

Question #1 of 45

A firm's *most likely* initial response to a cyclical increase in the inventory-to-sales ratio is to adjust their utilization of labor by:

- A) adding new workers.
- B) reducing overtime.
- C) laying off employees.



Explanation

As a cyclical indicator, an increase in the inventory-to-sales ratio is a sign of slowing economic growth. When decreasing their utilization of labor in response to a slowing economy, firms typically first reduce overtime. Firms tend to be slow to lay off workers until it is clear that an economic contraction is underway.

(Study Session 4, Module 17.1, LOS 17.b)

Question #2 of 45

Which of the following *most* accurately describes the Monetarist school of macroeconomic thought in relation to aggregate demand and aggregate supply? Monetarists believe that the money supply should be:

- A) reduced during inflationary periods and increased during recessionary periods.
- B) increased during inflationary periods and reduced during recessionary periods.
- C) increased by a predictable rate annually.



Explanation

Monetarists believe that to keep aggregate demand stable and growing, the central bank should follow a policy of steady and predictable increases in the money supply. Furthermore, monetarists believe that recessions are caused by inappropriate decreases in the money supply and that recessions can be persistent because money wage rates are downward sticky.

(Study Session 4, Module 17.1, LOS 17.c)

Question #3 of 45

Steve Walker, CFA, is attending an economics lecture, during which the lecturer makes the following two statements about consumer price inflation:

Statement 1: High-definition televisions are considerably more expensive than traditional models. This means consumers are spending more money per television unit, which represents a form of inflation.

Statement 2: Employment contracts with automatic increases based on the Consumer Price Index fail to increase wages as much as the increase in the cost of living because of biases in the price index.

Should Walker *agree* or *disagree* with these statements?

Statement 1

Statement 2

- | | | |
|-------------|----------|---|
| A) Agree | Agree |  |
| B) Disagree | Disagree |  |
| C) Disagree | Agree |  |

Explanation

Walker should disagree with both statements. Price changes resulting from increases in the quality of goods, do not represent inflation. However, the Consumer Price Index is affected by biases from product quality, as well as new goods and substitution, causing it to overstate the rate of inflation. As a result, increases in wages that are based on CPI will more than compensate for actual increases in the cost of living.

(Study Session 4, Module 17.2, LOS 17.d)

Question #4 of 45

As an economic expansion approaches its peak, the economy is *most likely* to show:

- | | |
|---|---|
| A) a decrease in inventory levels. |  |
| B) an increase in the inventory-to-sales ratio. |  |
| C) accelerating sales growth. |  |




Explanation

As the economy approaches its peak, sales growth begins to slow, unsold inventories begin to accumulate, and the inventory-to-sales ratio increases.

(Study Session 4, Module 17.1, LOS 17.b)

Question #5 of 45

According to Keynesian school theory, business cycles are caused by:

- | | |
|--|---|
| A) inappropriate variations in the growth of the money supply. |  |
| B) excessive optimism or pessimism among business managers. |  |
| C) changes in technology over time. |  |

Explanation

In Keynesian business cycle theory, business cycles are caused primarily by changes in expectations about economic growth. Business managers overinvest when they are excessively optimistic and underinvest when they are excessively pessimistic.

(Study Session 4, Module 17.1, LOS 17.c)

Question #6 of 45

Which type of unemployment describes a situation where workers who have been laid off due to economic changes and they are unable to find work due to a lack of education or the necessary skills to move into another available job?

A) Frictional.



B) Structural.



C) Cyclical.



Explanation

Structural unemployment is due to structural changes in the economy that eliminate some jobs while generating job openings for which unemployed workers are not qualified. Cyclical unemployment is when the economy is operating at less than full capacity.

(Study Session 4, Module 17.2, LOS 17.d)

Question #7 of 45

Which type of unemployment describes situations where qualified workers are not immediately matched with existing job openings?

A) Structural.



B) Cyclical.



C) Frictional.



Explanation

Frictional unemployment will prevent qualified workers from being immediately matched with existing job openings. Two causes are imperfect information and the job search conducted by both employers and employees.

(Study Session 4, Module 17.2, LOS 17.d)

Question #8 of 45

An economy with a consistently negative inflation rate is *best* described as experiencing:

A) disinflation.



B) hyperinflation.



C) deflation.






Explanation

Deflation is a sustained decline in the price level, which is reflected in a negative inflation rate. Disinflation refers to a decrease in the inflation rate over time but does not imply a negative inflation rate. Hyperinflation is an extremely high and accelerating inflation rate.

(Study Session 4, Module 17.2, LOS 17.e)

Question #9 of 45

Which one of the following is *most likely* to experience loss of wealth from an increase in the inflation rate?

