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Economics

1906 CFA一级押题

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Economics（1）

➤ The JPY/AUD spot exchange rate is 82.42, the JPY interest rate is 0.15%, and the AUD interest rate is 4.95%. If the interest rates are quoted on the basis of a 360-day year, the 90-day forward points in JPY/AUD would be closest to:

A. -377.0.

B. -97.7.

C. 98.9.

➤ **Solution: B**

The forward exchange rate is given by

$$F_{JPY/AUD} = S_{JPY/AUD}\left(\frac{1+i_{JPY}\tau}{1+i_{AUD}\tau}\right) = 82.42\left(\frac{1+.0015\left(\frac{90}{360}\right)}{1+.0495\left(\frac{90}{360}\right)}\right) == 82.42 \times .98815 = 81.443$$

The forward points are
100 X (F-S) =100 X (81.443 - 82.42) =100 X (-0.977) =-97.7.
Note that because the spot exchange rate is quoted with two decimal places, the forward points are scaled by 100.

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Economics（2）

➤ A wireless phone manufacturer introduced a next-generation phone that received a high level of positive publicity. Despite running several high-speed production assembly lines, the manufacturer is still falling short in meeting demand for the phone nine months after introduction. Which of the following statements is the most plausible explanation for the demand/supply imbalance?

A. The phone price is low relative to the equilibrium price.

B. Competitors introduced next-generation phones at a similar price.

C. Consumer incomes grew faster than the manufacturer anticipated.

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◆ Economics （2）

> **Solution: A.**

The situation described is one of excess demand because, in order for markets to clear at the given level of quantity supplied, the company would need to raise prices.

◆ Economics （3）

> An increase in the nominal money supply would shift the:
> A. IS curve and the LM curve.
> B. IS curve and the aggregate demand curve.
> C. LM curve and the aggregate demand curve.

> **Solution: C.**

The LM curve represents combinations of income and the interest rate at which the demand for real money balances equals the supply. For a given price level, an increase in the nominal money supply is also an increase in the real money supply. To increase the demand for real money balances, either the interest must decline or income must increase. Therefore, at each level of the interest rate, income (= expenditure) must increase—a rightward shift of the LM curve. Since the IS curve is downward sloping (higher income requires a lower interest rate), a rightward shift in the LM curve means that the IS and LM curves will intersect at a higher level of aggregate expenditure/income. This implies a higher level of aggregate expenditure at each price level—a rightward shift of the aggregate demand curve.

◆ Economics （4）

> The market demand function for four-year private universities is given by the equation
>
> $Q_{pr}^d = 84 - 3.1 P_{pr} + 0.8I + 0.9P_{pu}$
>
> Where Q_{pr}^d is the number of applicants to private universities per year in thousands, P_{pr} is the average price of private universities (in thousands of USD), I is the household monthly income (in thousands of USD), and P_{pu} is the average price of public (government-supported). Assume that P_{pr} is equal to 38, I is equal to 100, and P_{pu} is equal to 18.
> The cross-price elasticity of demand for private universities with respect to the price of public universities is closest to:
> A. 0.3.
> B. 3.1.
> C. 3.9.

Economics （4）

> **Solution: A.**

From the demand function:

Solve for Q_{pr}^{d}:

$\Delta Q_{pr}^{d}/\Delta P_{pu}=0.9$ (the coefficient in front of P_{pu})

$Q_{pr}^{d} = 84-3.1 P_{pr}+0.8I+0.9 P_{pu}$

$\quad\quad =84-3.1(38)+0.8(100)+0.9(18)$

$\quad\quad =62.4$

At $P_{pr} = 38$, and $P_{pu}=18$, the cross-price elasticity of demand

$\quad\quad =(\Delta Q_{pr}^{d}/\Delta P_{pu})(P_{pu}/ Q_{pr}^{d})=(0.9)(18 / 62.4)=0.3$

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Economics （5）

> If the Which of the following statements with respect to Giffen and Veblen goods is least accurate?

    A. Both types of goods demonstrate the possibility of a positively sloping demand curve.

    B. Both types of goods violate the fundamental axioms of demand theory.

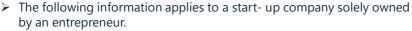   C. Giffen goods are "inferior," whereas Veblen goods are "high-status" goods.

