SS 05 Monetary and Fiscal Policy, International Trade, and Currency Exchange Rates

Answers

Question #1 of 196

Question ID: 413964

Given an exchange rate of USD/CAD 0.9250 and USD/CHF 1.6250, what is the cross rate for CAD/CHF?

✓ **A)** 1.7568.

✗ **B)** 1.5032.

✗ **C)** 0.5692.

Explanation

(USD/CHF 1.6250) / (USD/CAD 0.9250) = CAD/CHF 1.7568

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #2 of 196

Question ID: 413842

Banks choose to hold a higher percentage of deposits as reserves because they believe general business conditions in the economy are subject to greater uncertainty. If all else is held constant, what is the *most likely* impact of this action?

✓ **A)** The money supply will decrease.

✗ **B)** There will be no effect on the money supply.

✗ **C)** The money supply will increase during a period of inflation, but will decrease if the economy goes into a recession.

Explanation

If banks choose to hold excess reserves, they will decrease their lending. Less bank lending will cause the money supply to decrease.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #3 of 196

Question ID: 413868

A central bank has operational independence if it can independently determine:

- ✗ **A)** how inflation is calculated.
- ✓ **B)** the policy rate.
- ✗ **C)** the horizon over which to achieve its inflation target.

Explanation

A central bank is said to have operational independence if it has the authority to determine the policy rate independently. Determining how inflation is calculated and the time horizon for achieving its target rate of inflation refer to a central bank that has target independence.

References

Question From: Session 5 > Reading 18 > LOS j

Related Material:

- Key Concepts by LOS

Question #4 of 196

Question ID: 413934

Regional trade agreements exist primarily to:

- ✗ **A)** lower currency volatility for their members.
- ✓ **B)** improve economic welfare for their members.
- ✗ **C)** protect their members from unfair trading practices by non-members.

Explanation

The primary reason countries join regional trade agreements is to improve economic welfare by reducing or eliminating trade restrictions.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #5 of 196

Question ID: 413936

Which of the following lists of trading blocs is *most* accurately ordered by degree of economic integration, from least to most integrated?

- ✗ **A)** Free trade area, common market, customs union.

✓ **B)** Customs union, economic union, monetary union.

✗ **C)** Free trade area, economic union, common market.

Explanation

The order by degree of economic integration (from least to most integrated) is as follows: free trade areas, customs union, common market, economic union, and monetary union.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #6 of 196

Question ID: 413851

Which of the following statements about the demand and supply of money is *most* accurate? People who are:

✗ **A)** holding money when interest rates are lower will try to increase their money balances and, as a result, the supply of money increases.

✓ **B)** holding money when interest rates are higher will try to reduce their money balances and, as a result, the demand for money decreases.

✗ **C)** buying bonds to reduce their money balances will increase the demand for bonds with an associated increase in interest rates.

Explanation

Buying bonds would drive bond prices up and interest rates down. Selling bonds would have the opposite effect; driving bond prices down and interest rates up. When interest rates are lower, there is an excess demand for money. The supply of money is determined by the monetary authorities.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #7 of 196

Question ID: 413900

The government budget deficit of Country M is increasing. At the same time, the government budget surplus of Country N is decreasing. Are the fiscal policies of these countries expansionary or contractionary?

✓ **A)** Both are expansionary.

✗ **B)** Both are contractionary.

✗ **C)** One is expansionary and one is contractionary.

Explanation

Expansionary fiscal policy increases a budget deficit or decreases a budget surplus. Contractionary fiscal policy decreases a budget deficit or increases a budget surplus.

References

Question From: Session 5 > Reading 18 > LOS s

Related Material:

- Key Concepts by LOS

Question #8 of 196

Question ID: 413928

The primary benefits derived from tariffs usually accrue to:

✗ **A)** foreign producers of goods protected by tariffs.

✓ **B)** domestic suppliers of goods protected by tariffs.

✗ **C)** domestic producers of export goods.

Explanation

Tariffs raise domestic prices, benefiting domestic suppliers.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #9 of 196

Question ID: 413952

An exchange rate at which two parties agree to trade a specific amount of one currency for another a year from today is called a:

✗ **A)** spot exchange rate.

✓ **B)** forward exchange rate.

✗ **C)** real exchange rate.

Explanation

A forward exchange rate specifies the amount of two currencies that will be exchanged at a specific point of time in the future. A transaction that uses the spot exchange rate is one that would occur immediately. A real exchange rate is one that has been adjusted for the relative inflation rates in two countries, and could be referring to an exchange rate that prevails at any given time.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #10 of 196

Question ID: 434265

Country G and Country H have currencies that trade freely and have markets for forward currency contracts. If Country G has an interest rate greater than that of Country H, the no-arbitrage forward G/H exchange rate is:

✓ **A)** greater than the G/H spot rate.

✗ **B)** less than the G/H spot rate.

✗ **C)** equal to the G/H spot rate.

Explanation

$\frac{\text{forward}}{\text{spot}} = \frac{(1 + \text{interest rate}_{\text{Country G}})}{(1 + \text{interest rate}_{\text{Country H}})}$. If the interest rate in Country G is greater than the interest rate in Country H, the numerator is greater than the denominator on the right side of the equation. The left side must have the same relationship, so the forward rate must be greater than the spot rate.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS

Question #11 of 196

Question ID: 413988

The tendency for currency depreciation to increase a country's trade deficit in the short run is known as the:

✗ **A)** absorption effect.

✗ **B)** Marshall-Lerner effect.

✓ **C)** J-curve effect.

Explanation

The J-curve refers to a graph of the effect of currency depreciation on the trade balance over time. In the short run, a trade deficit may increase because current import and export contracts may be fixed in foreign currency units over the near term, and only reflect the exchange rate change over time. In the long run, currency depreciation should decrease a trade deficit.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS

Question #12 of 196

Question ID: 696228

The term "automatic stabilizers" refers to:

- ✗ **A)** changes in taxes and expenditure programs legislators automatically enact in response to changes the level of economic activity in order to smooth economic cycles.
- ✗ **B)** government expenditures and tax receipts that are required to balance over the course of the business cycle, although they may be out of balance in any single year.
- ✓ **C)** increases in transfer payments and decreases in tax revenues that result from an economic contraction without new legislation.

Explanation

Automatic stabilizers refers the increase (decrease) in transfer payments such as unemployment compensation and the decrease (increase) in tax revenue that result from a decrease (increase) in the level of economic activity. These effects tend to move the fiscal budget toward a deficit when economic activity decreases and toward surplus when economic activity increases, and tend to dampen economic cycles.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #13 of 196

Question ID: 413923

Which of the items below is NOT a valid reason why nations adopt trade restrictions? To:

- ✗ **A)** prohibit foreign firms from increasing market share by selling products below cost.
- ✓ **B)** protect industries in which they have a comparative advantage.
- ✗ **C)** protect industries that are highly sensitive to national security.

Explanation

If a particular country enjoys a comparative advantage in a particular industry, no protection is needed.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #14 of 196

Question ID: 434237

Promoting economic growth and price stability are the goals of:

- ✗ **A)** fiscal policy, but not monetary policy.
- ✗ **B)** monetary policy, but not fiscal policy.
- ✓ **C)** both fiscal and monetary policy.

Explanation

Both monetary and fiscal policies are used by policymakers with the goals of maintaining stable prices and producing positive economic growth.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #15 of 196

Question ID: 413965

Given the following quotes, GBP/USD 2.0000 and MXN/USD 8.0000, calculate the direct MXN/GBP spot cross exchange rate.

- ✓ **A)** 4.0000.
- ✗ **B)** 0.6250.
- ✗ **C)** 0.2500.

Explanation

Invert the first quote to read USD/GBP 0.5000. Then, $0.5000 \times 8.0000 = 4.0000$ MXN/GBP.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #16 of 196

Question ID: 413973

If the AUD/CAD spot exchange rate is 0.9875 and 60-day forward points are −25, the 60-day AUD/CAD forward rate is *closest to*:

- ✗ **A)** 0.9900.
- ✓ **B)** 0.9850.
- ✗ **C)** 0.9870.

Explanation

For an exchange rate quoted to four decimal places, forward points are expressed in units of 0.0001. The 60-day forward rate is 0.9875 + 0.0001(−25) = 0.9850.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS

Question #17 of 196

Question ID: 413896

Which of the following statements *best* explains the importance of the timing of changes in discretionary fiscal policy? Changes in discretionary fiscal policy must be timed properly if they are going to:

- ✓ **A)** exert a stabilizing influence on an economy.
- ✗ **B)** enable the government to control the money supply.
- ✗ **C)** help the government achieve a balanced budget.

Explanation

Proper timing of discretional policy is needed to reduce economic instability. If timed incorrectly, the fiscal policy change could increase rather than reduce economic instability.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #18 of 196

Question ID: 434261

The difference between Country D's nominal and real exchange rates with Country F is *most* closely related to:

✓ **A)** the ratio of the two countries' price levels.

✗ **B)** the risk-free interest rates of the two countries.

✗ **C)** Country D's inflation rate.

Explanation

The difference between real exchange rates and nominal exchange rates is the relative inflation rates over time between the two countries. Real exchange rate (D/F) = nominal exchange rate (D/F) × $\frac{CPI_F}{CPI_D}$.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #19 of 196

Question ID: 413931

In what way does a tariff differ from a quota? A tariff is:

✗ **A)** a tax imposed by a foreign government, whereas a quota is a limit on the total amount of trade allowed.

✓ **B)** a tax imposed on imports, whereas a quota is a limit on the number of units of a good that can be imported.

✗ **C)** not significantly different from a quota; tariffs are imposed by world organizations, whereas quotas are imposed by individual countries.

Explanation

The difference between a tariff and a quota is that a *tariff* is a tax imposed on imported goods, while a *quota* is an import quantity limitation. Also, a tariff will generate tax revenue, but a quota does not.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #20 of 196

Question ID: 413968

If the spot exchange rate between the British pound and the U.S. dollar is GBP/USD 0.7775, and the spot exchange rate between the Canadian dollar and the British pound is CAD/GBP 1.8325, what is the USD/CAD spot cross exchange rate?

✗ **A)** 0.42428.

✓ **B)** 0.70186.

✗ **C)** 1.42477.

Explanation

First, convert GBP/USD 0.7775 to 1/0.7775 = USD/GBP 1.28617.

Then, divide USD/GBP 1.28617 by CAD/GBP 1.8325 = USD/CAD 0.70187.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #21 of 196

Question ID: 413921

In the Ricardian model of trade, the source of comparative advantage is:

✓ **A)** labor productivity.

✗ **B)** the difference between labor productivity and capital productivity.

✗ **C)** capital productivity.

Explanation

The Ricardian model of trade only considers labor as a factor of production. Comparative advantage results from differences in labor productivity. Labor and capital inputs are both considered in the Heckscher-Ohlin model of trade.

References

Question From: Session 5 > Reading 19 > LOS d

Related Material:

- Key Concepts by LOS

Question #22 of 196

Question ID: 413878

An economy's long-term trend rate of real GDP growth is 3% and the central bank's target inflation rate is 2%. If the policy rate is 6%, monetary policy is:

✗ **A)** expansionary.

✗ **B)** neutral.

✓ **C)** contractionary.

Explanation

Monetary policy is contractionary when the policy rate is greater than the neutral rate, which is the sum of the real trend rate of economic growth and the target rate of inflation. Here, the neutral rate is 3% + 2% = 5% and the policy rate of 6% is greater than the neutral rate. Monetary policy is expansionary when the policy rate is less than the neutral interest rate.

References

Question From: Session 5 > Reading 18 > LOS m

Related Material:

- Key Concepts by LOS

Question #23 of 196

Question ID: 413914

The law of comparative advantage explains why a nation will benefit from trade when it:

- ✗ **A)** exports goods for which it is a high-cost producer, while importing those for which it is a low-cost producer.
- ✓ **B)** exports goods for which it is a low-cost producer, while importing those for which it is a high-cost producer.
- ✗ **C)** exports more than it imports.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. When trading partners specialize in producing products for which they have a comparative advantage; costs are minimized, output is greater, and both trading partners benefit.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #24 of 196

Question ID: 413855

The primary objective of a central bank is to:

- ✗ **A)** stabilize exchange rates.
- ✓ **B)** control inflation.
- ✗ **C)** achieve full employment.

Explanation

Although some central banks have other stated goals including stabilizing exchange rates and achieving full employment, the primary objective for a central bank is to control inflation and promote price stability.

References

Question From: Session 5 > Reading 18 > LOS f

Related Material:

- Key Concepts by LOS

Question #25 of 196

Question ID: 413891

The crowding-out model implies that a:

✗ **A)** budget surplus will retard aggregate demand and trigger an economic downturn.

✗ **B)** budget deficit will stimulate aggregate demand and trigger a multiplier effect which will lead to inflation.

✓ **C)** budget deficit will increase the real interest rate and thereby retard private investment.

Explanation

Increased budget deficits will increase the demand for loanable funds and lead to higher interest rates and thus lower private investment. Crowding-out implies that an increase in government spending will choke off private investment and reduce the intended impact of fiscal policy changes on aggregate demand.

References

Question From: Session 5 > Reading 18 > LOS q

Related Material:

- Key Concepts by LOS

Question #26 of 196

Question ID: 434257

Government-owned assets abroad and foreign-owned assets in the country are included in which of the balance of payments accounts?

✓ **A)** Financial account.

✗ **B)** Capital account.

✗ **C)** Current account.

Explanation

Government-owned assets abroad and foreign-owned assets in the country are sub-accounts of the financial account.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #27 of 196

Question ID: 434236

When the central bank reduces the quantity of money and credit in an economy, its monetary policy is *best* described as:

- ✗ **A)** accommodative.
- ✗ **B)** expansionary.
- ✓ **C)** contractionary.