- A) An individual investor who recently purchased a substantial amount of variable rate bonds. 
- B) An individual investor who financed the purchase of a home with a 30-year fixed rate mortgage. 
- C) A commercial bank that has a large quantity of fixed-rate mortgages in its loan portfolio. 

Explanation

If an economy experiences inflation, the losers are those who hold long-term contracts in which they are to receive fixed payments. A bank that has a large quantity of fixed-rate mortgages in its loan portfolio (i.e., they are investments for the bank) is receiving fixed-rate payments. Both remaining choices are investors who are either making fixed rate payments (the homeowner) or receiving floating-rate payments (the investor in variable rate bonds).

(Study Session 4, Module 17.2, LOS 17.e)

Question #10 of 45

Unemployment can be divided into the following three categories:

- A) Technical, frictional, seasonal. 
- B) Frictional, cyclical, structural. 
- C) Frictional, seasonal, cyclical. 

Explanation

Unemployment can be divided into frictional, cyclical, or structural unemployment.

(Study Session 4, Module 17.2, LOS 17.d)

Question #11 of 45

The inventory-to-sales ratio for manufacturing and trade is classified as a:

- A) leading indicator. 
- B) lagging indicator. 
- C) coincident indicator. 

Explanation

The inventory-to-sales ratio for manufacturing and trade is considered a lagging indicator because it peaks after the economy does, even though it is sometimes used in forecasting economic activity.

(Study Session 4, Module 17.2, LOS 17.i)

Question #12 of 45

When individuals are unemployed because they do not have perfect information concerning available jobs, this is:

A) frictional unemployment.



B) structural unemployment.



C) natural unemployment.



Explanation

Frictional unemployment exists because workers and employers do not have perfect information and must expend time and resources on search activities.

(Study Session 4, Module 17.2, LOS 17.d)

Question #13 of 45

Which of the following factors would *least likely* result in demand-pull inflation? An increase in:

A) exports.



B) the quantity of money.



C) energy prices.



Explanation

Demand-pull inflation can result from any factor that increases aggregate demand, including increases in the money supply, increases in exports, and increases in government purchases. Increases in the prices of productive inputs would result in cost-push inflation as aggregate supply decreases.

(Study Session 4, Module 17.2, LOS 17.h)

Question #14 of 45

Which of the following is *least likely* one of the types of unemployment?

A) Frictional.



B) Structural.



C) Temporal.



Explanation

There are three types of unemployment: frictional, cyclical, and structural.

- Frictional unemployment is due to constant changes in the economy that prevent qualified workers from being immediately matched with existing job openings.
- Cyclical unemployment is when the economy is operating at less than full capacity.
- Structural unemployment is due to structural changes in the economy that eliminate some jobs while generating job openings for which unemployed workers are not qualified.

(Study Session 4, Module 17.2, LOS 17.d)

Question #15 of 45

Which of the following economic indicators is classified as a leading indicator for the United States economy?

A) Average duration of unemployment.



B) Industrial production.



C) Index of consumer expectations.



Explanation

Consumer expectations are a leading indicator. Industrial production is a coincident indicator. Average duration of unemployment is a lagging indicator.

(Study Session 4, Module 17.2, LOS 17.i)

Question #16 of 45

When the economy enters an expansion phase, the *most likely* effect on external trade is a(n):

A) decrease in exports.



B) increase in imports.



C) increase in exports.



Explanation

When the domestic economy is expanding, demand for imports is likely to increase as domestic incomes increase. Exports tend to be independent of domestic economic growth and are more closely related to trading partners' economic growth.

(Study Session 4, Module 17.1, LOS 17.b)

Question #17 of 45

During an economic contraction:

A) the unemployment rate typically decreases.



B) inflation pressures are typically decreasing.



C) real GDP growth is greater than its sustainable long-term rate.



Explanation

An economic contraction (recession) is typically characterized by decreasing inflationary pressures, increasing unemployment, and low or negative real GDP growth.

(Study Session 4, Module 17.1, LOS 17.a)

Question #18 of 45

Inflation resulting from a decrease in taxes is *most likely*:

A) stagflation.



B) cost-push inflation.



C) demand-pull inflation.



Explanation

A decrease in taxes, other things equal, will increase personal disposable income and the consumption spending component of aggregate demand. An increase in aggregate demand from a position of long-run equilibrium is the most likely cause of demand-pull inflation.

(Study Session 4, Module 17.2, LOS 17.h)

Question #19 of 45

Which of the following is *least likely* a source of bias in CPI data?

