What is Inflation?

Worksheet

Inflation is the rate at which the average price level rises over time. It reduces purchasing power and occurs when there is too much money chasing too few goods (demand-pull) or rising production costs (cost-push).

Questions

1. If inflation is 5% and a book costs $20, what will it cost next year?

A) $19
B) $20
C) $21
D) $25

2. Inflation is primarily caused by…

A) Low interest rates
B) Too much money chasing too few goods
C) Strong currency
D) Low unemployment

3. A $1,000 savings account earns 1% interest. Inflation is 3%. Your real return is…

A) 1%
B) 3%
C) −2%
D) 4%

4. Moderate inflation is considered healthy because…

A) Prices stop rising
B) People spend and invest more
C) Savings grow quickly
D) There's no deflation

5. A gallon of milk costs $3 in Year 1. If inflation is 4% annually, what does it cost in Year 2?

6. Your salary is $50,000 per year. Inflation is 3%. How much purchasing power did you lose?

7. A basket of goods cost 100 last year and103 this year. What is the inflation rate?

8. Define: What is inflation?

9. Define: What causes inflation?

10. Define: Is moderate inflation good or bad?

Answer Key

1. C) \$21 — New price = 20×1.05 = \$21.

2. B) Too much money chasing too few goods — Demand-pull inflation: too much money, not enough goods.

3. C) −2% — Real return = nominal return − inflation = 1% − 3% = −2%. You lost purchasing power.

4. B) People spend and invest more — Moderate inflation (2–3%) encourages economic activity.

5. New price = Old price × (1 + inflation rate) Year 2 price = $3 \times (1 + 0.04) = 3 \times 1.04 = 3.12$ The milk is0.12 more expensive.

6. Purchasing power loss = Salary × inflation rate Loss = $50{,}000 \times 0.03 = 1{,}500$ You can buy1,500 less in goods than last year.

7. Inflation rate = (New price − Old price) / Old price Inflation = $(103 - 100) / 100 = 3 / 100 = 0.03 = 3\%$

8. The sustained rise in the average price level of goods and services, reducing purchasing power.

9. Too much money chasing too few goods (demand-pull), rising production costs (cost-push), or increased money supply.

10. Moderate inflation (2–3%) is considered healthy; it encourages spending and investment. High inflation (>5%) erodes savings.