2.4 Causes and Consequences of Inflation and Deflation: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for all explain and evaluate questions. Time guidance: 10 minutes.

1 Explain briefly two ways in which sustained deflation can raise the real burden of debt for households and firms in the UK.

(Total for Question 1 is 4 marks)

2 Define the term 'disinflation' in the context of UK consumer prices.

(Total for Question 2 is 2 marks)

3 State two groups that tend to gain from unexpected inflation, and give a one-sentence reason for each (UK context).

(Total for Question 3 is 2 marks)

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Mark scheme · 2.4 Causes and Consequences of Inflation and Deflation: 10-minute Pack

Question 1

deflation raises the real value of nominal debts because the money used to repay obligations gains purchasing power **M1**

example: fixed mortgage payments stay the same in nominal terms while incomes and prices fall, so payments become harder to meet in real terms **A1**

second mechanism: deflation can reduce incomes and profits, lowering borrowers' cash flows and increasing default risk **M1**

link: falling revenues for firms make servicing existing nominal debt more difficult, amplifying solvency problems during deflation **A1**

Answer: Deflation increases the real value of nominal debts, making fixed repayments heavier in real terms; and it reduces incomes and profits, cutting borrowers' ability to service debt and raising default risk.

Question 2

a fall in the rate of inflation, i.e. prices are still rising but at a slower rate than before **B1**

not to be confused with deflation, which is a fall in the general price level **B1**

Answer: A fall in the rate of inflation: prices continue to rise but at a slower rate than previously; not the same as deflation.

Question 3

one valid group with a reason, e.g. borrowers on fixed nominal rates (the real value of their debt falls); firms with pricing power (raise prices faster than costs); owners of property or other real assets whose value rises with prices; the government as a large debtor (real debt falls, fiscal drag raises tax revenue), oe **B1**

a second, different valid group with a reason, oe **B1**

Answer: Any two distinct groups, each with a reason: borrowers with fixed nominal debts gain because their real debt burden falls; firms with pricing power may raise prices faster than costs; owners of real assets may be protected if asset values rise with prices; government as a debtor may see its real debt fall. Other valid, justified groups are accepted.

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