

Name: _____ Date: _____ Period: _____

Part #1:

Answer the following questions using this Web site:

http://www.bls.gov/cpi/cpifaq.htm#Question_7

1. List five goods and services that consumer price index (CPI) covers.

1. Food and Beverages

2. Housing

3. Apparel

4. Transportation, Education and Communication

5. Medical Care, Recreation, Other Goods and Services

2. List two things that are not included in the consumer price index (CPI).

1. Stocks and Bonds

2. Real Estate, Life Insurance

Part #2:

Answer the following question using this Web site.

<http://www.bized.ac.uk/virtual/bank/economics/mpol/inflation/causes/theories1.htm>

3. In your own words explain the quantity theory of money.

The classical economists view of inflation revolved around this theory, and this theory was in turn derived from the Fisher Equation of Exchange. This equation says that:

$$MV = PT$$

Where:

M is the amount of money in circulation

V is the velocity of circulation of that money

P is the average price level

T is the number of transactions taking place

The equation is in fact an identity/truism. It says that the amount of the money stock times the rate at which it is used for transactions will be equal to the number of those transactions times the price of each transaction. It will always be true, as it simply says that National Income will be equal to National Expenditure and basic macroeconomics tells us that this is true anyways. So nothing stunning there! However, what makes it important is what classical economists predicted from it.

Classical economists suggested that V would be relatively stable and T would always tend to fill employment. Therefore they came to the conclusion that:



In other words increases in the money supply would lead to inflation. The message was simple; control the money supply to control inflation.

Part #3:

Answer the following question using this Web site.

<http://www.bized.ac.uk/virtual/bank/economics/mpol/inflation/causes/theories2.htm>

4. In your own words explain the cost-push theory of inflation.

*Cost-push inflation happens when costs increase **independently** of aggregate demand. It is important to look at why costs have increased, as quite often costs are increasing simply due to the economy booming. When costs increase for this reason it is generally just a symptom of demand-pull inflation and **not** cost-push inflation. For example, if wages are increasing because of a rapid expansion in demand, then they are simply reacting to market pressures. This is demand-pull inflation causing cost increases.*

Part #3:

Answer the following question using this Web site.

<http://www.bized.ac.uk/virtual/bank/economics/mpol/inflation/causes/theories3.htm>

5. In your own words explain the demand-pull theory of inflation.

Demand-pull inflation happens where there is 'too much money chasing too few goods.' Excessive growth in demand literally pulls prices up.

With the information you have gained, give a real life example for two of the three types of inflation.

Answers will vary, but should include examples from real lives such as; if a work force gets an increase in pay the company will increase the cost of their goods. This is cost push inflation.

If a government is printing too much money and everyone has as much as they want then that is demand-pull inflation.

When the Fed makes changes in the money supply through monetary policy it can increase or decrease the rate of inflation.