Explanation

When the central bank is reducing the quantity of money and credit in an economy, the monetary policy is said to be contractionary, restrictive, or tight.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #28 of 196

Question ID: 413974

The spot CHF/EUR exchange rate is 1.2025. If the 90-day forward quotation is +0.25%, the 90-day forward rate is *closest to*:

- ✗ **A)** 1.2000.
- ✓ **B)** 1.2055.
- ✗ **C)** 1.2050.

Explanation

The 90-day forward CHF/EUR exchange rate is 1.2025 × 1.0025 = 1.20551. The EUR is at a forward premium to the CHF.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS

Question #29 of 196

Question ID: 413862

If a monetary policy is focused on combating inflation, which open market actions by the Federal Reserve will *most* effectively accomplish this?

✓ **A)** Sell Treasury securities, causing aggregate demand to decrease.

✗ **B)** Purchase Treasury securities, causing aggregate demand to decrease.

✗ **C)** Sell Treasury securities, causing aggregate demand to increase.

Explanation

If the Federal Reserve wants to slow inflation, it needs to decrease aggregate demand (i.e., business investment, consumer purchases of durable goods, and exports). To accomplish this, the Federal Reserve could engage in open market sales of Treasury securities.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #30 of 196

Question ID: 413885

When an economy dips into a recession, automatic stabilizers will tend to alter government spending and taxation so as to:

✗ **A)** reduce the budget deficit (or increase the surplus).

✗ **B)** reduce interest rates, thus stimulating aggregate demand.

✓ **C)** enlarge the budget deficit (or reduce the surplus).

Explanation

During a recession unemployment is high, so the government will pay out more in unemployment compensation at the exact time that tax receipts from corporations and individuals are low. This will increase the size of the deficit and also maintain aggregate demand during recessionary periods.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #31 of 196

Question ID: 413985

In which of the following exchange rate regimes can a country participate without giving up its own currency?

- ✗ **A)** Crawling peg or formal dollarization.
- ✗ **B)** Monetary union or currency board.
- ✓ **C)** Target zone or conventional fixed peg.

Explanation

With formal dollarization or a monetary union, a country does not have its own currency. With a currency board, conventional fixed peg, target zone, or crawling peg, a country has its own currency and manages its exchange rate with another currency or basket of currencies.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS

Question #32 of 196

Question ID: 413845

Which of the following statements about the relationship between interest rates and the demand for and supply of money is *most* accurate? Interest rates affect:

- ✓ **A)** the demand for money only.
- ✗ **B)** both the demand for and supply of money.
- ✗ **C)** the supply of money only.

Explanation

Interest rates only affect the demand for money. With higher interest rates, the opportunity cost of holding money increases, and people hold less money and more interest-earning assets. Monetary authorities determine the supply of money. Therefore, the supply of money is independent of the interest rate.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #33 of 196

Question ID: 413829

Policies that can be used as tools for redistribution of wealth and income include:

- ✗ **A)** both fiscal policy and monetary policy.
- ✓ **B)** fiscal policy only.

☓ **C)** monetary policy only.

Explanation

Fiscal policy can be used as a tool for redistribution of income and wealth, through a variety of taxation and spending policies.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #34 of 196

Question ID: 413848

Which of the following statements regarding money demand and supply is *least* accurate?

☓ **A)** The supply curve for money is vertical.

✓ **B)** As the Fed reduces the money supply, short-term interest rates decrease.

☓ **C)** The supply of money is determined by the monetary authority and is not affected by changes in interest rates.

Explanation

As the Fed reduces the money supply, short-term interest rates increase. The other statements concerning the demand and supply for money are true.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #35 of 196

Question ID: 413972

The spot exchange rate is 1.1132 GBP/EUR and the 1-year forward rate is quoted as +1349 points. The 1-year forward exchange rate for GBP/EUR is *closest to*:

☓ **A)** 1.2634.

☓ **B)** 1.1267.

✓ **C)** 1.2481.

Explanation

The one year forward is 1.1132 + (1349/10,000) = 1.2481.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS

Question #36 of 196

Question ID: 413871

The open market sale of Treasury securities by the Federal Reserve is *least likely* to result in:

✓ **A)** increased exports of U.S. goods.

✗ **B)** a decreased rate of inflation.

✗ **C)** increased longer-term interest rates.

Explanation

When the Fed sells Treasuries, it causes both short- and long-term interest rates to increase. This rate increase causes the dollar to appreciate, which reduces foreign demand for domestic goods, causing exports to decline. The interest rate increase also puts downward pressure on price levels, which causes inflation to slow.

References

Question From: Session 5 > Reading 18 > LOS i

Related Material:

- Key Concepts by LOS

Question #37 of 196

Question ID: 434249

If a country can produce a good at a lower opportunity cost relative to another country, it is said to have a(n):

✗ **A)** absolute advantage.

✓ **B)** comparative advantage.

✗ **C)** autarkian advantage.

Explanation

A country is said to have a comparative advantage in the production of a good if its opportunity cost, in terms of other goods that could be produced instead, is lower than that of another country.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #38 of 196

Question ID: 434247

Compared to not engaging in international trade, a country that engages in international trade is *most likely* to experience:

- ✗ **A)** higher prices for consumer goods.
- ✓ **B)** increased specialization of domestic industries.
- ✗ **C)** lower employment in exporting industries.

Explanation

International trade should result in greater specialization in domestic industries because production shifts to lines in which domestic producers have a comparative advantage.

References

Question From: Session 5 > Reading 19 > LOS b

Related Material:

- Key Concepts by LOS

Question #39 of 196

Question ID: 434263

In the foreign exchange markets, transactions by households and small institutions for tourism, cross-border investment, or speculative trading comprise the:

- ✗ **A)** real money market.
- ✓ **B)** retail market.
- ✗ **C)** sovereign wealth market.

Explanation

The retail foreign exchange market refers to transactions by households and relatively small institutions and may be for tourism, cross-border investment, or speculative trading.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS

Question #40 of 196

Question ID: 413912

Suppose labor in Venezuela is less productive than labor in the United States in all areas of production. Which of the following statements about trading between Venezuela and the U.S. is *most* accurate?

- ✗ **A)** Venezuela will not have a comparative advantage in any good.
- ✓ **B)** Both nations can benefit from trade.
- ✗ **C)** Venezuela can benefit from trade but the U.S. cannot.

Explanation

Although one country may have an absolute advantage in all areas, trade is based on differences in opportunity costs, or comparative advantage. Any country will always have a comparative advantage in the production of some goods; thus, all countries can benefit from trade.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #41 of 196

Question ID: 413935

Which form of regional trading agreement is *least likely* to allow free movement of labor?

- ✓ **A)** Customs union.
- ✗ **B)** Economic union.
- ✗ **C)** Common market.

Explanation

Economic unions and common markets remove all barriers to the movement of labor and capital among their members. Customs unions do not have this feature.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #42 of 196

Question ID: 413937

The form of regional trading agreement (RTA) *least likely* to have the unintended negative effect of reducing a member country's low-cost imports from a non-member country is a:

✗ **A)** common market.

✓ **B)** free trade area.

✗ **C)** customs union.

Explanation

A free trade area removes barriers to trade among its members but does not require any of its members to change their trade policies with non-members. A common market and a customs union both impose uniformity on trade rules with non-member nations, which could restrict a member's low-cost imports from a nation that is not a member.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #43 of 196

Question ID: 413873

If the U.S. Federal Reserve decides to decrease the money supply, which of the following is *most likely* to occur in the short run?

✗ **A)** An increase in the velocity of money similar to decrease in the money supply.

✓ **B)** An increase in the real rate of interest.

✗ **C)** A decrease in the unemployment rate.

Explanation

If the U.S. Federal Reserve decreases the money supply, an increase in nominal and real interest rates will occur. Higher real rates will cause businesses to invest less, which will cause the unemployment rate to increase. Furthermore, households will decrease purchases of durable goods, automobiles, and other items that are typically financed at short-term rates. This will decrease aggregate demand. The decrease in aggregate demand and expenditures will cause incomes to go down, which further decreases consumption and investment. Moreover, this decrease in aggregate demand will decrease real GDP and the price level in the short run and the long run.

References

Question From: Session 5 > Reading 18 > LOS i

Related Material:

- Key Concepts by LOS

Question #44 of 196

Question ID: 413971

The spot exchange rate is 0.6243 USD/GBP and the 1-year forward rate is quoted as 3.016%. The 1-year forward exchange rate for USD/GBP is *closest to*:

✓ **A)** 0.6431.

✗ **B)** 0.6544.

✗ **C)** 0.6054.

Explanation

The one year forward rate is 0.6243 × (1 + 0.03016) = 0.6431.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS

Question #45 of 196

Question ID: 413940

Sales and purchases of non-produced, non-financial assets are included in which of a country's trade accounts?

✗ **A)** Current account.

✗ **B)** Financial account.

✓ **C)** Capital account.

Explanation

The capital account consists of sales and purchases of non-produced, non-financial assets plus capital transfers.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #46 of 196

Question ID: 413901

Which of the following fiscal and monetary policy scenarios is *most likely* to increase the size of the public sector relative to the private sector?

✓ **A)** Expansionary fiscal policy and contractionary monetary policy.

✗ **B)** Contractionary fiscal and monetary policy.

✗ **C)** Expansionary monetary policy and contractionary fiscal policy.

Explanation

Expansionary fiscal policy tends to expand the public sector. Contractionary monetary policy tends to contract the private sector.

References

Question From: Session 5 > Reading 18 > LOS t

Related Material:

- Key Concepts by LOS

Question #47 of 196

Question ID: 413920

The source of comparative advantage in the Heckscher-Ohlin model of trade is differences among countries in:

- ✗ **A)** labor productivity.
- ✓ **B)** relative scarcity of labor and capital.
- ✗ **C)** technological advancement.

Explanation

In the Heckscher-Ohlin model of trade, the source of comparative advantage is the relative scarcity of labor and capital in each country.

References

Question From: Session 5 > Reading 19 > LOS d

Related Material:

- Key Concepts by LOS

Question #48 of 196

Question ID: 413840

When additional or excess reserves are injected into the U.S. banking system, the money supply can potentially increase by an amount equal to the additional excess reserves multiplied by which of the following?

- ✓ **A)** Reciprocal of the required reserve ratio.
- ✗ **B)** Required reserve ratio.
- ✗ **C)** Reciprocal of one minus the required reserve ratio.

Explanation

The potential deposit expansion multiplier = 1 / (required reserve ratio)

The potential increase in the money supply = potential deposit expansion multiplier × increase in excess reserves

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #49 of 196

Question ID: 434262

A currency exchange rate that is set today for an exchange to be made 90 days in the future is *best* described as a:

- ✓ **A)** forward exchange rate.
- ✗ **B)** real exchange rate.
- ✗ **C)** spot exchange rate.

Explanation

A forward exchange rate is a currency exchange rate for an exchange to be made in the future. Forward rates are quoted for various future dates (e.g., 30 days, 60 days, 90 days, or one year).

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #50 of 196

Question ID: 434259

Ensuring that international trade flows smoothly and freely, settling trade disputes, and establishing agreements between trading partners *most accurately* describe the activities of the:

- ✗ **A)** International Monetary Fund.
- ✗ **B)** World Bank.
- ✓ **C)** World Trade Organization.

Explanation

The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible.

References

Question From: Session 5 > Reading 19 > LOS j

Related Material:

- Key Concepts by LOS

Question #51 of 196

Question ID: 434254

Merchandise and services, income receipts, and unilateral transfers are included in which of the balance of payments accounts?

- ✗ **A)** Financial account.
- ✓ **B)** Current account.
- ✗ **C)** Capital account.

Explanation

Merchandise and services, income receipts, and unilateral transfers are sub-accounts of the current account.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #52 of 196

Question ID: 413889

An argument against being concerned with the size of a fiscal deficit is that a deficit can:

- ✗ **A)** lead to higher future taxes that will increase government revenues.
- ✓ **B)** aid in increasing GDP and employment if the economy is operating at less than potential GDP.
- ✗ **C)** cause government borrowing to crowd out private borrowing.

Explanation

One potential argument against being concerned about the size of fiscal deficits is that a deficit can help increase GDP and employment if output is below potential GDP and the spending does not divert capital from productive uses. Higher deficits that lead to crowding out or higher future taxes that result in lower long-term economic growth are arguments for concern about the size of fiscal deficits.

References

Question From: Session 5 > Reading 18 > LOS q

Related Material:

- Key Concepts by LOS

Question #53 of 196

Question ID: 498749

An individual has just purchased a home by taking on a 30-year fixed rate mortgage. She would benefit *most* from this transaction if future inflation rates are:

- ✓ **A)** higher than anticipated.
- ✗ **B)** lower than anticipated.

✗ **C)** exactly as anticipated.

Explanation

Inflation that is higher than anticipated will result in a transfer of wealth from lenders to borrowers.

References

Question From: Session 5 > Reading 18 > LOS g

Related Material:

- Key Concepts by LOS

Question #54 of 196

Question ID: 413869

What are the three essential qualities an effective central bank should possess?

✗ **A)** Transparency, comprehensiveness, and consistency.

✓ **B)** Independence, credibility, and transparency.

✗ **C)** Understandability, relevance, and reliability.

Explanation

A central bank that is independent from political interference, possesses credibility, and exhibits transparency is more likely to achieve its monetary policy objectives than a central bank that lacks these qualities. The characteristics listed in the other answer choices relate to financial statements and financial reporting standards.

References

Question From: Session 5 > Reading 18 > LOS j

Related Material:

- Key Concepts by LOS

Question #55 of 196

Question ID: 472414

A government that imposes restrictions on capital flows into or out of the country is *most likely* attempting to:

✓ **A)** reduce the volatility of domestic asset prices.

✗ **B)** encourage competition in domestic industries.

✗ **C)** increase domestic interest rates.