> **Solution: B**

    Veblen goods violate the fundamental axioms of demand theory, whereas Giffen goods do not.

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Economics （6）

> The following information applies to a start- up company solely owned by an entrepreneur.

total units produced	3500
Average revenue	$1100
Average variable cost	$720
Total fixed cost	$200,000
Total investment	$1,500,000
Required rate of return	12%
Opportunity cost of owner's labor	$130,000

The company's economic profit is closest to:

A. $820,000.

B. $784,250.

C. $978,000.

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Economics （6）

> **Solution: A.**

Economic profit = Accounting profit – Total implicit opportunity costs

Where

Accounting profit = Total revenue – Total variable costs – Total fixed costs

Total opportunity costs = opportunity cost of capital + opportunity cost of labor

Total revenue	3,500 × $1,100	$3,850,000
Less Total variable costs	3,500 × $720	$2,520,000
Less Total fixed costs		$200,000
Accounting profit		$1,130,000
Opportunity cost:		
capital	$1,500,000 ×0.12	$180,000
owner's labor		$130,000
Total opportunity costs		$310,000
Economic profit		$820,000

Economics （7）

> A profit maximization is least likely to occur when:

A. average total cost is minimized.

B. marginal revenue equals marginal cost.

C. the difference between total revenue and total cost is maximized.

> **Solution: A.**

The quantity at which average total cost is minimized does not necessarily correspond to a profit maximum.

Economics （8）

> During the last month, a food company located in the United States had the following transactions:

Transaction	Amount (US$ millions)
Bought raw material from Indonesia	50.0
Sold food products to France	65.0
Received royalty fees from its branch in the United Kingdom	0.5
Donated to a charitable institution in Africa	0.1
Borrowed from a bank in Singapore	2.0
Paid legal fees to its German legal consultant company	1.2
Received interest coupon from its investment in Eurobonds issued in Luxembourg	0.8

> These transactions will most likely increase the U.S. current account by:

A. $14.5 million.

B. $17.0 million.

C. $15.0 million.

Economics （8）

> **Solution: C.**

Note that the borrowing from a bank in Singapore is not a current account transaction.

Transaction	Current Account (US$ millions)
Bought raw material from Indonesia	−50.0
Sold food products to France	65
Received royalty fees from its branch in the United Kingdom	0.5
Donated to charitable institution in Africa	−0.1
Borrowed from a bank in Singapore	Omit
Paid legal fees to its German legal consultant company	−1.2
Received interest coupon from its investment in Eurobonds issued in Luxembourg	0.8
Total	15

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Economics （9）

> The marginal revenue per unit sold for a firm doing business under conditions of perfect competition will most likely be:
>
> A. equal to average revenue.
>
> B. less than average revenue.
>
> C. greater than average revenue.

> **Solution: A.**

Under perfect competition, a firm is a price taker at any quantity supplied to the market, and AR = MR = Price.

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Economics （10）

> Under monopolistic competition, a firm that introduces a new and differentiated product is least likely to:
>
> A. increase its price.
>
> B. make an economic profit.
>
> C. face a demand that is more elastic.

> **Solution: C.**

A firm in a monopolistic competition that introduces a new and differentiated product is able to better differentiate its products, and thus demand would be less elastic as close substitutes would be less readily available. Thus the firm would be able to increase price and enjoy economic profit in the short run.

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◆ Economics （11）

➢ Aquarius, Inc. is the dominant company and the price leader in its market. One of the other companies in the market attempts to gain market share by undercutting the price set by Aquarius. The market share of Aquarius will most likely:

A. increase.
B. decrease.
C. stay the same

➢ **Solution: A.**

As prices decrease, smaller companies will leave the market rather than sell below cost. The market share of Aquarius, the price leader, will increase.

