

Question #1 of 87

Question ID: 1589790

When potential real GDP is less than actual real GDP, the economy is *most likely* experiencing:

- A) inflation. 
- B) recession. 
- C) underemployment. 

Explanation

The economy is in an inflationary phase if actual real GDP is greater than potential real GDP. When actual real GDP equals potential real GDP, the economy is said to be at full employment. The economy is in a recessionary phase if real GDP is less than potential GDP.

(Module 9.3, LOS 9.j)

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Question ID: 1589757

Which of the following models *most accurately* depicts the relationship among saving (S), private investment (I), the fiscal balance (G – T), and the trade balance (X – M)?

- A) $S = I + (G - T) - (X - M)$. 
- B) $S = I - (G - T) + (X - M)$. 
- C) $S = I + (G - T) + (X - M)$. 

Explanation




Savings equal investment plus the fiscal balance (G – T) plus the trade balance (X – M).

(Module 9.1, LOS 9.e)

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Question ID: 1589772

When national income in an important trading partner's economy increases, aggregate demand in the domestic economy is *most likely* to:

- A) increase because foreign consumers will tend to buy more export goods from the domestic country. 
- B) decrease because interest rates in the domestic economy will tend to increase. 
- C) decrease because foreign consumers will tend to buy less export goods from the domestic country. 

Explanation


When incomes in foreign countries increase, it is unlikely to have a direct effect on interest rates in the domestic economy. However, an increase in foreign incomes is likely to result in greater foreign purchases of goods exported from the domestic country, which increases the domestic country's net exports and aggregate demand.

(Module 9.2, LOS 9.h)

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Question ID: 1589796

From an initial long-run equilibrium, if aggregate demand increases while short-run aggregate supply decreases, the price level:

- A) will increase. 
- B) may increase or decrease. 
- C) will decrease. 

Explanation




Both an increase in aggregate demand and a decrease in short-run aggregate supply increase the price level.

(Module 9.3, LOS 9.l)

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Question ID: 1589794

Can an economy that is at long-run equilibrium adjust to produce real GDP which is greater than full-employment real GDP in the short run?

- A) No. 
- B) Yes, if aggregate demand increases. 
- C) Yes, if wages increase. 

Explanation




An increase in aggregate demand when the economy is operating at long-run equilibrium (at full employment) will increase both the price level and real GDP in the short run.

(Module 9.3, LOS 9.k)

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Question ID: 1589771

The sustainable growth rate of real GDP is *most likely* to be increased by:

- A) an increase in the propensity to consume by households. 
- B) an increase in government spending. 
- C) the discovery of untapped oil fields. 

Explanation

Sustainable growth in real GDP is defined as the growth rate in real GDP that is sustainable over the long term. The sustainable growth rate is positively affected by increases in the supply of natural resources, the supply of physical capital, or the supply or productivity of labor. An increase in government spending does not increase an economy's sustainable growth rate.

(Module 9.2, LOS 9.h)

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Question ID: 1589775

Which of the following events is *least likely* to cause a decrease in short-run aggregate supply?

- A) Inflation increases from 4% to 7%. 

B) Oil exporting countries reduce their production levels.



C) A labor stoppage causes the price of steel to rise.



Explanation

Changes in the price level represent movement along the short-run aggregate supply curve. The other items listed are events that are likely to shift the short-run aggregate supply curve to the left (decrease SRAS).

(Module 9.2, LOS 9.h)

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Which method of calculating gross domestic product requires data from each stage of production of goods?

A) Value of final output method.



B) Sum of value added method.



C) Income method.



Explanation

The sum-of-value-added method of calculating GDP requires data on the value added to goods at each stage of production and distribution. The value-of-final-output method only requires data on the final values of goods and services. The income approach to calculating GDP measures the total income of households and companies, rather than the value of goods and services.

(Module 9.1, LOS 9.b)

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Question ID: 1589797

If both aggregate demand and short-run aggregate supply increase, real GDP:

A) will increase.



B) will decrease.



C) may increase or decrease.



Explanation


Increases in AD and SRAS both cause real GDP to increase. An increase in AD increases the price level, but an increase in SRAS tends to decrease the price level, so their combined effect could be an increase or a decrease in the price level.

(Module 9.3, LOS 9.I)

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Question ID: 1589731

Which of the following *least* accurately describes a component of gross domestic product?

- A) Investment. 
- B) Consumption. 
- C) Net imports. 

Explanation




The components of GDP are consumption, investment, government spending, and net exports, which is exports minus imports.

(Module 9.1, LOS 9.a)

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Question ID: 1589728

Which of the following items is *most likely* to be included in gross domestic product at an estimated value?

- A) Owner-occupied housing. 
- B) Services provided by government. 
- C) Maintenance of rental properties. 

Explanation

The value of owner-occupied housing is included in GDP at an estimated value. Government services are included in GDP at their cost to the government. Maintenance of rental properties is a service that is included in GDP at its market price.

(Module 9.1, LOS 9.a)

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A shirt with a retail price of \$50 is produced using cloth with a value of \$40. The cloth is produced from cotton with a value of \$30. Using the sum-of-value-added method, what is the total value added to gross domestic product by producing the shirt?

