PRACTICAL AND FINANCIAL LITERACY

Inflation

Difficulty level: Intermediate

Practical and Financial Literacy

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Overview of the concept

This is how you understand why the same money buys less over time, like a chocolate bar that cost a dollar when you were young costing two dollars now. Prices rise a little most years, and over a decade those little rises add up to a big difference in what your money is worth. It matters when you save for the future, when you compare wages across years, and when you wonder why your parents could buy so much more with the same amount of money.



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Worked examples

EXAMPLE 1

Q A $100 item has 3% inflation for one year. What is its new price?

SOLUTION

This is an inflation question, and the one rule to remember is that inflation raises the price by a percent of the old price, so you add the rise on top.

3% of $100 is $3.

The new price is $100 + $3 = $103.

EXAMPLE 2

Q A loaf of bread costs $2.50 last year and $2.60 this year. What is the inflation rate for bread?

SOLUTION

The inflation rate is the rise as a percent of the old price.

The rise is $2.60 - $2.50 = $0.10. As a fraction of the old price that is $\frac{\$0.10}{\$2.50}$.

That is 0.04, so the inflation rate is 4%.

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Practice questions

1 A $200 item has 4% inflation for one year. What is its new price?

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2 Prices rise 4%. An item costs $104 this year. What did it cost last year?

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3 What is inflation?

- A A general rise in prices over time
- B A general fall in prices over time
- C A rise in the value of money
- D A fall in wages over time

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4 If prices rise 2% and your pay stays the same, can you buy more, less, or the same?

- A More
- B Less
- C The same

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5 The CPI (a price index that tracks average prices) was 200 last year and 210 this year. What is the inflation rate?

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6 The CPI was 200 last year. If inflation is 5%, what is the CPI this year?

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If inflation is 3% and your savings pay 1%, is your money keeping up?

A Yes, it keeps up

B No, it falls behind by about 2%

C No, it falls behind by about 4%

D Yes, it grows by about 2%

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What happens to a fixed $100 kept in cash for a year at 3% inflation?

A It buys about $3 less worth of goods

B It buys about $3 more worth of goods

C It buys the same worth of goods

D It buys about $30 less worth of goods

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Which is better for savers: high inflation or low inflation?

A High inflation

B Low inflation

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A wage rises 5% while prices rise 3%. Are you better off or worse off?

A Worse off, by about 2% in real terms

B Better off, by about 2% in real terms

C Better off, by about 8% in real terms

D No better or worse off

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ANSWER KEY

1. 208

2. 100

3. A general rise in prices over time

4. Less

5. 5%

6. 210

7. No, it falls behind by about 2%

8. It buys about $3 less worth of goods

9. Low inflation

10. Better off, by about 2% in real terms

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