

Topic: Price Level / Inflation

EU Inflation



Source: [ECB, 2026](#)

Additional resources:

- Class [Podcast](#) on this price stability
- Class website on price stability
- CSO inflation [calculator](#) and [here](#)
- [EU inflation](#)

- **Inflation:** is the steady and persistent increase in the general level of prices. It is the rate at which your money loses purchasing power or ability to buy goods and services.

Types of Price Changes

Types	Explanation
Hyperinflation	● Very rapid growth in inflation rate ● Causes money to lose value to point where alternative methods of exchange used ● Can cause complete lack of confidence in currency and great instability ○ E.g. South America in 1980's and Zimbabwe
Deflation	● Deflation occurs when there is a fall in the average price level of goods and services in an economy ○ Deflation only occurs when the percentage change in prices falls below zero % ● This causes consumers to postpone spending in hope that prices will fall further ● This decreases aggregate demand -> stagnation in economy -> increase in unemployment -> loss of consumer confidence etc etc.
Inflation	● Inflation is the steady and persistent increase in the general level of prices. It is the rate at which your money loses purchasing power or ability to buy goods and services.
Disinflation	● Disinflation occurs when the average price level is still rising, but at a lower rate than before ○ These figures demonstrate disinflation: Y1 = 5% Y2 = 4% Y3 = 2%

Inflation 2022-2026

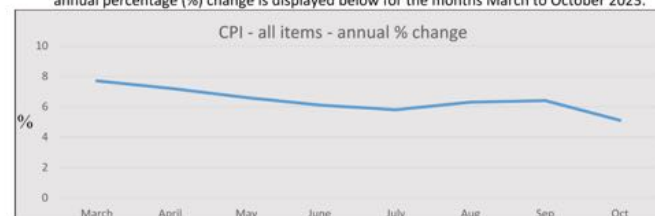
- In **2022**, prices were rising at around **7.8%**.
- In **2023**, this increase fell to roughly **4.6%**.
- In **2024**, they were still rising but by a much lower **1.0%**.
- In **2025**, slight increase, food and services pressure, 1.8-2%

The disinflation from **7.8% in 2022** to **2.0% in 2025** can be attributed to several factors:

1. A **reduction in global energy prices**, including oil, gas, and electricity, eased inflationary pressures compared to 2022 highs.
2. Improvements in **global supply chains** post-pandemic led to lower costs for goods and transportation.
3. **Interest rate hikes** by central banks helped curb demand and slow price increases.

Exam Question 2024:

- (b) Data from the Consumer Price Index (CPI) all items, which shows the inflation rate in Ireland, annual percentage (%) change is displayed below for the months March to October 2023.

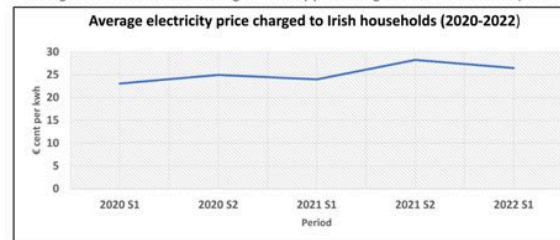


- (i) Outline the overall trend of the CPI annual % change in data as shown in the graph above. **Use figures from the graph.**

Outline:

Exam Question 2023

The diagram below shows the average electricity price charged to Irish households (2020-2022).



S = Semester

Adapted from seai

- (a) (i) Outline **one** key trend in electricity prices, using figures from the graph above **and** explain how this will have impacted on Irish consumer behaviour.

Trend:
Effect on consumer behaviour:

Calculating Inflation

1. Simple Price Index

- Unweighted index, [Video](#)
- Show percentage change in price of a good over a period of time
- Method
 - Step One – Choose a base year
 - Step Two – Find price of good each year
 - Step Three – Calculate index number for each year
 - $\frac{\text{this year's price}}{\text{price in base year}} \times 100$
- Note: – Base year will always have an index of 100
- Simple index does not take into account fraction of income spent on each good

2. Composite Price Index

- Does not give equal importance to each good
- Each good given a weight which reflects the fraction of income spent on it
 - Method
 - Step One – Choose a base year
 - Step Two – Decide what goods to include
 - Step Three – Find price of goods each year
 - Step Four – Calculate simple price index for each good
 - Step Five – Find % of income spent on each good (weight)
 - Household Budget Survey (CSO) establishes this
 - Step Six - Multiply each simple index by its weight and total to find composite price index for year

Consumer Price Index ([CPI](#))

- Most common composite price index used in Ireland
- Measures change in average level of prices paid for consumers goods and services by all private households in the country
- [Video](#) and [video 2](#)