Explanation

Reasons commonly cited by governments for imposing capital restrictions include reducing the volatility of domestic asset prices, maintaining control of exchange rates, keeping domestic interest rates low, and protecting strategic industries from foreign ownership.

References

Question From: Session 5 > Reading 19 > LOS g

Related Material:

- Key Concepts by LOS

Question #56 of 196

Question ID: 413864

Assume the U.S. economy is undergoing a recession. In its efforts to stimulate the economy by trying to influence short-term interest rates the Fed is *most likely* to take which two actions?

✗ **A)** Sell Treasury securities and decrease bank reserve requirements.

✗ **B)** Sell Treasury securities and increase bank reserve requirements.

✓ **C)** Buy Treasury securities and decrease bank reserve requirements.

Explanation

If the economy is in a recession, the Fed is likely to attempt to decrease short-term interest rates. Thus, the Fed will buy Treasury securities and decrease bank reserve requirements.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #57 of 196

Question ID: 413951

In the currency market, traders quote the:

✗ **A)** real exchange rate.

✓ **B)** nominal exchange rate.

✗ **C)** base currency rate.

Explanation

The nominal exchange rate is quite simply the price of one currency relative to another. It is the quote observed in currency markets.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #58 of 196

Question ID: 413880

Which of the following statements regarding the monetary policy transmission mechanism is *most* accurate?

✓ **A)** Central banks can control short-term interest rates directly, but long-term interest rates are beyond their control.

✗ **B)** Central banks can control short-term interest rates by increasing the money supply to increase interest rates or by decreasing the money supply to decrease interest rates.

✗ **C)** Central banks can control long-term interest rates directly because decisions by consumers and businesses are based on these rates.

Explanation

Central banks can control short-term interest rates directly. However, the decisions of consumers and businesses are based on long-term interest rates, which are beyond the control of central banks. Increasing the money supply will decrease interest rates and decreasing the money supply will increase interest rates.

References

Question From: Session 5 > Reading 18 > LOS n

Related Material:

- Key Concepts by LOS

Question #59 of 196

Question ID: 434264

If the current spot exchange rate for quotes of JPY/GBP is greater than the no-arbitrage 3-month forward exchange rate, the 3-month GBP interest rate is:

✗ **A)** less than the 3-month JPY interest rate.

✓ **B)** greater than the 3-month JPY interest rate.

✗ **C)** equal to the 3-month JPY interest rate.

Explanation

$\frac{\text{forward}_{JPY/GBP}}{\text{spot}_{JPY/GBP}} = \frac{(1 + \text{interest rate}_{JPY})}{(1 + \text{interest rate}_{GBP})}$. If the no-arbitrage forward JPY/GBP rate is less than the spot rate, the interest rate for JPY must be less than the interest rate for GBP.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS

Question #60 of 196

Question ID: 413927

David Forsythe and Linda Novak are discussing the advantages and disadvantages of import restrictions. They state the following:

> Forsythe: One of the groups that benefits from import restrictions is often the government that imposes them.
> Novak: Import restrictions impose costs on specific groups, such as the country's import industries, but these costs are more than offset by the benefits to other groups and to the economy as a whole.

With respect to these statements:

- ✗ **A)** both are incorrect.
- ✗ **B)** both are correct.
- ✓ **C)** only one is correct.

Explanation

Forsythe is correct. A primary reason why trade restrictions remain widespread is the revenue that governments receive from tariffs. Novak is incorrect. Trade restrictions benefit specific groups, such as workers in the protected industries, but those benefits are most often less than the costs imposed on consumers and other industries as a whole.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #61 of 196

Question ID: 413925

Suppose the world price of Mercury tennis shoes is $60, but they sell in the U.S. for $75 due to a $15 import tariff. Who will *most likely* be negatively affected by the tariff?

- ✗ **A)** Foreign consumers.
- ✓ **B)** U.S. consumers.
- ✗ **C)** Producers.

Explanation

Tariffs benefit domestic producers of products because the level of imports will be reduced due to an effective increase in the price of the goods. Consumers in the country lose due to higher prices.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #62 of 196

Question ID: 413989

The Marshall-Lerner condition suggests that a country's ability to narrow a trade deficit by devaluing its currency depends on:

- ✗ **A)** national saving relative to domestic investment.
- ✓ **B)** elasticity of demand for imports and exports.
- ✗ **C)** capacity utilization in the domestic economy.

Explanation

The Marshall-Lerner condition is an outcome of the elasticities approach to analyzing the balance of trade. It suggests that depreciation or devaluation of a currency is more likely to narrow a country's trade deficit if domestic demand for imports and foreign demand for the country's exports are more elastic. The absorption approach to analyzing the balance of trade implies that national saving must increase relative to domestic investment for a currency devaluation to narrow a trade deficit, which in turn depends on whether the economy is producing at maximum capacity (full employment or potential GDP) when the devaluation occurs.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS

Question #63 of 196

Question ID: 434253

Capital transfers and sales of non-financial assets are included in which of the balance of payments accounts?

- ✓ **A)** Capital account.
- ✗ **B)** Current account.
- ✗ **C)** Financial account.

Explanation

Capital transfers and sales of non-financial assets are sub-accounts of the capital account.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #64 of 196

Question ID: 413860

Frequent changes in advertised prices are one of the costs of:

✓ **A)** both expected and unexpected inflation.

✗ **B)** unexpected inflation only.

✗ **C)** expected inflation only.

Explanation

Inflation imposes "menu costs" on an economy as businesses must frequently change their advertised prices, regardless of whether inflation is expected or unexpected.

References

Question From: Session 5 > Reading 18 > LOS g

Related Material:

- Key Concepts by LOS

Question #65 of 196

Question ID: 413844

If households are holding larger real money balances than they desire, which of the following is *least likely*?

✗ **A)** The interest rate is higher than its equilibrium rate in the market for real money balances.

✓ **B)** The central bank must sell securities to absorb the excess money supply and establish equilibrium.

✗ **C)** The opportunity cost of holding money balances will decrease.

Explanation

If households' real money balances are larger than they desire, the interest rate (opportunity cost of holding money balances) is higher than its equilibrium rate. Households will use their undesired excess cash to buy securities, bidding up securities prices and reducing the interest rate toward equilibrium. This market process does not require any action by the central bank.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #66 of 196

Question ID: 413926

Who benefits *least* from tariffs?

✗ **A)** Foreign consumers.

✗ **B)** Domestic producers.

✓ **C)** Domestic consumers.

Explanation

A tax imposed on imports is called a tariff, which benefits domestic producers and domestic governments. Domestic consumers lose through higher prices, less choice of products, and lower quality products.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #67 of 196

Question ID: 413917

Which type of advantage determines the pattern of trade in the world?

✗ **A)** Absolute advantage.

✗ **B)** Advantages due to tariffs and quotas.

✓ **C)** Comparative advantage.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. According to the law of comparative advantage, trading partners are *both* better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for goods for which they are the high-opportunity cost producer.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #68 of 196

Question ID: 702536

The table below outlines the possible tradeoffs of producing units of cloth and corn, using one hour of labor input, for Country A and Country B.

Country A		Country B	
Units of Cloth	*Units of Corn*	*Units of Cloth*	*Units of Corn*
14	4	16	8

Country A has a comparative advantage in producing:

- ✓ **A)** cloth.
- ✗ **B)** corn.
- ✗ **C)** neither cloth nor corn.

Explanation

To produce a unit of cloth, Country A must give up 4/14 = 0.29 units of corn, while Country B must give up 8/16 = 0.50 units of corn. Therefore Country A has a comparative advantage (i.e., a lower opportunity cost) in producing cloth.

To produce a unit of corn, Country A must give up 14/4 = 3.5 units of cloth, while Country B must give up 16/8 = 2.0 units of cloth. Therefore Country B has a comparative advantage in producing corn.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #69 of 196

Question ID: 413879

The *most likely* reason for deflation to persist despite expansionary monetary policy is:

- ✗ **A)** bond market vigilantes.
- ✓ **B)** a liquidity trap.
- ✗ **C)** inelastic demand for money.

Explanation

Deflation is often associated with liquidity trap conditions. A liquidity trap is a situation in which demand for money becomes highly elastic. Expanding the money supply has little effect on economic activity under these conditions because individuals and firms choose to hold the additional money in cash. "Bond market vigilantes" is an expression referring to the fact that expansionary monetary policy may cause long-term interest rates to increase, instead of decreasing as intended, if bond market participants expect the expansionary policy to increase future inflation rates.

References

Question From: Session 5 > Reading 18 > LOS n

Related Material:

- Key Concepts by LOS

Question #70 of 196

Question ID: 413982

Currency depreciation is *most likely* to affect the balance of trade when a country's imports are goods that:

- ✗ **A)** represent a small proportion of consumer spending.
- ✗ **B)** have relatively inelastic demand.
- ✓ **C)** have close substitutes.

Explanation

According to the elasticities approach, the more elastic the demand for imports or exports, the greater the effect on the balance of trade from currency depreciation. Demand is more elastic for imports or exports when they are primarily goods with close substitutes, luxury goods, or goods that represent a large proportion of a consumer's spending.

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS

Question #71 of 196

Question ID: 413839

On January 5, the U.S. Federal Reserve (the Fed) bought $10,000,000 of U.S. Treasury securities in the open market. At the time, the reserve requirement was 25%, and all banks had zero excess reserves. What is the potential impact of the Fed's purchase on the U.S. money supply?

- ✗ **A)** $25,000,000 decrease.
- ✓ **B)** $40,000,000 increase.
- ✗ **C)** $10,000,000 increase.

Explanation

Buying securities by the Fed increases the money supply because they are injecting money into the banking system. The money supply can potentially increase by 1 / 0.25 × $10,000,000 = $40,000,000.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #72 of 196

Question ID: 413954

Participants in foreign exchange markets that can be characterized as "real money accounts" *most likely* include:

- ✗ **A)** central banks.
- ✓ **B)** insurance companies.
- ✗ **C)** hedge funds.

Explanation

Real money accounts are foreign exchange buy-side investors that do not use derivatives. Many mutual funds, pension funds, and insurance companies can be classified as real money accounts. Hedge funds typically use derivatives. Central banks usually do not act as investors in foreign exchange markets but may intervene in foreign exchange markets to achieve monetary policy objectives.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS

Question #73 of 196

Question ID: 413919

In the Heckscher-Ohlin model, whether a country has a comparative advantage relative to another country is determined by:

- ✓ **A)** amounts of labor and capital the countries possess.
- ✗ **B)** labor productivity differences.
- ✗ **C)** capital productivity differences.

Explanation

In the Heckscher-Ohlin model a country that has relatively more capital will export capital-intensive goods and import labor-intensive goods, while a country that has relatively more labor will export labor-intensive goods and import capital-intensive goods.

References

Question From: Session 5 > Reading 19 > LOS d

Related Material:

- Key Concepts by LOS

Question #74 of 196

Question ID: 494898

The table below outlines the possible output per unit of labor input of producing beer and cheese for Germany and Holland.

Germany		*Holland*	
Cheese	*Beer*	*Cheese*	*Beer*
5	10	4	6

Which of the following statements is *most* accurate?

- ✗ **A)** Germany would not gain from trade, because it has an absolute advantage in the production of both goods.
- ✓ **B)** Both countries would gain if Germany traded beer for Holland's cheese.
- ✗ **C)** Both countries would gain if Germany traded cheese for Holland's beer.

Explanation

Germany has an absolute advantage in both beer and cheese because it can produce more of both per unit of labor input than Holland. The opportunity cost of producing beer is 5/10 = 0.5 in Germany and 4/6 = 0.67 in Holland. The opportunity cost of producing cheese is 10/5 = 2 in Germany and 6/4 = 1.5 in Holland. Holland has a comparative advantage in producing cheese and Germany has a comparative advantage in producing beer. Both countries can gain if Germany trades beer for Holland's cheese.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #75 of 196

Question ID: 413969

The Japanese yen is trading at JPY/USD 115.2200 and the Danish krone (DKK) is trading at JPY/DKK 16.4989. The USD/DKK exchange rate is:

- ✗ **A)** 6.9835.
- ✗ **B)** 0.5260.
- ✓ **C)** 0.1432.

Explanation

The cross rate between USD and DKK is calculated in the following manner:

> (USD/JPY)(JPY/DKK) = (1 / 115.2200) × 16.4989 = USD/DKK 0.1432 (the Yen cancels out)

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #76 of 196

Question ID: 413832

Attempting to influence economic growth and inflation by changing tax rates and government spending is *best* described as:

- ✗ **A)** monetary policy.
- ✗ **B)** government policy.
- ✓ **C)** fiscal policy.

Explanation

Fiscal policy refers to actions by a government to influence economic activity through changes in taxes and government spending.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #77 of 196

Question ID: 413915

According to the law of comparative advantage:

- ✗ **A)** Mexico is considered to have a comparative advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.
- ✗ **B)** if a foreign government subsidizes the textile industry, the domestic government should impose a tariff.
- ✓ **C)** a nation will benefit from trade when it imports goods for which it is the high cost producer and exports goods for which it is the low-cost producer.

Explanation

This statement is the law of comparative advantage.

The other choices are incorrect. The law of comparative advantage supports international trade. According to the law of comparative advantage, both trading partners are better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for those goods for which they are the high-opportunity cost producer. Mexico is considered to have *an absolute* advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #78 of 196

Question ID: 413883

Which of the following statements *best* explains how automatic stabilizers work? Even without a change in fiscal policy, automatic stabilizers tend to promote:

- ✗ **A)** a budget deficit during a recession but do not promote a budget surplus during an inflationary expansion.
- ✓ **B)** a budget deficit during a recession and a budget surplus during an inflationary expansion.
- ✗ **C)** a budget surplus during a recession and a budget deficit during an inflationary expansion.