A) Sample selection



B) Quality changes



C) Substitution



Explanation

The three sources of bias associated with CPI data are: new goods, quality changes, and substitution.

(Study Session 4, Module 17.2, LOS 17.g)

Question #20 of 45

According to Austrian school theory, business cycles are caused by:

A) long-run structural changes in real economic variables.



B) government intervention in the economy.



C) excessive optimism or pessimism among business managers.



Explanation

In Austrian school business cycle theory, cycles are caused by government intervention that reduces interest rates below what they would be without government intervention, which leads to an artificial economic boom that must eventually collapse because the economy lacks the physical capital to support it.

(Study Session 4, Module 17.1, LOS 17.c)

Question #21 of 45

Joe Lebow, an analyst, is discussing the difference between inflation and price level. Lebow states: "The higher the price level in the current year compared to the price level in the previous year, the higher is the inflation rate of a country. Any increase in the price level is evidence of positive inflation." Lebow's statement is:

A) incorrect because not all increases in the price level indicate inflation.



B) correct.



C) incorrect because it inaccurately describes the calculation of an inflation rate.






Explanation

Lebow is incorrect because a one-time increase in the price level is not necessarily inflation. Inflation is an on-going process, not a one-time increase in the price level.

(Study Session 4, Module 17.2, LOS 17.e)

Question #22 of 45

Which of the following statements is *most* accurate regarding monetarists? Monetarists believe that:

- A) fiscal policy is the most powerful of all government tools used to affect prices and output. 
- B) discretionary monetary policy is the best way to moderate fluctuations in prices and output. 
- C) steady, predictable money growth is the best monetary policy. 

Explanation

Monetarists believe that the Fed's tools are powerful and should *not* be used to moderate fluctuations in prices and outputs. Thus, steady, predictable growth is the best monetary policy. They believe in the power of the money supply, not fiscal policy, to affect prices and outputs.

(Study Session 4, Module 17.1, LOS 17.c)

Question #23 of 45

Firms' initial responses to an emerging economic contraction are *most likely* to be:

- A) reducing overtime hours. 
- B) deferring maintenance of machinery. 
- C) laying off workers. 




Explanation

Early in an economic contraction, firms typically reduce output by using capital and labor less intensively than during an expansion (e.g., by reducing overtime). When they believe a contraction is likely to persist, firms decrease capacity by laying off workers and reducing their physical capital, often by deferring maintenance or not replacing worn-out equipment.

(Study Session 4, Module 17.1, LOS 17.b)

Question #24 of 45

Which of the following statements regarding inflation is *most* accurate?

- A) An economy experiences inflation when there is a persistent increase in the prices of almost all goods and services. 
- B) Inflation occurs when there is a steady increase in the relative prices of key commodities. 
- C) Inflation is present if the prices of some goods and services are increasing. 

Explanation

Inflation is a persistent increase in the price level over time. Inflation occurs when there is a sustained increase in the prices of almost *all* goods and services. Inflation indicates a decline in the purchasing power of a currency.

(Study Session 4, Module 17.2, LOS 17.e)

Question #25 of 45

Average weekly initial claims for unemployment insurance are classified as a:

- A) coincident indicator.
- B) lagging indicator.
- C) leading indicator.



Explanation

Initial claims for unemployment insurance are considered a leading indicator.

(Study Session 4, Module 17.2, LOS 17.i)

Question #26 of 45

Which of the following is *best* described as an example of structural unemployment?

- A) Although there were jobs available, Johnson was unable to find an employer with a satisfactory opening.
- B) Smith was laid off due to negative growth of GDP, and did not seek other employment until he was recalled to his job.
- C) When the plant was modernized, Jones lost her job because she did not have the skill needed to operate the new equipment.



Explanation

Structural unemployment exists when changes in the economy eliminate some jobs while generating new job openings for which unemployed workers are not qualified.

(Study Session 4, Module 17.2, LOS 17.d)

Question #27 of 45

Which of the following is the *most* accurate definition of the unemployment rate? The unemployment rate is the number of:

- A) unemployed individuals divided by the number of employed individuals.
- B) individuals employed divided by the number of people who are unemployed and retired.
- C) unemployed individuals divided by the total labor force.



Explanation

The unemployment rate of a country is the percentage of people in the labor force who are unemployed. It is calculated as: $\text{unemployment rate} = (\text{number of unemployed} / \text{labor force}) \times 100$. The labor force includes those individuals who are employed or are actively seeking employment.

(Study Session 4, Module 17.2, LOS 17.d)

Question #28 of 45

Which of the following statements *most* accurately describes the difference between headline inflation and core inflation?

A) Headline inflation is a better measure of the underlying trend in prices.



