Economics

PRACTICE PROBLEMS

1. If the price elasticity coefficient of the demand curve for paper clips is equal to −1, demand is:

   A. elastic.

   B. inelastic.

   C. unit elastic.

2. The demand for membership at a local health club is determined by the following equation:

   $$Q_{hm}^d = 400 - 5P_{hm}$$

   where Q_{hm}^d is the number of health club members and P_{hm} is the price of membership. If the price of health club membership is $35, the price elasticity of demand is *closest* to:

   A. −0.778.

   B. −0.500.

   C. −0.438.

The following information relates to questions 3-6

The market demand function for four-year private universities is given by the equation

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

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) universities (in thousands of USD). Assume that P_{pr} is equal to 38, I is equal to 100, and P_{pu} is equal to 18.

3. The price elasticity of demand for private universities is *closest* to:

   A. −3.1.

   B. −1.9.

   C. 0.6.

4. The income elasticity of demand for private universities is *closest* to:

   A. 0.5.

   B. 0.8.

   C. 1.3.

5. 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.

6. If the cross-price elasticity between two goods is negative, the two goods are classified as:

    A. normal.

    B. substitutes.

    C. complements.

7. Price elasticity of demand for a good will *most likely* be greater if:

    A. there are no substitutes for the good.

    B. consumers consider the good as discretionary.

    C. consumers spend a small portion of their budget on the good.

8. If the income elasticity of demand for a product is –0.6, a:

    A. 1% increase in income will result in a 0.6% increase in demand.

    B. 1% increase in income will result in a 0.6% decrease in demand.

    C. 0.6% increase in income will result in a 1% decrease in demand.

9. An individual's demand for onions is given by the following equation:

    $$Q_o^d = 3 - 0.05P_o + 0.009I - 0.16P_t$$

    where Q_o^d is the number of onions demanded, P_o is the price per pound of onions, I is the household income, and P_t is the price per pound of tomatoes.

    If the price of onions is $1.25, household income is $2,500, and the price of tomatoes is $3.75, the cross-price elasticity of demand for onions with respect to the price of tomatoes is *closest* to:

    A. –1.0597.

    B. –0.0242.

    C. –0.0081.

10. Movement along the demand curve for good X occurs due to a change in:

    A. income.

    B. the price of good X.

    C. the price of a substitute for good X.

11. 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.

12. In the case of a normal good with a decrease in own price, which of the following statements is *most likely* true?

A. Both the substitution and income effects lead to an increase in the quantity purchased.

B. The substitution effect leads to an increase in the quantity purchased, while the income effect has no impact.

C. The substitution effect leads to an increase in the quantity purchased, while the income effect leads to a decrease.

13. For a Giffen good, the:

A. demand curve is positively sloped.

B. substitution effect overwhelms the income effect.

C. income and substitution effects are in the same direction.

14. A company plans to hire additional factory employees. In the short run, marginal returns are most likely to decrease if:

A. the factory is operating at full capacity.

B. the factory is experiencing a labor shortage.

C. workers are required to multitask and share duties.

15. The production relationship between the number of machine hours and total product for a company is presented below.

Machine Hours	Total Product	Average Product
1	3	3.00
2	8	4.00
3	14	4.67
4	19	4.75
5	21	4.20

Diminishing marginal returns first occur beyond machine hour:

A. 3.

B. 4.

C. 5.

The following information relates to questions 16-17

The manager of a small manufacturing firm gathers the following information about the firm's labor utilization and production:

Exhibit 28: Exhibit 1	
Labor (L)	**Total Product (TP)**
0	0
1	150
2	320
3	510
4	660
5	800

16. Refer to the data in Exhibit 2. The number of workers resulting in the highest level of average product of labor is *closest* to:

   A. 3.

   B. 4.

   C. 5.

17. Refer to the data in Exhibit 2. The marginal product of labor demonstrates increasing returns for the firm if the number of workers is *closest* to but not more than:

   A. 2.

   B. 3.

   C. 4.

18. Normal profit is best described as:

   A. zero economic profit.

   B. total revenue minus all explicit costs.

   C. the sum of accounting profit plus economic profit.

19. The marketing director for a Swiss specialty equipment manufacturer estimates the firm can sell 200 units and earn total revenue of CHF500,000. However, if 250 units are sold, revenue will total CHF600,000. The marginal revenue per unit associated with marketing 250 units instead of 200 units is *closest* to:

   A. CHF 2,000.

   B. CHF 2,400.

   C. CHF 2,500.

20. An operator of a ski resort is considering offering price reductions on weekday ski passes. At the normal price of €50 per day, 300 customers are expected to buy passes each weekday. At a discounted price of €40 per day 450 customers are expected to buy passes each weekday. The marginal revenue per customer earned from offering the discounted price is *closest* to:

   A. €20.

   B. €40.

   C. €50.

The following information relates to questions 21-23

A firm's director of operations gathers the following information about the firm's cost structure at different levels of output:

Exhibit 29: Exhibit 1		
Quantity (Q)	**Total Fixed Cost (TFC)**	**Total Variable Cost (TVC)**
0	200	0
1	200	100
2	200	150
3	200	200
4	200	240
5	200	320

21. Refer to the data in Exhibit 1. When quantity produced is equal to 4 units, the average fixed cost (*AFC*) is *closest* to:

   A. 50.

   B. 60.

   C. 110.

22. Refer to the data in Exhibit 1. When the firm increases production from 4 to 5 units, the marginal cost (*MC*) is *closest* to:

   A. 40.

   B. 64.

   C. 80.

23. Refer to the data in Exhibit 1. The level of unit production resulting in the lowest average total cost (*ATC*) is *closest* to:

   A. 3.

    B. 4.

    C. 5.

24. An agricultural firm operating in a perfectly competitive market supplies wheat to manufacturers of consumer food products and animal feeds. If the firm were able to expand its production and unit sales by 10% the *most likely* result would be:

    A. a 10% increase in total revenue.

    B. a 10% increase in average revenue.

    C. an increase in total revenue of less than 10%.

25. 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.

26. A profit maximum 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.

27. The short-term breakeven point of production for a firm operating under perfect competition will *most likely* occur when:

    A. price is equal to average total cost.

    B. marginal revenue is equal to marginal cost.

    C. marginal revenue is equal to average variable costs.

28. The short-term shutdown point of production for a firm operating under perfect competition will *most likely* occur when:

    A. price is equal to average total cost.

    B. marginal revenue is equal to marginal cost.

    C. marginal revenue is equal to average variable costs.

29. Under conditions of perfect competition, a company will break even when market price is equal to the minimum point of the:

    A. average total cost curve.

    B. average variable cost curve.

    C. short-run marginal cost curve.

30. A company will shut down production in the short run if total revenue is less

than total:

A. fixed costs.

B. variable costs.

C. opportunity costs.

31. A company has total variable costs of $4 million and fixed costs of $3 million. Based on this information, the company will stay in the market in the long term if total revenue is at least:

A. $3.0 million.

B. $4.5 million.

C. $7.0 million.

32. When total revenue is greater than total variable costs but less than total costs, in the short term a firm will *most likely*:

A. exit the market.

B. stay in the market.

C. shut down production.

33. Under conditions of perfect competition, in the long run firms will *most likely* earn:

A. normal profits.

B. positive economic profits.

C. negative economic profits.

34. A firm that increases its quantity produced without any change in per-unit cost is experiencing:

A. economies of scale.

B. diseconomies of scale.

C. constant returns to scale.

35. A company is experiencing economies of scale when:

A. cost per unit increases as output increases.

B. it is operating at a point on the LRAC curve where the slope is negative.

C. It is operating beyond the minimum point on the long-run average total cost curve.

36. Diseconomies of scale *most likely* result from:

A. specialization in the labor force.

B. overlap of business functions and product lines.

C. discounted prices on resources when buying in larger quantities.

37. A firm is operating beyond minimum efficient scale in a perfectly competitive industry. To maintain long-term viability the *most likely* course of action for the firm is to:

    A. operate at the current level of production.

    B. increase its level of production to gain economies of scale.

    C. decrease its level of production to the minimum point on the long-run average total cost curve.

PRACTICE PROBLEMS

1. A market structure characterized by many sellers with each having some pricing power and product differentiation is *best* described as:

   A. oligopoly.

   B. perfect competition.

   C. monopolistic competition.

2. A market structure with relatively few sellers of a homogeneous or standardized product is *best* described as:

   A. oligopoly.

   B. monopoly.

   C. perfect competition.

3. The demand schedule in a perfectly competitive market is given by P = 93 − 1.5Q (for Q ≤ 62) and the long-run cost structure of each company is:

   Total cost: $256 + 2Q + 4Q^2$

   Average cost: $256/Q + 2 + 4Q$

   Marginal cost: $2 + 8Q$

   New companies will enter the market at any price greater than:

   A. 8.

   B. 66.

   C. 81.

4. If companies earn economic profits in a perfectly competitive market, over the long run the supply curve will *most likely*:

   A. shift to the left.

   B. shift to the right.

   C. remain unchanged.

5. A company doing business in a monopolistically competitive market will *most likely* maximize profits when its output quantity is set such that:

   A. average cost is minimized.

   B. marginal revenue equals average cost.

   C. marginal revenue equals marginal cost.

6. Oligopolistic pricing strategy *most likely* results in a demand curve that is:

   A. kinked.

   B. vertical.

    C. horizontal.

7. Collusion is *less likely* in a market when:

    A. the product is homogeneous.

    B. companies have similar market shares.

    C. the cost structures of companies are similar.

8. In an industry comprised of three companies, which are small-scale manufacturers of an easily replicable product unprotected by brand recognition or patents, the *most* representative model of company behavior is:

    A. oligopoly.

    B. perfect competition.

    C. monopolistic competition.

9. Deep River Manufacturing is one of many companies in an industry that make a food product. Deep River units are identical up to the point they are labeled. Deep River produces its labeled brand, which sells for $2.20 per unit, and "house brands" for seven different grocery chains which sell for $2.00 per unit. Each grocery chain sells both the Deep River brand and its house brand. The *best* characterization of Deep River's market is:

    A. oligopoly.

    B. perfect competition.

    C. monopolistic competition.

10. SigmaSoft and ThetaTech are the dominant makers of computer system software. The market has two components: a large mass-market component in which demand is price sensitive, and a smaller performance-oriented component in which demand is much less price sensitive. SigmaSoft's product is considered to be technically superior. Each company can choose one of two strategies:

    ▪ *Open architecture (Open):* Mass market focus allowing other software vendors to develop products for its platform.

    ▪ *Proprietary (Prop):* Allow only its own software applications to run on its platform.

Depending upon the strategy each company selects, their profits would be:

SigmaSoft – Open 400 / 600 **ThetaTech – Open**	**SigmaSoft – Prop** 650 / 700 **ThetaTech – Open**
SigmaSoft – Open 800 / 300 **ThetaTech – Prop**	**SigmaSoft – Prop** 600 / 400 **ThetaTech – Prop**

The Nash equilibrium for these companies is:

A. proprietary for SigmaSoft and proprietary for ThetaTech.

B. open architecture for SigmaSoft and proprietary for ThetaTech.

C. proprietary for SigmaSoft and open architecture for ThetaTech.

11. Companies *most likely* have a well-defined supply function when the market structure is:

A. oligopoly.

B. perfect competition.

C. monopolistic competition.

12. 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.

13. Over time, the market share of the dominant company in an oligopolistic market will *most likely*:

A. increase.

B. decrease.

C. remain the same.

14. Market competitors are *least likely* to use advertising as a tool of differentiation in an industry structure identified as:

A. monopoly.

B. perfect competition.

C. monopolistic competition.

15. Upsilon Natural Gas, Inc. is a monopoly enjoying very high barriers to entry. Its marginal cost is $40 and its average cost is $70. 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. $120.

16. A government entity that regulates an authorized monopoly will *most likely* base regulated prices on:

   A. marginal cost.

   B. long run average cost.

   C. first degree price discrimination.

17. An analyst gathers the following market share data for an industry:

Company	Sales (in millions of €)
ABC	300
Brown	250
Coral	200
Delta	150
Erie	100
All others	50

   The industry's four-company concentration ratio is *closest* to:

   A. 71%.

   B. 86%.

   C. 95%.

18. An analyst gathered the following market share data for an industry comprised of five companies:

Company	Market Share (%)
Zeta	35
Yusef	25
Xenon	20
Waters	10
Vlastos	10

   The industry's three-firm Herfindahl–Hirschmann Index is *closest* to:

   A. 0.185.

   B. 0.225.

   C. 0.235.

19. One disadvantage of the Herfindahl–Hirschmann Index is that the index:

   A. is difficult to compute.

   B. fails to reflect low barriers to entry.

   C. fails to reflect the effect of mergers in the industry.

PRACTICE PROBLEMS

1. Which of the following statements is the *most* appropriate description of gross domestic product (GDP)?

   A. The total income earned by all households, firms, and the government whose value can be verified

   B. The total amount spent on all final goods and services produced within the economy during a given period

   C. The total market value of resalable and final goods and services produced within the economy during a given period

2. The component *least likely* to be included in a measurement of gross domestic product (GDP) is:

   A. the value of owner occupied rent.

   B. the annual salary of a local police officer.

   C. environmental damage caused by production.

3. Which of the following would be included in Canadian GDP for a given year? The market value of:

   A. wine grown in Canada by US citizens.

   B. electronics made in Japan and sold in Canada.

   C. movies produced outside Canada by Canadian filmmakers.

4. Suppose a painting is produced and sold in 2018 for £5,000. The expenses involved in producing the painting amounted to £2,000. According to the sum-of-value-added method of calculating GDP, the value added by the final step of creating the painting was:

   A. £2,000.

   B. £3,000.

   C. £5,000.

5. Which of the following conditions is *least likely* to increase a country's GDP?

   A. An increase in net exports

   B. Increased investment in capital goods

   C. Increased government transfer payments

6. The *most* accurate description of nominal GDP is:

   A. a measure of total expenditures at current prices.

   B. the value of goods and services at constant prices.

   C. a measure to compare one nation's economy to another.

7. From the beginning to the ending years of a decade, the annual value of final goods and services for country *X* increased from €100 billion to €300 billion. During that period, the GDP deflator increased from 111 to 200. Over the decade, real GDP for country *X* increased by approximately:

   A. 50%.

   B. 67%.

   C. 200%.

8. If the GDP deflator values for Year 1 and Year 3 were 190 and 212.8, respectively, which of the following *best* describes the annual growth rate of the overall price level?