Method of constructing CPI

- 10 commodity groups - household, transport etc. (985 items)
- Over 51,000 prices collected once a month
- Household Budget Survey every 5 years in representative random sample of households to establish weights
- See methods of calculating composite price index

1. Calculation of Simple Price Index X Weight = Weighted Index

Category	Price of items this year divided by the price in the base year multiplied by 100	Simple Price Index Value	Weight	Weighted Index
Food	24/19 x 100		40%	
Transport	41/45 x 100		25%	
Health	33/28 x 100		35%	

2. Calculation of Simple Price Index X Weight = Weighted Index

Category	% of spending on item	Price of items in base year	Price of items in current year	Simple Price Index Value	Weight	Result
Food	30%	10	11.50			
Clothing	20%	40	36			
Other items	50%	20	22			
	100%				Composite price index for current year	

Exam Question 2024

- (ii) The table below shows a country's composite price index for the following categories of expenditure: food; transport; and other items. Use the information in the table below to calculate the price index for the current year. The base value is 100. Show your workings.

Category	% of income (weight) spent on item(s)	Price of item(s) in base year €	Price of item(s) in the current year €	Calculation of simple price index	Weight	Result
Food	65%	60	66			
Transport	20%	30	45			
Other Items	15%	80	96			
	100%				Price Index for the current year	

Exam Question 2023

- (iii) The table below shows a country's composite price index for the following categories of expenditure: food; transport; and other items. Using the information in the table below to calculate the price index for the current year. The base value is 100. Show your workings.

Category	% of income (weight) spent on item (s)	Price of item (s) in base year €	Price of item (s) in the current year €	Calculation of Simple Price Index	Weight	Result
Food	60%	50	55			
Transport	25%	20	24			
Other Items	15%	75	81			
	100%				Price Index for the current Year	

Exam Question: Old Course

State **four** steps involved in constructing a Consumer Price Index (CPI).

Step 1 _____

Step 2 _____

Step 3 _____

Step 4 _____

(16 marks)

6. (a) The CPI is an example of a composite price index.

- Explain the steps involved in constructing a composite price index.
- Distinguish between the terms **nominal wage** and **real wage**.
- With reference to the table below, calculate the percentage change in **real wages** in **each** of the years 2014 – 2016. **Show your workings**.

Consumer Price Index (CPI) and Wage Inflation in Ireland

Year	CPI Annual % Change	Nominal Wage Rate Annual % Change	Real Wage Rate Annual % Change.
2014	0.3	-0.2	?
2015	- 0.3	1.2	?
2016	0.0	1.1	?

(Source: CSO)

[25]

The Impact of Inflation on Different Stakeholders

Uses	Limitations
• Tracks inflation trends to measure price changes over time. • Evaluates government performance in managing the economy. • Guides wage negotiations to align with inflation • Maintenance of real value of social welfare payments • Assesses trade impacts by comparing international inflation rates.	• Based on “average” spending patterns, may not reflect individual habits. • Does not account for changes in product quality. • Excludes products introduced after the last Household Budget Survey. • Ignores consumer switches to cheaper brands. • A price index, not a cost of living index. • Despite limitations, it is the most accurate measure available.

Other Composite Price Indices

- Constant Tax Price Index
- **HICP (EU Harmonised Index of Consumer Prices)**
- Agricultural Output Price Index
- Agricultural Input Price Index
- Import Price Index
- Export Price Index

Newspaper article

Air fryers and gin added to CSO basket of goods, landlines and swiss rolls out

Adapted from RTE, Feb 2024 See [link](#)

The Central Statistics Office (CSO) updates its basket of goods every five years to measure inflation in Ireland, reflecting changes in consumer spending habits. Recent additions to the basket include air fryers, gin, disposable vapes, milk and meat substitutes, and wireless speakers, highlighting the influence of technology and new food trends. Services like delivery charges also made the list due to the rise in online shopping and fast-food deliveries.

Items removed from the basket include landline telephones, Swiss rolls, and digital cameras, as they are no longer significant in consumer spending. Other exclusions reflect shifts in society, such as nightclubs and playschool fees, and the changing role of technology, such as the removal of e-readers and MP4 players. Weightings for certain categories have also been adjusted—spending on restaurants, cafes, and fast food has increased, while spending on pubs, rent, and mortgage interest has decreased.

The Consumer Price Index (CPI) is calculated using data from price collectors, supermarkets, and CSO staff. This basket of 612 items gives insight into the evolving nature of Irish society and consumption patterns, as seen in past changes like the inclusion of vodka in 1975 or streaming services in 2016.

- 1. Why does the CSO change / add goods in the typical basket?
- 2. What is a limitation of the CPI regarding the inclusion of **new products**?
- 3. Why is the CPI considered the most **accurate measure available**, despite its limitations?

