# Exercise walk-through

## Price stability ▪ 4.6

eXercise

# You must be able to

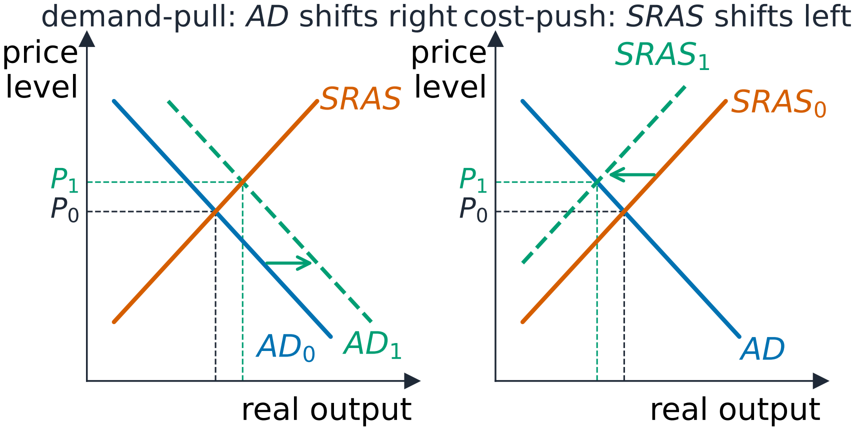
- define inflation, deflation and disinflation, and explain the CPI
- distinguish **demand-pull 需求拉动** from **cost-push 成本推动** inflation
- analyse the consequences of inflation and deflation

# Method — Causes of inflation

- **Inflation 通货膨胀**: a sustained rise in the general price level (money's **purchasing power 购买力** falls).
- **Deflation 通货紧缩**: prices fall; **disinflation 反通胀**: inflation is positive but slowing.
- **CPI 消费者价格指数**: tracks a weighted basket of goods.
- **Demand-pull:** AD rises faster than AS. **Cost-push:** rising costs shift SRAS left.

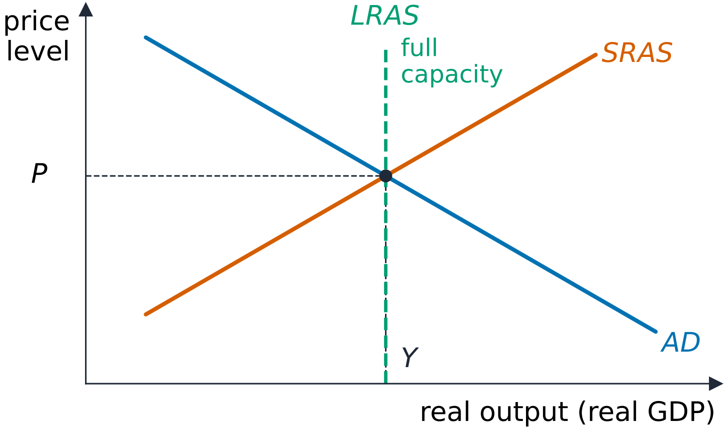
**Answer shapes:** an **Explain [up to 8]** answer may use an AD–AS diagram (AO3); **Discuss [12]** adds a judgement (AO4).

# Method — Causes of inflation




*Demand-pull comes from AD shifting right; cost-push from SRAS shifting left*

# Method — Causes of inflation




*Demand-pull raises the price level via AD; cost-push via a leftward SRAS shift*

# Practice 2.1 ▪ 2 marks

Define the term *inflation*.

# Solution 2.1

**Worked steps**

a sustained rise in the general price level, which lowers the purchasing power of money (2 for a clear definition; 1 for a partial idea).

## Practice 2.2 ▪ 2 marks

State the difference between *demand-pull* and *cost-push* inflation.

# Solution 2.2

Method: Causes of inflation

**Worked steps**

demand-pull inflation comes from aggregate demand rising faster than supply; cost-push inflation comes from rising costs shifting SRAS left (2 for a clear difference; 1 for a partial idea).

## Practice 2.3 ▪ 1 mark

State one group harmed by inflation.

# Solution 2.3

**Worked steps**

any one of: people on fixed incomes; savers; exporters (whose goods become dearer) (1).

# Exam-style 3.1 ▪ 1 mark

A rise in the general price level caused by higher production costs is:

**A** demand-pull inflation

**B** cost-push inflation

**C** disinflation

**D** deflation

# Solution 3.1

Method: Causes of inflation

**A** demand-pull inflation

**B** cost-push inflation ✓

**C** disinflation

**D** deflation

## Worked steps

**B**. Higher production costs cause cost-push inflation.

# Exam-style 3.2 ▪ 8 marks

Using an AD–AS diagram, explain how demand-pull inflation occurs.

# Solution 3.2

Method: Causes of inflation

**Worked steps**

*[8]* AO1 1 + **AO3 diagram up to 4** (AD shifts right along an upward-sloping SRAS, price level rises) + AO2/AO3 up to 3 — when AD rises faster than supply, “too much money chases too few goods” → firms raise prices → the price level rises; near full capacity the rise is mostly in prices.

# Exam-style 3.3 ▪ 12 marks

Discuss whether inflation is always harmful to an economy.

# Solution 3.3

Method: Causes of inflation

## Worked steps

*[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **Harmful:** inflation cuts purchasing power, hurts fixed-income groups and savers, creates uncertainty and makes exports dearer. **But:** low, stable inflation can signal healthy demand and helps borrowers, while deflation can be worse (delayed spending, falling output). Judgement: high or volatile inflation is harmful, but low, stable inflation is generally acceptable — it depends on the rate and whether it is anticipated.