   A. 5.8%.

   B. 6%.

   C. 12%.

9. The numerator of the GDP price deflator reflects:

   A. the value of base year output at current prices.

   B. the value of current year output at current prices.

   C. the value of current year output at base year prices.

10. Consider the following data for a hypothetical country:

Account name	Amount ($ trillions)
Consumption	15.0
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 21.1.

   C. 22.8 and 20.8.

11. In calculating personal income for a given year, which of the following would *not* be subtracted from national income?

   A. Indirect business taxes

   B. Undistributed corporate profits

   C. Unincorporated business net income

12. Equality between aggregate expenditure and aggregate output implies that the

government's fiscal deficit must equal:

A. Private saving – Investment – Net exports.

B. Private saving – Investment + Net exports.

C. Investment – Private saving + Net exports.

13. Because of a sharp decline in real estate values, the household sector has increased the fraction of disposable income that it saves. If output and investment spending remain unchanged, which of the following is *most likely*?

A. A decrease in the government deficit

B. A decrease in net exports and increased capital inflow

C. An increase in net exports and increased capital outflow

14. A GDP deflator less than 1 indicates that an economy has experienced:

A. inflation.

B. deflation.

C. stagflation.

15. In explaining the downward slope of the aggregate demand curve, the interest rate effect suggests that a higher price level will:

A. lead to lower interest rates, which will lead to higher levels of consumption and investment.

B. lead to higher interest rates, which will lead to lower levels of consumption and investment.

C. not affect interest rates and therefore will lead to a higher level of aggregate demand.

16. One of the reasons aggregate demand curve is downward sloping is because a lower price level means that the real exchange rate:

A. depreciates, making domestic goods cheaper in other countries and imports less competitive, resulting in a higher level of net exports.

B. appreciates, making domestic goods more expensive in other countries and imports more competitive, resulting in a higher level of net exports.

C. appreciates, making the country's exports and imports less competitive and leading to lower net exports.

17. The full employment, or natural, level of output is *best* described as:

A. the maximum level obtainable with existing resources.

B. the level at which all available workers have jobs consistent with their skills.

C. a level with a modest, stable pool of unemployed workers transitioning to new jobs.

18. Which of the following *best* describes the aggregate supply curve in the short run

(one to two years)? The short-run aggregate supply curve is:

A. flat, because output is more flexible than prices in the short run.

B. vertical, because wages and other input prices fully adjust to the price level.

C. upward sloping, because input prices do not fully adjust to the price level in the short run.

19. If wages were automatically adjusted for changes in the price level, the short-run aggregate supply curve would *most likely* be:

A. flatter.

B. steeper.

C. unchanged.

20. The *least likely* cause of a decrease in aggregate demand is:

A. higher taxes.

B. a weak domestic currency.

C. a fall in capacity utilization.

21. Which of the following is *most likely* to cause the long-run aggregate supply curve to shift to the left?

A. Higher nominal wages

B. A decline in productivity

C. An increase in corporate taxes

22. Increased household wealth will *most likely* cause an increase in:

A. household saving.

B. investment expenditures.

C. consumption expenditures.

23. The *most likely* outcome when both aggregate supply and aggregate demand increase is:

A. a rise in inflation.

B. higher employment.

C. an increase in nominal GDP.

24. Which of the following is *least likely* to be caused by a shift in aggregate demand?

A. Stagflation

B. A recessionary gap

C. An inflationary gap

25. Following a sharp increase in the price of energy, the overall price level is *most*

likely to rise in the short run:

A. and remain elevated indefinitely unless the central bank tightens.

B. but remain unchanged in the long run unless the money supply is increased.

C. and continue to rise until all prices have increased by the same proportion.

26. Among developed economies, which of the following sources of economic growth is *most likely* to explain superior growth performance?

A. Technology

B. Capital stock

C. Labor supply

27. Which of the following can be measured directly?

A. Potential GDP

B. Labor productivity

C. Total factor productivity

28. The sustainable growth rate is *best* estimated as:

A. the weighted average of capital and labor growth rates.

B. growth in the labor force plus growth of labor productivity.

C. growth in total factor productivity plus growth in the capital-to-labor ratio.

29. In the neoclassical or Solow growth model, an increase in total factor productivity reflects an increase in:

A. returns to scale.

B. output for given inputs.

C. the sustainable growth rate.

The following information relates to questions 30-31

An economic forecasting firm has estimated the following equation from historical data based on the neoclassical growth model:

Potential output growth = 1.5 + 0.72 × Growth of labor + 0.28 × Growth of capital

30. The intercept (1.5) in this equation is *best* interpreted as:

A. the long-run sustainable growth rate.

B. the growth rate of total factor productivity.

C. above-trend historical growth that is unlikely to be sustained.

31. The coefficient on the growth rate of labor (0.72) in this equation is *best* interpreted as:

    A. the labor force participation rate.

    B. the marginal productivity of labor.

    C. the share of income earned by labor.

32. Convergence of incomes over time between emerging market countries and developed countries is *most likely* the result of:

    A. total factor productivity.

    B. diminishing marginal productivity of capital.

    C. the exhaustion of non-renewable resources.

PRACTICE PROBLEMS

1. The characteristic business cycle patterns of trough, expansion, peak, and contraction are:

    A. periodic.

    B. recurrent.

    C. of similar duration.

2. During the contraction phase of a business cycle, it is *most likely* that:

    A. inflation indicators are stable.

    B. aggregate economic activity relative to potential output is decreasing.

    C. investor preference for government securities declines.

3. An economic peak is *most* closely associated with:

    A. accelerating inflation.

    B. stable unemployment.

    C. declining capital spending.

4. Based on typical labor utilization patterns across the business cycle, productivity (output per hours worked) is *most likely* to be highest:

    A. at the peak of a boom.

    B. into a maturing expansion

    C. at the bottom of a recession.

5. As the expansion phase of the business cycle advances from early stage to late stage, businesses *most likely* experience a decrease in:

    A. labor costs.

    B. capital investment.

    C. availability of qualified workers.

6. An analyst writes in an economic report that the current phase of the business cycle is characterized by accelerating inflationary pressures and borrowing by companies. The analyst is *most likely* referring to the:

    A. peak of the business cycle.

    B. contraction phase of the business cycle.

    C. early expansion phase of the business cycle.

7. With which sector of the economy would analysts most commonly associate credit cycles?

    A. Exports

B. Construction and purchases of property

C. Food retail

8. The reason analysts follow developments in the availability of credit is that:

   A. loose private sector credit may contribute to the extent of asset price and real estate bubbles and subsequent crises.