Exam questions: 2020

Answer (b) or (c)
(b) Explain **two** uses of the CPI.

1.
2.

OR
(c) Explain **two** limitations of the CPI.

1.
2.



Causes of Inflation

- An increase in the average prices in an economy can be caused by **demand pull** inflation or **cost push** inflation. Watch [video](#) here.

Main Causes of Inflation

Demand Pull Inflation	Cost Push Inflation
- Demand pull inflation is caused by excess demand in the economy Aggregate demand (AD) is the sum of all expenditure in the economy - AD = Consumption (C) + Investment (I) + Government spending (G) + Net Exports (X-M) - E.g There could be a high demand for exports due to rising foreign incomes. This would cause prices to rise. - E.g There could be increased consumer confidence in the economy causing increased borrowing / spending. This would cause prices to rise	- Cost push inflation is caused by increases in the costs of production in an economy - E.g cost of labour might increase, causing wage push inflation. Wage Drift – high demand for labour leads to firms paying above negotiated rates (e.g. bricklayer during the boom) - E.g increase in cost of imports. Energy prices have risen as well as the cost of other imports from Ukraine, such as wheat, fertiliser and aluminium. - The rise in the cost of production is passed on to consumers in the form of higher selling prices

Other Causes:

3. Government-induced Inflation

- Increase in indirect taxes
 - Increases cost of goods in CPI
 - Wage-price spiral
 - Increase in cost of raw materials
- Increase in government spending
 - Demand-pull inflation
- Increased availability of credit/decreased interest rates
 - Increased level of borrowing may lead to demand-pull inflation

4. Printing money

- Printing too much money causes it to fall in value.
- [Video](#)

Exam Question 2023

(ii) Distinguish between demand-pull inflation and cost-push inflation.

Demand-pull inflation:
Cost-push inflation:

Exam Questions

(ii) Outline **two** factors that can cause inflation.

1.
2.

4. Define 'cost-push' inflation. Identify **two** sources of this form of inflation in the Irish economy.

Definition: _____

Source 1: _____

Source 2: _____

(16 marks)

- (b) (i) State and explain **two** causes of inflation.
(ii) Outline **three** possible economic effects of high inflation in an economy.
(iii) Explain how deflation might, in the short run, lead to lower economic growth.

[30]

- (b) (i) Define the terms **demand-pull inflation** and **cost-push inflation**.
(ii) The Irish inflation rate was at, or close to, 0% between 2013 and 2016. Is such a low rate of inflation good or bad for (a) households and (b) firms? Explain your answer in **each** case.
(iii) Outline how the European Central Bank's (ECB) monetary policy changes might affect the rate of inflation.

[30]

The Consequences / Effects of Inflation

The Impact of Inflation on Different Stakeholders

Stakeholder	Explanation of Impact
Firms	- Rapid price changes create uncertainty and delay investment - Price changes force firms to change their menu prices too and this can be expensive
Consumers	- Decrease in purchasing power - Decrease in the real value of savings (as money will be worth less in real terms) - Fall in real income for those on fixed incomes/pension - Inflation is more harmful to low income households
Government	- Inflation erodes international competitiveness of export industries as the country's exports are now relatively more expensive - Economic growth may slow due to a fall in exports and a possible fall in consumption Trade-offs involved in tackling inflation e.g reducing inflation may increase unemployment and/or reduce economic growth
Workers	Demand higher wages to compensate for reduced purchasing power - If wage increases $\neq$ inflation, motivation and productivity may fall

Activity: Try the interactive interactive [practice](#)

Exam Question 2024

- (iii) Outline two possible economic effects of high price inflation on the Irish economy.

1.
2.

Exam Question 2022 Deferred

- (c) (i) In budget 2022 the government increased the old age pension by €5 per week. Given that the current rate of inflation has risen rapidly would old age pensioners be happy with this increase? Justify your answer.

Answer:
Justification:

Exam Q: 2007

State **FOUR** possible economic effects of rising **price inflation** on the Irish economy.

- (i) _____
- (ii) _____
- (iii) _____
- (iv) _____

(16 marks)

- (b) Irish citizens experienced an increase in the rate of price inflation during 2007.

- (i) Explain the underlined term.
- (ii) Discuss the economic effects of this development on the Irish economy.

(20 marks)

Lorraine Clancy

Solutions / Policies to Price Stability

- Monetary policy refers to the actions taken by a Central Bank (ECB) to influence the money supply, interest rates, and availability of credit.

