## Chapter 15 Testbank

- 1. The measure of the cost of a standard basket of goods and services in any period relative to the cost of the same basket of goods and services in the base year is called the:
  - A. cost-of-living indicator.
  - B. consumption production index.
  - C. consumer production index.
  - D. consumer price index.
- The consumer price index for the current year measures the cost of a standard basket in the \_\_\_\_\_ year relative to the cost of the same basket in the \_\_\_\_\_ year.
  - A. current; base
  - B. current; current
  - C. base; index
  - D. base; current
- 3. The CPI is a measure of the:
  - A. real wage.
  - B. price of a specific good or service.
  - C. rate of inflation.
  - D. average level of prices relative to prices in the base year.

- 4. Suppose that the total expenditures for a typical household in 2000 equaled \$2,500 per month, while the cost of purchasing exactly the same items in 2005 was \$3,000. If 2000 is the base year, the CPI for 2000 equals:
  - A. 0.83
  - B. 1.00
  - C. 1.20
  - D. 1.25
- 5. Suppose that the total expenditures for a typical household in 2000 equaled \$5,500 per month, while the cost of purchasing exactly the same items in 2005 was \$6,875. If 2000 is the base year, the CPI for the year 2005 equals:
  - A. 0.80
  - B. 1.00
  - C. 1.20
  - D. 1.25
- 6. If the total expenditures of a typical family equaled \$35,000 per year in 2000 and the exact same basket of goods and services cost \$40,000 in the year 2005, the family's cost of living:
  - A. increased by 14 percent.
  - B. decreased by 12.5 percent.
  - C. decreased by 14 percent.
  - D. increased by 12.5 percent.

- 7. The consumer price index for Planet Econ consists of only two items: books and sandwiches. In 2000, the base year, the typical consumer purchased 10 books for \$25 each and 25 sandwiches for \$2 each. In 2005, the typical consumer purchased 15 books for \$30 each and 30 sandwiches for \$3 each. The consumer price index for 2005 on Planet Econ equals:
  - A. 1.00
  - B. 1.08
  - C. 1.15
  - D. 1.25
- 8. The typical family on the Planet Econ consumes 10 pizzas, 7 pairs of jeans, and 20 liters of milk. In 2004 pizzas cost \$10 each, jeans cost \$40 per pair, and milk cost \$3 per liter. In 2005, the price of pizzas went down to \$8 each, while the price of jeans and milk remained the same. Between 2004 and 2005, a typical family's cost of living:
  - A. increased by 4.5 percent.
  - B. decreased by 4.5 percent.
  - C. remained the same.
  - D. decreased by 20 percent.
- 9. The typical family on the Planet Econ consumes 10 pizzas, 7 pairs of jeans, and 20 liters of milk. In 2004 pizzas cost \$10 each, jeans cost \$40 per pair, and milk cost \$3 per liter. In 2005, the price of pizzas increased to \$14 each, while the price of jeans and milk remained the same. Between 2004 and 2005, a typical family's cost of living:
  - A. increased by 9 percent.
  - B. decreased by 9 percent.
  - C. remained the same.
  - D. increased by 40 percent.

- 10. If the Consumer Price Index increased from 1.52 to 1.65, then it must be the case that \_\_\_\_\_\_ relative to prices in the base year.
  - A. all prices rose
  - B. the weighted average level of prices rose
  - C. all prices fell
  - D. some prices rose and some prices fell
- 11. The Consumer Price Index measures the cost of:
  - A. a fixed basket of goods and services.
  - B. a changing basket of goods and services.
  - C. all goods and services purchased by consumers.
  - D. goods and services required to live above the poverty level.
- 12. A consumer expenditure survey reports the following information on consumer protein spending:

	2005		2006	
	Price	Quantity	Price	Quantity
Fish	\$5	5	\$7	7
Chicken	\$3	10	\$4	12
Beef	\$6	7	\$5	10

Using 2005 as the base year, by how much does a "cost of protein" index increase between 2005 and 2006?

- A. 5.2%
- B. 8.6%
- C. 13.4%
- D. 14.3%

13. A consumer expenditure survey reports the following information on entertainment spending:

	2005		2006	
	Price	Quantity	Price	Quantity
Movies	\$7	5	\$8	7
Concerts	\$30	2	\$35	2
CDs	\$16	7	\$15	10

Using 2005 as the base year, by how much does a "cost of entertainment" index increase between 2005 and 2006?

A. 3.86%

B. 8.65%

C. 13.43%

D. 29.41%

14. A CPI that equals 1.34 in 2005 (when 2000 is the base year) means that:

A. prices in 2005 are 34 percent higher than in 2004.

B. the CPI equals \$1.34 in 2005.

- C. the inflation rate in 2005 is 134 percent.
- D. the average level of prices is 34 percent higher in 2005 than in the base year.
- 15. A measure of the average price of a given class of goods or services relative to the price of the same goods and services in a base year is called a:

A. real price.

- B. real quantity.
- C. rate of inflation.
- D. price index.

## 16. A price index measures:

- A. the price of specific good or service.
- B. the change in the price of a specific good or service.
- C. only the prices that change.
- D. the average price of a given class of goods or services relative to the price of the same goods and services in a base year.
- 17. The annual percentage rate of change in the price level is the:
  - A. relative price.
  - B. Fisher effect.
  - C. cost of living.
  - D. rate of inflation.
- 18. The inflation rate can be calculated as the percentage change in:
  - A. real GDP.
  - B. nominal GDP.
  - C. the Consumer Price Index.
  - D. the exchange rate.

- 19. The CPI in year one equaled 1.45. The CPI in year two equaled 1.51. The rate of inflation between years one and two was \_\_\_\_\_ percent.
  - A. 4.0
  - B. 4.1
  - C. 4.5
  - D. 6.0
- 20. The CPI in 1974 equaled 0.49. The CPI in 1975 equaled 0.54. The rate of inflation between 1974 and 1975 was \_\_\_\_\_ percent.
  - A. 5.4
  - B. 9.0
  - C. 9.3
  - D. 10.2
- 21. The CPI measures the \_\_\_\_\_; a measure of the rate of inflation is the \_\_\_\_\_.
  - A. base year price level; current year price level
  - B. level of prices; change in the level of prices
  - C. current year price level; base year price level
  - D. change in the level of prices; level of prices

- 22. The average price level is measured by the \_\_\_\_\_; a measure of the annual percentage change in the price level is the \_\_\_\_\_.
  - A. base year price index; current year price index
  - B. real price level; nominal price level
  - C. nominal price level; real price level
  - D. CPI; rate of inflation
- 23. In 1929 the CPI equaled 0.171 and in 1930 the CPI equaled 0.167. These data provide evidence of a period of
  - A. inflation.
  - B. deflation.
  - C. trade deficit.
  - D. expansion.
- 24. If the CPI in 2005 equaled 1.43 and in 2006 equaled 1.56, then between 2005 and 2006 there was:
  - A. inflation.
  - B. deflation.
  - C. a recession.
  - D. an expansion.

- 25. The CPI in 1930 equaled 0.17. The CPI in 1931 equaled 0.15. The rate of inflation between 1930 and 1931 was \_\_\_\_\_ percent.
  - A. -13.3
  - B. -11.8
  - C. 1.5
  - D. 11.8
- 26. The CPI in 1931 equaled 0.15. The CPI in 1932 equaled 0.14. The rate of inflation between 1931 and 1932 was \_\_\_\_\_ percent.
  - A. -7.1
  - B. -6.6
  - C. 1.4
  - D. 6.6
- 27. Deflation is a situation in which the:
  - A. quantity of goods and services produced is increasing over time.
  - B. quantity of goods and services produced is decreasing over time.
  - C. prices of most goods and services are falling over time.
  - D. prices of most goods and services are rising over time.

28. The situation when the price of most goods and services are falling over time is called:

- A. inflation.
- B. disinflation.
- C. a boom.
- D. deflation.
- 29. A nominal quantity is measured:
  - A. in physical terms.
  - B. in terms of current dollar value.
  - C. using the consumer price index.
  - D. by indexing.
- 30. A quantity measured in terms of current dollar value is called a(n) \_\_\_\_\_ quantity.
  - A. nominal
  - B. real
  - C. deflated
  - D. indexed
- 31. All of the following are nominal quantities EXCEPT the:
  - A. price of a new car.
  - B. wages paid to workers in a restaurant.
  - C. cost of purchasing a new computer.
  - D. number of new houses built in one month.

32. Which of the following is a nominal quantity?

- A. the number of people unemployed
- B. the current price of a barrel of oil
- C. the number of cars produced in 2005
- D. the amount of coal mined in one month
- 33. Which of the following is a real quantity?
  - A. the current wages paid to factory workers
  - B. the cost of a new car
  - C. the number of tons of steel produced in 2005
  - D. the current price of a barrel of oil
- 34. A real quantity is a quantity measured:
  - A. in physical terms.
  - B. in terms of current dollar value.
  - C. by the average quantity.
  - D. using real prices.
- 35. All of the following are real quantities EXCEPT the:
  - A. number of new cars produced in one year.
  - B. tons of steel shipped to South America.
  - C. millions of computer chips shipped to computer makers.
  - D. billions of dollars invested in stocks.

- 36. Deflating a nominal quantity is the process of dividing a \_\_\_\_\_ quantity by a \_\_\_\_\_ in order to express the quantity in \_\_\_\_\_ terms.
  - A. nominal; real quantity; nominal
  - B. nominal; nominal quantity; real
  - C. real; nominal quantity; real
  - D. nominal; price index; real
- 37. To correct a nominal quantity for changes in the price level, one should:
  - A. add a price index to it.
  - B. subtract a price index from it.
  - C. divide it by a price index.
  - D. multiply it by a price index.
- 38. To compare the purchasing power of nominal wages in two different years, one must:
  - A. compare the nominal values.
  - B. deflate both quantities by a common price index.
  - C. increase both quantities by the same percentage increase in a price index.
  - D. adjust both quantities by the real interest rate.