Explanation

Automatic stabilizers such as unemployment compensation, corporate profits tax, and the progressive income tax run a deficit during a business slowdown but run a surplus during an economic expansion. Therefore, they automatically implement countercyclical fiscal policy without the delays associated with policy changes that require legislative action.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #79 of 196

Question ID: 413980

The USD/EUR spot exchange rate is 1.3500 and 6-month forward points are −75. The 6-month forward exchange rate is:

- ✗ **A)** 1.3575, and the USD is at a forward discount.
- ✗ **B)** 1.3425, and the USD is at a forward discount.
- ✓ **C)** 1.3425, and the USD is at a forward premium.

Explanation

For an exchange rate quoted to four decimal places, each forward point represents 0.0001. The 6-month forward exchange rate is 1.3500 − 0.0075 = 1.3425 USD/EUR. The USD is expected to appreciate against the EUR and is trading at a forward premium.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS

Question #80 of 196

Question ID: 413930

Which of the following arguments in favor of trade restrictions is *least likely* to be supported by economists?

- ✗ **A)** Infant industries should be protected.
- ✓ **B)** Trade with low-wage countries depresses wage rates in high-wage countries.
- ✗ **C)** National defense industries should be protected.

Explanation

Trade with low-wage countries does not in itself depress wage rates since productivity must be considered. The other arguments have some support among economists.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #81 of 196

Question ID: 413963

The exchange rate of the Athelstan riyal (ATH) with the British pound is 9.00 ATH/GBP. The exchange rate of the Mordred ducat (MOR) with the U.S. dollar is 2.00 MOR/USD. If the USD/GBP exchange rate is 1.50, the ATH/MOR cross rate is *closest to*:

- ✗ **A)** 12.00 ATH/MOR.
- ✓ **B)** 3.00 ATH/MOR.
- ✗ **C)** 6.75 ATH/MOR.

Explanation

The ATH/MOR cross rate = 9.00 ATH/GBP × (1 / 1.50) GBP/USD × (1 / 2.00) USD/MOR = 3.00 ATH/MOR.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #82 of 196

Question ID: 434244

Fiscal policy includes a government's:

- ✗ **A)** spending, tax, and monetary policies.
- ✓ **B)** spending and tax policies only.
- ✗ **C)** tax policies only.

Explanation

Fiscal policy refers to a government's use of spending and taxation to meet macroeconomic goals. Monetary policy refers to central bank actions and is not considered part of fiscal policy.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #83 of 196

Question ID: 413846

The supply of money is primarily determined by:

- ✗ **A)** interest rates.
- ✗ **B)** inflation.
- ✓ **C)** the monetary authorities.

Explanation

The monetary authorities determine the quantity of money available to the economy. Inflation and interest rates affect the demand for money balances.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #84 of 196

Question ID: 413955

The sell side of the foreign exchange markets primarily consists of:

- ✓ **A)** multinational banks.
- ✗ **B)** retail investors.
- ✗ **C)** accounting firms.

Explanation

The sell side of foreign exchange markets is primarily large multinational banks. They are the primary dealers in currencies and originators of forward foreign exchange contracts.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS

Question #85 of 196

Question ID: 413902

Which one of the following Federal Reserve monetary policies, when pursued in line with the U.S. government's fiscal policies, would help increase aggregate demand during a period of high unemployment?

✓ **A)** A decrease in the discount rate.

✗ **B)** An increase in the reserve requirements for financial institutions.

✗ **C)** The sale of bonds by the Fed.

Explanation

A decrease in the Fed's lending rate is a monetary tool that the Fed can use to increase the money supply, thereby increasing aggregate demand during recessionary times when there is high unemployment. An increase in the reserve requirements and the sale of bonds by the Fed would all be restrictive monetary policies that would reduce the amount of money in the economy and reduce aggregate demand.

References

Question From: Session 5 > Reading 18 > LOS t

Related Material:

- Key Concepts by LOS

Question #86 of 196

Question ID: 413916

A country has a comparative advantage over another when:

✓ **A)** a nation has the ability to produce a good with a lower opportunity cost than another nation.

✗ **B)** it can produce a product with the fewest resources.

✗ **C)** a nation can produce more output with a given amount of input than another nation.

Explanation

A nation will have a comparative advantage in the production of good A when the number of units of B, given up to produce one unit of A, is lower than that for any other country.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #87 of 196

Question ID: 413961

If the exchange rate value of the CAD goes from USD 0.60 to USD 0.80, then the CAD:

✓ **A)** appreciated and Canadians will find U.S. goods cheaper.

✗ **B)** depreciated and Canadians will find U.S. goods more expensive.

✗ **C)** depreciated and Canadians will find U.S. goods cheaper.

Explanation

The CAD is now more expensive in terms of USD, and thus it has *appreciated*. Therefore, each CAD yields more USD than before, and Canadians are able to purchase more U.S. goods with each CAD, making U.S. goods relatively cheaper.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS

Question #88 of 196

Question ID: 413949

If we compare the prices of goods in two countries through time, we can use the price information in concert with the quoted foreign exchange rate to calculate the:

✓ **A)** real exchange rate.

✗ **B)** interest rate spread.

✗ **C)** nominal exchange rate.

Explanation

A comparison of consumption costs between two markets can, in concert with the foreign exchange rate (also called the nominal exchange rate), be used to calculate the real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #89 of 196

Question ID: 413882

Unemployment compensation is an example of:

- ✓ **A)** an automatic fiscal policy stabilizer.
- ✗ **B)** a discretionary fiscal policy stabilizer.
- ✗ **C)** an automatic monetary policy stabilizer.

Explanation

Unemployment compensation automatically rises and falls with the business cycle, therefore it is an example of an automatic fiscal policy stabilizer.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #90 of 196

Question ID: 413938

The North American Free Trade Agreement (NAFTA) is *most accurately* described as a:

- ✗ **A)** common market.
- ✗ **B)** customs union.
- ✓ **C)** free trade area.

Explanation

NAFTA is a free trade area, in which the member nations remove barriers to imports and exports among themselves. In a customs union, all members adopt common trade policies with non-members. A common market goes further, removing all barriers to movement of labor and capital among members.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #91 of 196

Question ID: 413908

This table below outlines the possible tradeoffs of producing milk and bread for Country A and Country B, in units of each product.

Country A		*Country B*	
Milk	*Bread*	*Milk*	*Bread*

0	5	0	8
10	0	12	0

Given these possible units of production:

- ☓ **A)** neither country would gain from trade.
- ✓ **B)** both countries would gain if Country A traded milk for B's bread.
- ☓ **C)** both countries would gain if Country A traded bread for B's milk.

Explanation

Country A gives up 1 bread to produce 2 milk. Country B gives up 1 bread to produce 1.5 milk. Country A should make milk and Country B should make bread.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #92 of 196

Question ID: 434246

The income from a country's citizens working abroad is included in:

- ☓ **A)** gross domestic product, but not gross national product.
- ✓ **B)** gross national product, but not gross domestic product.
- ☓ **C)** both gross domestic product and gross national product.

Explanation

Gross domestic product includes the total value of goods and services produced within a country's borders. The income of a country's citizens working abroad is included in its GNP but not in its GDP.

References

Question From: Session 5 > Reading 19 > LOS a

Related Material:

- Key Concepts by LOS

Question #93 of 196

Question ID: 472413

Which of the following is the *most likely* result of a central bank's shift to an expansionary monetary policy?

✓ **A)** Exports increase.

✗ **B)** Interest rates increase.

✗ **C)** Domestic currency appreciates.

Explanation

Expansionary monetary policy decreases interest rates. This should cause the domestic currency to depreciate, which should increase foreign demand for the country's exports.

References

Question From: Session 5 > Reading 18 > LOS k

Related Material:

- Key Concepts by LOS

Question #94 of 196

Question ID: 441026

The spot exchange rate for Canadian dollars (CAD) per Swiss franc (CHF) is 1.1350 CAD/CHF and the 12-month forward exchange rate is 1.1460 CAD/CHF. The forward quote is a:

✓ **A)** premium of 110 points and the CAD is at a forward discount to the CHF.

✗ **B)** premium of 11 points and the CAD is at a forward premium to the CHF.

✗ **C)** discount of 110 points and the CAD is at a forward discount to the CHF.

Explanation

Because the forward CAD/CHF exchange rate is higher than the spot rate, the quote is a forward premium. Forward points represent 0.0001 for an exchange rate quoted to four decimal places. Here, the forward discount is 1460 − 1350 = 110 points. The base currency, the CHF, is at a forward premium to the CAD, therefore the CAD is at a forward discount to the CHF.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS

Question #95 of 196

Question ID: 413865

When the Federal Reserve sells government securities on the open market, bank reserves are:

✗ **A)** decreased, which reduces the amount of money banks are able to lend, causing a decrease in the federal funds rate.

✗ **B)** increased, which increases the amount of money banks are able to lend, causing a decrease in the federal funds rate.

✓ **C)** decreased, which reduces the amount of money banks are able to lend, causing an increase in the federal funds rate.

Explanation

When the Federal Reserve wants to increase the federal funds rate through open market operations, it sells government securities. Open-market sales reduce bank reserves and cause the federal funds rate to increase.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #96 of 196

Question ID: 434255

In the balance of payments accounts, goods and financial assets that migrants bring to a country are included in the:

✓ **A)** capital account.

✗ **B)** current account.

✗ **C)** financial account.

Explanation

The capital account includes goods and financial assets that migrants bring when they come to a country or take with them when they leave.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #97 of 196

Question ID: 413948

Other things equal, a real exchange rate (stated as units of domestic currency per unit of foreign currency) will decrease as a result of an increase in the:

✓ **A)** domestic price level.

✗ **B)** nominal exchange rate (domestic/foreign).

✗ **C)** foreign price level.

Explanation

An increase in the domestic price level, other things equal, will decrease a real exchange rate. Increases in the nominal exchange rate or the foreign price level, other things equal, will increase a real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #98 of 196

Question ID: 413933

Prior to the beginning of summer, the government of Japan places a 150 percent tariff on imported chain saws. Assume for this example that this tariff has a significant impact on the supply of chain saws. The government's action:

- ✗ **A)** is more harmful than if the government had limited the amount of chain saws imported.
- ✓ **B)** benefits the Japanese government and domestic producers.
- ✗ **C)** will protect the jobs and high wages of Japanese chain saw industry workers.

Explanation

The Japanese government's action is an example of a *tariff*. A tariff is a tax imposed on imports and benefits the Japanese government because it collects the tariff. Domestic producers benefit because the reduction in the supply of imported goods means a higher domestic price.

The other choices are incorrect. A tariff is considered *less* harmful than a quota (an import quantity limitation) because under a quota, the domestic government does *not* receive any funds as it would under a tariff (the foreign producers receive the revenue transfer). In the long run, trade restrictions do not protect the net number of jobs in the country. The number of jobs protected by import restrictions will be offset by jobs lost in the import/export industry. Import/export firms will be unable to sell the overpriced domestic products abroad or import and sell the lower priced restricted foreign-made product.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #99 of 196

Question ID: 434248

Costs of international trade are *most likely* borne by:

- ✗ **A)** consumers who have fewer choices of goods.
- ✓ **B)** industries competing with imported goods.
- ✗ **C)** consumers who pay higher prices for consumer goods.

Explanation

Industries competing with imported goods may experience lower profit and employment due to international trade.

References

Question From: Session 5 > Reading 19 > LOS b

Related Material:

- Key Concepts by LOS

Question #100 of 196

Question ID: 413843

Which of the following relationships in regard to the quantity theory of money is *least* accurate?

- ✗ **A)** Nominal GDP = Money Supply × Velocity = Price × Real Output.
- ✗ **B)** Money × Velocity = Money Supply × Velocity.
- ✓ **C)** Nominal GDP = Price × Money Supply.

Explanation

The quantity theory of money holds that: Money Supply × Velocity = Nominal GDP = Price × Real Output.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #101 of 196

Question ID: 498751

Under the absorption approach, which of the following is *least likely* required to move the balance of payments towards surplus?

- ✓ **A)** Sufficient elasticities of export and import demand.
- ✗ **B)** Increased savings relative to domestic investment.
- ✗ **C)** Decreased domestic expenditure relative to income.

Explanation

Under the *elasticities approach* the elasticities of demand for exports and imports are the key to moving a country's balance of payments towards surplus. The *absorption approach* considers capital flows as well as goods flows. Under this approach, domestic expenditure relative to income must decrease to move the balance of trade towards surplus. Decreasing domestic expenditure relative to income is equivalent to increasing domestic savings, and an increase in savings relative to the current level of domestic investment will also move the balance of payments towards surplus under the absorption approach.

References

Question From: Session 5 > Reading 20 > LOS j

Related Material:

- Key Concepts by LOS

Question #102 of 196

Question ID: 413979

Spot and one-month forward exchange rates are as follows:

	Spot	*1-month forward*
EUR/DEF	2.5675	2.5925
EUR/GHI	4.3250	4.2800
EUR/JKL	7.0625	7.0075

Based on these exchange rates, the EUR is *closest* to a 1-month forward:

- ✗ **A)** premium of 1% to the DEF.
- ✗ **B)** discount of 1% to the JKL.
- ✓ **C)** premium of 1% to the GHI.

Explanation

The EUR is at a forward premium to the GHI because the EUR/GHI forward rate is less than the EUR/GHI spot rate. The base currency, GHI, is at a forward discount of forward/spot - 1 = 4.2800 / 4.3250 - 1 = -1.04%. The EUR is at a forward discount to the DEF and a forward premium to the JKL.

References

Question From: Session 5 > Reading 20 > LOS g

Related Material:

- Key Concepts by LOS

Question #103 of 196

Question ID: 413887

Robert Necco and Nelson Packard are economists at Economic Research Associates. ERA asks Necco and Packard for their opinions about the effects of fiscal policy on real GDP for an economy currently experiencing a recession. Necco states that real GDP is likely to increase if both government spending and taxes are increased by the same amount. Packard states that if both government spending and taxes are increased by the same amount, there is no expected net effect on real GDP.

