Prices in Motion

Trace price changes from causes to consequences

E.C.5.4 "Define inflation as a sustained increase in the general price level and explain its relationship to changes in the money supply, aggregate demand, and aggregate supply. Compare inflation, deflation,hyperinflation, and stagflation..."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline how inflation is measured, circle causes of price changes, and number the four price conditions described in the passage. Use your marks to compare their effects.

When Prices Change

1. Imagine a family in Ohio buying groceries, paying rent, and filling a car with gas. Inflation is a sustained rise in the general price level, not a one-day jump in one item's price. The Bureau of Labor Statistics measures one version with the Consumer Price Index (CPI), which tracks prices of a weighted basket of goods and services bought by urban consumers. If the CPI rises from 300 to 315 over a year, the inflation rate is 5 percent: the 15-point increase divided by 300. Because spending patterns differ, that average may not match a particular household's costs.

2. When households and firms want to buy more than the economy can readily produce, stronger aggregate demand can push prices up. A larger money supply can add to that demand if people spend more, but money growth does not guarantee inflation: spending and production also matter. Meanwhile, a widespread increase in production costs, such as higher energy prices, can reduce aggregate supply and raise prices. Unlike inflation, deflation is a sustained fall in the general price level. Falling prices may help buyers initially, but they can squeeze business revenue and make fixed debts harder to repay, increasing layoffs and reducing tax receipts.

3. Hyperinflation is an extremely rapid, runaway rise in prices. Savings and paychecks lose purchasing power quickly, firms struggle to set prices, and governments struggle to plan budgets and collect taxes worth what they expected. Stagflation combines high inflation with weak growth and high unemployment. Families face rising bills and job insecurity, businesses face higher costs and slower sales, and governments face demands for aid even as tax revenue weakens. Ordinary inflation also has uneven effects across the United States economy: retirees on fixed incomes may lose buying power, while some borrowers repay fixed-rate loans with dollars worth less than before.

2 ANSWER WITH EVIDENCE

Use the passage

1. How does the passage calculate the inflation rate from a CPI of 300 to 315, and why might one family's costs rise by a different percentage?

2. Explain how a larger money supply and a drop in aggregate supply could each raise prices. Why does the passage say money growth does not guarantee inflation?

3. Compare deflation and hyperinflation. What happens to the general price level in each, and what is one possible effect on businesses or households?

4. Why can stagflation strain both households and governments? Give one effect on each from the passage.

3 YOUR TURN

Your own words

Suppose a nationwide shortage of key materials slows production in many industries while new lending lets households spend more. In four or five sentences, explain how each change could affect prices, name the demand or supply mechanism, describe one effect on a business and one on a household, and explain why one month of higher prices would not prove inflation.

ANSWER KEY

Prices in Motion

HIGH SCHOOL · E.C.5.4

PART 1 · READ AND MARK

Underline how inflation is measured, circle causes of price changes, and number the four price conditions described in the passage. Use your marks to compare their effects. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How does the passage calculate the inflation rate from a CPI of 300 to 315, and why might one family's costs rise by a different percentage?	**The CPI rose 15 points; 15 divided by 300 equals 5 percent. A family's spending may differ from the CPI basket.**
2	Explain how a larger money supply and a drop in aggregate supply could each raise prices. Why does the passage say money growth does not guarantee inflation?	**A larger money supply may increase spending and aggregate demand. A drop in aggregate supply means fewer goods and services are available at current costs, pushing prices up. Money growth alone does not guarantee inflation because spending and production also matter.**
3	Compare deflation and hyperinflation. What happens to the general price level in each, and what is one possible effect on businesses or households?	**Deflation is a sustained fall in the general price level and can squeeze business revenue. Hyperinflation is an extremely rapid, runaway rise in prices and can quickly reduce the purchasing power of savings and paychecks.**
4	Why can stagflation strain both households and governments? Give one effect on each from the passage.	**Households face rising bills and job insecurity. Governments face greater demand for aid while tax revenue weakens.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

A nationwide shortage of key materials would reduce aggregate supply, pushing the general price level up. New lending could raise aggregate demand if households spend the borrowed money, adding more upward pressure on prices. A furniture maker might pay more for inputs and raise prices or cut output. A household with a fixed paycheck could afford fewer goods and services. One month of rising prices would not prove inflation, which requires a sustained increase in the general price level.

Accept other plausible business and household effects that follow from higher costs or prices. Students should distinguish a sustained rise in the general price level from a single month of higher prices.