   B. loose credit helps reduce the extent of asset price and real estate bubbles.

   C. credit cycles are of same length and depth as business cycles.

9. In a recession, companies are *most likely* to adjust their stock of physical capital by:

   A. selling it at fire sale prices.

   B. not maintaining equipment.

   C. quickly canceling orders for new construction equipment.

10. The inventory–sales ratio is *most likely* to be rising:

    A. as a contraction unfolds.

    B. partially into a recovery.

    C. near the top of an economic cycle.

11. A decrease in a country's total imports is *most likely* caused by:

    A. an increase in the pace of domestic GDP growth.

    B. a cyclical downturn in the economies of primary trading partners.

    C. persistent currency depreciation relative to primary trading partners.

12. Monetarists favor a limited role for the government because they argue:

    A. government policy responses may lag.

    B. firms take time to adjust to systemic shocks to the economy.

    C. resource use is efficient with marginal revenue and cost equal.

13. A national government responds to a severe recession by funding numerous infrastructure projects using deficit spending. Which school of economic thought is *most* consistent with such action?

    A. Keynesian

    B. Monetarist

    C. Neoclassical

14. According to Real Business Cycle models, an economic contraction is *most likely* caused by:

    A. sticky wages.

    B. rising energy prices.

    C. a contraction in the money supply.

15. The Austrian economic school attributes the primary cause of the business cycle to:

    A. misguided government intervention.

    B. the creative destruction of technological progress.

    C. sticky price and wage expectations that exaggerate trends.

16. According to the Austrian school, the *most* appropriate government response to an economic recession is to:

    A. allow the market to adjust naturally.

    B. maintain steady growth in the money supply.

    C. decrease the market rate of interest below its natural value.

17. Which of the following statements is the *best* description of the characteristics of economic indicators?

    A. Leading indicators are important because they track the entire economy.

    B. Lagging indicators, in measuring past conditions, do not require revisions.

    C. A combination of leading and coincident indicators can offer effective forecasts.

18. When the spread between 10-year US Treasury yields and the federal funds rate narrows and at the same time the prime rate stays unchanged, this mix of indicators *most likely* forecasts future economic:

    A. growth.

    B. decline.

    C. stability.

19. Current economic statistics indicating little change in services inflation, rising residential building permits, and increasing average duration of unemployment are *best* interpreted as:

    A. conflicting evidence about the direction of the economy.

    B. evidence that a cyclical upturn is expected to occur in the future.

    C. evidence that a cyclical downturn is expected to occur in the future.

20. If relative to prior values of their respective indicators, the inventory–sales ratio has risen, unit labor cost is stable, and real personal income has decreased, it is *most likely* that a peak in the business cycle:

    A. has occurred.

    B. is just about to occur.

    C. will occur sometime in the future.

21. When aggregate real personal income, industrial output, and the S&P 500 Index

all increase in a given period, it is *most accurate* to conclude that a cyclical up-turn is:

A. occurring.

B. about to end.

C. about to begin.

22. Which of the following is *most likely* to increase after an increase in aggregate real personal income?

A. Equity prices

B. Building permits for new private housing units

C. The ratio of consumer installment debt to income

23. Which of the following indicators is *most* appropriate in predicting a turning point in the economy?

A. The Industrial Production Index

B. The average bank prime lending rate

C. Average weekly hours, manufacturing

24. The unemployment rate is considered a lagging indicator because:

A. new job types must be defined to count their workers.

B. multi-worker households change jobs at a slower pace.

C. businesses are slow to hire and fire due to related costs.

25. During an economic recovery, a lagging unemployment rate is *most likely* attributable to:

A. businesses quickly rehiring workers.

B. new job seekers entering the labor force.

C. underemployed workers transitioning to higher-paying jobs.

26. A decrease in both the labor force participation ratio and the unemployment rate is *most likely* caused by:

A. an increase in discouraged workers.

B. an increase in underemployed workers.

C. a decrease in voluntarily unemployed persons.

27. The treasury manager of a large company has recently left his position to accept a promotion with a competitor six months from now. A statistical employment survey conducted now should categorize the status of the former treasury manager as:

A. underemployed.

B. voluntarily unemployed.

    C.   frictionally unemployed.

28. The discouraged worker category is defined to include people who:

    A.   are overqualified for their job.

    B.   could look for a job but choose not to.

    C.   currently look for work without finding it.

29. The category of persons who would be *most likely* to be harmed by an increase in the rate of inflation is:

    A.   homeowners with fixed 30-year mortgages.

    B.   retirees relying on a fixed annuity payment.

    C.   workers employed under contracts with escalator clauses.

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

    A.   deflation.

    B.   stagflation.

    C.   disinflation.

31. Deflation is *most likely* to be associated with:

    A.   a shortage of government revenue.

    B.   substantial macroeconomic contraction.

    C.   explicit monetary policy to combat inflation.

32. The *least likely* consequence of a period of hyperinflation is the:

    A.   reduced velocity of money.

    B.   increased supply of money.

    C.   possibility of social unrest.

The following information relates to questions 33-34

Exhibit 22: Exhibit 1: Consumption Baskets and Prices over Two Months				
	November 2010		**December 2010**	
Goods	**Quantity**	**Price**	**Quantity**	**Price**
Sugar	70 kg	€0.90/kg	120 kg	€1.00 /kg

	November 2010		December 2010	
Goods	**Quantity**	**Price**	**Quantity**	**Price**
Cotton	60 kg	€0.60/kg	50 kg	€0.80/kg

33. Assuming the base period for 2010 consumption is November and the initial price index is set at 100, then the inflation rate after calculating the December price index as a Laspeyres index is *closestto*:

A. 19.2%.

B. 36.4%.

C. 61.6%.

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

A. 116.

B. 148.

C. 160.

35. A central bank will *most likely* allow the economy to self-correct in periods of:

A. high inflation, fast economic growth, and low unemployment.

B. low inflation, slow economic growth, and high unemployment.

C. high inflation, slow economic growth, and high unemployment.

36. Disinflation is *best* described as a:

A. decline in price levels.

B. negative inflation rate.

C. decline in the inflation rate.

37. The characteristic of national consumer price indexes that is *most likely* shared across major economies worldwide is:

A. the geographic areas covered in their surveys.

B. the weights they place on covered goods and services.

C. their use in the determination of macroeconomic policy.

38. Of the following statements regarding the Producer Price Index (PPI), which is the *least likely*? The PPI:

A. can influence the future CPI.

B. category weights can vary more widely than analogous CPI terms.

C. is used more frequently than CPI as a benchmark for adjusting labor contract payments.

39. The following presents selected commodity price data for July–August 20X0:

	July 20X0		August 20X0	
Goods	**Quantity**	**Price**	**Quantity**	**Price**
Milk	18 liters	€1.00/liter	17 liters	€1.00/liter
Orange juice	6 liters	€2.00/liter	4 liters	€2.50/liter

Given the consumption basket and prices presented, which type of price index will result in the highest calculated inflation rate over a two-month time period?