Are the statements made by Necco and Packard CORRECT?

Necco	Packard

☓ **A)** Incorrect Incorrect

✓ **B)** Correct Incorrect

☓ **C)** Incorrect Correct

Explanation

Necco is correct because the multiplier effect is stronger for government expenditures versus government taxes. All of the increase in government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save). Packard is incorrect; the effect on real GDP of an increase in government spending combined with equal increase in taxes will be positive because the multiplier effect is stronger for government spending versus the tax increase.

References

Question From: Session 5 > Reading 18 > LOS p

Related Material:

- Key Concepts by LOS

Question #104 of 196

Question ID: 413849

The demand for money curve represents the relationship between the quantity of money demanded and:

☓ **A)** the quantity of money supplied.

✓ **B)** short-term interest rates.

☓ **C)** the price level.

Explanation

The demand for money curve represents the relationship between short-term interest rates and the quantity of real money that households and firms demand to hold.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #105 of 196

Question ID: 413877

To determine whether monetary policy is expansionary or contractionary, an analyst should compare the central bank's policy rate to the:

✓ **A)** neutral interest rate.

✗ **B)** target inflation rate.

✗ **C)** trend rate of real growth.

Explanation

The neutral interest rate is the sum of the trend rate of real economic growth and the target inflation rate. Monetary policy is expansionary if the policy rate is less than the neutral interest rate and contractionary if the policy rate is greater than the neutral interest rate.

References

Question From: Session 5 > Reading 18 > LOS m

Related Material:

- Key Concepts by LOS

Question #106 of 196

Question ID: 445333

The *most* accurate description of the relative roles played by the International Monetary Fund, World Bank, and World Trade Organization is that the only one explicitly focused on:

✗ **A)** expanding international trade is the World Trade Organization.

✓ **B)** reducing poverty is the World Bank.

✗ **C)** providing funding to member nations is the International Monetary Fund.

Explanation

The World Bank has the explicit mission of fighting poverty. Both the WTO and IMF work to expand international trade. Both the World Bank and IMF provide funds to member nations, the World Bank for development and the IMF when member nations experience balance of payments difficulties.

References

Question From: Session 5 > Reading 19 > LOS j

Related Material:

- Key Concepts by LOS

Question #107 of 196

Question ID: 500858

Which of the following is *least likely* a common objective of governmental capital restrictions?

✓ **A)** Keep domestic interest rates high.

✗ **B)** Maintain fixed exchange rates.

✗ **C)** Reduce the volatility of domestic asset prices.

Explanation

A common objective of capital restrictions is to keep domestic interest rates low (not high), by eliminating competition by other countries for investor funds. The other two choices are common objectives of capital restrictions.

References

Question From: Session 5 > Reading 19 > LOS g

Related Material:

- Key Concepts by LOS

Question #108 of 196

Question ID: 413899

A government that is implementing a contractionary fiscal policy is *most likely* to:

✗ **A)** decrease income tax rates.

✗ **B)** increase spending on public works.

✓ **C)** decrease transfer payments to households.

Explanation

Decreasing spending or increasing taxes are contractionary fiscal policy actions. Increasing spending or decreasing taxes are expansionary.

References

Question From: Session 5 > Reading 18 > LOS s

Related Material:

- Key Concepts by LOS

Question #109 of 196

Question ID: 413833

A distinction between fiscal policy and monetary policy is that fiscal policy:

✗ **A)** is aimed at promoting economic growth, while monetary policy is aimed at promoting price stability.

✗ **B)** is typically expansionary, while monetary policy is typically contractionary.

✓ **C)** concerns taxes and government spending, while monetary policy concerns the money supply.

Explanation

The distinction between fiscal and monetary policy is that a country's government determines fiscal policy through taxes and spending, but its central bank determines monetary policy by controlling the money supply. Both fiscal and monetary policy can be used to promote economic growth and price stability. Either fiscal policy or monetary policy can be expansionary or contractionary.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #110 of 196

Question ID: 413913

The law of comparative advantage holds that trading partners can be made better off if they:

- ✓ **A)** specialize in production of goods for which they are the low opportunity cost producer.
- ✗ **B)** import those goods for which they have a comparative advantage.
- ✗ **C)** specialize in production of goods for which they are the low exchange rate adjusted producer.

Explanation

The law of comparative advantage holds that trading partners can be made better off if they specialize in production of goods for which they are the low opportunity cost producer. They should export, not import, goods for which they have a comparative advantage. Absolute and exchange rate adjusted costs are not relevant to the concept of comparative advantage.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #111 of 196

Question ID: 413895

Which of the following statements about achieving proper timing in fiscal policy is *least* accurate?

- ✗ **A)** There is usually a time lag between when a change in policy is needed and when the need is recognized by policy makers.
- ✓ **B)** Improvements in quantitative methods have made the occurrence of recessions or expansions quite predictable.
- ✗ **C)** Policy errors are inevitable due to unpredictable events.

Explanation

One problem in achieving proper timing in fiscal policy is the inability to accurately predict a recession or expansion.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #112 of 196

Question ID: 434251

In 20X5, Carthage's merchandise imports exceeded the value of its merchandise exports. In this case, Carthage would *most likely* have which of the following?

✓ **A)** Capital account surplus.

✗ **B)** Current account surplus.

✗ **C)** Balance of trade surplus.

Explanation

If a country is running a current account deficit, it must have an inflow of foreign capital, creating a surplus in the capital account.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #113 of 196

Question ID: 413893

The time it takes for policy makers to enact a fiscal policy action is *best* described as:

✗ **A)** implementation lag.

✓ **B)** action lag.

✗ **C)** legislative lag.

Explanation

The time it takes for fiscal policy actions to be proposed, approved, and implemented is referred to as action lag.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #114 of 196

Question ID: 413858

Which of the following is *least likely* to be a function of the central bank?

- ✗ **A)** Issue currency.
- ✓ **B)** Tax collection.
- ✗ **C)** Control money supply.

Explanation

The three functions of a central bank are to issue a country's currency, regulate its banking system, and to manage the money supply. Tax collection is typically conducted by a government agency created specifically to carry out that function.

References

Question From: Session 5 > Reading 18 > LOS f

Related Material:

- Key Concepts by LOS

Question #115 of 196

Question ID: 413957

Which of the following would least likely be a participant in the forward market?

- ✗ **A)** Arbitrageurs.
- ✗ **B)** Traders.
- ✓ **C)** Long-term investors.

Explanation

Forward contracts are for 30, 90, 180, and 360-day periods and would, therefore, be considered short-term investment choices. Other participants in the forward market are hedgers who use forward contracts to protect the home currency value of foreign currency denominated assets on their balance sheets over the life of the contracts involved.

References

Question From: Session 5 > Reading 20 > LOS b

Related Material:

- Key Concepts by LOS

Question #116 of 196

Question ID: 413960

The exchange rate for Japanese yen (JPY) per euro (EUR) changes from 98.00 to 103.00 JPY/EUR. How has the value of the EUR changed relative to the JPY in percentage terms?

☓ **A)** Appreciated by 4.9%.

☓ **B)** Depreciated by 4.9%.

✓ **C)** Appreciated by 5.1%.

Explanation

Because the exchange rates are quoted with the EUR as the base currency, the percentage change is simply 103.00 / 98.00 − 1 = 5.1%. The increase in the quoted JPY/EUR exchange rate means it now requires 5.1% more JPY to purchase one EUR. Thus, the EUR has appreciated by 5.1% against the JPY.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS

Question #117 of 196

Question ID: 413872

Silvano Jimenez, an analyst at Banco del Rey, is reviewing recent actions taken by the U.S. Federal Reserve (the Fed) in setting monetary policy. Recently, the Fed decided to increase the money supply, which has resulted in a decrease in real interest rates. At a staff meeting, Jimenez brings this matter to the attention of his colleagues and makes the following statements:

Statement 1: Although the money supply increase has led to a decrease in real interest rates, we should begin to see U.S. investors decrease their investments abroad and the U.S. dollar will appreciate in the foreign exchange market.

Statement 2: The Fed's increase in the money supply will increase the amount of imports into the U.S.

Are Statement 1 and Statement 2 as made by Jimenez CORRECT?

	Statement 1	Statement 2
☓ **A)**	Correct	Incorrect
✓ **B)**	Incorrect	Incorrect
☓ **C)**	Incorrect	Correct

Explanation

If the Fed increases the money supply and real interest rates decline, U.S. investors will seek higher real rates of return abroad and the U.S. dollar will depreciate as the dollar will be exchanged for foreign currencies in order to buy the foreign investments. Likewise, the decrease in real interest rates will reduce the inflow of funds from abroad as foreign investors seek higher rates of return outside the U.S. With a dollar that has depreciated, U.S. exports should increase, as U.S. products will become cheaper for foreign buyers. As such, both statements are incorrect.

References

Question From: Session 5 > Reading 18 > LOS k

Related Material:

- Key Concepts by LOS

Question #118 of 196

Question ID: 434250

The most integrated type of trading bloc or regional trade agreement is a(n):

- ✗ **A)** common market.
- ✗ **B)** economic union.
- ✓ **C)** monetary union.

Explanation

A monetary union, such as the European Union, is the most integrated type of trading bloc or regional trade agreement because the members adopt a common currency.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #119 of 196

Question ID: 434240

Central banks pursuing expansionary policies may:

- ✗ **A)** increase the policy rate and make open market purchases of securities.
- ✗ **B)** decrease the policy rate and make open market sales of securities.
- ✓ **C)** decrease the policy rate and make open market purchases of securities.

Explanation

Decreasing the policy rate, decreasing reserve requirements, and purchasing securities in the open market are expansionary monetary policy actions.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #120 of 196

Question ID: 492013

A government that wishes to reduce the volatility of domestic asset prices and protect domestic industries is *most likely* to:

- ✗ **A)** participate in regional trading agreements.
- ✓ **B)** impose capital restrictions.
- ✗ **C)** adopt voluntary export restraints.

Explanation

Objectives commonly cited for imposing capital restrictions include reducing the volatility of domestic asset prices, protecting domestic industries, maintaining fixed exchange rates, and keeping domestic interest rates low.

References

Question From: Session 5 > Reading 19 > LOS g

Related Material:

- Key Concepts by LOS

Question #121 of 196

Question ID: 413861

Compared to the costs of inflation that is unexpected, costs of inflation that iscorrectly anticipated are *most likely* to be:

- ✓ **A)** less severe.
- ✗ **B)** equally severe.
- ✗ **C)** more severe.

Explanation

Costs of inflation are less severe when inflation is correctly anticipated than when inflation is unexpected. Unexpected inflation results in wealth being transferred from lenders to borrowers. In addition, producers might misallocate resources if they cannot determine whether an increase in the price of their output reflects inflation or a genuine increase in demand.

References

Question From: Session 5 > Reading 18 > LOS g

Related Material:

- Key Concepts by LOS

Question #122 of 196

Question ID: 413890

Arguments for being concerned about the size of a fiscal deficit *least likely* include:

☓ **A)** the crowding-out effect.

✓ **B)** Ricardian equivalence.

☓ **C)** a reduction in long-term economic growth.

Explanation

If Ricardian equivalence holds, private savings will increase in anticipation of the future taxes required by a fiscal deficit. The crowding-out effect of government borrowing on private investment and the reduction in long-term economic growth due to higher future taxes argue in favor of being concerned about the size of a fiscal deficit.

References

Question From: Session 5 > Reading 18 > LOS q

Related Material:

- Key Concepts by LOS

Question #123 of 196

Question ID: 413967

If the CAD is trading at USD/CAD 0.6403 and the GBP is trading CAD/GBP 2.5207, the USD/GBP exchange rate is:

☓ **A)** 3.9367.

✓ **B)** 1.6140.

☓ **C)** 0.6196.

Explanation

USD/CAD 0.643 × CAD/GBP 2.5207 = USD/GBP 1.6140.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #124 of 196

Question ID: 434241

If a central bank's targeted inflation rate is above the current rate, the central bank is *most likely* to:

☓ **A)** increase the reserve requirement.

✓ **B)** buy government securities.

☓ **C)** increase the overnight lending rate.

Explanation

Buying government securities is an expansionary policy that would increase the money supply and allow the inflation rate to increase to the targeted range. Increasing reserve requirements and overnight lending rates are contractionary and would have the opposite effects.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #125 of 196

Question ID: 413922

In the context of foreign trade, quotas are *best* described as:

✓ **A)** limits on the amounts of imports a country allows over some period.

✗ **B)** government payments to firms that export goods.

✗ **C)** taxes on imported goods collected by the government.

Explanation

Quotas are limits on the amounts of imports allowed into a country in a period of time. Government payments to firms that export goods are known as export subsidies. Taxes on imported goods collected by the government are known as tariffs.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #126 of 196

Question ID: 434245

Arguments against being concerned about the size of a fiscal deficit include:

✗ **A)** higher future taxes.

✗ **B)** the crowding-out effect.

✓ **C)** Ricardian equivalence.

Explanation

Ricardian equivalence suggests that it does not matter whether a government finances its spending with debt or a tax increase because the effect on the total level of demand in the economy is the same. Arguments for being concerned about the size of the fiscal deficit include the crowding-out effect of government borrowing taking the place of private sector borrowing and the negative effects on work incentives and entrepreneurship from higher future taxes.

References

Question From: Session 5 > Reading 18 > LOS q

Related Material:

- Key Concepts by LOS

Question #127 of 196

Question ID: 413850

If the money interest rate is measured on the y-axis and the quantity of money is measured on the x-axis, the money supply curve is:

✓ **A)** vertical.
✗ **B)** upward sloping to the upper right.
✗ **C)** downward sloping to the lower right.

