IGCSE ECONOMICS · 2.1 GOVERNMENT AND THE ECONOMY · CHAPTER 26 · PAPER 2

Inflation

Topic question sheet L26 | **Total: 30 marks** | **Time: 35 minutes** | **Student Book pp. 203–210**

Instructions: answer **all** questions. Write your answers on lined paper. The marks for each question are shown in brackets: use them as a guide to how much to write.

Calculators may be used. Show your working. Draw diagrams in pencil and label them fully. The mark scheme starts on a new page: do not look at it until you have finished.

Section A: Multiple choice

One mark each. Choose **one** answer: A, B, C or D.

1 Inflation caused by firms raising prices because wages have increased is called: **(1)**

A demand-pull inflation
B hyperinflation
C deflation
D cost-push inflation

2 Which of the following is likely to cause demand-pull inflation? **(1)**

A Falling consumer spending due to higher taxes
B A large fall in exports
C Rapid increases in government spending
D A rise in interest rates

3 The costs to a restaurant of reprinting its menus because of rising prices are: **(1)**

A shoe leather costs
B menu costs
C external costs
D fixed costs

4 To reduce inflation, a central bank is most likely to: **(1)**

A cut interest rates
B raise interest rates
C print more money
D cut income tax

Section B: Short answers

Define, state, calculate, draw and explain. Show your working for calculations.

5 Define **inflation**. **(1)**

6 Calculate Lumora's rate of inflation last year. You are advised to show your working. **(2)**

7 State **two** costs of inflation. **(2)**

8 Explain how low interest rates can cause inflation. **(3)**

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Section C: Data response

Read the extract, then answer the questions. Use evidence from the extract in every answer.

Extract: Prices in Lumora

The fictional country of Lumora's CPI rose from 120 to 129.6 last year. The central bank had kept interest rates at 1% for three years, and household borrowing rose by 18%. The government also cut income tax.

At the same time, the price of imported fuel rose 30%. Lumora's exporters say their goods are now more expensive than rivals' abroad, and a survey shows that business investment plans fell by 12%.

Fictional case, written for this sheet.

9 With reference to the extract, analyse the causes of inflation in Lumora. **(6)**

10 With reference to the extract, evaluate the impact of 8% inflation on Lumora's economy. **(12)**

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Mark scheme: Inflation

How to mark: Multiple choice, Define, State: 1 mark. **What is meant by** (2): two separate parts to the definition. **Calculate**: working and answer (with units). **Draw** (3): one mark per correct labelled feature. **Explain** (3): 1 for a point, 2 for developing it in context. **Analyse** (6): knowledge 2, application 2, analysis 2. **Assess** (9) and **Evaluate** (12) are marked by levels: choose the level that best fits the whole answer. Indicative content is a guide: credit other valid points.

Section A

1 *Inflation caused by firms raising prices because wages have increased is called: (1 mark)*

Answer: D (cost-push inflation). Rising costs push prices up.

2 *Which of the following is likely to cause demand-pull inflation? (1 mark)*

Answer: C (Rapid increases in government spending). Aggregate demand rises.

3 *The costs to a restaurant of reprinting its menus because of rising prices are: (1 mark)*

Answer: B (menu costs). Costs of changing prices.

4 *To reduce inflation, a central bank is most likely to: (1 mark)*

Answer: B (raise interest rates). Borrowing and demand fall.

Section B

5 *Define inflation. (1 mark)*

A general and continuing rise in prices (1).

6 *Calculate Lumora's rate of inflation last year. You are advised to show your working. (2 marks)*

Working: (129.6 − 120) ÷ 120 × 100 (1).

Answer: 8% (1).

7 *State two costs of inflation. (2 marks)*

Any two (1 each): lower purchasing power; menu costs; shoe leather costs; uncertainty; lower exports; lower investment; wage-price spiral.

8 *Explain how low interest rates can cause inflation. (3 marks)*

Point: borrowing becomes cheaper (1).

Development: households and firms borrow more, increasing the money supply (1), so demand rises faster than supply and prices rise (1).

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Section C

9 *With reference to the extract, analyse the causes of inflation in Lumora. (6 marks · K2 · Ap2 · An2)*

Knowledge (2): demand-pull and cost-push.

Application (2): interest rates 1%, borrowing +18%, tax cuts; imported fuel +30%.

Analysis (2): cheap credit and tax cuts raise aggregate demand (demand-pull); dearer fuel raises firms' costs, which they pass on as higher prices (cost-push).

Knowledge 2 · Application 2 · Analysis 2.

10 *With reference to the extract, evaluate the impact of 8% inflation on Lumora's economy. (12 marks · levels)*

Negative: exports less competitive (worse balance of payments, job losses); investment plans down 12% (lower future growth); falling purchasing power; uncertainty.

Less serious: if wages rise as fast, living standards are protected; rising demand may cut unemployment; not hyperinflation.

Judgement: moderately harmful, mainly via exports and investment; depends on whether the central bank raises rates and whether fuel prices keep rising.

Levels: L1 1–3 · L2 4–6 · L3 7–9 · L4 10–12 (balanced, well-developed arguments using the data throughout, and a justified conclusion that answers the question).

Original practice questions written in the style of the Pearson Edexcel International GCSE Economics (4EC1) papers. This is not an official paper. Unless a source is given, the firms, countries and figures are fictional and made up for practice.

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