Solutions

2.1

- Base: $12(1.50) + 600 + 30(4) = 18 + 600 + 120 = £738$.
- Now: $12(1.65) + 672 + 30(4.20) = 19.8 + 672 + 126 = £817.8$.
- CPI $= 817.8/738 \times 100 = 110.8$; inflation $= \mathbf{10.8}\%$.

2.2

- Rates: loaves +10%, rent +12%, bus +5%.
- Weights: $18/738 = 2.44\%$, $600/738 = 81.3\%$, $120/738 = 16.3\%$.
- Points: $0.24 + 9.76 + 0.81$.
- $= 10.8$ ✓ – rent is nine-tenths of the headline.

2.3

- Fisher: $1.08/1.05 - 1 = \mathbf{2.86}\%$.
- Naive: $8 - 5 = 3.0\%$ – overstated by 0.14 points.

2.4

- $u = 6$: $\pi = 3 - 0.7(2) = \mathbf{1.6}\%$.
- $u = 4$: $\pi = \mathbf{3.0}\%$ – inflation at expectations.
- $u = 4$ is the **natural rate**.

2.5

- The labour force shrank faster than employment: discouraged workers left, and the rate falls mechanically when they do.
- Check employment or participation directly before calling it an improvement.

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