- 39. The price of a liter of gasoline at the pump increased by 10 percent at the same time that the inflation rate was 5 percent. The nominal price of gasoline \_\_\_\_\_ and the real price of gasoline
  - A. increased; increased

- B. increased; decreased
- C. increased; did not change
- D. decreased; increased
- 40. The price of a liter of gasoline at the pump increased by 10 percent at the same time that the inflation rate was 15 percent. The nominal price of gasoline \_\_\_\_\_ and the real price of gasoline

A. increased; increased

- B. increased; decreased
- C. increased; did not change
- D. decreased; increased
- 41. If the CPI equaled 1.00 in 1995 and 1.65 in 2005 and a typical household's income equaled \$35,000 in 1995 and \$40,000 in 2005, then between 1995 and 2005, real household income:
  - A. increased.
  - B. decreased.
  - C. was constant.
  - D. may have increased or decreased.

- 42. A college graduate in 1972 found a job paying \$7,200. The CPI was 0.418 in 1972. A college graduate in 2000 found a job paying \$30,000. The CPI was 1.68 in 2005. The 1972 graduate's job paid \_\_\_\_\_ in nominal terms and \_\_\_\_\_ in real terms than the 2005 graduate's job.
  - A. more; less
  - B. more; more
  - C. less; the same
  - D. less, less
- 43. A college graduate in 1972 found a job paying \$7,200. The CPI was 0.418 in 1972. A college graduate in 2005 found a job paying \$28,000. The CPI was 1.68 in 2005. The 1972 graduate's job paid \_\_\_\_\_ in nominal terms and \_\_\_\_\_ in real terms than the 2005 graduate's job.
  - A. more; less
  - B. more; more
  - C. less; the same
  - D. less; more
- 44. One family earned an income of \$28,000 in 1990. Over the next five years, their income increased by 15%, while the CPI increased by 12%. After five years, this family's nominal income \_\_\_\_\_ and their real income \_\_\_\_\_.
  - A. decreased; decreased
  - B. decreased; increased
  - C. increased; did not change
  - D. increased; increased

- 45. One family earned an income of \$28,000 in 1990. Over the next five years, their income increased by 15%, while the CPI increased by 15%. After five years, this family's nominal income \_\_\_\_\_ and their real income \_\_\_\_\_.
  - A. decreased; decreased
  - B. decreased; increased
  - C. increased; did not change
  - D. increased; increased
- 46. Suppose that a year's tuition at a university near your home cost \$250 in 1972 when the CPI equaled 0.418. The cost of a year's tuition at the same university cost \$3000 in 2005 when the CPI equaled 1.68. The real cost of tuition between 1972 and 2005:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. may have either increased or decreased.
- 47. The price of a liter of gasoline was \$0.35 in 1972 when the CPI equaled 0.418. The cost of a liter of gasoline was \$2.25 in 2005 when the CPI equaled 1.91. The real cost of a liter of gasoline between 1972 and 2005:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. may have either increased or decreased.

48. The wage paid to workers measured in terms of real purchasing power is called the:

- A. nominal wage.
- B. cost of living.
- C. minimum wage.
- D. real wage.
- 49. The real wage is the wage:
  - A. measured in current dollars.
  - B. required to maintain a minimum standard of living.
  - C. employers are required to pay workers.
  - D. measured in terms of purchasing power.
- 50. If workers received a 5 percent wage increase and the rate of inflation was 10 percent, then their real wage:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. equaled the nominal wage.

- 51. If workers received a 5 percent wage increase and the rate of inflation was 3 percent, then their real wage:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. equaled the nominal wage.
- 52. Suppose that a report indicates that the average real wage in manufacturing declined by 2% between 1990 and 2000. If the CPI equaled 1.30 in 1990, 1.69 in 2000, and the average nominal wage in manufacturing was \$35 in 2000, what was the average nominal wage in manufacturing in 1990?
  - A. \$20.71
  - B. \$21.12
  - C. \$26.92
  - D. \$27.46
- 53. Suppose that a report indicates that the average annual real income of agricultural workers declined by 2% between 1990 and 2000. If the CPI equaled 1.30 in 1990, 1.69 in 2000, and the nominal income of agricultural workers was \$35,000 in 2000, what was the average nominal income of agricultural workers in 1990?
  - A. \$20,710
  - B. \$21,124
  - C. \$26,923
  - D. \$27,462

- 54. A factory worker earned \$10 an hour in 1980. The CPI was 0.82 in 1980. The same factory worker was earning \$15 an hour in 1990 when the CPI was 1.31. From 1980 to 1990, the factory worker's hourly real wage:
  - A. increased from \$7.63 to \$18.29.
  - B. decreased from \$12.20 to \$11.45.
  - C. remained constant.
  - D. increased from \$10 to \$15.
- 55. The practice of increasing a nominal quantity each period by an amount equal to the percentage increase in a specified price index is called:
  - A. a substitution bias.
  - B. the Fisher effect.
  - C. deflating.
  - D. indexing.
- 56. Indexing is the process of:
  - A. dividing a real quantity by a price index.
  - B. dividing a nominal quantity by a price index.
  - C. increasing a nominal quantity by an amount equal to the percentage change in a price index.
  - D. increasing a real quantity by an amount equal to the percentage change in a price index.

- 57. To insure that your salary maintains its real purchasing power from year to year, your nominal salary must be:
  - A. deflated.
  - B. indexed.
  - C. aggregated.
  - D. hyperinflated.
- 58. If you wish to maintain a constant purchasing power when you retire, you should choose retirement income options that are:
  - A. deflated.
  - B. nominal.
  - C. indexed.
  - D. inflated.
- 59. Because Congress fixes the minimum wage in nominal terms, when there is inflation, the nominal minimum wage \_\_\_\_\_\_ and the real minimum wage \_\_\_\_\_\_.
  - A. remains constant; falls
  - B. remains constant; remains constant
  - C. remains constant; increases
  - D. increases; falls

- 60. The CPI equals 1.00 in year one and 1.15 in year two. If the nominal wage is \$15 in year one and a contract calls for the wage to be indexed to the CPI, what will be the nominal wage in year two?
  - A. \$13.04
  - B. \$15.00
  - C. \$16.15
  - D. \$17.25
- 61. A labor contract provides for a first-year wage of \$10 per hour, and specifies that the real wage will rise by 3 percent in the second year of the contract. The CPI is 1.00 in the first year and 1.07 in the second year. What dollar wage must be paid in the second year?
  - A. \$10.00
  - B. \$10.30
  - C. \$10.70
  - D. \$11.02
- 62. A labor contract provides for a first-year wage of \$15 per hour, and specifies that the real wage will rise by 2 percent in the second year of the contract. The CPI is 1.00 in the first year and 1.09 in the second year. What dollar wage must be paid in the second year?
  - A. \$15.00
  - B. \$15.30
  - C. \$16.09
  - D. \$16.68

- 63. A labor contract provides for a first-year wage of \$10 per hour, and specifies that the real wage will rise by 3 percent in the second year of the contract and by another 3 percent in the third year. The CPI is 1.00 in the first year, 1.07 in the second year, and 1.15 in the third year. What dollar wage must be paid in the third year?
  - A. \$10.00
  - B. \$10.61
  - C. \$11.15
  - D. \$12.20
- 64. To ensure that a nominal payment represents a constant level of purchasing power over time, one should:
  - A. add a price index to it.
  - B. subtract a price index from it.
  - C. divide it by a price index.
  - D. increase it by a percentage equal to the rate of inflation for that year.
- 65. Two methods used to adjust nominal values for inflation are:
  - A. substituting and complementing.
  - B. indexing and deflating.
  - C. aggregating and disaggregating.
  - D. real and nominal.

66. The CPI may be a poor measure of true inflation because it \_\_\_\_\_ the true inflation rate.

- A. is independent of
- B. understates
- C. exacerbates
- D. overstates
- 67. If the conclusion that the CPI \_\_\_\_\_ the "true" inflation rate is correct, then indexing Social Security benefits to the CPI is \_\_\_\_\_ the government billions of dollars.
  - A. understates; costing
  - B. overstates; costing
  - C. understates; saving
  - D. measures; saving
- 68. If the conclusion that the CPI \_\_\_\_\_ the "true" inflation rate is correct, then the true improvement in living standards over time is \_\_\_\_\_.
  - A. understates; overestimated
  - B. understates; underestimated
  - C. overstates; underestimated
  - D. measures; overestimated

- 69. Suppose that the CPI does indeed overstate the rate of inflation. When the CPI increases by 5% and household incomes increase by 5%, we should conclude that the real incomes of households:
  - A. increased.
  - B. stayed constant.
  - C. decreased.
  - D. increased more slowly than inflation.
- 70. When statisticians fail to take into account improvements in the quality of goods and services, the CPI will tend to \_\_\_\_\_ the rate of inflation.
  - A. understate
  - B. precisely measure
  - C. be unrelated to
  - D. overstate
- 71. Suppose manufacturers introduce a new model car to replace a car currently included in the CPI basket. The price of the new car is 10 percent higher than the discontinued model, but the new car also includes additional safety features. In this situation the CPI will tend to \_\_\_\_\_ inflation as a result of \_\_\_\_\_ bias.
  - A. overstate; substitution
  - B. understate; substitution
  - C. accurately measure; substitution
  - D. overstate; quality adjustment

- 72. The quality adjustment bias in the CPI refers to the failure of statisticians to:
  - A. allow for the possibility that consumers switch from products whose prices are rising.
  - B. allow for the possibility that consumers switch stores at which they shop.
  - C. take into account improvements in goods and services.
  - D. take into account price changes in goods and services.
- 73. Product improvements make it difficult for the statisticians who construct the CPI to distinguish between \_\_\_\_\_ changes and \_\_\_\_\_ changes.
  - A. price; quality
  - B. quantity; price
  - C. quantity; quality
  - D. income; price
- 74. Inflation in the health-care sector apparently is overstated because the CPI does not adequately adjust for \_\_\_\_\_ changes.
  - A. price
  - B. quality
  - C. volume
  - D. quantity