A. One that uses a current consumption basket

B. One that uses a constant consumption basket

C. One reflecting substitutions made by consumers over time

40. The inflation rate *most likely* relied on to determine public economic policy is:

A. core inflation.

B. headline inflation.

C. index of food and energy prices.

41. What is the *most* important effect of labor productivity in a cost-push inflation scenario?

A. Rising productivity indicates a strong economy and a bias towards inflation.

B. The productivity level determines the economy's status relative to its "natural rate of unemployment."

C. As productivity growth proportionately exceeds wage increases, product price increases are less likely.

42. A product is part of a price index based on a fixed consumption basket. If, over time, the product's quality improves while its price stays constant, the measured inflation rate is *most likely*:

A. unaffected.

B. biased upward.

C. biased downward.

43. A price index of goods and services that excludes food and energy is *most likely* used to calculate:

A. core inflation.

B. the GDP deflator.

C. headline inflation.

44. An economist expects the following:

- The decline in the unemployment rate will result in higher revenues for home retailers.

- A tighter labor market will put upward pressure on wages, compelling home retailers to raise prices.

Which type of inflation *best* corresponds to the economist's expectations?

A. Stagflation

B. Cost-push inflation

C. Demand-pull inflation

PRACTICE PROBLEMS

1. As the reserve requirement increases, the money multiplier:

   A. increases.

   B. decreases.

   C. remains the same.

2. Which is the *most* accurate statement regarding the demand for money?

   A. Precautionary money demand is directly related to GDP.

   B. Transactions money demand is inversely related to returns on bonds.

   C. Speculative demand is inversely related to the perceived risk of other assets.

3. The following exhibit shows the supply and demand for money:
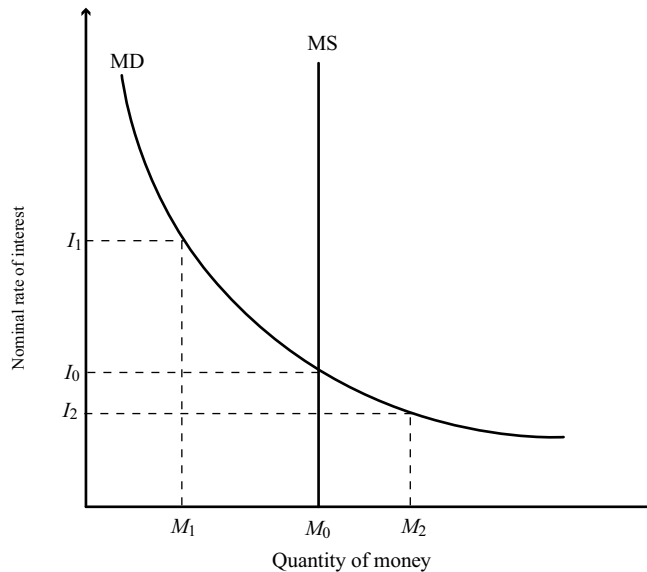
   There is an excess supply of money when the nominal rate of interest is:

   A. I_0.

   B. I_1.

   C. I_2.

4. According to the theory of money neutrality, money supply growth does *not* affect variables such as real output and employment in:

   A. the long run.

   B. the short run.

   C. the long and short run.

5. Which of the following *best* describes a fundamental assumption when monetary policy is used to influence the economy?

   A. Financial markets are efficient.

    B. Money is not neutral in the short run.

    C. Official rates do not affect exchange rates.

6. Monetarists are *most likely* to believe:

    A. there is a causal relationship running from inflation to money.

    B. inflation can be affected by changing the money supply growth rate.

    C. rapid financial innovation in the market increases the effectiveness of monetary policy.

7. The proposition that the real interest rate is relatively stable is *most* closely associated with:

    A. the Fisher effect.

    B. money neutrality.

    C. the quantity theory of money.

8. Which of the following equations is a consequence of the Fisher effect?

    A. Nominal interest rate = Real interest rate + Expected rate of inflation.

    B. Real interest rate = Nominal interest rate + Expected rate of inflation.

    C. Nominal interest rate = Real interest rate + Market risk premium.

9. Which role is a central bank *least likely* to assume?

    A. Lender of last resort.

    B. Sole supervisor of banks.

    C. Supplier of the currency.

10. Central banks would typically be *most* concerned with costs of:

    A. low levels of inflation that are anticipated.

    B. moderate levels of inflation that are anticipated.

    C. moderate levels of inflation that are not anticipated.

11. Monetary policy is *least likely* to include:

    A. setting an inflation rate target.

    B. changing an official interest rate.

    C. enacting a transfer payment program.

12. Which is the *most* accurate statement regarding central banks and monetary policy?

    A. Central bank activities are typically intended to maintain price stability.

    B. Monetary policies work through the economy via four independent channels.

C. Commercial and interbank interest rates move inversely to official interest rates.

13. When a central bank announces a decrease in its official policy rate, the desired impact is an increase in:

   A. investment.

   B. interbank borrowing rates.

   C. the national currency's value in exchange for other currencies.

14. Which action is a central bank *least likely* to take if it wants to encourage businesses and households to borrow for investment and consumption purposes?

   A. Sell long-dated government securities.

   B. Purchase long-dated government treasuries.

   C. Purchase mortgage bonds or other securities.

15. A central bank's repeated open market purchases of government bonds:

   A. decreases the money supply.

   B. is prohibited in most countries.

   C. is consistent with an expansionary monetary policy.

16. A central bank that decides the desired levels of interest rates and inflation and the horizon over which the inflation objective is to be achieved is *most* accurately described as being:

   A. target independent and operationally independent.

   B. target independent but not operationally independent.

   C. operationally independent but not target independent.

17. A country that maintains a target exchange rate is *most likely* to have which outcome when its inflation rate rises above the level of the inflation rate in the target country?

   A. An increase in short-term interest rates.

   B. An increase in the domestic money supply.

   C. An increase in its foreign currency reserves.

18. In theory, setting the policy rate equal to the neutral interest rate should promote:

   A. stable inflation.

   B. balanced budgets.

   C. greater employment.

19. A prolonged period of an official interest rate very close to zero without an in-

crease in economic growth *most likely* suggests:

A. quantitative easing must be limited to be successful.

B. there may be limits to the effectiveness of monetary policy.

C. targeting reserve levels is more important than targeting interest rates.

20. Raising the reserve requirement is *most likely* an example of which type of monetary policy?

A. Neutral.

B. Expansionary.

C. Contractionary.

21. 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 cannot fall significantly below zero.

22. The *least likely* limitation to the effectiveness of monetary policy is that central banks cannot:

A. accurately determine the neutral rate of interest.

B. regulate the willingness of financial institutions to lend.

C. control amounts that economic agents deposit into banks.

23. Quantitative easing, the purchase of government or private securities by the central banks from individuals and/or institutions, is an example of which monetary policy stance?

A. Neutral.

B. Expansionary.

C. Contractionary.

24. The *least likely* goal of a government's fiscal policy is to:

A. redistribute income and wealth.

B. influence aggregate national output.

C. ensure the stability of the purchasing power of its currency.

25. Which of the following *best* represents a contractionary fiscal policy?

A. Public spending on a high-speed railway.

B. A temporary suspension of payroll taxes.

C. A freeze in discretionary government spending.

26. A "pay-as-you-go" rule, which requires that any tax cut or increase in entitlement

spending be offset by an increase in other taxes or reduction in other entitlement spending, is an example of which fiscal policy stance?