Explanation

The money supply schedule is vertical because it is not affected by changes in the interest rate but is determined by the monetary authorities such as the Federal Reserve System (Fed) in the United States.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #128 of 196

Question ID: 413897

The country of Zurkistan is experiencing both high interest rates and high inflation. The government passes laws that reduce government spending and increase taxes. It takes many months before interest rates fall and inflation is reduced. This is an example of:

✗ **A)** recognition lag in discretionary fiscal policy.
✓ **B)** impact lag in discretionary fiscal policy.
✗ **C)** action lag and automatic stabilizers.

Explanation

This is an example of discretionary fiscal policy involving impact lag because it takes time for the impact of the change in taxing and spending to be felt throughout the economy.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #129 of 196

Question ID: 413881

Discretionary fiscal policy refers to:

✓ **A)** active decisions regarding spending and taxing to affect economic growth.

✗ **B)** increasing aggregate demand through lower interest rates.

✗ **C)** built-in devices that counteract the business cycle phase.

Explanation

Discretionary fiscal policy, in contrast to automatic stabilizers, refers to active decisions by the government to affect economic growth through changes in government spending and taxation. Increasing aggregate demand through lower interest rates describes expansionary *monetary* policy.

References

Question From: Session 5 > Reading 18 > LOS o

Related Material:

- Key Concepts by LOS

Question #130 of 196

Question ID: 413924

An anti-dumping restriction on trade:

✗ **A)** protects infant industries.

✗ **B)** keeps some highly sensitive products in the country.

✓ **C)** prohibits foreign firms from selling products below cost to gain market share.

Explanation

Firms dump their goods at a price lower than cost in order to drive out the competition. Once this is complete, they will be able to raise prices to much higher levels in order to gain abnormal profits. Of course, once prices are increased, new competitors may arise.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #131 of 196

Question ID: 413907

Which of the following statements about the costs and benefits of international trade is *most* accurate?

✓ **A)** The costs of trade primarily affect those in domestic industries that compete with imports.

✗ **B)** Increased international trade benefits all groups in the trading countries.

✗ **C)** The costs of trade are greater than the benefits with regard to domestic employment.

Explanation

The benefits of trade are greater than the costs for the overall economy, but those in domestic industries competing with imports may suffer costs in the form of reduced profits or employment.

References

Question From: Session 5 > Reading 19 > LOS b

Related Material:

- Key Concepts by LOS

Question #132 of 196

Question ID: 413903

For a country that produces 100 million more income from foreign capital invested within the country than from domestic investment abroad, and produces 100 million more goods and services by foreign labor within the country than by its citizens abroad, gross national product is:

✗ **A)** equal to gross domestic product.

✓ **B)** less than gross domestic product.

✗ **C)** greater than gross domestic product.

Explanation

GNP measures output produced by a country's citizens and capital owned by its citizens. GDP measures output produced within a country. In this example, production within the country (GDP) is greater than production by the country's citizens (GNP).

References

Question From: Session 5 > Reading 19 > LOS a

Related Material:

- Key Concepts by LOS

Question #133 of 196

Question ID: 413943

In a country that has a current account surplus, it is *most likely* that:

✗ **A)** private domestic savings are greater than the budget deficit.

✗ **B)** domestic investment is greater than government savings.

✓ **C)** domestic savings are greater than domestic investment.

Explanation

The relationship between saving, investment, and the trade deficit can be expressed as:
(exports - imports) = private savings + government savings - investment

A country will have a current account surplus (exports > imports) if the sum of domestic private savings and government savings is greater than domestic investment, or a current account deficit (imports > exports) if the sum of domestic private savings and government savings is less than domestic investment.

References

Question From: Session 5 > Reading 19 > LOS i

Related Material:

- Key Concepts by LOS

Question #134 of 196

Question ID: 413856

If a bank needs to borrow funds from the Federal Reserve to fund a temporary shortage in reserves, it would borrow funds at the:

✗ **A)** prime rate.

✗ **B)** federal funds rate.

✓ **C)** discount rate.

Explanation

Banks are able to borrow from the Fed at the discount rate. The federal funds rate is the interest rate banks charge other banks to borrow reserves from other banks. The prime rate is the rate that commercial banks charge their best customers.

References

Question From: Session 5 > Reading 18 > LOS f

Related Material:

- Key Concepts by LOS

Question #135 of 196

Question ID: 472412

Contractionary monetary policy is *least likely* to decrease consumption spending by decreasing:

✗ **A)** securities prices.

✓ **B)** the foreign exchange value of the currency.

✗ **C)** expectations for economic growth.

Explanation

Contractionary monetary policy is likely to increase the value of the domestic currency in the foreign exchange market, which decreases foreign demand for the country's exports. Contractionary monetary policy should cause both securities prices and expectations for economic growth to decrease, each of which is likely to cause consumers to decrease spending.

References

Question From: Session 5 > Reading 18 > LOS i

Related Material:

- Key Concepts by LOS

Question #136 of 196

Question ID: 434266

The spot rate for Japanese yen per UK pound is 138.78. If the UK interest rate is 1.75% and the Japanese interest rate is 1.25%, the 6-month no-arbitrage forward rate is *closest to:*

✗ **A)** 138.10 JPY/GBP.

✗ **B)** 138.95 JPY/GBP.

✓ **C)** 138.44 JPY/GBP.

Explanation

The calculation is as follows:

$$F_{\frac{JPY}{GBP}} = S_{\frac{JPY}{GBP}} \times \frac{(1+i_{Japan})}{(1+i_{Great\ Britain})}$$

$$= 138.78 \times \frac{(1+0.0125/2)}{(1+0.0175/2)}$$

$$= 138.44$$

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS

Question #137 of 196

Question ID: 413874

If a central bank implements an exchange rate targeting policy successfully, the country's inflation rate is *most likely* to be:

✓ **A)** the same as that of the target currency.

- ✗ **B)** less than that of the target currency.
- ✗ **C)** greater than that of the target currency.

Explanation

Successful exchange rate targeting should result in the same inflation rate in the targeting country as in the country of the target currency.

References

Question From: Session 5 > Reading 18 > LOS l

Related Material:

- Key Concepts by LOS

Question #138 of 196

Question ID: 434243

Which of the following conditions is difficult for monetary policy to address because a central bank cannot reduce its nominal policy rate below zero?

- ✓ **A)** Deflation.
- ✗ **B)** Stagflation.
- ✗ **C)** Inflation.

Explanation

Deflation is difficult for central banks to address when policy rates cannot be lowered any further. Inflation can be addressed by contractionary monetary policy. Stagflation is difficult to address because monetary policy cannot pursue higher growth and lower inflation at the same time.

References

Question From: Session 5 > Reading 18 > LOS n

Related Material:

- Key Concepts by LOS

Question #139 of 196

Question ID: 413838

The amount of money a commercial bank has available to lend is known as:

- ✗ **A)** fractional reserves.
- ✗ **B)** required reserves.
- ✓ **C)** excess reserves.

Explanation

Excess reserves are the amount of money a commercial bank has available with which to make new loans, after depositing its required reserves with the central bank.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #140 of 196

Question ID: 413898

An example of a contractionary fiscal policy change is a(n):

- ✗ **A)** increase in a fiscal deficit.
- ✓ **B)** increase in a fiscal surplus.
- ✗ **C)** decrease in a fiscal surplus.

Explanation

An increase in a fiscal surplus or a decrease in a fiscal deficit is contractionary. An increase in a fiscal deficit or a decrease in a fiscal surplus is expansionary.

References

Question From: Session 5 > Reading 18 > LOS s

Related Material:

- Key Concepts by LOS

Question #141 of 196

Question ID: 413853

According to the Fisher effect, which of the following interest rates includes a premium for the expected rate of inflation?

- ✗ **A)** Yields on long-term corporate debt, but not yields on short-term government debt.
- ✓ **B)** Both yields on short-term government debt and yields on long-term corporate debt.
- ✗ **C)** Neither yields on short-term government debt nor yields on long-term corporate debt.

Explanation

The Fisher effect holds that all nominal interest rates include a premium for expected inflation.

References

Question From: Session 5 > Reading 18 > LOS e

Related Material:

- Key Concepts by LOS

Question #142 of 196

Question ID: 485768

Two countries trade freely with each other and have agreed to specific tariffs on imports from other countries. The workers in either country may freely cross the common border to work in the other country. The two countries have agreed to common economic policies, but they use separate currencies. This type of cooperation is *best* described as a(n):

- ✗ **A)** monetary union.
- ✓ **B)** economic union.
- ✗ **C)** customs union.

Explanation

The two countries are a part of an economic union. In an economic union, there is (1) free trade among members, (2) common restrictions (tariffs) on imports from non-members, (3) free movement of production factors (labor), and (4) common economic institutions and coordination of economic policies. While a customs union has common tariffs on imports from non-union countries and free trade, it does not allow workers to cross the borders freely and does not have common economic institutions. A monetary union requires all of the listed items and a common currency.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #143 of 196

Question ID: 434267

The spot rate for Chinese yuan per Canadian dollar is 6.4440. If the Canadian interest rate is 2.50% and the Chinese interest rate is 3.00%, the 3-month no-arbitrage forward rate is *closest to:*

- ✗ **A)** 6.475 CNY/CAD.
- ✗ **B)** 6.436 CNY/CAD.
- ✓ **C)** 6.452 CNY/CAD.

Explanation

The calculation is as follows:

$$F_{\frac{CNY}{CAD}} = S_{\frac{CNY}{CAD}} \times \frac{(1 + i_{China})}{(1 + i_{Canada})}$$

$$= 6.444 \times \frac{(1 + 0.030/4)}{(1 + 0.025/4)}$$

$$= 6.452$$

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS

Question #144 of 196

Question ID: 434258

Promoting international monetary cooperation, promoting exchange stability, and assisting members experiencing balance of payments difficulties are the goals of the:

- ✗ **A)** World Trade Organization.
- ✓ **B)** International Monetary Fund.
- ✗ **C)** World Bank.

Explanation

The IMF's main goals are promoting international monetary cooperation; facilitating the expansion and balanced growth of international trade; promoting exchange stability; assisting in the establishment of a multilateral system of payments; and making resources available (with adequate safeguards) to members.

References

Question From: Session 5 > Reading 19 > LOS j

Related Material:

- Key Concepts by LOS

Question #145 of 196

Question ID: 434256

A country that has imports valued more than its exports is said to have a:

- ✗ **A)** capital account deficit.
- ✗ **B)** current account surplus.
- ✓ **C)** current account deficit.

Explanation

A country that has imports valued more than its exports is said to have a current account (trade) deficit, while countries with more exports than imports are said to have a current account surplus.

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #146 of 196

Question ID: 485766

Xanadu attempts to decrease its inflation rate by implementing contractionary monetary policy. Which of the following is *most likely* to be the long-run effect on Xanadu's trade balance as a result of the monetary policy change?

- ✗ **A)** Remain the same.
- ✗ **B)** Improve.
- ✓ **C)** Worsen.

Explanation

Contractionary monetary policy likely will cause higher domestic interest rates and attract foreign capital. As foreign capital flows in, the currency will appreciate relative to other currencies. The higher cost of its currency will result in higher cost exports that become less attractive to other countries. Xanadu's trade balance will most likely worsen.

References

Question From: Session 5 > Reading 18 > LOS k

Related Material:

- Key Concepts by LOS

Question #147 of 196

Question ID: 413834

Money serves as a unit of account because:

- ✗ **A)** money is accepted as the form of payment for goods.
- ✓ **B)** prices of goods and services are expressed in units of money.
- ✗ **C)** money received for work or goods can be saved to purchase goods or services in the future.

Explanation

Money has three primary functions: it serves as a unit of account because prices of goods and services are expressed in units of money; it provides a store of value because money received for work or goods can be saved to purchase goods or services at another time; and it serves as a medium of exchange because money is accepted as a form a payment.

References

Question From: Session 5 > Reading 18 > LOS b

Related Material:

- Key Concepts by LOS

Question #148 of 196

Question ID: 413918

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	*Country B*
Food	9	5
Drink	7	5

Which of the following statements is *most* accurate?

- ✗ **A)** Since B workers can produce more of food and drink than A workers, no gains from trade are possible.
- ✗ **B)** Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.
- ✓ **C)** Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.

Explanation

Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production. The reason centers on comparative advantage. Country A must give up 7/9th unit of drink to produce one unit of food. Country B must give up 1 unit of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for B than for A. If B produces 5 units of drink and A produces 9 units of food, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #149 of 196

Question ID: 413958

The exchange rate for Chinese yuan (CNY) per euro (EUR) changed from CNY/EUR 8.1588 to CNY/EUR 8.3378 over a 3-month period. It is *most accurate* to state that the:

- ✓ **A)** EUR has appreciated 2.19% relative to the CNY.
- ✗ **B)** CNY has depreciated 2.19% relative to the EUR.
- ✗ **C)** EUR has appreciated 2.15% relative to the CNY

Explanation

The percentage change in the CNY value of one EUR is (8.3378 / 8.1588) - 1 = 0.0219. The EUR has appreciated 2.19% relative to the CNY. This is not the same as CNY depreciating by 2.19% relative to the EUR. The percentage change in the CNY is [(1 / 8.3378) / (1 / 8.1588)] - 1 = -0.0215 = -2.15%.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS

Question #150 of 196

Question ID: 434238

The three reasons for holding money are most accurately described as:

- ✗ **A)** narrow money demand, precautionary demand, and speculative demand.
- ✓ **B)** transaction demand, precautionary demand, and speculative demand.
- ✗ **C)** broad money demand, narrow money demand, and transaction demand.

