**Inflation is a phenomenon that many countries in the world have to deal with.**

* **Examine in detail the causes of cost-push inflation. (26)**
* **Has South Africa's inflation-targeting policy been beneficial to the economy?**

**Motivate your response. (10) [40]**

**INTRODUCTION**

Inflation is a sustained and significant increase in general price level over a period of time and a simultaneous decrease in the purchasing power of money**.** 

Accept any other relevant introduction. **(Max. 2)**

**BODY: MAIN PART**

**Causes of cost-push inflation**

* **Increase in Wages:** 

 In South Africa, increase in wages constitute more than 50% of Gross Value

Added at basic prices  If the increase in wages is not accompanied by an increase in production, the cost of production will rise   Producers will increase the prices of their products to offset the high cost of production   Strikes and stay-aways / labour union activities 

* **Key inputs/ increase in prices of imported capital goods** 

 When the prices of key inputs that are imported increase, domestic cost of production increases especially in the manufacturing sector   Supply shocks e.g. sudden increase of oil causes a knock-off effect 

* **Exchange rate depreciation**   A decrease in the value of the rand will result in an increase in prices of imports 

* **Profit margins**   When firms increase profit margins, the prices that consumers pay also increase   Sometimes firms use their market power to push up prices 

* **Productivity**  Less productive factors of production will lead to increased cost per unit 

 Strikes and stay-aways often reduce production output and can result in price increases 

* **Natural disasters**  Natural disasters such as drought, flood and global warming can impact on the cost of production 

 This is often the case in relation to food prices 

* **Interest rates** 
  + - An increase in interest rates results businesses paying more money for capital loaned 
    - Firms recover these costs by increasing the prices of their products 

* **Increase in taxation**   Increase in *direct tax* like company income tax may lead to businesses increasing their prices to offset the extra burden 

 Increase in *indirect tax* such as custom duty will lead to increase in costs of supplying a particular product, therefore the price will increase 

* **Administered prices increase**  e.g. fuel prices 
* Shoplifting and losses caused by employees are added to the prices of products 

Accept any other relevant fact. Maximum 8 marks for headings. (**Max. 26**)

**BODY: ADDITIONAL PART**

**YES / NO** 

* Inflation targeting is when a particular percentage is set as an acceptable level for an increase in general price levels 
* The SARB's inflation target is a range of 3% and 6% 
* The aim of inflation targeting policy is to achieve and maintain price stability 
* The implementation of the inflation target is easy to understand – expressed in numbers which makes it very clear and transparent 
* It reduces uncertainty and promotes sound planning in the public and private sectors 
* It provides an explicit yardstick that serves to discipline monetary policy and improves the accountability of the central banks 

•• The government make use of fiscal policy regarding public sector revenue and expenditure The SARB make in flation within the target range use of monetary policy, specifically the repo rate to keep the 

**Positive effects**

* Where demand is higher than supply an increase in interest rates help to bring the demand down 
* The policy can helps businesses to make economic plans without worrying about the effects of high inflation 
* South Africa's price level has been fairly stable since the introduction of the inflation targeting policy in 2000 

**Negative effects**

* Inflation targeting can cause a reduction in economic growth 
* This is because the raising of interest rates, result in a decrease in total spending which is needed for production to increase 
* Decreased economic growth can increase unemployment 

•• South Africa has been experiencing an increase in unemployment since the impleInflation targeting is difficult to implement when the causshocksmentation of the policy in 2000   e of inflation is supply (Max. 10)

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| **CONCLUSION**    Any relevant higher order conclusion that should include:   * A summary of what has been discussed without repeating facts already mentioned in the body. * An opinion or valued judgement on the facts discussed. * Additional support information to strengthen the discussion. * A contradictory viewpoint with motivation. * Recommendations.     E.g. Inflation can be a threat to the normal functioning of the economy; therefore measures like monetary and fiscal are vital to keep the phenomenon under control.   **(Max. 2)** |  | **[40]** |