A. Neutral.

B. Expansionary.

C. Contractionary.

27. The *most likely* argument against high national debt levels is that:

A. the debt is owed internally to fellow citizens.

B. they create disincentives for economic activity.

C. they may finance investment in physical and human capital.

28. Which statement regarding fiscal deficits is *most* accurate?

A. Higher government spending may lead to higher interest rates and lower private sector investing.

B. Central bank actions that grow the money supply to address deflationary conditions decrease fiscal deficits.

C. According to the Ricardian equivalence, deficits have a multiplicative effect on consumer spending.

29. Which of the following is the *most likely* example of a tool of fiscal policy?

A. Public financing of a power plant.

B. Regulation of the payment system.

C. Central bank's purchase of government bonds.

30. Which statement regarding fiscal policy is *most* accurate?

A. To raise business capital spending, personal income taxes should be reduced.

B. Cyclically adjusted budget deficits are appropriate indicators of fiscal policy.

C. An increase in the budget surplus is associated with expansionary fiscal policy.

31. The *least likely* explanation for why fiscal policy cannot stabilize aggregate demand completely is that:

A. private sector behavior changes over time.

B. policy changes are implemented very quickly.

C. fiscal policy focuses more on inflation than on unemployment.

32. Given an independent central bank, monetary policy actions are *more likely* than fiscal policy actions to be:

A. implementable quickly.

B. effective when a specific group is targeted.

    C. effective when combating a deflationary economy.

33. Which policy alternative is *most likely* to be effective for growing both the public and private sectors?

    A. Easy fiscal/easy monetary policy.

    B. Easy fiscal/tight monetary policy.

    C. Tight fiscal/tight monetary policy.

PRACTICE PROBLEMS

1. Which of these is likely lowest on a country's hierarchy of interests?

   A. Tariff harmonization

   B. Military determination

   C. Cultural program development

2. Which of the following actions by a country is *most likely* a form of geopolitical cooperation?

   A. Acting as a conduit for trade

   B. Engaging in rules standardization

   C. Opting to use soft power over military retaliation

3. Which of the following statements represents an aspect of geopolitical risk?

   A. Modeling geopolitical risk is relatively easy to standardize.

   B. An engaged country can be considered cooperative, even if it does not reciprocate.

   C. The strength of a country's institutions is relevant to the durability of its cooperative relationships.

4. Which of the following statements regarding a country's political cooperation is *most* accurate?

   A. If a country is engaged in military conflict, there is a higher cost to cooperation.

   B. A country with few internal resources is not likely to rely on political cooperation.

   C. Interest prioritization does not determine the depth and nature of political cooperation.

5. For the following contrasting pairs of archetypes of globalization and cooperation, which one reflects the *greatest* differences in country behavior?

   A. Bilateralism vs. autarky

   B. Multilateralism vs. autarky

   C. Multilateralism vs. hegemony

6. Which of these actions would do the most to increase geopolitical risk?

   A. Increase capital flows

   B. Restrict foreign currency exchange

   C. Engage in trade of goods and services

7. A consequence of one of the disadvantages of globalization is that:

   A. pay differences between countries have narrowed.

   B. emerging market trade flows have grown more important.

   C. greater economic and financial cooperation has increased interdependence.

8. Which of the following outcomes is *most* likely a result of globalization?

   A. Unequal gains

   B. Increased independence

   C. Decreased access to talent

9. A US company expanding critical spare part inventories for local customers made at its existing Canadian facility after a supply chain disruption is *most likely* using the coping tactic of:

   A. reshoring the essentials.

   B. re-globalizing production.

   C. doubling down on key markets.

10. In the following table, match the geopolitical tool with the *most* appropriate example of each tool by drawing a line between the two.

Geopolitical Tool	Example
1. Financial	A. Nationalization
2. Economic	B. Espionage
3. National security	C. Free exchange of currency across borders

11. An example of a geopolitical multi-tool for furthering national interests is:

   A. cabotage.

   B. armed conflict.

   C. nationalization of key export industries.

12. Which of these is most likely to be described as an event risk?

   A. An earthquake

   B. An election

   C. An ongoing civil war

13. Exogenous risks are *best* described as those that:

   A. are known and evolve and expand over a period of time.

   B. evolve around set dates, such as elections, new legislation, or other date-driven milestones, such as holidays or political anniversaries.

   C. are sudden or unanticipated and impact either a country's cooperative stance, the ability of non-state actors to globalize, or both.

14. Which of the following statements about geopolitical threats in the investment environment is *most* accurate?

   A. Geopolitical risk is not always present in the investment environment.

   B. Highly collaborative, interconnected countries are vulnerable to geopolitical risk.

   C. Geopolitical risk tends to have less of an impact on markets already experiencing a general contraction or economic downturn.

15. An applicable conclusion drawn from the Geopolitical Risk Index (GPR) is that:

   A. high geopolitical risk results in tangible macroeconomic effects.

   B. recurring geopolitical risk events lead to reduced corporate investment.

   C. the adverse impact of actual events is greater over time than that of the threat of such events.

16. Fill in the blank: The basic geopolitical risk type *most likely* in comparison to have the smallest degree of uncertainty is _____.

   A. exogenous risk.

   B. event risk.

   C. thematic risk.

PRACTICE PROBLEMS

1. Which of the following statements *best* describes the benefits of international trade?

    A. Countries gain from exchange and specialization.

    B. Countries receive lower prices for their exports and pay higher prices for imports.

    C. Absolute advantage is required for a country to benefit from trade in the long term.

2. Which of the following statements *best* describes the costs of international trade?

    A. Countries without an absolute advantage in producing a good cannot benefit significantly from international trade.

    B. Resources may need to be allocated into or out of an industry and less-efficient companies may be forced to exit an industry, which in turn may lead to higher unemployment.

    C. Loss of manufacturing jobs in developed countries as a result of import competition means that developed countries benefit far less than developing countries from trade.

3. Suppose the cost of producing tea relative to copper is lower in Tealand than in Copperland. With trade, the copper industry in Copperland would *most likely*:

    A. expand.

    B. contract.

    C. remain stable.

4. A country has a comparative advantage in producing a good if:

    A. it is able to produce the good at a lower cost than its trading partner.

    B. its opportunity cost of producing the good is less than that of its trading partner.

    C. its opportunity cost of producing the good is more than that of its trading partner.

5. Suppose Mexico exports vegetables to Brazil and imports flashlights used for mining from Brazil. The output per worker per day in each country is as follows:

	Flashlights	Vegetables
Mexico	20	60
Brazil	40	80

    Which country has a comparative advantage in the production of vegetables and what is the *most* relevant opportunity cost?

    A. Brazil: 2 vegetables per flashlight.

B. Mexico: 1.5 vegetables per flashlight.

C. Mexico: 1/3 flashlight per vegetable.

6. Suppose three countries produce bananas and pencils with output per worker per day in each country as follows:

	Bananas	Pencils
Mexico	20	40
Brazil	30	90
Canada	40	160

Which country has the greatest comparative advantage in the production of bananas?

