ANSWERS - INFLATION

1. - Between inflation and purchasing power a negative relationship exits . An

- Increase in the inflation rate decreases purchasing power . 🗸🗸

- A decrease in purchasing power implies that less goods and services can be bought by

given amount of money. 🗸🗸 (4)

2 - Increased spending by households. 🗸

- Increased investment spending by firms. 🗸

- Increased spending by government. 🗸

- Increased spending by the foreign sector. 🗸 (2)

3 - An increase in wages and salaries. 🗸

- A decline in productivity. 🗸

- An increase in profit margins by firms. 🗸

- Increase in the price of imported goods. 🗸 (2)

4 -An increases in taxes to decrease the disposable income available to households. 🗸

-A decrease in government spending. 🗸

-A restrictive monetary policy entails the use of the interest rate to decrease total spending in the economy. 🗸

-Limit the amount of credit available. 🗸 (4)

5. -To deal with increases in wages an incomes policy can be used. 🗸🗸

- To decrease the cost of production polices aimed at increasing productivity can be useful. 🗸

-To decrease profit margins more competitive market can make a valuable contributions 🗸 (4).

6 -Inflation has an impact on economic growth. Due to the distributional effect savings are discouraged and the less savings in the economy the less funds are available for real investment. 🗸🗸

-Inflation also impact on the investment decision. Why invest in productive assets if an investment in speculative assets such as shares, properties, foreign currencies, works of art, antiques, and so on which might bring a better return due to inflation. Instead of investing in productive assets, market participants try to outwit each other by speculating. Businesses

become preoccupied with inflation and how they can beat it rather than worrying about more productive issues. Time and resources are wasted to anticipate inflation and protect oneself against it. 🗸🗸

-Inflation also has an impact on the balance of payments. If the inflation rate in South Africa is higher than that of our trading partners it can have negative consequences for the balance of payments in that it increases the cost of the export industries with a resultant loss of international competitiveness. 🗸🗸

-High inflation also impact on the functioning of the price mechanism. Changes in relative prices are important signal to both consumers and producers. With high inflation these price signal are more difficult to correctly interpret. It causes a noise in the system in the same way as a radio message is harder to interpret the higher the static in the system.

-High inflation also causes further inflation. This is the so-called inflation spiral which is caused by people’s expectations about inflation. Since people expect inflation to continue, they do things that further fuel inflation and if this get out of hand the result might be hyperinflation. 🗸🗸 (8)