AP MACROECONOMICS • EXERCISE SHEET

2.5 Costs of Inflation

Name: ____________ Class: ________ Date: __________ **Total: 9 marks**

KEY WORDS anticipated 预期 • unanticipated 未预期 • shoe-leather costs 皮鞋成本 • menu costs 菜单成本 • inflation 通货膨胀

Objective

Build the skills to answer exam questions on **the costs of inflation**.

You must be able to:

- distinguish **anticipated** 预期 from **unanticipated** 未预期 inflation
- explain how unanticipated inflation redistributes purchasing power between **borrowers** and **lenders**
- describe **menu costs** 菜单成本 and **shoe-leather costs** 皮鞋成本
- explain how inflation erodes savings and fixed nominal incomes

1 Worked examples

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

Anticipated vs unanticipated

If inflation is fully **anticipated**, contracts adjust and little harm is done. **Unanticipated** inflation redistributes wealth by surprise.

Borrowers vs lenders

Surprise inflation lets **borrowers** repay in cheaper money — they **gain**; **lenders** and savers **lose**.

Menu and shoe-leather costs

Menu costs = the effort of re-pricing goods. **Shoe-leather costs** = the bother of holding less cash and visiting the bank more often. Inflation also erodes the real value of savings and fixed incomes.

2 Practice

2.1 State who gains from unanticipated inflation: borrowers or lenders. [1]

2.2 Define menu costs. [1]

2.3 Explain how inflation hurts people living on a fixed income. [2]

3 Exam-style questions

3.1 Unanticipated inflation benefits [1]

A lenders
B borrowers
C savers
D everyone equally

3.2 Shoe-leather costs arise because people [1]

A re-print price tags
B hold less cash and visit the bank more
C save more
D borrow less

3.3 Inflation turns out much higher than expected.

(a) State whether a borrower with a fixed-rate loan gains or loses. [1]

(b) Explain why. [2]