

26. Many workers in Country A emigrated to other countries. All the job vacancies resulting from the emigration were filled by unemployed people. As a result, the unemployment rate of Country A _____.

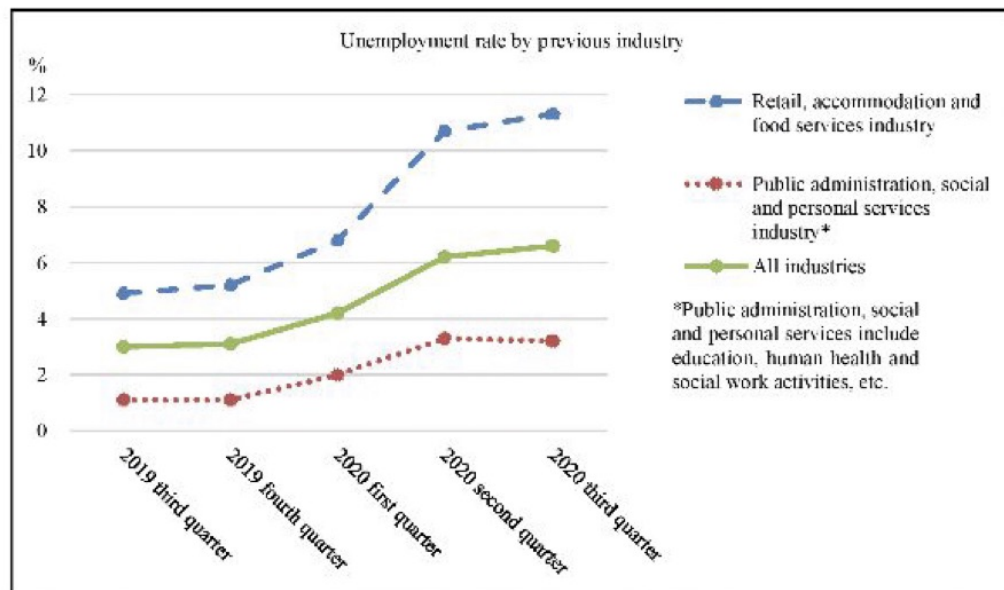
- A. would increase
- B. would decrease
- C. would remain unchanged
- D. cannot be determined

39. If there is unexpected inflation, which of the following persons will lose?

- A. a consumer who used credit cards to buy goods
- B. an employer who signed fixed nominal wage contracts with his employees
- C. a holder of certificate of deposits
- D. an investor of bonds with the rate of return adjusted according to the inflation rate

11. The Government launched the Consumption Voucher Scheme in 2021 to relieve the impact of COVID-19 on the Hong Kong economy.

Source A: Statistical data about unemployment rate in Hong Kong



Source B: An extract of information about the Consumption Voucher Scheme

All Hong Kong permanent residents and new arrivals aged 18 or above, who comply with the 'residing in Hong Kong' requirement, could register to receive electronic consumption vouchers with a total value of \$5 000 by instalments.




Source C: Information about the four designated stored value facilities to receive the \$5 000 consumption vouchers by instalments

	AlipayHK	Octopus	Tap & Go	WeChat Pay HK
Public transportation with the above payment facilities installed	MTR, bus, mini bus and ferry	MTR, bus, mini bus and ferry	Bus and mini bus	None
Promotions to consumption voucher users	5 e-coupons	First 2 million registered customers enjoy \$18 of stored value	\$50 awarded when using virtual Tap & Go Unionpay card for the first transaction with an amount equal to or larger than \$50	e-coupons

Source D: Some reminders for the Consumption Voucher Scheme

- Consumption vouchers cannot be used in transactions such as payments to the government (e.g. tax), public utilities (e.g. electricity charges), purchase of financial products (e.g. insurance), and direct purchase from merchants located outside Hong Kong.
- There are deadlines for using consumption vouchers.