- A) \$70. 
- B) \$50. 
- C) \$20. 

Explanation

Producing the shirt adds \$50 to GDP under either the sum-of-value-added approach or the value-of-final-output approach.

Stage of production	Value	Value added
Cotton	\$30	\$30
Cloth	\$40	\$10
Shirt	\$50	<u>\$10</u>
Sum of value added		\$50

(Module 9.1, LOS 9.b)




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Question ID: 1589753

If the government is running a budget deficit, which of the following relationships are *least likely* to occur in the economy at the same time?

Exports relative to imports

Savings relative to investment

- A) exports < imports private savings > private investment 
- B) exports > imports private savings < private investment 
- C) exports < imports private savings < private investment 

Explanation




A government budget deficit, a trade surplus, and an excess of private investment over private savings cannot all occur at the same time. If the government runs a budget deficit, the deficit must be financed by a trade deficit (exports < imports), surplus private savings (private savings > private investment), or both.

(Module 9.1, LOS 9.e)

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Question ID: 1589793

If the economy is in short-run disequilibrium below full employment, the *most likely* explanation is that:

- A) aggregate demand has decreased. 
- B) long-run aggregate supply has decreased. 
- C) money wage rates have decreased. 

Explanation




A decrease in aggregate demand can reduce output below its full-employment level. A decline in long-run aggregate supply would mean the full-employment output level itself has decreased. Wage rates are assumed to be fixed in the short run, but the long-run effect of decreases in wage rates would be to increase (shift) short-run aggregate supply, leading to an increase in output.

(Module 9.3, LOS 9.k)

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The long-run aggregate supply curve is *best* described as:

- A) elastic because most input prices are variable in the long run. 
- B) perfectly elastic because input prices are sticky in the long run. 
- C) perfectly inelastic because input prices change proportionately with the price level in the long run. 

Explanation




The long-run aggregate supply curve is perfectly inelastic because in the long run, wages and other input prices adjust to changes in the overall price level. Long-run aggregate supply equals potential GDP.

(Module 9.2, LOS 9.g)

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Other things equal, aggregate demand is *most likely* to decrease as a result of a decrease in:

- A) taxes. 
- B) the money supply. 
- C) the foreign exchange value of the domestic currency. 

Explanation




A decrease in the money supply will cause short-term interest rates to increase, decreasing investment and consumption spending and thereby decreasing AD. A decrease in taxes will increase disposable incomes, consumption spending, and AD. If the foreign exchange value of the domestic currency decreases, the country's products become relatively less expensive to foreign buyers, while foreign goods become relatively more expensive to domestic buyers. As a result, net exports increase, which increases AD.

(Module 9.2, LOS 9.h)

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What are the *most likely* effects on aggregate demand in the current period of an increase in expected future incomes and of an increase in the money supply?

- A) One increases aggregate demand and one decreases aggregate demand. 
- B) Both decrease aggregate demand. 
- C) Both increase aggregate demand. 

Explanation




An increase in expected future incomes will cause consumers to increase current expenditures (reduce current savings) in anticipation of the higher future incomes. An increase in the money supply will tend to decrease interest rates which will lead to increased consumer spending on durable goods and increased investment by businesses. Both effects increase aggregate demand.

(Module 9.2, LOS 9.h)

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Short-run disequilibrium is *most likely* to be associated with a decreasing price level if it results from a decrease in:

- A) both aggregate demand and short-run aggregate supply. 
- B) short-run aggregate supply, if aggregate demand is unchanged. 
- C) aggregate demand, if short-run aggregate supply is unchanged. 

Explanation



A decrease in aggregate demand, holding short-run aggregate supply constant, would decrease the price level. A decrease in short-run aggregate supply, holding aggregate demand constant, would increase the price level. If both aggregate demand and short-run aggregate supply decrease, the price level may increase or decrease.

(Module 9.3, LOS 9.j)

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If a fiscal budget deficit increases, which of the following factors must also increase if all other factors are held constant?

- A) Savings. 
- B) Trade surplus. 
- C) Investment. 

Explanation




The relationship between the fiscal balance, savings, investment, and the trade balance is $(G - T) = (S - I) - (X - M)$. An increase in a fiscal budget deficit ($G - T$) must be funded by an increase in savings (S), a decrease in investment (I), or a decrease in net exports ($X - M$), which would decrease a trade surplus or increase a trade deficit.

(Module 9.1, LOS 9.e)

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A country's statistical bureau reports a GDP deflator of 106.5. An analyst should interpret this statistic to mean that since the base period:

- A) the annual inflation rate is 6.5%. 
- B) nominal GDP has increased 6.5% relative to real GDP. 
- C) real GDP has increased 6.5%. 

Explanation




If the GDP deflator is 106.5, the price level has increased 6.5% since the base period and nominal GDP is 6.5% greater than real GDP. Because the base period is not necessarily the previous year, we cannot conclude that 6.5% is the annual inflation rate.

(Module 9.1, LOS 9.c)

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The aggregate expenditure/aggregate output model implies that a fiscal surplus must be accompanied by:

- A) savings greater than investment or imports greater than exports. 
- B) savings greater than investment or exports greater than imports. 
- C) investment greater than savings or exports greater than imports. 

Explanation