Your notes

GCSE Economics: revision notes

Inflation

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What inflation is

- **Inflation** is a sustained rise in the general price level. It means money buys less (lower **purchasing power**).
- It is measured by the **Consumer Prices Index** (CPI), which tracks the prices of a typical "basket" of goods and services. The Retail Prices Index (RPI) also includes mortgage interest payments.
- **Deflation** is a fall in the general price level.

Causes

- **Demand-pull inflation**: demand grows faster than the economy can supply, so prices are pulled up.
- **Cost-push inflation**: rising costs of production (such as energy, wages or imported materials) push prices up.
- A fall in the value of the pound makes imports more expensive, adding to **cost-push inflation**.

Effects

- Savers lose if interest rates are lower than **inflation**; borrowers can gain because debts are worth less in real terms.
- People on fixed incomes lose **purchasing power**.
- Exports become less competitive if prices rise faster than in other countries.
- Uncertainty can reduce business investment. Firms face menu costs of changing prices.

Calculating price changes

- Percentage change = (new – old) ÷ old × 100. If a basket costs £200 one year and £206 the next, **inflation** is 3%.

Key terms

Inflation	A sustained rise in the general price level.
Deflation	A sustained fall in the general price level.
Consumer Prices Index	The main UK measure of inflation.
Purchasing power	The amount of goods money can buy.
Demand-pull inflation	Inflation caused by demand growing faster than supply.
Cost-push inflation	Inflation caused by rising costs of production.
Real interest rate	The interest rate minus inflation.

Quick questions

Cover the answers and test yourself: remembering is what makes it stick.

1. What is inflation?
2. What is the main UK measure of inflation?
3. What is cost-push inflation?
4. What is demand-pull inflation?
5. Who tends to lose from inflation?
6. Who can gain from inflation?
7. A basket of goods costs £200 one year and £206 the next. What is the rate of inflation?
8. What is deflation?

Answers

1. A sustained rise in the general price level
2. The Consumer Prices Index (CPI)
3. Inflation caused by rising costs of production
4. Inflation caused by demand growing faster than supply
5. Savers and people on fixed incomes
6. Borrowers
7. 3%
8. A sustained fall in the general price level

What to do next

Practise 10 questions on this topic

Try 3 exam questions, with mark schemes

Read the lesson, one step at a time

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