- 75. The substitution bias in the CPI refers to the failure of statisticians to:
  - A. allow for the possibility that consumers switch from products whose prices are rising.
  - B. allow for the possibility that consumers switch stores at which they shop.
  - C. take into account improvements in goods and services.
  - D. take into account new products purchased by consumers.
- 76. When statisticians fail to allow for the possibility that consumers switch from products with rising prices to those whose prices are stable or falling, the CPI will tend to \_\_\_\_\_ the rate of inflation.
  - A. understate
  - B. precisely measure
  - C. be unrelated to
  - D. overstate
- 77. Suppose that the price of chicken rises sharply compared to the price of turkey. People buy more turkey and less chicken than they did in the CPI base year. In this situation the CPI will tend to \_\_\_\_\_ inflation as a result of \_\_\_\_\_ bias.
  - A. overstate; substitution
  - B. understate; substitution
  - C. accurately measure; substitution
  - D. overstate; quality adjustment

- 78. Two types of bias that tend to cause the CPI to overstate the "true" rate of inflation are the \_\_\_\_\_ bias and the \_\_\_\_\_ bias.
  - A. substitution; quality adjustment
  - B. price; quantity
  - C. aggregation; price
  - D. quality adjustment; price adjustment
- 79. The substitution bias in the CPI arises because the CPI:
  - A. is based on a fixed basket of goods and services.
  - B. does not adequately allow for improvements in products.
  - C. measures prices at two different times.
  - D. understates the "true" rate of inflation.
- 80. When consumers substitute a cheaper good for a more expensive one, the CPI will \_\_\_\_\_ change in the cost of living.
  - A. equal the
  - B. understate the
  - C. precisely measure the
  - D. overstate the

81. The price level is:

- A. the rate of inflation.
- B. a measure of overall prices at a particular point in time.
- C. the percentage change in a price index such as the CPI.
- D. the price of a specific good in comparison to the prices of other goods and services.
- 82. A relative price is:
  - A. the rate of inflation.
  - B. a measure of overall prices at a particular point in time.
  - C. the percentage change in a price index such as the CPI.
  - D. the price of a specific good in comparison to the prices of other goods and services.
- 83. A measure of overall prices at a particular point in time is called:
  - A. a relative price.
  - B. the price level.
  - C. a real price.
  - D. inflation.
- 84. If the price of hotel rooms increases by 10% while the prices of other goods and services increase by 5% on average, the relative price of hotel rooms has:
  - A. increased.
  - B. decreased by 5%.
  - C. decreased by 10%.
  - D. remained constant.

85. If all prices, including the price of beef, increase by 3%, then the relative price of beef \_\_\_\_\_ and

there \_\_\_\_\_ inflation.

- A. increased; is
- B. increased; is no
- C. remained constant; is
- D. remained constant; is no

86. To counteract relative price changes, the government would implement:

- A. monetary policy.
- B. fiscal policy.
- C. polices that affect the supply and demand for a specific good.
- D. policies that affect the supply and demand for all goods and services.
- 87. Changes in the average price level are called \_\_\_\_\_, while changes in the price of a specific good in comparison with other goods and services are called \_\_\_\_\_.
  - A. quality adjustments; substitution bias.
  - B. changes in a relative price; inflation.
  - C. inflation; changes in a relative price.
  - D. price level adjustments; quality adjustments.

88. To counteract inflation, the government could implement all of the following EXCEPT:

- A. monetary policy.
- B. fiscal policy.
- C. polices that affect the supply and demand for a specific good.
- D. policies that affect the supply and demand for all goods and services.
- 89. Suppose the value of the CPI is 1.10 in year 1, 1.21 in year 2, and 1.331 in year 3. Assume also that the price of computers increases by 3% between year 1 and year 2, and by another 3% between year 2 and year 3. The price level is increasing, the inflation rate is \_\_\_\_\_, and the relative price of computers is \_\_\_\_\_.
  - A. increasing; increasing
  - B. constant; increasing
  - C. constant; decreasing
  - D. increasing; decreasing
- 90. Suppose the value of the CPI is 1.10 in year 1, 1.16 in year 2, and 1.27 in year 3. Assume also that the price of computers increases by 3% between year 1 and year 2, and by another 3% between year 2 and year 3. The price level is increasing, the inflation rate is \_\_\_\_\_, and the relative price of computers is \_\_\_\_\_.
  - A. increasing; increasing
  - B. constant; increasing
  - C. constant; decreasing
  - D. increasing; decreasing

- 91. \_\_\_\_\_ is an increase in the price level, while \_\_\_\_\_ is an increase in the price of a good in comparison to other goods and services.
  - A. Inflation; hyperinflation
  - B. A relative price increase; inflation
  - C. Hyperinflation; inflation
  - D. Inflation; a relative price increase
- 92. Inflation makes it difficult to distinguish relative price changes from changes in the general level of prices. Consequently, inflation \_\_\_\_\_ the efficiency of the market system.
  - A. increases
  - B. decreases
  - C. does not change
  - D. may either increase or decrease
- 93. Inflation \_\_\_\_\_ the signals sent by price changes to demanders and suppliers of goods and services.
  - A. amplifies
  - B. obscures
  - C. enhances
  - D. has no impact on

- 94. The phenomenon known as \_\_\_\_\_ occurs when inflation causes people to pay an increasing percentage of their income in taxes even when their real incomes have not changed.
  - A. hyperinflation
  - B. bracket creep
  - C. the Fisher effect
  - D. substitution bias
- 95. To prevent people paying a higher percentage of their income in taxes even when their real incomes have not changed Congress:
  - A. implemented a flat tax.
  - B. reduced the capital gains tax.
  - C. indexed the income tax brackets to the CPI.
  - D. deflated the income tax brackets to the CPI.
- 96. In Econoland in 2000, people with incomes between \$20,000 and \$30,000 must pay 12% of their income in taxes and people with incomes between \$30,001 and \$40,000 must pay 15%. In 2000, the CPI in Econoland equals 1.20 and increases to 1.26 in 2001. If the government of Econoland wants to keep households with a given real income from being pushed up into a higher tax bracket by inflation, the \$20,000 to \$30,000 bracket will be changed to:
  - A. \$15,873 to \$23,810
  - B. \$21,000 to \$31,500
  - C. \$24,000 to \$37,800
  - D. \$25,200 to \$37,800

97. The shoe leather costs of inflation include all of the following EXCEPT:

- A. the lost purchasing power of cash.
- B. the extra costs incurred to avoid holding cash.
- C. the cost of more frequent trips to the bank.
- D. the installation of a new cash management system.
- 98. The extra costs incurred to avoid holding cash when there is inflation are called the:
  - A. average costs of inflation.
  - B. consumer price index costs.
  - C. external costs.
  - D. shoe leather costs.
- 99. Nadia's Cookie Shop needs \$1,000 cash per day for customer transactions. Nadia has a choice between going to the bank first thing on Monday morning to withdraw \$5,000 enough cash for the whole week or going to the bank first thing every morning for \$1,000 each time. Nadia puts the cost of going to the bank at \$1 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Nadia's Cookie shop is open 5 days a week for 50 weeks each year. If Nadia goes to the bank everyday when the inflation rate is 10%, then the annual cost of going to the bank is \_\_\_\_\_ and Nadia's annual losses from holding cash are \_\_\_\_\_.
  - A. \$50;\$5,000
  - B. \$50;\$1,000
  - C. \$250; \$100
  - D. \$250; \$1,000

100.Sarah's Java Café needs \$4,000 cash per day for customer transactions. Sarah has a choice between going to the bank first thing on Monday morning to withdraw \$20,000 - enough cash for the whole week - or going to the bank first thing every morning for \$4,000 each time. Sarah puts the cost of going to the bank at \$3 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Sarah's Java Cafe is open 5 days a week for 50 weeks each year. When the inflation rate is 10% Sarah goes to the bank everyday instead of once a week. Sarah's annual shoe leather costs of inflation equal

A. \$ 3

B. \$150

C. \$600

D. \$750

101.Sarah's Java Café needs \$3,000 cash per day for customer transactions. Sarah has a choice between going to the bank first thing on Monday morning to withdraw \$15,000 - enough cash for the whole week - or going to the bank first thing every morning for \$3,000 each time. Sarah puts the cost of going to the bank at \$2 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Sarah's Java Cafe is open 5 days a week for 50 weeks each year. When the inflation rate is 10% Sarah goes to the bank everyday instead of once a week. Sarah's annual shoe leather costs of inflation equal

A. \$ 2

B. \$100

C. \$400

D. \$500

- 102.Making more frequent, but smaller cash withdrawals from banks \_\_\_\_\_ the inflation losses from holding cash and \_\_\_\_\_ the shoe leather costs of inflation.
  - A. increases; increases
  - B. increases; reduces
  - C. reduces; has no impact on
  - D. reduces; increases
- 103.Increases in the rate of inflation will induce consumers to make more frequent trips to the bank to withdraw cash whenever the cost of the extra trips is \_\_\_\_\_ the benefit of holding less cash subject to purchasing power losses from inflation.
  - A. greater than
  - B. less than
  - C. equal to
  - D. greater than or less than
- 104.At high rates of inflation, the cost to a consumer of more frequent trips to the bank to make cash withdrawals is an increase in the:
  - A. shoe leather costs of inflation.
  - B. loss of purchasing power of cash.
  - C. tax distortion generated by inflation.
  - D. "noise" in the price system.

- 105.If workers and employers agree to a three-year wage contract expecting 3% inflation and inflation turns out to be 5%, then:
  - A. workers gain and employers gain.
  - B. workers gain and employers lose.
  - C. workers lose and employers gain.
  - D. workers lose and employers lose.
- 106.If a borrower and lender agree to an interest rate on a loan when inflation is expected to be 7% and inflation turns out to be 10% over the life of the loan, then the borrower \_\_\_\_\_ and the lender
  - A. gains; gains

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- B. gains; loses
- C. is not affected; gains
- D. loses; gains
- 107.When inflation turns out to be different than expected, wealth is \_\_\_\_\_.
  - A. destroyed
  - B. redistributed
  - C. increased
  - D. decreased

108.It is difficult to engage in long-term financial planning when inflation is:

- A. high and erratic.
- B. low and stable.
- C. accounted for through indexing.
- D. predictable.

