11 UNDERSTANDING BUSINESS CYCLES

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

   (A) A commercial bank that has a large quantity of fixed-rate mortgages in its loan portfolio.

   (B) An individual investor who financed the purchase of a home with a 30-year fixed rate mortgage.

   (C) An individual investor who recently purchased a substantial amount of variable rate bonds.

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

   (A) decreasing inflation pressure.

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

   (C) payroll employment turning from positive to negative.

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

   (A) often occurs because of an increase in short-run aggregate supply.

   (B) results from excess short-run aggregate demand.

   (C) typically results from a significant price increase in a production input.

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

   (A) adding new workers.

   (B) laying off employees.

   (C) reducing overtime.

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

   (A) reduced during inflationary periods and increased during recessionary periods.

   (B) increased by a predictable rate annually.

   (C) increased during inflationary periods and reduced during recessionary periods.

6. Maddeline Bradley left her position at a commercial bank to raise her two-year-old daughter. How is Bradley classified from the viewpoint of employment statistics?

(A) Not in the labor force.

(B) Employed.

(C) Unemployed.

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

(A) Smith was laid off due to negative growth of GDP, and did not seek other employment until he was recalled to his job.

(B) When the plant was modernized, Jones lost her job because she did not have the skill needed to operate the new equipment.

(C) Although there were jobs available, Johnson was unable to find an employer with a satisfactory opening.

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

(A) hyperinflation.

(B) deflation.

(C) disinflation.

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

Economic growth	Inflation
(A) Increasing	Decreasing
(B) Increasing	Increasing
(C) Decreasing	Increasing

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

(A) Quality changes

(B) Sample selection

(C) Substitution

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

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

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

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

	Panelist 1	Panelist 2
(A)	Keynesian	New Keynesian
(B)	Neoclassical	Keynesian
(C)	New Classical	Monetarist

12. Which type of unemployment describes a situation where workers who have been laid off due to economic changes and they are unable to find work due to a lack of education or the necessary skills to move into another available job?
    (A) Cyclical.
    (B) Frictional.
    (C) Structural.

13. Which of the following statements regarding inflation is most accurate?
    (A) The purchasing power of money increases as a result of inflation.
    (B) As a result of inflation, all borrowers gain at the expense of lenders.
    (C) Inflation is a persistent increase in the general price level of goods and services.

14. As an economic expansion approaches its peak, the economy is *most likely to* show:
    (A) a decrease in inventory levels.
    (B) accelerating sales growth.
    (C) an increase in the inventory-to-sales ratio.

15. Consumer price indexes are *least likely to:*
    (A) be calculated for stages of processing.
    (B) compare current prices to prices in a base year.
    (C) reflect the typical purchasing patterns of consumers.

16. Which of the following statements regarding inflation is *most accurate?*
    (A) Inflation occurs when there is a steady increase in the relative prices of key commodities.
    (B) Inflation is present if the prices of some goods and services are increasing.
    (C) An economy experiences inflation when there is a persistent increase in the prices of almost all goods and services.

17. Which of the following factors would least likely result in demand-pull inflation? An increase in:
    (A) energy prices.
    (B) exports.
    (C) the quantity of money.

18. If the number of employed remains constant, what effects will a decrease in the labor force have on the unemployment rate?

  (A) Increase.

  (B) Decrease.

  (C) No effect.

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

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

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

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

Statement 1	Statement 2
(A) Disagree	Agree
(B) Disagree	Disagree
(C) Agree	Agree

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

  (A) laying off workers

  (B) reducing overtime hours.

  (C) deferring maintenance of machinery.

21. The labor-force participation rate is defined as the percentage of the:

  (A) working-age population who are working or actively looking for work.

  (B) working-age population who are working.

  (C) labor force who are working.

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

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

  (B) government intervention in the economy.

  (C) excessive optimism or pessimism among business managers.

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

  (A) coincident indicator.

  (B) leading indicator.

  (C) lagging indicator.