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◆ Economics （12）

➢ Upsilon Natural Gas, Inc. is a monopoly enjoying very high barriers to entry. Its marginal cost is $50 and its average cost is $80. A recent market study has determined the price elasticity of demand is 1.5. The company will most likely set its price at:

A. $40.
B. $70.
C. $150.

➢ **Solution: C.**

Profits are maximized when MR = MC. For a monopoly, $MR=P(1-1/E_p)$.
Setting this equal to MC and solving for P:
$50= P(1-1/1.5)=P\times0.333$
$P=$150$

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◆ Economics （13）

➢ The term that describes when inflation declines but nonetheless remains at a positive level is:

A. deflation.
B. stagflation.
C. disinflation.

➢ **Solution: C**

Disinflation is known as a reduction of inflation from a higher to lower, but still above zero, level.

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◆ Economics （14）

➤ Which of the following is most likely to cause a shift to the right in the aggregate demand curve?

A. Boom in the stock market

B. Decrease in real estate values

C. Increase in taxes

➤ **Solution: A.**

A boom in the stock market increases the value of financial assets and household wealth. An increase in household wealth increases consumer spending and shifts the aggregate demand curve to the right.

◆ Economics （15）

➤ Consider the following data for 2010 for a hypothetical country:

Account name	Amount ($ trillions)
Consumption	15.0
Statistical discrepancy	0.5
Capital consumption allowance	1.5
Government spending	3.8
Imports	1.7
Gross private domestic investment	4.0
Exports	1.5

Based only on the data given, the gross domestic product and national income are respectively closest to:

A. 21.1 and 20.6.

B. 22.6 and 20.6.

C. 22.8 and 20.8.

◆ Economics （15）

➤ **Solution: B**

GDP = Consumption + Gross private domestic investment + Government Spending + Exports — Imports = 15 + 4 + 3.8 + 1.5 — 1.7 = 22.6. National income = GDP — CCA — Statistical discrepancy = 22.6 — 1.5 — 0.5 = 20.6.

Economics （16）

> The following information Exhibit 1 relates to two following questions:

Date	November 2010		December 2010	
Goods	Quantity	Price	Quantity	Price
Sugar	80kg	€0.90/kg	110kg	€1.00/kg
Cotton	60kg	€0.60/kg	50kg	€0.80/kg

For the December consumption basket in Exhibit 1, the value of the Paasche index is closest to:

A. 116.

B. 148.

C. 160.

Economics （16）

> **Solution: A.**

The Paasche index uses the current product mix of consumption combined with the variation of prices. So for December, its value is:
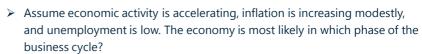
(110 X 1 + 50 X 0.8)/ (110 X 0.9 + 50 x 0.6) = (150/129) X 100= 116.3.

Economics （17）

> Assume economic activity is accelerating, inflation is increasing modestly, and unemployment is low. The economy is most likely in which phase of the business cycle?

A. Peak

B. Early expansion

C. Late expansion

> **Solution: C.**

The late expansion phase is characterized by acceleration of growth rate, decreasing of unemployment rate, and increasing of inflation rate.

	Early Expansion	Late Expansion	Peak
Economic Activity	Gross domestic product (GDP), industrial production, and other measures of economic activity turn from decline to expansion.	Activity measures show an accelerating rate of growth.	Activity measures show decelerating rate of growth

Economics （17）

	Early Expansion	Late Expansion	Peak
Employment	Layoffs slow (and net employment turns positive), but new hiring does not yet occur and the unemployment rate remains high. At first, business turns to overtime and temporary employees to meet rising product demands.	Business begins full time rehiring as overtime hours rise. The unemployment rate falls to low levels.	Business slows its rate of hiring; however, the unemployment rate continues to fall.
Inflation	Inflation remains moderate and may continue to fall.	Inflation picks up modestly.	Inflation further accelerates.

A is incorrect because the peak phase is characterized by deceleration of growth rate.

B is incorrect because the early expansion phase is not characterized by low unemployment.

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Economics （18）

➤ Which of the following is most consistent with real business cycle (RBC) models? The arguments and recommendations of RBC models suggest that:
A. monetary variables have a major impact on GDP growth.
B. persons are unemployed because their asking wages are too high.
C. governments should intervene when the economy is in contraction.

➤ **Solution: B.**

As suggested particularly by the earliest RBC models, a person is unemployed because he or she is asking for wages that are too high, or in other words, this person's utility function is maximized by having more leisure (e.g., free time to visit museums, watch games on TV, and enjoy time with friends) and less consumption (which could be increased by giving up some leisure and finding a job).