109. The real costs of inflation to society include:

A. an increase in the general level of prices.

- B. lost purchasing power of holding cash.
- C. higher relative prices.
- D. interference with long-term planning.

110.The "true" costs of inflation are:

- A. higher relative prices.
- B. lower relative prices.
- C. reduced economic growth and efficiency.
- D. a higher overall price level.

111. The "true" costs of inflation to an economy include all of the following EXCEPT:

- A. shoe-leather costs.
- B. higher relative prices.
- C. noise in the price system.
- D. unexpected redistribution of wealth.
112.Inflation reduces economic efficiency through all of the following channels EXCEPT by:

- A. Distorting incentives through interaction with the tax laws.
- B. Obscuring information transmitted by prices.
- C. Inducing people to minimize cash holdings.
- D. Changing relative prices.

113.Extremely high rates of inflation are called \_\_\_\_\_.

- A. super inflations
- B. deflations
- C. disinflations
- D. hyperinflations

114.Hyperinflations are:

- A. frequently experienced in the United States.
- B. very erratic inflations.
- C. extremely high rates of inflation.
- D. extremely low rates of inflation.

115.An inflation rate of over 500 percent per year is called a(n):

## A. relative inflation.

- B. deflation.
- C. inflation.
- D. hyperinflation.

- 116.Compared to low inflation periods, empirical evidence shows that periods of very high inflation (12-month inflation rates greater than 100%) result in:
  - A. high rates of real output per capita growth.
  - B. high rates of real consumption per capita growth.
  - C. high rate of real investment per capita growth.
  - D. larger government budget deficits.

117.Hyperinflations are extremely costly to economies because they:

- A. reduce both current and future growth because of reduced investment spending.
- B. reduce nominal, but not real values.
- C. reduce trade deficits, but increase government budget deficits.
- D. disproportionately benefit poor workers who are least likely to have indexed wages.

118.Hyperinflations are extremely costly to economies because they:

- A. reduce nominal, but not real values.
- B. distort relative price changes leading to asset misallocations.
- C. reduce trade deficits, but increase government budget deficits.
- D. disproportionately benefit poor workers who are least likely to have indexed wages.

119.The real interest rate is the:

- A. market interest rate.
- B. annual percentage increase in the nominal value of a financial asset.
- C. annual percentage increase in the purchasing power of a financial asset.
- D. the interest rate charged on a loan in dollar terms.

120. The nominal interest rate is the:

- A. annual percentage increase in the dollar value of a financial asset.
- B. annual percentage increase in the purchasing power of a financial asset.
- C. real rate of return on an asset.
- D. the real interest rate minus the inflation rate.
- 121. The annual increase in the dollar value of a financial asset is called the:
  - A. real rate of return.
  - B. inflation rate.
  - C. real interest rate.
  - D. nominal interest rate.

122. If the real interest rate is 3% and the inflation rate is 7%, then the nominal interest rate equals:

- A. 3%.
- B. 4%.
- C. 7%.
- D. 10%.

123.If the market interest rate is 10% and the inflation rate is 3%, then the real interest rate equals:

- A. 3%
- B. 7%
- C. 10%
- D. 13%

124. If the market interest rate is 8% and the inflation rate is 3%, then the real interest rate equals:

A. 3%

- B. 5%
- C. 8%
- D. 11%

125.The nominal interest rate equals the:

A. real interest rate minus the inflation rate.

B. real interest rate plus the inflation rate.

C. real interest rate divided by the inflation rate.

D. inflation rate minus the real interest rate.

126. The real interest rate equals the:

A. nominal interest rate plus the inflation rate.

B. nominal interest rate minus the inflation rate.

C. inflation rate minus the real interest rate.

D. inflation rate plus the real interest rate.

- 127. The market interest rate in Alpha is 7% and the market interest rate in Beta is 10%, but the inflation rate in Alpha is 3% and inflation rate in Beta is 8%. Which of the following statements is true?
  - A. The real interest rate is higher in Alpha, but the nominal interest rate is higher in Beta.
  - B. The real interest rate is lower in Alpha, but the nominal interest rate is lower in Beta.
  - C. Both the real and nominal interest rates are higher in Alpha.
  - D. Both the real and nominal interest rates are higher in Beta.
- 128.On January 1, 2004, Samia invested \$5,000 at 5% interest for one year. The CPI on January 1, 2004 stood at 1.60. On January 1, 2005, the CPI was 1.68. The real rate of interest earned by Samia was \_\_\_\_\_ percent.
  - A. -5
  - B. 0
  - C. 5
  - D. 8
- 129.On January 1, 2004, Ahmed invested \$10,000 at 5% interest for one year. The CPI on January 1, 2004 stood at 1.60. On January 1, 2005, the CPI was 1.76. The real rate of interest earned by Ahmed was \_\_\_\_\_ percent.
  - A. -5
  - B. 0
  - C. 5
  - D. 8

- 130.Salima is lending Jack \$1,000 for one year. The CPI is 1.60 at the time the loan is made. They expect it to be 1.68 in one year. If Salima and Jack agree that Salima should earn a 3% real return for the year, the nominal interest rate on this loan should be \_\_\_\_\_ percent.
  - A. 0

В. З

- C. 5
- D. 8
- 131.Maryam is lending Martin \$1,000 for one year. The CPI is 1.60 at the time the loan is made. They expect it to be 1.76 in one year. If Maryam and Martin agree that Maryam should earn a 3% real return for the year, the nominal interest rate on this loan should be \_\_\_\_\_ percent.
  - A. 0
  - B. 3
  - C. 7
  - D. 13
- 132.If the bank agrees to make a loan at a 7% interest rate and the inflation rate is 3%, then 4% is the \_\_\_\_\_ rate.
  - A. nominal interest
  - B. real interest
  - C. hyperinflation
  - D. disinflation

133. If the borrower and lender agree to a loan at 8% when the inflation rate is 3%, then 8% is the

\_\_\_\_\_ interest rates and 5% is the \_\_\_\_\_ interest rate.

- A. real; nominal
- B. nominal; real
- C. relative; nominal
- D. real; relative

134.For a given nominal interest rate, an unexpectedly high inflation rate \_\_\_\_\_ the real interest rate.

- A. increases
- B. decreases
- C. has no impact on
- D. may either increase or decrease

135. The real rate of return on holding cash is:

- A. the nominal interest rate.
- B. the real interest rate.
- C. the expected inflation rate.
- D. minus the inflation rate.

- 136.If both the lender and borrower agree on an 8% interest rate, both expect a 4% inflation rate, and inflation turns out to be 4%, then \_\_\_\_\_ by the inflation.
  - A. the borrower is hurt and the lender gains
  - B. the borrower gains and the lender is hurt
  - C. neither the borrower nor the lender are hurt
  - D. both the borrower and lender are hurt

137.For a given nominal interest rate, an unexpectedly low inflation rate \_\_\_\_\_ the real interest rate.

- A. increases
- B. decreases
- C. has no impact on
- D. may either increase or decrease

138. The real rate of return on holding cash \_\_\_\_\_ inflation is correctly anticipated.

- A. is higher when
- B. is lower when
- C. does not depend on whether
- D. increases when

139.Unexpectedly high inflation \_\_\_\_\_ borrowers and \_\_\_\_\_ lenders.

- A. helps; hurts
- B. helps; helps
- C. hurts; hurts
- D. hurts; helps

- 140. The tendency for nominal interest rates to be high when inflation is high and low when inflation is low is known as:
  - A. the consumer price index
  - B. deflating
  - C. shoe leather costs
  - D. the Fisher effect

141. The Fisher effect is the tendency for \_\_\_\_\_ interest rates to be \_\_\_\_\_ when inflation is high.

- A. real; high
- B. real; low
- C. market; low
- D. nominal; high
- 142.To obtain a given real rate of return, lenders must charge a \_\_\_\_\_ nominal interest rate when the inflation rate is high.
  - A. real
  - B. high
  - C. low
  - D. zero

# Chapter 15 Testbank Key

- The measure of the cost of a standard basket of goods and services in any period relative to the cost of the same basket of goods and services in the base year is called the:
  - A. cost-of-living indicator.
  - B. consumption production index.
  - C. consumer production index.
  - D. consumer price index.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #1 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

The consumer price index for the current year measures the cost of a standard basket in the \_\_\_\_\_ year relative to the cost of the same basket in the \_\_\_\_\_ year.

