

Name: _____ Date: _____ Period: _____

Complete the questions below using the information from this Web site:
http://www.socialstudieshelp.com/Eco_Inflation.htm

1. What is inflation?

Inflation is a rise in the general price level and is reported in rates of change.

2. To measure the price level, economists select a variety of goods and construct a price index such as the Consumer Price Index (CPI).

3. Describe two reasons for the causes of inflation.

- 1. One explanation is the demand-pull theory, which states that all sectors in the economy try to buy more than the economy can produce. Shortages are then created and merchants lose business. To compensate, some merchants raise their prices. Others don't offer discounts or sales. In the end, the price level rises.*
- 2. A second explanation involves the deficit of the federal government. If the Federal Reserve System expands the money supply to keep the interest rate down, the federal deficit can contribute to inflation. If the debt is not monetized, some borrowers will be crowded out if interest rates rise. This results in the federal deficit having more of an impact on output and employment than on the price level.*
- 3. A third reason involves the cost-push theory which states that labor groups cause inflation. If a strong union wins a large wage contract, it forces producers to raise their prices in order to compensate for the increase in salaries they have to pay. The fourth explanation is the wage-price spiral, which states that no single group is to blame for inflation. Higher prices force workers to ask for higher wages. If they get their way, then producers try to recover with higher prices. Basically, if either side tries to increase its position with a larger price hike, the rate of inflation continues to rise.*
- 4. Finally, another reason for inflation is excessive monetary growth. When any extra money is created, it will increase some group's buying power. When this money is spent, it will cause a demand-pull effect that drives up prices. For inflation to continue, the money supply must grow faster than the real GDP.*

4. What types of people are most negatively affected by inflation and the depreciation of the dollar?

People with fixed incomes. Retired people often live off of a fixed income so they are negatively affected by inflation.

5. Lenders are generally hurt more than Borrowers during long inflationary periods, which mean that loans made earlier are repaid later in inflated dollars.