

Exercise walk-through

4.7

Inflation

IGCSE Economics

Inflation

Inflation is a general rise in prices, from:

- **demand-pull** – too much spending
- **cost-push** – rising costs

Demand-pull

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

Cost-push

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

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

Around the business cycle

Boom

High output and strong demand; inflationary pressure may increase if capacity is stretched.

Slump

A deep **slump** : output low, unemployment high, and investment may be postponed.

Recovery

Recovery : output starts rising again; confidence and employment may improve at different times.

How it is measured

By **gross domestic product**
sumer prices index

, in real terms for output; the **con-**
separately tracks the price level.

Policy may counter demand fluctuations; the choice depends on causes, spare capacity and conflicting aims. **Redistribution of income** runs through both.

Check yourself

- 1 What does fiscal policy change?
- 2 Which policy uses interest rates?
- 3 Which tax takes a bigger % from the rich?
- 4 Name one cause of inflation.



Answers 1. government spending & taxation 2. monetary policy 3. a progressive tax 4. demand-pull or cost-push

Exercises 2.1-2.3

2.1 Define the term *inflation*.

[2]

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

[2]

2.3 State one effect of inflation on people who have savings.

[1]

Exercises 2.1-2.3

2.1 Define the term *inflation*.

[2]

2.1

- **inflation** is a **sustained rise** in the average level of prices over time (K)

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

[2]

2.2

- **demand-pull** inflation comes from total demand growing faster than supply (K)
- **cost-push** inflation comes from rising costs that firms pass on (K)

2.3 State one effect of inflation on people who have savings.

[1]

2.3

- the **real value** of savings **falls** (their money buys less) (K)

Exercises 3.1·3.2

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

[1]

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A demand-pull inflation

B cost-push inflation

C deflation

D disinflation

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

[4]

Exercises 3.1-3.2

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

[1]

☐

A demand-pull inflation

B cost-push inflation

C deflation

D disinflation

3.1 B

- higher wage and material costs cause **cost-push inflation** (K)
- A is excess demand; C is falling prices; D is a falling inflation *rate*

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

[4]

3.2

- a **basket** of goods a typical family buys is chosen (K)
- each good is given a **weight** for how much people spend on it (An)
- the percentage change in the basket's cost is the **inflation rate** (An)

Exercise 3.3

3.3 Discuss whether inflation is always bad for an economy.

[8]

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3.3

- **bad**: inflation cuts purchasing power, reduces the value of savings, makes exports dearer, and creates uncertainty (K + An)
- **not always**: low, steady inflation can show healthy demand; **deflation** can be worse (people delay buying) (An)
- **judgement (Ev)**: high inflation is harmful, but **low, stable** inflation is acceptable and better than deflation