A. current; base

- B. current; current
- C. base; index
- D. base; current

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #2 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

## 3. The CPI is a measure of the:

- A. real wage.
- B. price of a specific good or service.
- C. rate of inflation.
- D. average level of prices relative to prices in the base year.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #3 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 4. Suppose that the total expenditures for a typical household in 2000 equaled \$2,500 per month, while the cost of purchasing exactly the same items in 2005 was \$3,000. If 2000 is the base year, the CPI for 2000 equals:
  - A. 0.83
  - **B.** 1.00
  - C. 1.20
  - D. 1.25

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #4 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 5. Suppose that the total expenditures for a typical household in 2000 equaled \$5,500 per month, while the cost of purchasing exactly the same items in 2005 was \$6,875. If 2000 is the base year, the CPI for the year 2005 equals:
  - A. 0.80
  - B. 1.00
  - C. 1.20
  - <u>D.</u> 1.25

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #5 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 6. If the total expenditures of a typical family equaled \$35,000 per year in 2000 and the exact same basket of goods and services cost \$40,000 in the year 2005, the family's cost of living:
  - A. increased by 14 percent.
  - B. decreased by 12.5 percent.
  - C. decreased by 14 percent.
  - D. increased by 12.5 percent.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #6 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 7. The consumer price index for Planet Econ consists of only two items: books and sandwiches. In 2000, the base year, the typical consumer purchased 10 books for \$25 each and 25 sandwiches for \$2 each. In 2005, the typical consumer purchased 15 books for \$30 each and 30 sandwiches for \$3 each. The consumer price index for 2005 on Planet Econ equals:
  - A. 1.00
  - B. 1.08
  - C. 1.15
  - <u>D.</u> 1.25

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #7 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 8. The typical family on the Planet Econ consumes 10 pizzas, 7 pairs of jeans, and 20 liters of milk. In 2004 pizzas cost \$10 each, jeans cost \$40 per pair, and milk cost \$3 per liter. In 2005, the price of pizzas went down to \$8 each, while the price of jeans and milk remained the same. Between 2004 and 2005, a typical family's cost of living:
  - A. increased by 4.5 percent.
  - B. decreased by 4.5 percent.
  - C. remained the same.
  - D. decreased by 20 percent.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #8 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 9. The typical family on the Planet Econ consumes 10 pizzas, 7 pairs of jeans, and 20 liters of milk. In 2004 pizzas cost \$10 each, jeans cost \$40 per pair, and milk cost \$3 per liter. In 2005, the price of pizzas increased to \$14 each, while the price of jeans and milk remained the same. Between 2004 and 2005, a typical family's cost of living:
  - A. increased by 9 percent.
  - B. decreased by 9 percent.
  - C. remained the same.
  - D. increased by 40 percent.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #9 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 10. If the Consumer Price Index increased from 1.52 to 1.65, then it must be the case that \_\_\_\_\_\_ relative to prices in the base year.
  - A. all prices rose
  - B. the weighted average level of prices rose
  - C. all prices fell
  - D. some prices rose and some prices fell

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #10 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 11. The Consumer Price Index measures the cost of:
  - A. a fixed basket of goods and services.
  - B. a changing basket of goods and services.
  - C. all goods and services purchased by consumers.
  - D. goods and services required to live above the poverty level.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #11 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

12. A consumer expenditure survey reports the following information on consumer protein spending:

	2005		2006	
	Price	Quantity	Price	Quantity
Fish	\$5	5	\$7	7
Chicken	\$3	10	\$4	12
Beef	\$6	7	\$5	10

Using 2005 as the base year, by how much does a "cost of protein" index increase between 2005 and 2006?

- A. 5.2%
- B. 8.6%
- **C.** 13.4%
- D. 14.3%

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 15 #12

Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level 13. A consumer expenditure survey reports the following information on entertainment spending:

	2005		2006	
	Price	Quantity	Price	Quantity
Movies	\$7	5	\$8	7
Concerts	\$30	2	\$35	2
CDs	\$16	7	\$15	10

Using 2005 as the base year, by how much does a "cost of entertainment" index increase between 2005 and 2006?

<u>A.</u> 3.86%

B. 8.65%

C. 13.43%

D. 29.41%

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #13 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 14. A CPI that equals 1.34 in 2005 (when 2000 is the base year) means that:
  - A. prices in 2005 are 34 percent higher than in 2004.
  - B. the CPI equals \$1.34 in 2005.
  - C. the inflation rate in 2005 is 134 percent.
  - **D.** the average level of prices is 34 percent higher in 2005 than in the base year.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #14 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 15. A measure of the average price of a given class of goods or services relative to the price of the same goods and services in a base year is called a:
  - A. real price.
  - B. real quantity.
  - C. rate of inflation.
  - **D.** price index.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #15 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level

- 16. A price index measures:
  - A. the price of specific good or service.
  - B. the change in the price of a specific good or service.
  - C. only the prices that change.
  - <u>D.</u> the average price of a given class of goods or services relative to the price of the same goods and services in a base year.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #16 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: The Consumer Price Index: Measuring the Price Level 17. The annual percentage rate of change in the price level is the:

- A. relative price.
- B. Fisher effect.
- C. cost of living.
- D. rate of inflation.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #17 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 18. The inflation rate can be calculated as the percentage change in:
  - A. real GDP.
  - B. nominal GDP.
  - C. the Consumer Price Index.
  - D. the exchange rate.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #18 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 19. The CPI in year one equaled 1.45. The CPI in year two equaled 1.51. The rate of inflation between years one and two was \_\_\_\_\_ percent.
  - A. 4.0
  - <u>B.</u> 4.1
  - C. 4.5
  - D. 6.0

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #19 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 20. The CPI in 1974 equaled 0.49. The CPI in 1975 equaled 0.54. The rate of inflation between 1974 and 1975 was \_\_\_\_\_ percent.
  - A. 5.4
  - B. 9.0
  - C. 9.3
  - <u>D.</u> 10.2

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #20 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

## 21. The CPI measures the \_\_\_\_; a measure of the rate of inflation is the \_\_\_\_\_.

- A. base year price level; current year price level
- B. level of prices; change in the level of prices
- C. current year price level; base year price level
- D. change in the level of prices; level of prices

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #21 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 22. The average price level is measured by the \_\_\_\_\_; a measure of the annual percentage change in the price level is the \_\_\_\_\_.
  - A. base year price index; current year price index
  - B. real price level; nominal price level
  - C. nominal price level; real price level
  - D. CPI; rate of inflation

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #22 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 23. In 1929 the CPI equaled 0.171 and in 1930 the CPI equaled 0.167. These data provide evidence of a period of
  - A. inflation.
  - **B.** deflation.
  - C. trade deficit.
  - D. expansion.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #23 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 24. If the CPI in 2005 equaled 1.43 and in 2006 equaled 1.56, then between 2005 and 2006 there was:
  - A. inflation.
  - B. deflation.
  - C. a recession.
  - D. an expansion.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #24 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 25. The CPI in 1930 equaled 0.17. The CPI in 1931 equaled 0.15. The rate of inflation between1930 and 1931 was \_\_\_\_\_ percent.
  - A. -13.3
  - <u>**B.</u> -11.8</u></u>**
  - C. 1.5
  - D. 11.8

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #25 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 26. The CPI in 1931 equaled 0.15. The CPI in 1932 equaled 0.14. The rate of inflation between 1931 and 1932 was \_\_\_\_ percent.
  - A. -7.1
  - **B.** -6.6
  - C. 1.4
  - D. 6.6

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #26 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 27. Deflation is a situation in which the:
  - A. quantity of goods and services produced is increasing over time.
  - B. quantity of goods and services produced is decreasing over time.
  - C. prices of most goods and services are falling over time.
  - D. prices of most goods and services are rising over time.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #27 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 28. The situation when the price of most goods and services are falling over time is called:
  - A. inflation.
  - B. disinflation.
  - C. a boom.
  - D. deflation.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #28 Learning Objective: 15-01 Explain how the consumer price index (CPI) is constructed and use it to calculate the inflation rate. Section: Inflation

- 29. A nominal quantity is measured:
  - A. in physical terms.
  - **B.** in terms of current dollar value.
  - C. using the consumer price index.
  - D. by indexing.

30. A quantity measured in terms of current dollar value is called a(n) \_\_\_\_\_ quantity.

- A. nominal
- B. real
- C. deflated
- D. indexed

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #30 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

31. All of the following are nominal quantities EXCEPT the:

- A. price of a new car.
- B. wages paid to workers in a restaurant.
- C. cost of purchasing a new computer.
- D. number of new houses built in one month.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #31 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- A. the number of people unemployed
- B. the current price of a barrel of oil
- C. the number of cars produced in 2005
- D. the amount of coal mined in one month

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #32 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 33. Which of the following is a real quantity?
  - A. the current wages paid to factory workers
  - B. the cost of a new car
  - C. the number of tons of steel produced in 2005
  - D. the current price of a barrel of oil

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #33 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

34. A real quantity is a quantity measured:

A. in physical terms.

- B. in terms of current dollar value.
- C. by the average quantity.
- D. using real prices.

## 35. All of the following are real quantities EXCEPT the:

- A. number of new cars produced in one year.
- B. tons of steel shipped to South America.
- C. millions of computer chips shipped to computer makers.
- D. billions of dollars invested in stocks.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #35 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

36. Deflating a nominal quantity is the process of dividing a \_\_\_\_ quantity by a \_\_\_\_ in order to express the quantity in \_\_\_\_ terms.

- A. nominal; real quantity; nominal
- B. nominal; nominal quantity; real
- C. real; nominal quantity; real
- D. nominal; price index; real

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #36 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 37. To correct a nominal quantity for changes in the price level, one should:
  - A. add a price index to it.
  - B. subtract a price index from it.
  - C. divide it by a price index.
  - D. multiply it by a price index.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #37 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

38. To compare the purchasing power of nominal wages in two different years, one must:

A. compare the nominal values.

- B. deflate both quantities by a common price index.
- C. increase both quantities by the same percentage increase in a price index.
- D. adjust both quantities by the real interest rate.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #38 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 39. The price of a liter of gasoline at the pump increased by 10 percent at the same time that the inflation rate was 5 percent. The nominal price of gasoline \_\_\_\_\_ and the real price of gasoline
  - A. increased; increased
  - B. increased; decreased
  - C. increased; did not change
  - D. decreased; increased

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #39 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 40. The price of a liter of gasoline at the pump increased by 10 percent at the same time that the inflation rate was 15 percent. The nominal price of gasoline \_\_\_\_\_ and the real price of gasoline \_\_\_\_\_.
  - A. increased; increased
  - B. increased; decreased
  - C. increased; did not change
  - D. decreased; increased

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #40 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 41. If the CPI equaled 1.00 in 1995 and 1.65 in 2005 and a typical household's income equaled \$35,000 in 1995 and \$40,000 in 2005, then between 1995 and 2005, real household income:
  - A. increased.
  - B. decreased.
  - C. was constant.
  - D. may have increased or decreased.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #41 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 42. A college graduate in 1972 found a job paying \$7,200. The CPI was 0.418 in 1972. A college graduate in 2000 found a job paying \$30,000. The CPI was 1.68 in 2005. The 1972 graduate's job paid \_\_\_\_\_ in nominal terms and \_\_\_\_\_ in real terms than the 2005 graduate's job.
  - A. more; less
  - B. more; more
  - C. less; the same
  - D. less, less