A. Canada.

B. Brazil.

C. Mexico.

7. In the Ricardian trade model, a country captures more of the gains from trade if:

A. it produces all products while its trade partner specializes in one good.

B. the terms of trade are closer to its autarkic prices than to its partner's autarkic prices.

C. the terms of trade are closer to its partner's autarkic prices than to its autarkic prices.

8. Germany has much more capital per worker than Portugal. In autarky each country produces and consumes both machine tools and wine. Production of machine tools is relatively capital intensive whereas winemaking is labor intensive. According to the Heckscher–Ohlin model, when trade opens:

A. Germany should export machine tools and Portugal should export wine.

B. Germany should export wine and Portugal should export machine tools.

C. Germany should produce only machine tools and Portugal should produce only wine.

9. According to the Heckscher–Ohlin model, when trade opens:

A. the scarce factor gains relative to the abundant factor in each country.

B. the abundant factor gains relative to the scarce factor in each country.

C. income is redistributed between countries but not within each country.

10. Which type of trade restriction would *most likely* increase domestic government revenue?

A. Tariff.

B. Import quota.

C. Export subsidy.

11. Which of the following trade restrictions is likely to result in the greatest welfare loss for the importing country?

A. A tariff.

B. An import quota.

C. A voluntary export restraint.

12. A large country can:

A. benefit by imposing a tariff.

B. benefit with an export subsidy.

C. not benefit from any trade restriction.

13. If Brazil and South Africa have free trade with each other, a common trade policy against all other countries, but no free movement of factors of production between them, then Brazil and South Africa are part of a:

A. customs union.

B. common market.

C. free trade area (FTA).

14. Which of the following factors *best* explains why regional trading agreements are more popular than larger multilateral trade agreements?

A. Minimal displacement costs.

B. Trade diversions benefit members.

C. Quicker and easier policy coordination.

15. The sale of mineral rights would be captured in which of the following balance of payments components?

A. Capital account.

B. Current account.

C. Financial account.

16. Patent fees and legal services are recorded in which of the following balance of payments components?

A. Capital account.

B. Current account.

C. Financial account.

17. During the most recent quarter, a steel company in South Korea had the following transactions

- Bought iron ore from Australia for AUD50 million.
- Sold finished steel to the United States for USD65 million.
- Borrowed AUD50 million from a bank in Sydney, Australia.

- Received a USD10 million dividend from US subsidiary.
- Paid KRW550 million to a Korean shipping company.

Which of the following would be reflected in South Korea's current account balance for the quarter?

A. The loan.

B. The shipping.

C. The dividend.

18. Which of the following *most likely* contributes to a current account deficit?

A. High taxes.

B. Low private savings.

C. Low private investment.

19. Which of the following chronic deficit conditions is *least* alarming to the deficit country's creditors?

A. High consumption.

B. High private investment.

C. High government spending.

20. Which of the following international trade organizations regulates cross-border exchange among nations on a global scale?

A. World Bank Group (World Bank).

B. World Trade Organization (WTO).

C. International Monetary Fund (IMF).

21. Which of the following international trade organizations has a mission to help developing countries fight poverty and enhance environmentally sound economic growth?

A. World Bank Group (World Bank).

B. World Trade Organization (WTO).

C. International Monetary Fund (IMF).

22. Which of the following organizations helps to keep global systemic risk under control by preventing contagion in scenarios such as the 2010 Greek sovereign debt crisis?

A. World Bank Group (World Bank).

B. World Trade Organization (WTO).

C. International Monetary Fund (IMF).

23. Which of the following international trade bodies was the only multilateral body governing international trade from 1948 to 1995?

A. World Trade Organization (WTO).

B. International Trade Organization (ITO).

C. General Agreement on Tariffs and Trade (GATT).

PRACTICE PROBLEMS

1. A decrease in the real exchange rate (quoted in terms of domestic currency per unit of foreign currency) is *most likely* to be associated with an increase in which of the following?

   A. Foreign price level.

   B. Domestic price level.

   C. Nominal exchange rate.

2. In order to minimize the foreign exchange exposure on a euro-denominated receivable due from a German company in 100 days, a British company would *most likely* initiate a:

   A. spot transaction.

   B. forward contract.

   C. real exchange rate contract.

3. Which of the following counterparties is *most likely* to be considered a sell-side foreign-exchange market participant?

   A. A large corporation that borrows in foreign currencies.

   B. A sovereign wealth fund that influences cross-border capital flows.

   C. A multinational bank that trades foreign exchange with its diverse client base.

4. What will be the effect on a direct exchange rate quote if the domestic currency appreciates?

   A. Increase

   B. Decrease

   C. No change

5. An executive from Switzerland checked into a hotel room in Spain and was told by the hotel manager that 1 EUR will buy 1.2983 CHF. From the executive's perspective, an indirect exchange rate quote would be:

   A. 0.7702 EUR per CHF.

   B. 0.7702 CHF per EUR.

   C. 1.2983 EUR per CHF.

6. Over the past month, the Swiss Franc (CHF) has depreciated 12 percent against pound sterling (GBP). How much has the pound sterling appreciated against the Swiss Franc?

   A. 12%

   B. Less than 12%

   C. More than 12%

7. An exchange rate between two currencies has increased to 1.4500. If the base currency has appreciated by 8% against the price currency, the initial exchange rate between the two currencies was *closest* to:

   A. 1.3340.

   B. 1.3426.

   C. 1.5660.

The following information relates to questions 8-9

A dealer provides the following quotes:

Ratio	Spot rate
CNY/HKD	0.8422
CNY/ZAR	0.9149
CNY/SEK	1.0218

8. The spot ZAR/HKD cross-rate is *closest* to:

   A. 0.9205.

   B. 1.0864.

   C. 1.2978.

9. Another dealer is quoting the ZAR/SEK cross-rate at 1.1210. The arbitrage profit that can be earned is *closest* to:

   A. ZAR 3671 per million SEK traded.

   B. SEK 4200 per million ZAR traded.

   C. ZAR 4200 per million SEK traded.

10. 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.

11. A three-month forward exchange rate in CAD/USD is listed by a dealer at 1.0123. The dealer also quotes 3-month forward points as a percentage at 6.8%. The CAD/USD spot rate is *closest* to:

   A. 0.9478.

   B. 1.0550.

    C. 1.0862.

12. If the base currency in a forward exchange rate quote is trading at a forward discount, which of the following statements is *most* accurate?

    A. The forward points will be positive.

    B. The forward percentage will be negative.

    C. The base currency is expected to appreciate versus the price currency.

13. A forward premium indicates:

    A. an expected increase in demand for the base currency.

    B. the interest rate is higher in the base currency than in the price currency.

    C. the interest rate is higher in the price currency than in the base currency.

14. 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.