B) Core inflation refers to producer prices.



C) Core inflation does not include food and energy prices.



Explanation

Core inflation excludes food and energy and is thus a better measure of the underlying trend in prices.

(Study Session 4, Module 17.2, LOS 17.f)

Question #29 of 45

The expansion phase of a business cycle is *least likely* characterized by:

A) increasing inflationary pressures.



B) increasing unemployment.



C) a positive rate of economic growth.



Explanation

Unemployment is typically decreasing during the expansion phase of a business cycle.

(Study Session 4, Module 17.1, LOS 17.a)

Question #30 of 45

A peak in the business cycle is *most likely* associated with:

A) decreasing inflation pressure.



B) the highest level of economic output during the cycle.



C) payroll employment turning from positive to negative.



Explanation

The peak phase of a business cycle represents the highest level of economic output (real GDP) reached during that cycle. Inflation pressure that built during the expansion may continue into the early part of the contraction that follows the peak. Employment typically does not begin to decline until sometime after the peak.

(Study Session 4, Module 17.1, LOS 17.a)

Question #31 of 45

A price index that is calculated using the current weights of the index's basket of goods and services is known as a:

- A) hedonic price index.
- B) Laspeyres price index.
- C) chained price index.



Explanation

A chained or chain-weighted price index uses updated weights for each good and service in its market basket. A price index that is not chain-weighted, such as a Laspeyres index, is calculated using weights for each good and service in the market basket as of the index's base period. Hedonic pricing is a technique used to adjust a price index for upward bias from quality changes of goods in its market basket.

(Study Session 4, Module 17.2, LOS 17.g)

Question #32 of 45

Bradley works a 14-hour-per-week job as a bartender at McQuigley's Pub. Maddeline left her position at a commercial bank to raise her two-year old daughter. How would these individuals be classified from the viewpoint of employment statistics?

Bradley

Maddeline

- | | | |
|-----------------------|--------------------|--|
| A) Employed | Not in labor force | |
| B) Not in labor force | Not in labor force | |
| C) Employed | Employed | |



Explanation

The labor force includes all people who are either employed or actively seeking employment. As such, Bradley is considered employed from the viewpoint of employment statistics whereas Maddeline is not counted in the labor force.

(Study Session 4, Module 17.2, LOS 17.d)

Question #33 of 45

The current annual inflation rate, as measured by using the Consumer Price Index (CPI), is *best* defined as:

- A) increase in the CPI from a year ago.
- B) percentage change in the CPI from a year ago.
- C) percentage change in the CPI from its base period.



Explanation

The inflation rate is the percentage change in the price index from a year earlier.

(Study Session 4, Module 17.2, LOS 17.f)

Question #34 of 45

Which of the following statements regarding inflation is *most* accurate?

- A) The purchasing power of money increases as a result of inflation. ✗
- B) As a result of inflation, all borrowers gain at the expense of lenders. ✗
- C) Inflation is a persistent increase in the general price level of goods and services. ✓

Explanation

Inflation is defined as a persistent increase in the price level over time. Inflation indicates that there has been a general decline in the purchasing power of a currency. Fixed-rate borrowers gain at the expense of lenders when inflation is greater than expected.

(Study Session 4, Module 17.2, LOS 17.e)

Question #35 of 45

At a recent symposium, "The Great Economic Debate of the Decade" several panelists were asked to state their opinions on aggregate demand and aggregate supply.

Panelist 1 stated that he believed shifts in both aggregate demand and aggregate supply were driven primarily by changes in technology over time.

Panelist 2 stated that she believed the focus of economic policy should be to directly increase aggregate demand by increasing the money supply or through fiscal policy.

The views of Panelist 1 and Panelist 2 would *best* be described as which economic school of thought?

- | <u>Panelist 1</u> | <u>Panelist 2</u> | |
|-------------------|-------------------|---|
| A) Neoclassical | Keynesian | ✓ |
| B) New Classical | Monetarist | ✗ |
| C) Keynesian | New Keynesian | ✗ |




Explanation

The neoclassical economists believe that shifts in both aggregate demand and aggregate supply are primarily driven by changes in technology over time. Keynesian economists believe that aggregate demand can be increased through monetary policy (increasing the money supply) or through fiscal policy (increasing government spending, decreasing taxes, or both). They do not focus on aggregate supply. Monetarists believe that the main factor leading to business cycles and deviations from full-employment equilibrium is monetary policy.

(Study Session 4, Module 17.1, LOS 17.c)

Question #36 of 45

Which of the following statements is *most* accurate? Cost-push inflation:

- A) often occurs because of an increase in short-run aggregate supply. 
- B) results from excess short-run aggregate demand. 
- C) typically results from a significant price increase in a production input. 