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #42 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 43. A college graduate in 1972 found a job paying \$7,200. The CPI was 0.418 in 1972. A college graduate in 2005 found a job paying \$28,000. The CPI was 1.68 in 2005. The 1972 graduate's job paid \_\_\_\_\_ in nominal terms and \_\_\_\_\_ in real terms than the 2005 graduate's job.
  - A. more; less
  - B. more; more
  - C. less; the same
  - D. less; more

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #43 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 44. One family earned an income of \$28,000 in 1990. Over the next five years, their income increased by 15%, while the CPI increased by 12%. After five years, this family's nominal income \_\_\_\_\_ and their real income \_\_\_\_\_.
  - A. decreased; decreased
  - B. decreased; increased
  - C. increased; did not change
  - D. increased; increased

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #44 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 45. One family earned an income of \$28,000 in 1990. Over the next five years, their income increased by 15%, while the CPI increased by 15%. After five years, this family's nominal income \_\_\_\_\_ and their real income \_\_\_\_\_.
  - A. decreased; decreased
  - B. decreased; increased
  - C. increased; did not change
  - D. increased; increased

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #45 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 46. Suppose that a year's tuition at a university near your home cost \$250 in 1972 when the CPI equaled 0.418. The cost of a year's tuition at the same university cost \$3000 in 2005 when the CPI equaled 1.68. The real cost of tuition between 1972 and 2005:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. may have either increased or decreased.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #46 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation 47. The price of a liter of gasoline was \$0.35 in 1972 when the CPI equaled 0.418. The cost of a liter of gasoline was \$2.25 in 2005 when the CPI equaled 1.91. The real cost of a liter of gasoline between 1972 and 2005:

A. increased.

- B. decreased.
- C. remained constant.
- D. may have either increased or decreased.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #47 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

48. The wage paid to workers measured in terms of real purchasing power is called the:

A. nominal wage.

## B. cost of living.

- C. minimum wage.
- D. real wage.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #48 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- A. measured in current dollars.
- B. required to maintain a minimum standard of living.
- C. employers are required to pay workers.
- D. measured in terms of purchasing power.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #49 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 50. If workers received a 5 percent wage increase and the rate of inflation was 10 percent, then their real wage:
  - A. increased.
  - **B.** decreased.
  - C. remained constant.
  - D. equaled the nominal wage.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #50 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 51. If workers received a 5 percent wage increase and the rate of inflation was 3 percent, then their real wage:
  - A. increased.
  - B. decreased.
  - C. remained constant.
  - D. equaled the nominal wage.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #51 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 52. Suppose that a report indicates that the average real wage in manufacturing declined by 2% between 1990 and 2000. If the CPI equaled 1.30 in 1990, 1.69 in 2000, and the average nominal wage in manufacturing was \$35 in 2000, what was the average nominal wage in manufacturing in 1990?
  - A. \$20.71
  - B. \$21.12
  - C. \$26.92
  - D. \$27.46

AACSB: Analytical Skills Blooms: Analysis Frank - Chapter 15 #52 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 53. Suppose that a report indicates that the average annual real income of agricultural workers declined by 2% between 1990 and 2000. If the CPI equaled 1.30 in 1990, 1.69 in 2000, and the nominal income of agricultural workers was \$35,000 in 2000, what was the average nominal income of agricultural workers in 1990?
  - A. \$20,710
  - B. \$21,124
  - C. \$26,923
  - <u>D.</u> \$27,462

AACSB: Analytical Skills Blooms: Analysis Frank - Chapter 15 #53 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 54. A factory worker earned \$10 an hour in 1980. The CPI was 0.82 in 1980. The same factory worker was earning \$15 an hour in 1990 when the CPI was 1.31. From 1980 to 1990, the factory worker's hourly real wage:
  - A. increased from \$7.63 to \$18.29.
  - **B.** decreased from \$12.20 to \$11.45.
  - C. remained constant.
  - D. increased from \$10 to \$15.

AACSB: Analytical Skills Blooms: Analysis Frank - Chapter 15 #54 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 55. The practice of increasing a nominal quantity each period by an amount equal to the percentage increase in a specified price index is called:
  - A. a substitution bias.
  - B. the Fisher effect.
  - C. deflating.
  - D. indexing.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #55 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 56. Indexing is the process of:
  - A. dividing a real quantity by a price index.
  - B. dividing a nominal quantity by a price index.
  - <u>C.</u> increasing a nominal quantity by an amount equal to the percentage change in a price index.
  - D. increasing a real quantity by an amount equal to the percentage change in a price index.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #56 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation
- 57. To insure that your salary maintains its real purchasing power from year to year, your nominal salary must be:
  - A. deflated.
  - B. indexed.
  - C. aggregated.
  - D. hyperinflated.

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #57 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 58. If you wish to maintain a constant purchasing power when you retire, you should choose retirement income options that are:
  - A. deflated.
  - B. nominal.
  - C. indexed.
  - D. inflated.

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #58 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 59. Because Congress fixes the minimum wage in nominal terms, when there is inflation, the nominal minimum wage \_\_\_\_\_ and the real minimum wage \_\_\_\_\_.
  - A. remains constant; falls
  - B. remains constant; remains constant
  - C. remains constant; increases
  - D. increases; falls

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #59 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 60. The CPI equals 1.00 in year one and 1.15 in year two. If the nominal wage is \$15 in year one and a contract calls for the wage to be indexed to the CPI, what will be the nominal wage in year two?
  - A. \$13.04
  - B. \$15.00
  - C. \$16.15
  - **D.** \$17.25

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #60 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 61. A labor contract provides for a first-year wage of \$10 per hour, and specifies that the real wage will rise by 3 percent in the second year of the contract. The CPI is 1.00 in the first year and 1.07 in the second year. What dollar wage must be paid in the second year?
  - A. \$10.00
  - B. \$10.30
  - C. \$10.70
  - **D.** \$11.02

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #61 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 62. A labor contract provides for a first-year wage of \$15 per hour, and specifies that the real wage will rise by 2 percent in the second year of the contract. The CPI is 1.00 in the first year and 1.09 in the second year. What dollar wage must be paid in the second year?
  - A. \$15.00
  - B. \$15.30
  - C. \$16.09
  - <u>D.</u> \$16.68

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #62 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 63. A labor contract provides for a first-year wage of \$10 per hour, and specifies that the real wage will rise by 3 percent in the second year of the contract and by another 3 percent in the third year. The CPI is 1.00 in the first year, 1.07 in the second year, and 1.15 in the third year. What dollar wage must be paid in the third year?
  - A. \$10.00
  - B. \$10.61
  - C. \$11.15
  - <u>D.</u> \$12.20

AACSB: Analytical Skills Blooms: Analysis Frank - Chapter 15 #63 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 64. To ensure that a nominal payment represents a constant level of purchasing power over time, one should:
  - A. add a price index to it.
  - B. subtract a price index from it.
  - C. divide it by a price index.
  - **D.** increase it by a percentage equal to the rate of inflation for that year.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #64 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

- 65. Two methods used to adjust nominal values for inflation are:
  - A. substituting and complementing.
  - B. indexing and deflating.
  - C. aggregating and disaggregating.
  - D. real and nominal.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #65 Learning Objective: 15-02 Show how the CPI is used to adjust economic data to eliminate the effects of inflation. Section: Adjusting for Inflation

66. The CPI may be a poor measure of true inflation because it \_\_\_\_\_ the true inflation rate.

- A. is independent of
- B. understates
- C. exacerbates
- D. overstates

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #66 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 67. If the conclusion that the CPI \_\_\_\_\_ the "true" inflation rate is correct, then indexing Social Security benefits to the CPI is \_\_\_\_\_ the government billions of dollars.
  - A. understates; costing
  - B. overstates; costing
  - C. understates; saving
  - D. measures; saving

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #67 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 68. If the conclusion that the CPI \_\_\_\_\_ the "true" inflation rate is correct, then the true improvement in living standards over time is \_\_\_\_\_.
  - A. understates; overestimated
  - B. understates; underestimated
  - C. overstates; underestimated
  - D. measures; overestimated

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #68 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation? 69. Suppose that the CPI does indeed overstate the rate of inflation. When the CPI increases by 5% and household incomes increase by 5%, we should conclude that the real incomes of households:

A. increased.

- B. stayed constant.
- C. decreased.
- D. increased more slowly than inflation.

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #69 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 70. When statisticians fail to take into account improvements in the quality of goods and services, the CPI will tend to \_\_\_\_\_ the rate of inflation.
  - A. understate
  - B. precisely measure
  - C. be unrelated to
  - D. overstate

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #70 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 71. Suppose manufacturers introduce a new model car to replace a car currently included in the CPI basket. The price of the new car is 10 percent higher than the discontinued model, but the new car also includes additional safety features. In this situation the CPI will tend to \_\_\_\_\_\_ inflation as a result of \_\_\_\_\_ bias.
  - A. overstate; substitution
  - B. understate; substitution
  - C. accurately measure; substitution
  - D. overstate; quality adjustment

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #71 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 72. The quality adjustment bias in the CPI refers to the failure of statisticians to:
  - A. allow for the possibility that consumers switch from products whose prices are rising.
  - B. allow for the possibility that consumers switch stores at which they shop.
  - C. take into account improvements in goods and services.
  - D. take into account price changes in goods and services.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #72 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 73. Product improvements make it difficult for the statisticians who construct the CPI to distinguish between \_\_\_\_\_ changes and \_\_\_\_\_ changes.
  - A. price; quality
  - B. quantity; price
  - C. quantity; quality
  - D. income; price

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #73 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 74. Inflation in the health-care sector apparently is overstated because the CPI does not adequately adjust for \_\_\_\_\_ changes.
  - A. price
  - B. quality
  - C. volume
  - D. quantity

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #74 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation? 75. The substitution bias in the CPI refers to the failure of statisticians to:

