AP MACROECONOMICS • EXERCISE SHEET

2.4 Price Indices and Inflation

Name: _____ Class: _____ Date: _____ **Total: 10 marks**

Objective

Build the skills to answer exam questions on **price indices and inflation**.

You must be able to:

- define **inflation** 通货膨胀, **deflation** 通货紧缩, and **disinflation** 通胀放缓
- explain how the **Consumer Price Index (CPI)** 消费者价格指数 is built from a fixed basket
- calculate the **inflation rate** as the percentage change in a price index
- compute a price index with index $= \dfrac{\text{cost now}}{\text{cost in base year}} \times 100$

1 Worked examples

Study these first. Each one shows the method for a question type used later.

The CPI

Track the cost of a **fixed basket** of goods: CPI $= \dfrac{\text{cost of basket now}}{\text{cost in base year}} \times 100$. The base year has CPI $= 100$.

The inflation rate

The **percentage change** in the index between two periods:

$$\text{inflation rate} = \frac{\text{new index} - \text{old index}}{\text{old index}} \times 100.$$

The three terms

Inflation = rising prices; **deflation** = falling prices; **disinflation** = inflation that is still positive but **slowing**.

2 Practice

2.1 Define inflation. [1]

2.2 A basket costs \$250 now and \$200 in the base year. Find the CPI. [2]

2.3 The CPI rises from 120 to 126. Find the inflation rate. [2]

3 Exam-style questions

3.1 The CPI is based on [1]

- **A** every good in the economy
- **B** a fixed basket of goods
- **C** food only
- **D** exports

3.2 Disinflation means that [1]

- **A** prices are falling
- **B** inflation is slowing but still positive
- **C** prices are rising very fast
- **D** there is no inflation at all

3.3 A basket cost \$400 in 2020 (the base year) and \$460 in 2024.

(a) Find the 2024 CPI. [2]

(b) State the total percentage rise in prices. [1]

4 Go further

- work through the **2.4 Price Indices and Inflation** lesson on the **Learn** page;

- read the **Economic Indicators and the Business Cycle** section of the AP Macroeconomics handout on the **Know** page.

Solutions

2.1 a sustained rise in the general price level.

2.2 $\text{CPI} = \dfrac{250}{200} \times 100 = 125$.

2.3 $\dfrac{126 - 120}{120} \times 100 = 5\%$.

3.1 **B**.

3.2 **B**.

3.3 (a) $\text{CPI} = \dfrac{460}{400} \times 100 = 115$. (b) 15%.