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Economics （19）

➤ Holding the working-age population constant, if the labor force participation rate declines while the number of people employed remains unchanged, the unemployment rate will most likely:
A. decrease.
B. remain unchanged.
C. increase.

➤ **Solution: A.**

For a given working-age population, a decline in the labor force participation rate (often caused by an increase in discouraged workers) reduces the labor force. If the number of people employed remains the same while the labor force becomes smaller, the number of workers defined to be unemployed must be smaller and thus the unemployment rate lower.

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◆ Economics （20）

➢ Which of the following is a limitation on the ability of central banks to stimulate growth in periods of deflation?

    A. Ricardian equivalence

    B. The interaction of monetary and fiscal policy

    C. The fact that interest rates have a minimum value (0%)

➢ **Solution: C.**

    Deflation poses a challenge to conventional monetary policy because once the central bank has cut nominal interest rates to zero to stimulate the economy, they cannot cut them further.

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◆ Economics （21）

➢ In an economy, consumption is 70% of pre-tax income and the average tax rate is 25% of total income. If planned government expenditures are expected to increase by $1.25 billion, the increase in total incomes and spending, in billions, is closest to:

    A. $1.3.

    B. $2.6.

    C. $4.2.

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◆ Economics （21）

➢ **Solution: C.**

    Explain the implementation of fiscal policy and the difficulties of implementation.

The fiscal multiplier is $1/[1-c(1-T)]$		
where		
	c	$MPC = \dfrac{comsumption}{disposable\ income}$
	T	the tax rate
Assuming pre-tax income of $100		
Disposable income		$100×(1-0.25)=\$75$
Marginal propensity to consume		$70÷\$75=0.933$
The fiscal multiplier		$1÷[1-0.933×(1-0.25)]=3.33$
With government expenditure of $1.25 Billion, total incomes and spending will rise by $1.25 Billion×3.33=$4.2 Billion		

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◆ Economics （22）

➢ A BRL/MXN spot rate is listed by a dealer at 0.1378. The 6-month forward rate is 0.14193. The 6-month forward points are closest to:

   A. -41.3.

   B. +41.3.

   C. +299.7.

➢ **Solution: B.**

   The number of forward points equals the forward rate minus the spot rate, or 0.14193 — 0.1378 = 0.00413, multiplied by 10,000: 10,000 X 0.00413 = 41.3 points. By convention, forward points are scaled so that ±1 forward point corresponds to a change of ±1 in the last decimal place of the spot exchange rate.

◆ Economics （23）

➢ An investor examines the following rate quotes for the Brazilian real and the Australian dollar:

Spot rate BRL/AUD	2.1131	BRL 1-year interest rate	4%
Forward rate BRL/AUD	2.1392	AUD 1-year interest rate	3%

   If the investor shorts BRL400,000 he will achieve a risk-free arbitrage profit (in BRL) closest to:

   A. -6,327.

   B. 1,088.

   C. 6,405.

◆ Economics （23）

➢ **Solution: B.**

   If the right side of the following equation is greater than the left, an arbitrage opportunity exists.

   $$\left(1 + i_d\right) = \frac{S_{f/d}}{F_{f/d}} \times \left(1 + i_f\right)$$

   The arbitrage profit is the right side of the equation minus the left side. Right Side:

Step 1	BRL400,000 × (1/2.1131AUD/BRL) = AUD189,295
Step 2	AUD189,295 × (1.03) = AUD194,974
Step 3	AUD194,974 × 2.1392 = BRL417,088

   Arbitrage profit = BRL417,088 (right side above) – BRL416,000 (left side above) = 1,088.

◆ Economics （24）

➢ Based on the elasticities approach, a country can implement an exchange rate policy to improve its trade balance most effectively if it imports and exports products:

A. that are consumer necessities.

B. with no good substitute.

C. traded in competitive markets.

➢ **Solution: C.**

In the elasticities approach, changes in exchange rate policy will be a more-effective mechanism for trade balance adjustment if a country imports and exports products that trade in competitive markets, with good substitutes, and luxury products rather than necessities.