Explanation

Cost-push inflation typically results from a significant price increase in a production input that causes a decrease in short-run aggregate supply.

(Study Session 4, Module 17.2, LOS 17.h)

Question #37 of 45

Which of the following statements about biases that affect the consumer price index (CPI) is *least* accurate?

- A) The net effect of built-in biases in the CPI is to underestimate inflation. 
- B) The basket of goods on which the CPI is based becomes a less accurate measure of household costs as new goods appear on the market. 
- C) Price increases that result from quality improvements are reflected as increases in the CPI. 




Explanation

The CPI is generally believed to overestimate inflation by about 1% per year. Upward biases include quality improvements (price increases due to improving quality do not represent inflation but are reflected in the CPI), new and more expensive goods replacing older and less expensive goods, and commodity substitution (consumers substitute less expensive goods for more expensive ones, rather than continuing to consume a fixed basket of goods).

(Study Session 4, Module 17.2, LOS 17.g)

Question #38 of 45

When economists are speaking of the labor-force participation rate, they are referring to which of the following? The labor-force participation rate is the percentage of the:

- A) working-age population who are either working or actively looking for work. 
- B) working-age population who are working. 
- C) labor force who are new entrants (less than one year of work experience). 

Explanation

The labor-force participation rate is the percentage of the working-age population who are employed or actively seeking employment. The labor-force participation rate can be calculated as: $(\text{the labor force} / \text{working-age population}) \times 100$.

(Study Session 4, Module 17.2, LOS 17.d)

Question #39 of 45

Manufacturing and trade sales are *best* described as a:

- A) coincident indicator.
- B) leading indicator.
- C) lagging indicator.



Explanation

Manufacturing and trade sales are a coincident indicator that generally reflects the current phase of the business cycle.

(Study Session 4, Module 17.2, LOS 17.i)

Question #40 of 45

Phases of a business cycle *least likely* include:

- A) restriction.
- B) expansion.
- C) trough.



Explanation

The four phases of a business cycle are expansion, peak, contraction (recession), and trough.

(Study Session 4, Module 17.1, LOS 17.a)

Question #41 of 45

Consumer price indexes are *least likely* to:

- A) reflect the typical purchasing patterns of consumers.
- B) compare current prices to prices in a base year.
- C) be calculated for stages of processing.






Explanation

Stages of processing are components of producer price indexes. Consumer price indexes compare the current prices of a typical consumption basket to prices in a base year.

(Study Session 4, Module 17.2, LOS 17.f)

Question #42 of 45

An economy has been producing at its full-employment level of output and the price level has been stable. Businesses then begin experiencing unintended decreases in their inventory levels. What does this *most likely* imply about the short-run outlook for economic growth and inflation?

| <u>Economic growth</u> | <u>Inflation</u> | |
|------------------------|------------------|---|
| A) Decreasing | Increasing |  |
| B) Increasing | Increasing |  |
| C) Increasing | Decreasing |  |




Explanation

Starting from conditions of long-run equilibrium, unintended decreases in inventory levels suggest that aggregate demand has increased. Producers will respond in the short run by increasing output and prices, so economic growth and inflation will increase.

(Study Session 4, Module 17.1, LOS 17.b)

Question #43 of 45

A Laspeyres price index tends to:

- A) overstate the inflation rate because its market basket is variable. 
- B) understate the inflation rate because its market basket is fixed. 
- C) overstate the inflation rate, because its market basket is fixed. 




Explanation

A Laspeyres price index tends to overstate the inflation rate because it uses fixed market basket weights from a base period. This does not consider that consumers will substitute away from goods that have risen dramatically in price.

(Study Session 4, Module 17.2, LOS 17.g)

Question #44 of 45

Which of the following is the *most* accurate definition of the labor force?

- A) Those people of working age who are not retired or in prison. 
- B) Those people of working age who are either employed or seeking employment. 
- C) All people of working age. 

Explanation

The labor force includes people of working age (16+) who are either employed or seeking employment. People who are not employed or seeking employment (e.g., homemakers, full-time students, "discouraged" workers) are not counted as part of the labor force.

(Study Session 4, Module 17.2, LOS 17.d)

Question #45 of 45

Which of the following types of price index is *most likely* to include a sub-index for raw materials?

A) GDP deflator.



B) Consumer price index.



C) Wholesale price index.



Explanation

Wholesale or producer price indexes typically include sub-indexes for finished goods, intermediate goods, and raw materials or crude goods.

(Study Session 4, Module 17.2, LOS 17.f)

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