Exercise walk-through

Inflation ▪ 4.7

eXercise

You must be able to

- define inflation and explain the CPI
- distinguish demand-pull from cost-push inflation
- analyse the effects of inflation and deflation

Method — Causes of inflation

- **Inflation 通货膨胀**: a sustained rise in the average price level. **Deflation 通货紧缩**: prices fall.
- **CPI 消费者价格指数**: tracks a weighted "basket" of goods a typical family buys.
- **Demand-pull 需求拉动**: demand grows faster than supply. **Cost-push 成本推动**: firms' costs rise.
- **Effects:** money loses **purchasing power 购买力**, savings worth less, exports dearer.

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

Method — Causes of inflation

Demand-pull

total demand grows
faster than supply →
"too much money
chasing too few goods"

Cost-push

firms' costs rise
(wages, materials) →
they raise prices
to cover them

Exam: demand-pull = AD excess; cost-push = rising costs (wages, oil, imported inputs)

Demand-pull versus cost-push inflation

Practice 2.1 ▪ 2 marks

Define the term *inflation*.

Solution 2.1

Worked steps

a sustained rise in the average level of prices over time (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 total demand growing faster than supply; cost-push inflation comes from rising costs (wages, materials) that firms pass on (2 for a clear difference; 1 for a partial idea).

Practice 2.3 ▪ 1 mark

State one effect of inflation on people who have savings.

Solution 2.3

Method: Causes of inflation

Worked steps

the real value of their savings falls (their money buys less) (1).

Exam-style 3.1 ▪ 1 mark

A rise in prices caused by higher wage and material costs is:

A demand-pull inflation

B cost-push inflation

C deflation

D disinflation

Solution 3.1

Method: Causes of inflation

A demand-pull inflation

B cost-push inflation ✓

C deflation

D disinflation

Worked steps

B. Higher wage and material costs cause cost-push inflation.

Exam-style 3.2 ▪ 4 marks

Explain how inflation is measured using the Consumer Prices Index (CPI).

Solution 3.2

Method: Causes of inflation

Worked steps

[4] K 1 + An up to 3 — a "basket" of goods a typical family buys is chosen $\rightarrow$ each good is given a weight for how much people spend on it $\rightarrow$ the cost of the whole basket is tracked from year to year $\rightarrow$ the percentage change in the basket's cost is the inflation rate.

Exam-style 3.3 ▪ 8 marks

Discuss whether inflation is always bad for an economy.

Solution 3.3

Method: Causes of inflation

Worked steps

[8] K/App/An up to 5 + Ev up to 3. **Bad:** inflation cuts purchasing power, reduces the value of savings, makes exports dearer, and creates uncertainty. **Not always:** low, steady inflation can show healthy demand and helps borrowers, while *deflation* can be worse (people delay buying, so demand and output fall). **Judgement (Ev):** high or rising inflation is harmful, but low, stable inflation is acceptable and better than deflation — so it depends on the rate.