Contractionary Policies to Control Inflation

Contractionary Monetary Policy	Contractionary Fiscal Policy
Monetary policy is the use of interest rates, money supply or credit availability to achieve economic objectives. - Sets interest rates - Control money supply	Fiscal Policy is any action taken by the government which influences the timing, magnitude and structure of current revenue and expenditure - E.g., increase taxes and reduce spending

1. Contractionary Monetary Policy

- Setting interest rates:** The ECB is responsible for maintaining purchasing power of the Euro, aim is to have 2%

Impact of interest rates on inflation	
High interest rates	Low interest rates
- Discourages borrowing for households / businesses - fall in demand, reduction in economic activity and fall in demand	- Encourages borrowing for households / businesses - rise in demand, increase in economic activity and rise in demand

Impact of interest rates on savings	
High interest rates	Low interest rates
- Incentive to save - Reduce inflation	- Incentive to spend rather than save - Increase inflation

b. Adjust money supply

- Quantitative easing: occurs when a central bank buys financial assets from commercial banks with new money that the central bank has created (printing money).

2. Contractionary Fiscal Policy

- Is defined any action taken by the government which influences the timing, magnitude and structure of current revenue and expenditure (**taxes / spending**)

Impact of contractionary fiscal policy	
Increase Taxes	Reduce Spending
- The government disencourage consumption by increasing income taxes to decrease disposable income. This would likely decrease aggregate demand (GDP) and inflation. - If a government would like to discourage investment, then it can increase corporate tax (tax on profits). This would likely decrease aggregate demand (GDP).	Governments have major investment projects themselves and may decrease their spending on public services (hospitals, schools, infrastructure). This would directly decrease aggregate demand (GDP).

Exam Question

(ii) Explain **one** method the government could use to address rising inflation.

Exam Question 2022 Deferred Paper

(ii) Suggest two measures the Irish Government could take to alleviate the effects of high inflation on citizens.

1.
2.

(iii) If inflation continues at a high rate in Europe, outline one measure the ECB could implement to address these high inflation rates.

Exam Question 2024

(c) The President of the European Central Bank (ECB), Christine Lagarde, defended the interest rate increases made by the ECB in 2022/2023 and has said she recognised that interest rate increases were a burden for some people.

Adapted from RTÉ.ie

(i) Explain one economic effect these interest rate increases have on **each** of the following:

Level of consumer spending:
Cost of servicing the national debt:

European Central Bank Central Bank

- The aim is to make prices stable, the aim is ECB goal < 2% inflation. They do this by using monetary policy, this involves setting interest rates and money supply (video on [ECB](#))

Other Roles of ECB

- Regulation: Oversees Eurozone banks maintain financial stability and provides protection for depositors and investors.
- Distribution Euro: Responsible for the production and distribution of euro notes and coins to Eurozone member countries.
- Conducts Economic Research: Writes reports and advises the EU and governments on economic issues. This guidance helps shape policies that promote growth, stability, and sound financial management across the Eurozone.

Other roles:

- Acts as the government's banker, managing its accounts and transactions.
- Functions as the lender of last resort, providing credit to financial institutions facing difficulties when other funding options are unavailable.

Exam Question:

Question 5

KBC Bank Ireland was fined €18.3 million by the Central Bank of Ireland for its role in the tracker mortgage scandal.

Adapted from The Irish Times

(b) Other than the regulation of commercial banks, outline two other **duties** of the Central Bank of Ireland.

1.	
2.	

Evaluation of Low Inflation Rates (Less than 2%)

Advantage of low Inflation Rate

Advantage	Explanation
More competitive exports	- As Irish prices will be lower than in the Euro area and the UK this would mean that Irish exports are more competitive - Resulting in increased exports and increased employment in these industries. - More tourists may decide to holiday in Ireland.
Competitive Costs	- With lower prices Irish firms may experience reduced costs which should maintain their competitive prices. - With lower costs the business can expand production and /or innovate new products / methods of production. - Lower costs than in other regions should act as an incentive for foreign firms to locate in Ireland.
Domestic spending / savings	- With low price inflation prices are competitive and this may encourage an increase in spending within the economy with benefits for domestic employment and economic growth. - Low price inflation will help maintain the value of savings.

Disadvantage of low Inflation Rate

Disadvantage	Explanation
Consumers may postpone spending	- Consumers may expect prices to fall even further in the future. - Some firms may close down and this may lead to a loss in service for the consumer.
Low wage increase	- With real wages increasing / prices falling employers may only be willing to offer low or no wage increases. - Hence, they might find filling job vacancies difficult.
Debt burden effect	- The real cost of repaying the loan rises. the real value of the borrower's payments increases. - Borrowers lose because the real burden of their debt rises.

Exam Question

(ii) Outline the potential **advantages** to Ireland as a country of maintaining the lowest price inflation rate relative to these other areas over this period.

Exam Question

(b) (i) Outline two possible **disadvantages** to Irish citizens of a low inflation rate in Ireland.

1.