24. Which of the following is the most accurate definition of the labor force?

    (A) People of working age who are not confined to institutions.

    (B) People of working age who are either employed or seeking employment.

    (C) All people of working age.

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

    (A) frictional unemployment.

    (B) natural unemployment.

    (C) structural unemployment.

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

    (A) fiscal policy is the most powerful of all government tools used to affect prices and output.

    (B) discretionary monetary policy is the best way to moderate fluctuations in prices and output

    (C) steady, predictable money growth is the best monetary policy.

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

    (A) changes in technology over time.

    (B) excessive optimism or pessimism among business managers.

    (C) inappropriate variations in the growth of the money supply.

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

    (A) hedonic price index.

    (B) Laspeyres price index.

    (C) Paasche price index.

29. A Laspeyres price index tends to:

    (A) overstate the inflation rate because its market basket is variable.

    (B) overstate the inflation rate, because its market basket is fixed.

    (C) understate the inflation rate because its market basket is fixed.

30. During an economic contraction:

    (A) inflation pressures are typically decreasing.

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

    (C) the unemployment rate typically decreases.

31. Joe Lebow, an analyst, is discussing the difference between inflation and price level. Lebow states: "The higher the price level in the current year compared to the price level in the previous year, the higher is the inflation rate of a country. Any increase in the price level is evidence of positive inflation." Lebow's statement is:
    (A) correct.
    (B) incorrect because not all increases in the price level indicate inflation.
    (C) incorrect because it inaccurately describes the calculation of an inflation rate.

32. Manufacturing and trade sales are best described as a:
    (A) coincident indicator.
    (B) lagging indicator.
    (C) leading indicator.

33. Which of the following types of price index is *most likely to* include a sub-index for raw materials?
    (A) GDP deflator.
    (B) Consumer price index.
    (C) Wholesale price index.

34. The expansion phase of a business cycle is most likely characterized by:
    (A) increasing employment.
    (B) decreasing inflationary pressures.
    (C) the rate of economic growth changing from negative to positive.

35. Which of the following economic indicators is classified as a leading indicator for the United States economy?
    (A) Average duration of unemployment.
    (B) Index of consumer expectations.
    (C) Industrial production.

36. The inventory-to-sales ratio for manufacturing and trade is classified as a:
    (A) leading indicator.
    (B) coincident indicator
    (C) lagging indicator

37. Which of the following statements most accurately describes the difference between headline inflation and core inflation? Core inflation:
    (A) excludes raw materials and goods in process, while headline inflation includes all goods.
    (B) refers to producer prices, while headline inflation refers to consumer prices.
    (C) excludes food and energy prices, while headline inflation includes them.

38. Which of the following statements about biases that affect the consumer price index (CPI) is *least accurate?*
    (A) The basket of goods on which the CPI is based becomes a less accurate measure of household costs as new goods appear on the market.
    (B) The net effect of built-in biases in the CPI is to underestimate inflation.
    (C) Price increases that result from quality improvements are reflected as increases in the CPI.

39. Inflation resulting from a decrease in taxes is most likely
    (A) demand-pull inflation.
    (B) stagflation.
    (C) cost-push inflation.

40. Which of the following is *least likely one* of the three types of unemployment?
    (A) Seasonal.
    (B) Frictional.
    (C) Structural.

41. Which type of unemployment describes situations where qualified workers are not immediately matched with existing job openings?
    (A) Frictional.
    (B) Structural.
    (C) Cyclical.

42. The unemployment rate is the number of unemployed individuals divided by the:
    (A) number of employed individuals
    (B) total labor force.
    (C) working-age population.

43. When the economy enters an expansion phase, the most likely effect on external trade is a(n):
    (A) decrease in exports.
    (B) increase in exports.
    (C) increase in imports.

44. The current annual inflation rate, as measured by using the Consumer Price Index (CPI), is *best* defined as:
    (A) increase in the CPI from a year ago.
    (B) percentage change in the CPI from a year ago.
    (C) percentage change in the CPI from its base period.