

1.5: External Environment: Exam Practice Question

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1.5 EXTERNAL ENVIRONMENT: EXAM PRACTICE QUESTION

Read the case study information below and answer the questions that follow.

CHINA TO TAKE ACTION AGAINST INFLATION – ECONOMIC FACTORS IN STEEPLE ANALYSIS

The Chinese government is becoming increasingly concerned about higher rates of inflation. Rising oil and petrol prices have increased costs to industries and firms are being forced to raise their prices to cover these higher costs. In addition, rising demand for food from a wealthier population, together with supply problems resulting from excess demand, have led to the price of pork rising by 63% and fresh vegetable prices by 46%.

The People's Bank of China has just increased interest rates a further 0.25%. This is the third such increase in less than a year. A spokeswoman from Goldman Sachs, the investment bank, reported that the increase shows that the central bank is now much more prepared to use interest rates to manage the economy and tighten monetary policy at the first signs of the booming economy overheating. China's GDP increased by 10.7% in 2007, and the prime minister has said that this rate of growth is becoming "unsustainable". China's leaders face conflicting pressures in balancing the top priority of maintaining high-speed economic growth to create millions of new jobs each year, with managing environmental problems and rising cost-push pressures causing higher inflation.

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25 MARKS, 45 MINUTES

1. If the Chinese government increased interest rates again, explain what impact this could have on:
 - i. Consumer spending on luxury goods
 - ii. Spending on new expansion projects by Chinese businesses
 - iii. The exchange rate of China's currency**[9 marks]**
2. Examine possible changes to the long-term objectives set by Chinese businesses if inflation is not bought under control. **[6 marks]**
3. China has experienced rapid economic growth in recent years. Discuss the likely effects of this on the strategies adopted by Chinese car manufacturers. **[10 marks]**