2.4 Causes and Consequences of Inflation and Deflation: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 20 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for all explain and evaluate questions. Time guidance: 20 minutes.

1 Multiple choice: In the context of inflation causes in a UK-style open economy, which of the following best describes demand-pull inflation?

- ☐ A. A sustained rise in the general price level caused by a persistent fall in aggregate demand
- ☐ B. A rise in prices resulting from increases in firms' costs of production, such as wages or raw materials
- ☐ C. A rise in the general price level because aggregate demand increases faster than aggregate supply
- ☐ D. A temporary increase in prices caused solely by one-off supply shocks such as poor harvests

(Total for Question 1 is 1 mark)

2 Explain one likely effect of moderate inflation on a country's international competitiveness and one reason why very high inflation can worsen competitiveness further.

(Total for Question 2 is 3 marks)

3 Define 'deflation' and give one likely short-run economic cost for households in a UK-style economy.

(Total for Question 3 is 2 marks)

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4 Real wage calculation. A UK worker's nominal annual pay rises from £21,000 to £21,000 (no change in nominal pay) while the annual inflation rate is 5.0%. Calculate the worker's real wage in GBP in current-year purchasing-power terms (i.e. adjust the nominal pay for inflation), rounded to the nearest whole pound. Show working.

(Total for Question 4 is 4 marks)

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

(Total for Question 5 is 2 marks)

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Mark scheme · 2.4 Causes and Consequences of Inflation and Deflation: Test Pack

Question 1

selects C, demand outstripping supply at existing prices causes demand-pull inflation — **B1**

Answer: C

Question 2

moderate inflation can erode price competitiveness if domestic prices rise faster than trading partners', reducing net exports — **M1**

give brief mechanism: higher domestic prices make exports relatively more expensive, lowering demand for them abroad — **A1**

very high inflation adds uncertainty, raises wage-price spirals and can cause a currency depreciation that initially raises import costs and may not restore competitiveness if inflation remains unchecked — **A1**

Answer: Moderate inflation can reduce competitiveness because domestic prices rise relative to trading partners, lowering export demand; very high inflation increases uncertainty and wage-price spirals and can damage competitiveness even if the currency falls, because costs remain elevated and firms lose foreign market share.

Question 3

deflation is a fall in the general price level, i.e. negative inflation — **B1**

one short-run cost: households may postpone spending expecting lower prices, reducing demand and possibly causing rising unemployment — **B1**

Answer: Deflation is a fall in the general price level. A cost is that households delay purchases expecting lower prices, reducing demand and harming incomes and jobs.

Question 4

method: real wage = nominal pay / (1 + inflation rate) or nominal / 1.05 — **M1**

accurate calculation: 21000 / 1.05 = 20000 — **A1**

statement of units: £20,000 — **A1**

working check: shows division or equivalent arithmetic — **B1**

Answer: £20,000 (21000 / 1.05 = 20000).

Question 5

one valid group with a reason, e.g. savers on fixed nominal interest rates (inflation erodes the real return); workers whose nominal pay lags prices (real wages fall); pensioners or others on fixed incomes; lenders at fixed interest rates (repaid in money worth less); firms locked into fixed-price contracts, oe — **B1**

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

Answer: Any two distinct groups, each with a reason: savers or lenders on fixed nominal rates lose real returns; workers or pensioners on fixed nominal incomes lose purchasing power; firms tied to fixed selling prices may face higher costs and lower margins. Other valid, justified groups are accepted.

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