Explanation

The three reasons for holding money are: transaction demand, for buying goods and services; precautionary demand, to meet unforeseen future needs; and speculative demand, to take advantage of investment opportunities. Narrow money and broad money refer to measures of money in circulation.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #151 of 196

Question ID: 413888

Assuming the economy currently is experiencing high inflation, an example of appropriate discretionary fiscal policy is:

- ✗ **A)** reduce the money supply.
- ✓ **B)** reduce government expenditures on major government construction projects.
- ✗ **C)** increase the federal funds target rate.

Explanation

Discretionary fiscal policy refers to the federal government's decisions regarding government spending and taxing. A reduction in government spending on major government construction projects is likely to lead to a reduction in aggregate demand and less pressure on prices, reducing inflation.

References

Question From: Session 5 > Reading 18 > LOS p

Related Material:

- Key Concepts by LOS

Question #152 of 196

Question ID: 413847

Which of the following statements about the demand for and supply of money is *least* accurate?

✗ **A)** As inflation rises, the demand for money by households and businesses also rises.

✓ **B)** As the interest rate rises, the supply of money also rises.

✗ **C)** As gross domestic product rises, the demand for money balances also rises.

Explanation

The supply of money is determined by the monetary authorities and is not affected by changes in interest rates. Thus, the supply of money curve is vertical.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #153 of 196

Question ID: 413959

The exchange rate for Australian dollars per British pound (AUD/GBP) was 1.4800 five years ago and is 1.6300 today. The percent change in the Australian dollar relative to the British pound is *closest to*:

✗ **A)** appreciation of 10.1%.

✗ **B)** depreciation of 10.1%.

✓ **C)** depreciation of 9.2%.

Explanation

To correctly calculate the percentage change in AUD relative to GBP, convert the exchange rates so that AUD is the base currency: 1 / 1.4800 = 0.6757 GBP/AUD five years ago and 1 / 1.6300 = 0.6135 GBP/AUD today. The percentage change in the Australian dollar against the British pound is 0.6135 / 0.6757 − 1 = −9.2%.

Note that the GBP has appreciated against the AUD by 1.6300 / 1.4800 − 1 = 10.1% over the same period.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS

Question #154 of 196

Question ID: 413857

A country is experiencing a core inflation rate of 7% during a recessionary period of real GDP growth. If the central bank has a single mandate to achieve price stability and uses inflation targeting with an acceptable range of zero to 4%, its monetary policy response is *most likely* to decrease:

- ✓ **A)** GDP growth in the short run.
- ✗ **B)** short-term interest rates.
- ✗ **C)** the foreign exchange value of the country's currency.

Explanation

If the central bank has a price stability mandate, it will most likely respond to the above-target inflation rate by decreasing the money supply, even though GDP growth is in a recessionary phase. Decreasing the money supply will result in higher short-term interest rates and appreciation of the currency, but will likely cause GDP growth to decrease further in the short run.

References

Question From: Session 5 > Reading 18 > LOS f

Related Material:

- Key Concepts by LOS

Question #155 of 196

Question ID: 434242

Central banks that are able to define how inflation is computed and determine its desired level are *best* described as having:

- ✓ **A)** target independence.
- ✗ **B)** operational independence.
- ✗ **C)** transparency.

Explanation

Target independence means the central bank defines how inflation is computed, sets the target inflation level, and determines the horizon over which the target is to be achieved. Central banks that have operational independence are allowed to determine the policy rate. Transparency refers to the degree to which central banks report to the public on the state of the economic environment and is one of the three essential qualities of an effective central bank.

References

Question From: Session 5 > Reading 18 > LOS j

Related Material:

- Key Concepts by LOS

Question #156 of 196

Question ID: 413859

Central banks are *most likely* to pursue a target inflation rate:

✓ **A)** between 0 and 3%.

✗ **B)** above 3%.

✗ **C)** equal to 0%.

Explanation

Central banks typically define price stability as a stable inflation rate of about 2% to 3%. A target of zero is not typically used because it would risk deflation.

References

Question From: Session 5 > Reading 18 > LOS f

Related Material:

- Key Concepts by LOS

Question #157 of 196

Question ID: 413970

The spot exchange rate for CHF/EUR is 0.8342 and the 1-year forward quotation is −0.353%. The 1-year forward exchange rate for EUR/CHF is *closest to*:

✗ **A)** 1.2022.

✓ **B)** 1.2029.

✗ **C)** 0.8313.

Explanation

The forward rate for CHF/EUR is 0.8342 × (1 − 0.00353) = 0.8313. The 1-year forward EUR/CHF exchange rate is 1 / 0.8313 = 1.2030.

References

Question From: Session 5 > Reading 20 > LOS e

Related Material:

- Key Concepts by LOS

Question #158 of 196

Question ID: 413905

In contrast to gross domestic product (GDP), gross national product (GNP) includes income earned by:

X **A)** foreign labor working domestically.

✓ **B)** domestic capital invested abroad.

X **C)** foreign capital invested domestically.

Explanation

GNP includes goods and services produced outside the country by domestic factors of production, both labor and capital.

References

Question From: Session 5 > Reading 19 > LOS a

Related Material:

- Key Concepts by LOS

Question #159 of 196

Question ID: 434239

The Fisher effect describes a nominal interest rate as the:

X **A)** expected inflation rate less the real interest rate.

X **B)** actual inflation rate less the real interest rate.

✓ **C)** expected inflation rate plus the real interest rate.

Explanation

The Fisher effect states that a nominal interest rate is equal to the real interest rate plus the expected inflation rate.

References

Question From: Session 5 > Reading 18 > LOS e

Related Material:

- Key Concepts by LOS

Question #160 of 196

Question ID: 413975

If the no-arbitrage forward exchange rate for a euro in Japanese yen is less than the spot rate, then the interest rate in:

X **A)** the eurozone is less than in Japan.

✓ **B)** Japan is less than in the eurozone.

X **C)** Japan is the same as in the eurozone.

Explanation

If the quote is in terms of JPY per EUR, this implies that the JPY is expected to appreciate relative to the EUR. There will be no arbitrage opportunity only if the interest rate in Japan is lower than the interest rate in the eurozone.

References

Question From: Session 5 > Reading 20 > LOS f

Related Material:

- Key Concepts by LOS

Question #161 of 196

Question ID: 413986

With respect to exchange rate regimes, crawling bands are *most likely* used in a transition toward:

- ✗ **A)** a fixed peg arrangement.
- ✗ **B)** a monetary union.
- ✓ **C)** floating exchange rates.

Explanation

When exchange rates are managed within crawling bands, the margin around a target exchange rate increases over time. This technique is sometimes used in a transition from fixed exchange rates to freely floating exchange rates.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS

Question #162 of 196

Question ID: 413892

The time it takes for a fiscal policy action to affect the economy is *best* described as:

- ✗ **A)** fiscal lag.
- ✗ **B)** economic lag.
- ✓ **C)** impact lag.

Explanation

The time it takes for a fiscal policy action, once implemented, to have its effect on the economy is referred to as impact lag.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #163 of 196

Question ID: 696229

For an analyst interested in measuring activity within an economy, the *most appropriate* measure to use is:

- ✗ **A)** gross national product.
- ✗ **B)** national income.
- ✓ **C)** gross domestic product.

Explanation

Gross domestic product measures the economic output produced within a country Gross national product includes output produced by citizens working abroad and output from foreign productive assets owned by a country's citizens and does not include output produced within a country by foreign workers or from productive assets in the domestic economy owned by foreigners. GDP includes production to replace physical capital as it wears out; national income does not.

References

Question From: Session 5 > Reading 19 > LOS a

Related Material:

- Key Concepts by LOS

Question #164 of 196

Question ID: 434252

The balance of payments accounts consist of:

- ✓ **A)** current account, capital account, and financial account.
- ✗ **B)** current account, capital account, and currency account.
- ✗ **C)** capital account, financial account, and non-financial account.

Explanation

According to the U.S. Federal Reserve, "The BOP [balance of payments] includes the current account, which mainly measures the flows of goods and services; the capital account, which consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets; and the financial account, which records investment flows."

References

Question From: Session 5 > Reading 19 > LOS h

Related Material:

- Key Concepts by LOS

Question #165 of 196

Question ID: 413987

A country's central bank announces a monetary policy goal of a stable exchange rate with the euro, which it defines as deviations of no more than 3% from its current exchange rate of 2.5000. The country's exchange rate regime is *best* described as a:

- ✗ **A)** fixed peg.
- ✓ **B)** target zone.
- ✗ **C)** crawling band.

Explanation

This exchange rate regime is best described as a target zone, or a system of pegged exchange rates within horizontal bands. A target zone allows wider exchange rate fluctuations than a conventional fixed peg arrangement, which typically limits the permitted range to within 1% of the pegged exchange rate. Management of exchange rates within crawling bands allows the percentage deviation from the pegged exchange rate to increase over time.

References

Question From: Session 5 > Reading 20 > LOS i

Related Material:

- Key Concepts by LOS

Question #166 of 196

Question ID: 413841

On January 3, Logan Industries deposited $1,000,000 in cash at Federal Savings Bank. No excess reserves were present at the time Logan made the deposit and the required reserve ratio is 10%. What is the maximum amount by which Federal Savings Bank can increase its lending?

- ✗ **A)** $10,000,000.
- ✓ **B)** $900,000.
- ✗ **C)** $100,000.

Explanation

Since there are no excess reserves present at the time that Logan deposited the money, the bank would be required to maintain $100,000 ($1,000,000 × 0.10) on reserve and would be able to loan out or increase the money supply by $900,000.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #167 of 196

Question ID: 413966

An analyst observes that the exchange rate for Mexican pesos is MXN/USD 8.0000, and the exchange rate for Polish zlotys is PLN/USD 6.0000. The MXN/PLN exchange rate is closest to:

- ✗ **A)** 0.7500.
- ✓ **B)** 1.3333.
- ✗ **C)** 14.0000.

Explanation

The cross rate of MXN/PLN is (MXN/USD 8) / (PLN/USD 6) = 1.3333 MXN/PLN.

References

Question From: Session 5 > Reading 20 > LOS d

Related Material:

- Key Concepts by LOS

Question #168 of 196

Question ID: 413984

The spot exchange rate for United States dollars per United Kingdom pound (USD/GBP) is 1.5775. If 30-day interest rates are 1.5% in the United States and 2.5% in the United Kingdom, and interest rate parity holds, the 30-day forward USD/GBP exchange rate should be:

- ✗ **A)** 1.5621.
- ✗ **B)** 1.5788.
- ✓ **C)** 1.5762.

Explanation

Forward USD/GBP = spot USD/GBP × (1 + U.S. interest rate) / (1 + UK interest rate)
= 1.5775 × [(1 + 0.015/12) / (1 + 0.025/12)]
= 1.5762

References

Question From: Session 5 > Reading 20 > LOS h

Related Material:

- Key Concepts by LOS

Question #169 of 196

Question ID: 413835

Money functions as a store of value because:

- ✗ **A)** money is accepted as the form of payment for goods.
- ✓ **B)** money received for work or goods can be saved to purchase goods or services in the future.
- ✗ **C)** prices of goods and services are expressed in units of money.

Explanation

Money has three primary functions: it provides a store of value because money received for work or goods can be saved for future consumption; it serves as a unit of account because prices of all goods and services are expressed in units of money; and it serves as a medium of exchange because money is accepted as a form a payment.

References

Question From: Session 5 > Reading 18 > LOS b

Related Material:

- Key Concepts by LOS

Question #170 of 196

Question ID: 444963

Policies used with the goal of maintaining stable prices and producing economic growth include:

- ✓ **A)** both fiscal policy and monetary policy.
- ✗ **B)** monetary policy only.
- ✗ **C)** fiscal policy only.

Explanation

Both fiscal and monetary policies are used to maintain stable prices and produce economic growth. Fiscal policy does so by mechanisms that involve spending and taxation, and monetary policy uses central bank tools to modify the availability of money and credit.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #171 of 196

Question ID: 413906

Country P imports goods from Country Q. In the long run, the benefits of international trade *most likely* accrue to:

- ✗ **A)** Country P only.
- ✗ **B)** Country Q only.
- ✓ **C)** Both Country P and Country Q.

Explanation

The overall benefits of international trade are greater than the costs for the global economy as a whole. All countries should benefit in the long run as costs of international trade are mostly short run effects.

References

Question From: Session 5 > Reading 19 > LOS b

Related Material:

- Key Concepts by LOS

Question #172 of 196

Question ID: 413852

Which of the following is determined by the equilibrium between the demand for money and the supply of money?

✗ **A)** Money supply.

✗ **B)** Inflation rate.

✓ **C)** Interest rate.

Explanation

Interest rates are determined by the equilibrium between money supply and money demand.

References

Question From: Session 5 > Reading 18 > LOS d

Related Material:

- Key Concepts by LOS

Question #173 of 196

Question ID: 413911

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	*Country B*
Food	4	8
Drink	6	7

Which of the following statements about the chart is *most* accurate?

✗ **A)** Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.

✓ **B)** Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.

✗ **C)** Since B workers can produce more of food and drink than A workers, no gains from trade are possible.

Explanation

Mutual gains could be realized from trade if A specialized in drink production and B specialized in food production. The reason centers on comparative advantage. Country A must give up 1.5 units of drink to produce one unit of food. Country B must give up 0.875 units of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for A than for B. If B produces 8 units of food and A produces 6 units of drink, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

References

Question From: Session 5 > Reading 19 > LOS c

Related Material:

- Key Concepts by LOS

Question #174 of 196

Question ID: 413942

Other things equal, a current account deficit will tend to narrow if:

✗ **A)** taxes decrease.

✓ **B)** domestic investment decreases.

✗ **C)** private savings decrease.

Explanation

The relation between the trade deficit (the current account), savings (both private and government) and domestic investments is stated as (X - M) = private savings + government savings - investment. A current account deficit will tend to narrow if private savings increase, government savings increase (either taxes increase or government spending decreases), or domestic investment decreases.

