

CHAPTER 31 INFLATION AND DEFLATION

A decorative graphic consisting of a grid of circles. The top two rows each contain five yellow circles. The third row contains three yellow circles. The bottom-most circle in the grid is blue.

Macroeconomics - year11

Agenda

Drive growth of monthly sales volume of purchases

- Multiple choice
- Essay

Be the most desirable brand



RECAP

1. **Inflation:** a general and sustained rise in price of goods and services over a period of time.
2. **Deflation:** a general and sustained fall in price of goods and services over a period of time.
3. **Disinflation:** a fall in the rate of inflation.
4. **Consumer Price Index (CPI):** A measure of inflation that tracks the changes in the prices of a basket of goods and services commonly purchased by households.
5. **Causes of Inflation:**
 - Increased aggregate demand
 - Cost-push pressures from rising production costs
 - Money supply growth.
6. **Causes of Deflation:** decreased aggregate demand and supply-side factors like increased productivity

RECAP

7. **Effects of Inflation:** include reduced purchasing power, uncertainty in investment, and potential impacts on international trade competitiveness.
8. **Effects of Deflation:** include increased real debt burdens, reduced consumer spending, potential delays in consumption, and increased risk of economic recession.
9. **Policies to Reduce Inflation:**
 - **Contractionary fiscal and monetary policies** aimed at reducing aggregate demand
 - **Supply-side policies** to increase productivity and lower production costs, and price controls.
10. **Policies to Reduce Deflation:**
 - **Expansionary fiscal and monetary policies** to boost aggregate demand
 - **Supply-side policies** to stimulate investment and consumer spending.

Part1-Multiple choice

1. What is the most commonly used measure of inflation?

A) Gross Domestic Product (GDP)

B) Consumer Price Index (CPI)

C) Money Supply Growth

D) Balance of Trade

Part1-Multiple choice

1. What is the most commonly used measure of inflation?

A) Gross Domestic Product (GDP)

B) Consumer Price Index (CPI)

C) Money Supply Growth

D) Balance of Trade

Answer: B) Consumer Price Index (CPI)

(CPI measures the average change in prices of goods and services over time.)

Part1-Multiple choice

2. Which of the following statements is true regarding inflation and interest rates?

- A) If inflation rises, real interest rates always increase
- B) If nominal interest rates are lower than inflation, real interest rates are negative
- C) A central bank lowering interest rates always reduces inflation
- D) Inflation has no impact on the effectiveness of interest rates

Part1-Multiple choice

2. Which of the following statements is true regarding inflation and interest rates?

A) If inflation rises, real interest rates always increase

B) If nominal interest rates are lower than inflation, real interest rates are negative

C) A central bank lowering interest rates always reduces inflation

D) Inflation has no impact on the effectiveness of interest rates

✓ Answer: B) If nominal interest rates are lower than inflation, real interest rates are negative

(Real interest rate = Nominal rate - Inflation rate.)

Part1-Multiple choice

3. Which monetary policy tool is most effective in controlling demand-pull inflation?

- A) Increasing the money supply
- B) Lowering interest rates
- C) Raising interest rates
- D) Increasing government subsidies

Part1-Multiple choice

3. Which monetary policy tool is most effective in controlling demand-pull inflation?

- A) Increasing the money supply
- B) Lowering interest rates
- C) Raising interest rates
- D) Increasing government subsidies

Answer: C) Raising interest rates

(Higher interest rates discourage borrowing and spending, reducing inflationary pressures.)

Part1-Multiple choice

4. If an economy is experiencing cost-push inflation, what policy is likely to be most effective in controlling it?

- A) Increasing indirect taxes
- B) Cutting corporate taxes to reduce production costs
- C) Raising minimum wages
- D) Expanding government spending

Part1-Multiple choice

4. If an economy is experiencing cost-push inflation, what policy is likely to be most effective in controlling it?

- A) Increasing indirect taxes
- B) Cutting corporate taxes to reduce production costs
- C) Raising minimum wages
- D) Expanding government spending

Answer: B) Cutting corporate taxes to reduce production costs

(Reducing business costs can help control inflation caused by higher production expenses.)

Part1-Multiple choice

5. Which of the following would likely cause deflation in an economy?

A) Increase in money supply

B) Reduction in consumer and business confidence

C) Increase in government spending

D) High levels of borrowing

Part1-Multiple choice

5. Which of the following would likely cause deflation in an economy?

- A) Increase in money supply
- B) Reduction in consumer and business confidence
- C) Increase in government spending
- D) High levels of borrowing

Answer: B) Reduction in consumer and business confidence

(Low confidence reduces demand, leading to falling prices.)

Part1-Multiple choice

6. If a country's inflation rate is 8% and its interest rate is 6%, what is the real interest rate?

- A) -2%
- B) 2%
- C) 6%
- D) 14%

Part1-Multiple choice

6. If a country's inflation rate is 8% and its interest rate is 6%, what is the real interest rate?

- A) -2%
- B) 2%
- C) 6%
- D) 14%

Answer: A) -2%

(Real interest rate = Nominal interest rate - Inflation rate = 6% - 8% = -2%.)

Part2-Essay

1 (a) What is meant by 'deflation'? [2]

2 (b) Describe two positive effects of deflation.[4]

3 (b) Distinguish between demand-pull inflation and cost-push inflation. [4]

4 (c) Analyse how how a central bank could reduce inflation. [6]

**5 Evaluate whether raising taxes is an effective strategy to combat inflation.
[8]**

Part2-Essay

Macro aims

- 1 High growth
- 2 low unemployment
- 3 low inflation
- 4 Balance of payment stability
5. Reduce poverty and income equality
6. Reducing pollution and resource waste

Parties in economy

- 1 consumer/workers // producer,MNC
- 2 gov //tax payer
- 3 exporter // importer
- 4 saver // borrower (for inflation topic)

2 (b) Describe two positive effects of deflation.[4]

Part2-Essay

3 (b) Distinguish between demand-pull inflation and cost-push inflation. [4]

Part2-Essay

5 Evaluate whether raising taxes is an effective strategy to combat inflation.

[8]

Part2-Essay

5 Evaluate whether raising taxes is an effective strategy to combat inflation.

[8]

The End