A. allow for the possibility that consumers switch from products whose prices are rising.

- B. allow for the possibility that consumers switch stores at which they shop.
- C. take into account improvements in goods and services.
- D. take into account new products purchased by consumers.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #75 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 76. When statisticians fail to allow for the possibility that consumers switch from products with rising prices to those whose prices are stable or falling, the CPI will tend to \_\_\_\_\_ the rate of inflation.
  - A. understate
  - B. precisely measure
  - C. be unrelated to
  - D. overstate

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #76 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 77. Suppose that the price of chicken rises sharply compared to the price of turkey. People buy more turkey and less chicken than they did in the CPI base year. In this situation the CPI will tend to \_\_\_\_\_ inflation as a result of \_\_\_\_\_ bias.
  - A. overstate; substitution
  - B. understate; substitution
  - C. accurately measure; substitution
  - D. overstate; quality adjustment

AACSB: Reflective Thinking Skills Blooms: Understanding Frank - Chapter 15 #77 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 78. Two types of bias that tend to cause the CPI to overstate the "true" rate of inflation are the \_\_\_\_\_ bias and the \_\_\_\_\_ bias.
  - A. substitution; quality adjustment
  - B. price; quantity
  - C. aggregation; price
  - D. quality adjustment; price adjustment

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #78 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

## 79. The substitution bias in the CPI arises because the CPI:

- $\underline{\textbf{A.}}$  is based on a fixed basket of goods and services.
- B. does not adequately allow for improvements in products.
- C. measures prices at two different times.
- D. understates the "true" rate of inflation.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #79 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

- 80. When consumers substitute a cheaper good for a more expensive one, the CPI will \_\_\_\_\_\_ change in the cost of living.
  - A. equal the
  - B. understate the
  - C. precisely measure the
  - D. overstate the

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #80 Learning Objective: 15-03 Discuss the two most important biases in the CPI. Section: Does the CPI Measure "True" Inflation?

## 81. The price level is:

- A. the rate of inflation.
- **B.** a measure of overall prices at a particular point in time.
- C. the percentage change in a price index such as the CPI.
- D. the price of a specific good in comparison to the prices of other goods and services.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #81 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 82. A relative price is:
  - A. the rate of inflation.
  - B. a measure of overall prices at a particular point in time.
  - C. the percentage change in a price index such as the CPI.
  - **D.** the price of a specific good in comparison to the prices of other goods and services.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #82 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 83. A measure of overall prices at a particular point in time is called:
  - A. a relative price.
  - **B.** the price level.
  - C. a real price.
  - D. inflation.

84. If the price of hotel rooms increases by 10% while the prices of other goods and services increase by 5% on average, the relative price of hotel rooms has:

A. increased.

- B. decreased by 5%.
- C. decreased by 10%.
- D. remained constant.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #84 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

85. If all prices, including the price of beef, increase by 3%, then the relative price of beef \_\_\_\_\_ and there \_\_\_\_\_ inflation.

A. increased; is

- B. increased; is no
- C. remained constant; is
- D. remained constant; is no

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #85 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 86. To counteract relative price changes, the government would implement:
  - A. monetary policy.
  - B. fiscal policy.
  - C. polices that affect the supply and demand for a specific good.
  - D. policies that affect the supply and demand for all goods and services.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #86 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 87. Changes in the average price level are called \_\_\_\_\_, while changes in the price of a specific good in comparison with other goods and services are called \_\_\_\_\_.
  - A. quality adjustments; substitution bias.
  - B. changes in a relative price; inflation.
  - C. inflation; changes in a relative price.
  - D. price level adjustments; quality adjustments.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #87 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think 88. To counteract inflation, the government could implement all of the following EXCEPT:

- A. monetary policy.
- B. fiscal policy.
- C. polices that affect the supply and demand for a specific good.
- D. policies that affect the supply and demand for all goods and services.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #88 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 89. Suppose the value of the CPI is 1.10 in year 1, 1.21 in year 2, and 1.331 in year 3. Assume also that the price of computers increases by 3% between year 1 and year 2, and by another 3% between year 2 and year 3. The price level is increasing, the inflation rate is \_\_\_\_\_, and the relative price of computers is \_\_\_\_\_.
  - A. increasing; increasing
  - B. constant; increasing
  - C. constant; decreasing
  - D. increasing; decreasing

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #89 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 90. Suppose the value of the CPI is 1.10 in year 1, 1.16 in year 2, and 1.27 in year 3. Assume also that the price of computers increases by 3% between year 1 and year 2, and by another 3% between year 2 and year 3. The price level is increasing, the inflation rate is \_\_\_\_\_, and the relative price of computers is \_\_\_\_\_.
  - A. increasing; increasing
  - B. constant; increasing
  - C. constant; decreasing
  - D. increasing; decreasing

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #90 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

91. \_\_\_\_\_ is an increase in the price level, while \_\_\_\_\_ is an increase in the price of a good in comparison to other goods and services.

- A. Inflation; hyperinflation
- B. A relative price increase; inflation
- C. Hyperinflation; inflation
- D. Inflation; a relative price increase

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #91 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The Costs of Inflation: Not What You Think

- 92. Inflation makes it difficult to distinguish relative price changes from changes in the general level of prices. Consequently, inflation \_\_\_\_\_ the efficiency of the market system.
  - A. increases
  - B. decreases
  - C. does not change
  - D. may either increase or decrease

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #92 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 93. Inflation \_\_\_\_\_ the signals sent by price changes to demanders and suppliers of goods and services.
  - A. amplifies
  - B. obscures
  - C. enhances
  - D. has no impact on

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #93 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 94. The phenomenon known as \_\_\_\_\_ occurs when inflation causes people to pay an increasing percentage of their income in taxes even when their real incomes have not changed.
  - A. hyperinflation
  - B. bracket creep
  - C. the Fisher effect
  - D. substitution bias

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #94 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 95. To prevent people paying a higher percentage of their income in taxes even when their real incomes have not changed Congress:
  - A. implemented a flat tax.
  - B. reduced the capital gains tax.
  - C. indexed the income tax brackets to the CPI.
  - D. deflated the income tax brackets to the CPI.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #95 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 96. In Econoland in 2000, people with incomes between \$20,000 and \$30,000 must pay 12% of their income in taxes and people with incomes between \$30,001 and \$40,000 must pay 15%. In 2000, the CPI in Econoland equals 1.20 and increases to 1.26 in 2001. If the government of Econoland wants to keep households with a given real income from being pushed up into a higher tax bracket by inflation, the \$20,000 to \$30,000 bracket will be changed to:
  - A. \$15,873 to \$23,810
  - **B.** \$21,000 to \$31,500
  - C. \$24,000 to \$37,800
  - D. \$25,200 to \$37,800

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #96 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 97. The shoe leather costs of inflation include all of the following EXCEPT:
  - A. the lost purchasing power of cash.
  - B. the extra costs incurred to avoid holding cash.
  - C. the cost of more frequent trips to the bank.
  - D. the installation of a new cash management system.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #97 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 98. The extra costs incurred to avoid holding cash when there is inflation are called the:
  - A. average costs of inflation.
  - B. consumer price index costs.
  - C. external costs.
  - D. shoe leather costs.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #98 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 99. Nadia's Cookie Shop needs \$1,000 cash per day for customer transactions. Nadia has a choice between going to the bank first thing on Monday morning to withdraw \$5,000 enough cash for the whole week or going to the bank first thing every morning for \$1,000 each time. Nadia puts the cost of going to the bank at \$1 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Nadia's Cookie shop is open 5 days a week for 50 weeks each year. If Nadia goes to the bank everyday when the inflation rate is 10%, then the annual cost of going to the bank is \_\_\_\_\_ and Nadia's annual losses from holding cash are \_\_\_\_\_.
  - A. \$50;\$5,000
  - B. \$50;\$1,000
  - **C.** \$250; \$100
  - D. \$250; \$1,000

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #99 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 100. Sarah's Java Café needs \$4,000 cash per day for customer transactions. Sarah has a choice between going to the bank first thing on Monday morning to withdraw \$20,000 enough cash for the whole week or going to the bank first thing every morning for \$4,000 each time. Sarah puts the cost of going to the bank at \$3 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Sarah's Java Cafe is open 5 days a week for 50 weeks each year. When the inflation rate is 10% Sarah goes to the bank everyday instead of once a week. Sarah's annual shoe leather costs of inflation equal \_\_\_\_\_.
  - A. \$ 3

B. \$150

**C.** \$600

D. \$750

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #100 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 101. Sarah's Java Café needs \$3,000 cash per day for customer transactions. Sarah has a choice between going to the bank first thing on Monday morning to withdraw \$15,000 enough cash for the whole week or going to the bank first thing every morning for \$3,000 each time. Sarah puts the cost of going to the bank at \$2 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Sarah's Java Cafe is open 5 days a week for 50 weeks each year. When the inflation rate is 10% Sarah goes to the bank everyday instead of once a week. Sarah's annual shoe leather costs of inflation equal \_\_\_\_\_.
  - A. \$2
  - B. \$100
  - **C.** \$400
  - D. \$500

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #101 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 102. Making more frequent, but smaller cash withdrawals from banks \_\_\_\_\_ the inflation losses from holding cash and \_\_\_\_ the shoe leather costs of inflation.
  - A. increases; increases
  - B. increases; reduces
  - C. reduces; has no impact on
  - D. reduces; increases

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #102 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 103. Increases in the rate of inflation will induce consumers to make more frequent trips to the bank to withdraw cash whenever the cost of the extra trips is \_\_\_\_\_ the benefit of holding less cash subject to purchasing power losses from inflation.
  - A. greater than
  - B. less than
  - C. equal to
  - D. greater than or less than

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #103 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 104. At high rates of inflation, the cost to a consumer of more frequent trips to the bank to make cash withdrawals is an increase in the:
  - A. shoe leather costs of inflation.
  - B. loss of purchasing power of cash.
  - C. tax distortion generated by inflation.
  - D. "noise" in the price system.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #104 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 105. If workers and employers agree to a three-year wage contract expecting 3% inflation and inflation turns out to be 5%, then:
  - A. workers gain and employers gain.
  - B. workers gain and employers lose.
  - <u>C.</u> workers lose and employers gain.
  - D. workers lose and employers lose.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #105 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 106. If a borrower and lender agree to an interest rate on a loan when inflation is expected to be 7% and inflation turns out to be 10% over the life of the loan, then the borrower \_\_\_\_\_ and the lender \_\_\_\_\_.
  - A. gains; gains
  - B. gains; loses
  - C. is not affected; gains
  - D. loses; gains

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #106 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation 107. When inflation turns out to be different than expected, wealth is \_\_\_\_\_.