15. An exchange rate:

    A. is most commonly quoted in real terms.

    B. is the price of one currency in terms of another.

    C. between two currencies ensures they are fully convertible.

16. Which of the following is *not* a condition of an ideal currency regime?

    A. Fully convertible currencies.

    B. Fully independent monetary policy.

    C. Independently floating exchange rates.

17. In practice, both a fixed parity regime and a target zone regime allow the exchange rate to float within a band around the parity level. The *most likely* rationale for the band is that the band allows the monetary authority to:

    A. be less active in the currency market.

    B. earn a spread on its currency transactions.

    C. exercise more discretion in monetary policy.

18. A fixed exchange rate regime in which the monetary authority is legally required to hold foreign exchange reserves backing 100% of its domestic currency issuance is best described as:

    A. dollarization.

   B. a currency board.

   C. a monetary union.

19. A country with a trade deficit will *most likely*:

   A. have an offsetting capital account surplus.

   B. save enough to fund its investment spending.

   C. buy assets from foreigners to fund the imbalance.

20. A large industrialized country has recently devalued its currency in an attempt to correct a persistent trade deficit. Which of the following domestic industries is *most likely* to benefit from the devaluation?

   A. Luxury cars.

   B. Branded prescription drugs.

   C. Restaurants and live entertainment venues.

21. A country with a persistent trade surplus is being pressured to let its currency appreciate. Which of the following *best* describes the adjustment that must occur if currency appreciation is to be effective in reducing the trade surplus?

   A. Domestic investment must decline relative to saving.

   B. Foreigners must increase investment relative to saving.

   C. Global capital flows must shift toward the domestic market.

Financial Statement Analysis

PRACTICE PROBLEMS

1. Which of the following *best* describes the role of financial statement analysis?

    A. To provide information about a company's performance

    B. To provide information about a company's changes in financial position

    C. To form expectations about a company's future performance and financial position

2. The role of financial statement analysis is *best* described as:

    A. providing information useful for making investment decisions.

    B. evaluating a company for the purpose of making economic decisions.

    C. using financial reports prepared by analysts to make economic decisions.

3. Providing information about the performance and financial position of companies so that users can make economic decisions *best* describes the role of:

    A. auditing.

    B. financial reporting.

    C. financial statement analysis.

4. A company's financial position would *best* be evaluated using the:

    A. balance sheet.

    B. income statement.

    C. statement of cash flows.

5. A company's profitability for a period would *best* be evaluated using the:

    A. balance sheet.

    B. income statement.

    C. statement of cash flows.

6. The financial statement that presents a shareholder's residual claim on assets is the:

    A. balance sheet.

    B. income statement.

    C. cash flow statement.

7. A company's profitability over a period of time is *best* evaluated using the:

    A. balance sheet.

    B. income statement.

    C. cash flow statement.

8. The income statement is *best* used to evaluate a company's:

    A. financial position.

    B. sources of cash flow.

    C. financial results from business activities.

9. Which of the following *best* describes why the notes that accompany the financial statements are required? The notes:

    A. permit flexibility in statement preparation.

    B. standardize financial reporting across companies.

    C. provide information necessary to understand the financial statements.

10. Accounting policies, methods, and estimates used in preparing financial statements are *most likely* to be found in the:

    A. auditor's report.

    B. management commentary.

    C. notes to the financial statements.

11. Information about management and director compensation are *least likely* to be found in the:

    A. auditor's report.

    B. proxy statement.

    C. notes to the financial statements.

12. Information about a company's objectives, strategies, and significant risks are *most likely* to be found in the:

    A. auditor's report.

    B. management commentary.

    C. notes to the financial statements.

13. What type of audit opinion is preferred when analyzing financial statements?

    A. Qualified.

    B. Adverse.

    C. Unqualified.

14. An auditor determines that a company's financial statements are prepared in accordance with applicable accounting standards except with respect to inventory reporting. This exception is *most likely* to result in an audit opinion that is:

    A. adverse.

    B. qualified.

    C. unqualified.

15. An independent audit report is *most likely* to provide:

    A. absolute assurance about the accuracy of the financial statements.

    B. reasonable assurance that the financial statements are fairly presented.

    C. a qualified opinion with respect to the transparency of the financial statements.

16. Interim financial reports released by a company are *most likely* to be:

    A. monthly.

    B. unaudited.

    C. unqualified.

17. Which of the following sources of information used by analysts is found outside a company's annual report?

    A. Auditor's report

    B. Peer company analysis

    C. Management's discussion and analysis

18. Ratios are an input into which step in the financial statement analysis framework?

    A. Process data.

    B. Collect input data.

    C. Analyze/interpret the processed data.

19. Which phase in the financial statement analysis framework is *most likely* to involve producing updated reports and recommendations?

    A. Follow-up

    B. Analyze/interpret the processed data

    C. Develop and communicate conclusions and recommendations

PRACTICE PROBLEMS

1. Which of the following is *most likely* not an objective of financial statements?

   A. To provide information about the performance of an entity.

   B. To provide information about the financial position of an entity.

   C. To provide information about the users of an entity's financial statements.

2. International financial reporting standards are currently developed by which entity?

   A. The IFRS Foundation.

   B. The International Accounting Standards Board.

   C. The International Organization of Securities Commissions.

3. US generally accepted accounting principles are currently developed by which entity?

   A. The Securities and Exchange Commission.

   B. The Financial Accounting Standards Board.

   C. The Public Company Accounting Oversight Board.

4. A core objective of the International Organization of Securities Commissions is to:

   A. eliminate systemic risk.

   B. protect users of financial statements.

   C. ensure that markets are fair, efficient, and transparent.

5. According to the *Conceptual Framework for Financial Reporting,* which of the following is *not* an enhancing qualitative characteristic of information in financial statements?

   A. Accuracy.

   B. Timeliness.

   C. Comparability.

6. Which of the following is *not* a constraint on the financial statements according to the *Conceptual Framework*?

   A. Understandability.

   B. Benefit versus cost.

   C. Balancing of qualitative characteristics.

7. The assumption that an entity will continue to operate for the foreseeable future is called:

   A. accrual basis.

    B. comparability.

    C. going concern.

8. The assumption that the effects of transactions and other events are recognized when they occur, not when the cash flows occur, is called:

    A. relevance.

    B. accrual basis.

    C. going concern.

9. Neutrality of information in the financial statements most closely contributes to which qualitative characteristic?

    A. Relevance.

    B. Understandability.

    C. Faithful representation.

10. Valuing assets at the amount of cash or equivalents paid or the fair value of the consideration given to acquire them at the time of acquisition most closely describes which measurement of financial statement elements?

    A. Current cost.

    B. Historical cost.

    C. Realizable value.

11. The valuation technique under which assets are recorded at the amount that would be received in an orderly disposal is:

    A. current cost.

    B. present value.

    C. realizable value.

12. Which of the following elements of financial statements is *most* closely related to measurement of performance?

    A. Assets.

    B. Expenses.

    C. Liabilities.

13. Which of the following elements of financial statements is *most* closely related to measurement of financial position?

    A. Equity.

    B. Income.

    C. Expenses.

14. Which of the following disclosures regarding new accounting standards provides

the *most* meaningful information to an analyst?

A. The impact of adoption is discussed.

B. The standard will have no material impact.

C. Management is still evaluating the impact.

15. Which of the following is *not* a required financial statement according to IAS No. 1?

A. Statement of financial position.

B. Statement of changes in income.

C. Statement of comprehensive income.