete with China in other export markets, Credit Suisse analysts said in a report. At the same time, these countries are also at risk because of their reliance on the rising number of Chinese tourists, who may now find it costlier to travel overseas.

www.dailymail.co.uk, 14 Aug 2015

Table 1: Economic growth projections for 2015 – 2016
% change in GDP

	2013	2014	2015*	2016*
World	3.1	3.3	3.7	3.9
United States	2.2	2.2	3.1	3.0
Euro area	-0.4	0.8	1.1	1.7
China	7.7	7.3	7.1	6.9
Japan	1.5	0.9	1.1	1.7

* estimates Source: www.oecd.org

Extract 7: Economic growth will disappoint again in 2016, warns IMF's Head

The world's stuttering economic recovery will continue to disappoint next year, the head of the International Monetary Fund (IMF), Christine Lagarde has warned. Ms Lagarde also highlighted the "spillover" effects from the first interest rate hike in the US in nine years, warning that it could lead to tighter credit conditions and higher debt servicing costs for emerging markets. Companies that have loaded up on dollar-denominated debt are at particular risk from the Federal Reserve's decisions. The IMF has urged both the European Central Bank and the Bank of Japan to continue their quantitative easing policies and maintain record low interest rates in an uncertain global environment. "Most highly developed economies except the US and possibly Britain will continue to need loose monetary policy but all countries in this category should comprehensively factor spillover effects into their decision making," she said.

Source: www.telegraph.co.uk, 29 Dec 2015

Extract 8: It's official - Britain is in deflation

The Bank of England forecast that Britain would dip into deflation in April, but Governor Mark Carney has consistently said that any period of negative inflation is likely to be temporary, and will not morph into the harmful deflation seen in countries such as Japan. "As the Governor of the Bank of England said only last week, we should not mistake this for damaging deflation. Instead we should welcome the positive effects that lower food and energy prices bring for households at a time when wages are rising strongly, unemployment is falling and the economy is growing.

Source: www.telegraph.co.uk, 19 May 2015

Questions

(a) Describe USA's trade balance with China between 2010 and 2015. [2]

(b) Explain whether the information provided in Figure 3 is sufficient to conclude that the US dollar strengthened against the yuan between 2015 and 2016. [4]

(c) Explain how price elasticity of demand for imports affects the success of a devaluation in improving a country's trade balance. [2]

(d) With the aid of a diagram, explain why economists worry about "periods of persistently falling prices" (Extract 5). [4]

(e) Discuss how different Chinese producers might be affected by the devaluation of the yuan. [8]

(f) "Most highly developed economies except the US and possibly Britain, will continue to need loose monetary policy" (Extract 7).

To what extent should central banks of different countries adopt similar changes to their interest rates? [10]

Total: 30 m

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