References

Question From: Session 5 > Reading 19 > LOS i

Related Material:

- Key Concepts by LOS

Question #175 of 196

Question ID: 413831

Monetary policy refers to actions that influence economic activity by increasing or decreasing:

✗ **A)** government purchases of goods and services.

✗ **B)** tax rates on income and consumption.

✓ **C)** the supply of money and credit.

Explanation

Monetary policy attempts to influence economic growth and inflation by increasing or decreasing the money supply and the availability of credit in the economy. Taxes and government spending are tools of fiscal policy.

References

Question From: Session 5 > Reading 18 > LOS a

Related Material:

- Key Concepts by LOS

Question #176 of 196

Question ID: 413886

Assuming the federal government maintains a balanced budget, the *most likely* effects of a tax increase on government expenditures and real GDP are:

	Government Expenditures	Real GDP
✗ **A)**	Increase	Decrease
✗ **B)**	Decrease	Decrease
✓ **C)**	Increase	Increase

Explanation

The amount of the spending program exactly offsets the amount of the tax increase, leaving the budget unaffected (balanced budget). The multiplier effect is stronger for government spending versus the tax increase. Therefore, the balanced budget multiplier will be positive. All of the government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save).

References

Question From: Session 5 > Reading 18 > LOS p

Related Material:

- Key Concepts by LOS

Question #177 of 196

Question ID: 413946

The international organization whose primary role is settling disputes among trading nations is the:

✗ **A)** World Bank.

✓ **B)** World Trade Organization.

✗ **C)** International Monetary Fund.

Explanation

The role of the World Trade Organization is to deal with rules of global trade and settle trade-related disputes among nations.

References

Question From: Session 5 > Reading 19 > LOS j

Related Material:

- Key Concepts by LOS

Question #178 of 196

Question ID: 413837

Which of the following is the *most* accurate definition of the velocity of money? The velocity of money is the:

✗ **A)** GDP of a country divided by its price level.

✗ **B)** money supply of a country divided by its price level.

✓ **C)** GDP of a country divided by its money supply.

Explanation

Velocity is the average number of times per year each dollar is used to buy goods and services (velocity = nominal GDP / money). Therefore, the money supply multiplied by velocity must equal nominal GDP. The equation of exchange must hold with velocity defined in this way. Letting money supply = M, velocity = V, price = P, and real output = Y, the equation of exchange may be symbolically expressed as: $MV = PY$.

References

Question From: Session 5 > Reading 18 > LOS c

Related Material:

- Key Concepts by LOS

Question #179 of 196

Question ID: 413863

Which of the following statements regarding U.S. Federal Reserve open market operations is *least* accurate?

✓ **A)** If the Fed wants to stimulate the economy, it will sell Treasury securities to banks.

✗ **B)** When the Fed buys Treasury securities, short-term interest rates will generally decrease.

✗ **C)** When the Fed sells Treasury securities, excess reserves decrease.

Explanation

If the Fed intends to stimulate the economy, they will buy, not sell, Treasury securities. Buying Treasury securities injects reserves into the banking system.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #180 of 196

Question ID: 413962

If the exchange rate value of the CAD goes from USD 0.60 to USD 0.80, then the CAD:

- ✗ **A)** depreciated and Canadians will find U.S. goods cheaper.
- ✗ **B)** depreciated and Canadians will find U.S. goods more expensive.
- ✓ **C)** appreciated and Canadians will find U.S. goods cheaper.

Explanation

The CAD is now more expensive in terms of USD, and thus it has *appreciated*. Therefore, each CAD yields more USD than before, and Canadians are able to purchase more U.S. goods with each CAD, making U.S. goods relatively cheaper.

References

Question From: Session 5 > Reading 20 > LOS c

Related Material:

- Key Concepts by LOS

Question #181 of 196

Question ID: 413867

Which of the following policy tools is the *least likely* to be available to the U.S. Federal Reserve Board?

- ✓ **A)** Requiring the banking system to tighten or loosen its credit policies.
- ✗ **B)** Setting the discount rate at which banks can borrow from the Federal Reserve.
- ✗ **C)** Buying and selling Treasury securities in the open market.

Explanation

The U.S. Federal Reserve can encourage or persuade banks as a whole to tighten or loosen their credit policies, but it cannot compel them to do so.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #182 of 196

Question ID: 413866

If the Federal Reserve wishes to lower market interest rates without changing the discount rate, it can:

- ✗ **A)** raise the yield on Treasury securities.
- ✓ **B)** buy Treasury securities.
- ✗ **C)** increase bank reserve requirements.

Explanation

Buying Treasury securities pumps money into the economy, lowering interest rates. Higher reserve requirements will restrict the money supply, causing rates to rise. The Federal Reserve has no direct control over the yield on existing Treasury securities.

References

Question From: Session 5 > Reading 18 > LOS h

Related Material:

- Key Concepts by LOS

Question #183 of 196

Question ID: 413854

The Fisher effect holds that a nominal rate of interest equals a real rate:

- ✗ **A)** plus actual inflation.
- ✗ **B)** minus expected inflation.
- ✓ **C)** plus expected inflation.

Explanation

The Fisher effect states that a nominal rate of interest equals a real rate plus expected inflation.

References

Question From: Session 5 > Reading 18 > LOS e

Related Material:

- Key Concepts by LOS

Question #184 of 196

Question ID: 498750

Which of the following is currently the most-used target for central banks?

✗ **A)** Money supply targeting.

✗ **B)** Interest rate targeting.

✓ **C)** Inflation targeting.

Explanation

Inflation targeting is the most-used tool of central banks for making monetary policy decisions.

References

Question From: Session 5 > Reading 18 > LOS l

Related Material:

- Key Concepts by LOS

Question #185 of 196

Question ID: 413894

The time it takes for policy makers to determine that the economy requires a fiscal policy action is *best* described as:

✗ **A)** action lag.

✗ **B)** impact lag.

✓ **C)** recognition lag.

Explanation

Recognition lag refers to the time it takes for fiscal policy makers to determine the need for a policy action.

References

Question From: Session 5 > Reading 18 > LOS r

Related Material:

- Key Concepts by LOS

Question #186 of 196

Question ID: 413929

Which of the following groups in the country of Minidonia would *least likely* be helped by the imposition of tariffs on Minidonian imports of transportation equipment?

✗ **A)** Automotive manufacturers.

✗ **B)** Minidonia's government.

✓ **C)** Trucking companies.

Explanation

Tariffs on transportation equipment benefit the government in the form of tariff revenue, and benefit domestic producers and industry workers in the form of higher prices for transportation equipment. The users of transportation equipment, such as trucking companies, suffer from higher costs due to the higher prices of transportation equipment.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #187 of 196

Question ID: 413876

An analyst has determined the projected trend rate of real GDP growth is 2.5% and the central bank's inflation target is 2.5%. If the central bank policy rate is 5.0%, monetary policy is *most likely*:

- ✗ **A)** contractionary.
- ✗ **B)** expansionary.
- ✓ **C)** neutral.

Explanation

The neutral rate of interest is real trend rate of economic growth plus the inflation target. In this example, the neutral rate = 2.5% +2.5% = 5.0%. Because the policy rate is the same as the neutral rate of interest, monetary policy is neither contractionary nor expansionary.

References

Question From: Session 5 > Reading 18 > LOS m

Related Material:

- Key Concepts by LOS

Question #188 of 196

Question ID: 485767

The government is reducing its spending to balance the budget, while the central bank is lowering its official policy rate. What will *most likely* be the combined effect on the economy?

- ✗ **A)** The public and private sectors as a percentage of GDP will neither decrease nor increase.
- ✗ **B)** The public sector as a percentage of GDP will increase.
- ✓ **C)** The private sector as a percentage of GDP will increase.

Explanation

The private sector will expand as a percentage of GDP because (1) the public sector will decrease as a percentage of GDP due to government spending cuts and (2) lower interest rates should cause the private sector to expand.

References

Question From: Session 5 > Reading 18 > LOS t

Related Material:

- Key Concepts by LOS

Question #189 of 196

Question ID: 413945

The primary goals of the International Monetary Fund (IMF) include:

- ✗ **A)** resolving trade-related disputes among nations.
- ✓ **B)** promoting exchange rate stability.
- ✗ **C)** reducing global poverty.

Explanation

The primary goals of the IMF are to promote international monetary cooperation, facilitate growth of international trade, promote exchange rate stability, assist in establishing a multilateral payment system, and provide resources to members with balance of payments difficulties. Reducing global poverty is a role of the World Bank. Resolving trade disputes is a role of the World Trade Organization.

References

Question From: Session 5 > Reading 19 > LOS j

Related Material:

- Key Concepts by LOS

Question #190 of 196

Question ID: 413939

In the context of international trading blocs, the primary feature of an economic union that distinguishes it from a common market is the adoption of a common:

- ✓ **A)** set of economic policies.
- ✗ **B)** currency.
- ✗ **C)** set of trade restrictions with non-members.

Explanation

An economic union is a common market that has also adopted common institutions and economic policy. Both common markets and economic unions adopt a common set of trade restrictions with non-members. Neither requires the adoption of a common currency, which is a characteristic of a monetary union.

References

Question From: Session 5 > Reading 19 > LOS f

Related Material:

- Key Concepts by LOS

Question #191 of 196

Question ID: 413944

Holding other factors constant, a country can reduce its trade deficit by increasing its:

✗ **A)** government budget deficit.

✓ **B)** private saving.

✗ **C)** domestic capital investment.

Explanation

Other things equal, increasing savings would decrease a current account deficit, while increasing a government budget deficit or domestic investment would increase a current account deficit.

References

Question From: Session 5 > Reading 19 > LOS i

Related Material:

- Key Concepts by LOS

Question #192 of 196

Question ID: 434260

Assuming no changes in the prices of a representative consumption basket in two currency areas over the measurement period, changes in the nominal exchange rate:

✓ **A)** are equal to changes in the real exchange rate.

✗ **B)** can be converted to the real exchange rate using interest rates.

✗ **C)** can be extrapolated to calculate interest rates.

Explanation

The real interest rate = the nominal interest rate × ratio of consumption basket (or index) price levels in both countries. Assuming no price changes, the real exchange rate has remained the same as the nominal interest rate during the period.

You can think of the ratio of the consumption basket (or index) price levels in two countries as the bracketed portion of the Fisher relation for two countries. Here is the Fisher relation for two countries:

$$\frac{(1 + R_{\text{nominal A}})}{(1 + R_{\text{nominal B}})} = \frac{(1 + R_{\text{real A}})[1 + E(\text{inflation}_A)]}{(1 + R_{\text{real B}})[1 + E(\text{inflation}_B)]}$$

Here is the ratio of the consumption basket (or index) price levels in two countries:

$$\frac{[1 + E(\text{inflation}_A)]}{[1 + E(\text{inflation}_B)]}$$

If inflation in A is 10% and inflation in B is 0%, the ratio of consumption basket (or index) price levels is 1.1. If inflation in both countries is 0%, the ratio of consumption basket (or index) price levels is 1 and the nominal interest rate = the real interest rate. If the nominal interest rate = the real interest rate, changes in the nominal exchange rate = changes in the real exchange rate.

References

Question From: Session 5 > Reading 20 > LOS a

Related Material:

- Key Concepts by LOS

Question #193 of 196

Question ID: 413932

Who benefits the *most* from a quota?

✗ **A)** Foreign consumers.

✓ **B)** Domestic producers.

✗ **C)** Foreign producers.

Explanation

Quotas restrict the supply of imported goods, which increases the price domestically benefiting domestic producers. Some foreign producers also benefit from the higher prices created by the quota if they receive the revenue transfer (due to higher prices received for all goods sold under the import license). However, overall the foreign producers do not sell as much of their product and have lost revenues.

References

Question From: Session 5 > Reading 19 > LOS e

Related Material:

- Key Concepts by LOS

Question #194 of 196

Question ID: 413870

If a country's economy is growing at an unsustainably rapid rate and the central bank decreases its target overnight interest rate, the country's:

✗ **A)** expected rate of inflation is likely to decline.

✗ **B)** long-term rate of economic growth will increase.

✓ **C)** inflation rate is likely to increase.

Explanation

The central bank should increase target interest rates when the economy is growing at an unsustainable (above-full-employment) level. Decreasing the target overnight rate is likely to further increase aggregate demand and cause inflation to accelerate, which will be detrimental to the long-term growth rate of the economy.

References

Question From: Session 5 > Reading 18 > LOS k

Related Material:

- Key Concepts by LOS

Question #195 of 196

Question ID: 413875

A central bank follows an inflation targeting monetary policy. If the permissible band is plus-or-minus 2% around the target inflation rate, the central bank is *most likely* to choose a target inflation rate of:

- ✓ **A)** 3%.
- ✗ **B)** 0%.
- ✗ **C)** 1%.

Explanation

Because they consider deflation to be disruptive to an economy, central banks typically choose inflation targets and bands that do not include a negative rate of inflation.

References

Question From: Session 5 > Reading 18 > LOS l

Related Material:

- Key Concepts by LOS

Question #196 of 196

Question ID: 413836

When comparing a barter economy with an economy that uses money as a medium of exchange we would expect increased efficiencies due to a reduction in which of the following?

- ✓ **A)** Transaction costs.
- ✗ **B)** The need to specialize.
- ✗ **C)** Nominal interest rates.

Explanation

Money functions as a medium of exchange because it is accepted as payment for goods and services. Compare this to a barter economy, where if I have goat and want an ox, I have to find someone willing to trade. Finding someone takes time and time is costly. With money, I can sell the goat and buy the ox. Thus, transaction costs are reduced. Having money as a medium of exchange would not reduce the inflation rate, interest rates, or the need to specialize in the production of those goods in which we have a comparative advantage (low opportunity cost producer).

References

Question From: Session 5 > Reading 18 > LOS b

Related Material:

- Key Concepts by LOS