- A. destroyed
- B. redistributed
- C. increased
- D. decreased

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #107 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

108. It is difficult to engage in long-term financial planning when inflation is:

A. high and erratic.

- B. low and stable.
- C. accounted for through indexing.
- D. predictable.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #108 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 109. The real costs of inflation to society include:
  - A. an increase in the general level of prices.
  - B. lost purchasing power of holding cash.
  - C. higher relative prices.
  - D. interference with long-term planning.

Blooms: Knowledge Frank - Chapter 15 #109 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 110. The "true" costs of inflation are:
  - A. higher relative prices.
  - B. lower relative prices.
  - C. reduced economic growth and efficiency.
  - D. a higher overall price level.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #110 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

111. The "true" costs of inflation to an economy include all of the following EXCEPT:

- A. shoe-leather costs.
- B. higher relative prices.
- C. noise in the price system.
- D. unexpected redistribution of wealth.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #111 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

- 112. Inflation reduces economic efficiency through all of the following channels EXCEPT by:
  - A. Distorting incentives through interaction with the tax laws.
  - B. Obscuring information transmitted by prices.
  - C. Inducing people to minimize cash holdings.
  - D. Changing relative prices.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #112 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: The True Costs of Inflation

113. Extremely high rates of inflation are called \_\_\_\_\_.

- A. super inflations
- B. deflations
- C. disinflations
- D. hyperinflations

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #113 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: Hyperinflation

- 114. Hyperinflations are:
  - A. frequently experienced in the United States.
  - B. very erratic inflations.
  - C. extremely high rates of inflation.
  - D. extremely low rates of inflation.

- 115. An inflation rate of over 500 percent per year is called a(n):
  - A. relative inflation.
  - B. deflation.
  - C. inflation.
  - D. hyperinflation.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #115 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: Hyperinflation

- 116. Compared to low inflation periods, empirical evidence shows that periods of very high inflation (12-month inflation rates greater than 100%) result in:
  - A. high rates of real output per capita growth.
  - B. high rates of real consumption per capita growth.
  - C. high rate of real investment per capita growth.
  - D. larger government budget deficits.

AACSB: Analytical Skills

Blooms: Understanding

Frank - Chapter 15 #116

Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: Hyperinflation

- 117. Hyperinflations are extremely costly to economies because they:
  - A. reduce both current and future growth because of reduced investment spending.
  - B. reduce nominal, but not real values.
  - C. reduce trade deficits, but increase government budget deficits.
  - D. disproportionately benefit poor workers who are least likely to have indexed wages.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #117 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: Hyperinflation

- 118. Hyperinflations are extremely costly to economies because they:
  - A. reduce nominal, but not real values.
  - B. distort relative price changes leading to asset misallocations.
  - C. reduce trade deficits, but increase government budget deficits.
  - D. disproportionately benefit poor workers who are least likely to have indexed wages.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #118 Learning Objective: 15-04 Distinguish between inflation and relative price changes in order to find the true costs of inflation. Section: Hyperinflation

- 119. The real interest rate is the:
  - A. market interest rate.
  - B. annual percentage increase in the nominal value of a financial asset.
  - C. annual percentage increase in the purchasing power of a financial asset.
  - D. the interest rate charged on a loan in dollar terms.

Blooms: Knowledge Frank - Chapter 15 #119 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

120. The nominal interest rate is the:

A. annual percentage increase in the dollar value of a financial asset.

- B. annual percentage increase in the purchasing power of a financial asset.
- C. real rate of return on an asset.
- D. the real interest rate minus the inflation rate.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #120 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

121. The annual increase in the dollar value of a financial asset is called the:

- A. real rate of return.
- B. inflation rate.
- C. real interest rate.
- D. nominal interest rate.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #121 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates 122. If the real interest rate is 3% and the inflation rate is 7%, then the nominal interest rate equals:

A. 3%.

- B. 4%.
- C. 7%.
- <u>D.</u> 10%.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #122 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 123. If the market interest rate is 10% and the inflation rate is 3%, then the real interest rate equals:
  - A. 3%
  - **B**. 7%
  - C. 10%
  - D. 13%

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #123 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates 124. If the market interest rate is 8% and the inflation rate is 3%, then the real interest rate equals:

A. 3%

- **B.** 5%
- C. 8%
- D. 11%

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #124 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 125. The nominal interest rate equals the:
  - A. real interest rate minus the inflation rate.
  - B. real interest rate plus the inflation rate.
  - C. real interest rate divided by the inflation rate.
  - D. inflation rate minus the real interest rate.

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #125 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 126. The real interest rate equals the:
  - A. nominal interest rate plus the inflation rate.
  - **B.** nominal interest rate minus the inflation rate.
  - C. inflation rate minus the real interest rate.
  - D. inflation rate plus the real interest rate.

- 127. The market interest rate in Alpha is 7% and the market interest rate in Beta is 10%, but the inflation rate in Alpha is 3% and inflation rate in Beta is 8%. Which of the following statements is true?
  - A. The real interest rate is higher in Alpha, but the nominal interest rate is higher in Beta.
  - B. The real interest rate is lower in Alpha, but the nominal interest rate is lower in Beta.
  - C. Both the real and nominal interest rates are higher in Alpha.
  - D. Both the real and nominal interest rates are higher in Beta.

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #127 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 128. On January 1, 2004, Samia invested \$5,000 at 5% interest for one year. The CPI on January 1, 2004 stood at 1.60. On January 1, 2005, the CPI was 1.68. The real rate of interest earned by Samia was \_\_\_\_\_ percent.
  - A. -5
  - **B**. 0
  - C. 5
  - D. 8

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #128 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 129. On January 1, 2004, Ahmed invested \$10,000 at 5% interest for one year. The CPI on January 1, 2004 stood at 1.60. On January 1, 2005, the CPI was 1.76. The real rate of interest earned by Ahmed was \_\_\_\_ percent.
  - **A.** -5
  - B. 0
  - C. 5
  - D. 8

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #129 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 130. Salima is lending Jack \$1,000 for one year. The CPI is 1.60 at the time the loan is made. They expect it to be 1.68 in one year. If Salima and Jack agree that Salima should earn a 3% real return for the year, the nominal interest rate on this loan should be \_\_\_\_\_ percent.
  - A. 0

B. 3

- C. 5
- <u>D.</u> 8

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #130 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 131. Maryam is lending Martin \$1,000 for one year. The CPI is 1.60 at the time the loan is made. They expect it to be 1.76 in one year. If Maryam and Martin agree that Maryam should earn a 3% real return for the year, the nominal interest rate on this loan should be \_\_\_\_\_ percent.
  - A. 0
  - B. 3
  - C. 7
  - <u>D.</u> 13

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #131 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 132. If the bank agrees to make a loan at a 7% interest rate and the inflation rate is 3%, then 4% is the \_\_\_\_\_ rate.
  - A. nominal interest
  - B. real interest
  - C. hyperinflation
  - D. disinflation

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #132 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates
- 133. If the borrower and lender agree to a loan at 8% when the inflation rate is 3%, then 8% is the \_\_\_\_\_ interest rates and 5% is the \_\_\_\_\_ interest rate.
  - A. real; nominal
  - **B.** nominal; real
  - C. relative; nominal
  - D. real; relative

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #133 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 134. For a given nominal interest rate, an unexpectedly high inflation rate \_\_\_\_\_ the real interest rate.
  - A. increases
  - B. decreases
  - C. has no impact on
  - D. may either increase or decrease

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #134 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates 135. The real rate of return on holding cash is:

- A. the nominal interest rate.
- B. the real interest rate.
- C. the expected inflation rate.
- D. minus the inflation rate.

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #135 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 136. If both the lender and borrower agree on an 8% interest rate, both expect a 4% inflation rate, and inflation turns out to be 4%, then \_\_\_\_\_ by the inflation.
  - A. the borrower is hurt and the lender gains
  - B. the borrower gains and the lender is hurt
  - C. neither the borrower nor the lender are hurt
  - D. both the borrower and lender are hurt

AACSB: Analytical Skills Blooms: Application Frank - Chapter 15 #136 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates 137. For a given nominal interest rate, an unexpectedly low inflation rate \_\_\_\_\_ the real interest rate.

## A. increases

- B. decreases
- C. has no impact on
- D. may either increase or decrease

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #137 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

138. The real rate of return on holding cash \_\_\_\_\_ inflation is correctly anticipated.

- A. is higher when
- B. is lower when
- $\underline{\mathbf{C}}_{\cdot}$  does not depend on whether
- D. increases when

AACSB: Analytical Skills Blooms: Understanding Frank - Chapter 15 #138 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- $\underline{A.}$  helps; hurts
- B. helps; helps
- C. hurts; hurts
- D. hurts; helps

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #139 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 140. The tendency for nominal interest rates to be high when inflation is high and low when inflation is low is known as:
  - A. the consumer price index
  - B. deflating
  - C. shoe leather costs
  - D. the Fisher effect

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #140 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- A. real; high
- B. real; low
- C. market; low
- D. nominal; high

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #141 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

- 142. To obtain a given real rate of return, lenders must charge a \_\_\_\_\_ nominal interest rate when the inflation rate is high.
  - A. real
  - **B.** high
  - C. low
  - D. zero

AACSB: Analytical Skills Blooms: Knowledge Frank - Chapter 15 #142 Learning Objective: 15-05 Understand the connections among inflation, nominal interest rates, and real interest rates. Section: Inflation and Interest Rates

## Chapter 15 Testbank Summary

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