What is Inflation vs Deflation?

Worksheet

Inflation means rising prices reduce your money's purchasing power. Deflation means falling prices increase it. Both distort the economy and hurt investments in different ways.

Questions

1. Inflation definition?

A) Rising prices reducing purchasing power
B) Falling prices
C) Stable prices
D) Currency strength change

2. Deflation effect?

A) Prices fall, money buys more
B) Prices up
C) No effect on purchasing power
D) GDP falls only

3. 5% inflation example?

A) 100 buys95 worth of goods
B) $105 worth
C) No change
D) $50 worth

4. Most serious deflation risk?

A) Wages fall more than prices
B) Debts grow in real terms
C) Spending drops sharply
D) All of the above

5. Inflation at 5% annually. A coffee costs $3 today. How much will it cost in one year?

6. Deflation at 3% annually. A car costs $30,000 today. What is the price in one year?

7. $10,000 in savings with 4% inflation for 3 years. Real purchasing power?

8. Define: What is inflation?

9. Define: What is deflation?

10. Define: What causes inflation?

Answer Key

1. A) Rising prices reducing purchasing power — Inflation = prices up = money buys less.

2. A) Prices fall, money buys more — Deflation = prices down = money buys more, but debt becomes real burden.

3. A) 100 buys95 worth of goods — 5% inflation means your 100 has lost 5% purchasing power—buys95 worth.

4. D) All of the above — All three occur in deflation: wage lags, debt burden, and loss of demand.

5. Annual inflation rate = 5% New price = 3 × (1 + 0.05) =3 × 1.05 = 3.15 Your100 buys less goods a year later

6. Annual deflation rate = 3% New price = 30,000 × (1 − 0.03) =30,000 × 0.97 = $29,100 But wages also fall and spending drops

7. After 1 year: 10,000 / 1.04 = 9,615 (in purchasing power) After 2 years: 10,000 / 1.0816 = 9,245 After 3 years: 10,000 / 1.1249 = 8,889 in real terms

8. A sustained increase in prices reducing purchasing power.

9. A sustained decrease in prices increasing purchasing power.

10. Too much money chasing too few goods, rising production costs, or currency devaluation.