Practice Assessment — Task 7: Monetary Policy (Extended Answer)

This practice task mirrors **Task 7** in the course assessment outline: an extended-response question on monetary policy. Write a sustained, structured, evaluative response. Recommended time: 40 minutes (20 marks).

> This is an **evaluate**-style question — it needs both sides and a supported judgement, not just description. Trace the transmission mechanism, then weigh strengths against weaknesses before concluding.

Question (20 marks)

Explain how a change in the cash rate is transmitted to the level of economic activity, and evaluate the strengths and weaknesses of monetary policy as a tool for managing aggregate demand in Australia.

Your response

Plan (verb, paragraph points, diagram, judgement):

Response:

Marking guide (teacher)

Indicative band: 17–20 thorough explanation of the mechanism plus a balanced evaluation with a justified judgement; 13–16 sound but judgement thin; 9–12 mostly descriptive, mechanism only; 5–8 fragmentary; 0–4 minimal. A response with no judgement cannot reach the top band for an "evaluate" question.

- **Cash rate & objective:** the RBA targets the overnight cash rate to pursue its objectives (2–3% inflation, full employment, welfare).
- **Transmission mechanism:** a cut flows through lending rates (cheaper borrowing → C and I up), the exchange rate (depreciation → net exports up), asset prices/wealth (→ C up) and household cash flow (→ C up); together these raise aggregate demand.

- **AD/AS link:** the stance shifts AD; an easing shifts AD right (output up), a tightening shifts AD left (eases inflation).
- **Strengths:** set independently of the political cycle; implemented quickly and adjusted frequently; effective economy-wide.
- **Weaknesses:** long and variable lag (often a year+); a blunt, economy-wide instrument that can't target regions/sectors; loses traction near the zero lower bound (hence unconventional policy).
- **Judgement:** a supported overall assessment — e.g. effective and nimble for fine-tuning demand but limited in deep downturns where fiscal policy is needed. Reward a clear, evidence-based conclusion.
- **Diagram:** the transmission-mechanism flow or an AD/AS shift, referenced in the prose.