Source E: Some views on the Consumption Voucher Scheme in Hong Kong

<p>A housewife</p> 	<p>I have spent more than \$5 000 as there are e-coupons from the stored value facility provider. A lot of promotions in large retail chains and malls have also tempted me to consume!</p>
<p>A former chef in a restaurant</p> 	<p>I have been laid off and have stayed home for months. No one knows when the travellers would be back. I hope that the Consumption Voucher Scheme will bring more local people to spend on food and beverage and the whole industry can survive the pandemic. Otherwise, many workers will be forced to leave the industry.</p>
<p>A doctor working in a public hospital</p> 	<p>Resources should be allocated to the medical sector, instead of giving everyone an equal amount under the Consumption Voucher Scheme. The public hospitals lacked space, manpower and equipment even before the pandemic. Start building new hospitals earlier so that more lives could be saved.</p>

- (a) Refer to Source A.
- In which phase of business cycle the Hong Kong economy most likely was? Apart from the change in unemployment rate, list **ONE** other economic phenomenon of this phase. (2 marks)
 - Why did the unemployment rate of retail, accommodation and food services industry increase faster than that of public administration, social and personal services industry during the pandemic? (2 marks)
- (b) Refer to Source B. Would the \$5 000 distributed under the Consumption Voucher Scheme be included in the calculation of government consumption expenditure? Explain your answer. (2 marks)
- (c) Based on the information given in Source C, explain with **TWO** reasons why the market of stored value facilities in Hong Kong is **NOT** perfectly competitive. (4 marks)
- (d) Refer to Source D. Some citizens claimed, 'I would rather receive \$5 000 cash instead of consumption vouchers.' In terms of functions of money, explain such a claim with **TWO** reasons. (4 marks)

For part (e), candidates are required to present their answers in essay form. Criteria for marking will include use of sources and economic theories, relevant content, logical presentation and clarity of expression.

- (e) Suppose the Government plans to spend another sum of money to cope with the pandemic. The following are two suggestions.

Scheme C	Distribute the sum of money using the same mechanism as the existing Consumption Voucher Scheme.
Scheme H	Spend the sum of money on building new hospitals and hiring additional medical staff.

With reference to the above sources and your own knowledge in Economics, discuss which scheme the Government will prefer in order to achieve **EACH** of the following policy objectives respectively.

Objective 1: to relieve unemployment in an industry severely affected by the pandemic

Objective 2: to increase average labour productivity

Objective 3: to increase aggregate output (in the short run and/or in the long run)

(14 marks)

[Use a separate paragraph for comparing the effects of the two schemes under each policy objective.]

SECTION 2: MACROECONOMIC PROBLEMS

2.1 UNEMPLOYMENT

Multiple Choice Questions

1994/CE/II/37

Which of the following people would be classified as 'unemployed' in Hong Kong?

- A. Jack, aged 30, who has retired after winning the Mark Six
- B. Peter, aged 14, who cannot find a job after completing Form three
- C. John, who has quit his job and has gone on a trip to Europe
- D. Mary, who lost her job five weeks ago and has been looking for a new job for one month

1995/CE/II/37

Which of the following are the possible losses to society caused by unemployment?

- (1) loss of output
- (2) a higher crime rate
- (3) a greater expenditure in public assistance
- (4) a reduction in the government's tax revenue

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (4) only
- D. (3) and (4) only

1996/CE/II/33

David has quit his job for two months because he has been ill and is resting in bed. According to the Hong Kong government, he is

- A. unemployed.
- B. underemployed.
- C. employed.
- D. not in the labour force.

1997/CE/II/26

Study the following data about Hong Kong in a certain year:

	Number of Persons
Employed Population	2 931 000
Underemployed Population	33 000
Unemployed Population	69 000

The unemployment rate is

- A. 2.27%
- B. 2.30%
- C. 3.36%
- D. 3.40%

1997/CE/11/55

An increase in the number of Form 7 graduates studying in the universities will result in

- (1) a decrease in the present labour supply.
 - (2) a decrease in the present unemployment rate.
 - (3) an increase in future average labour productivity.
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)

1998/CE/11/24

Which of the following are included in the calculation of the labour force of Hong Kong?

- (1) an employee with a foreign nationality working in a law firm in Hong Kong
 - (2) Mr Chan, who is unemployed and searching for a job
 - (3) Mr Wong, who works as a volunteer in a community centre after his retirement
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)

1998/CE/11/28

If some Hong Kong residents who emigrated return to Hong Kong to fill up some posts which have been vacant for a long time, then Hong Kong's labour force would _____ and here unemployment rate would _____.

- A. increase fall
B. decrease fall
C. increase rise
D. decrease rise

1999/CE/11/32

Many imported workers who had stayed in Hong Kong several years working on the new airport project, have gone back to their home countries. What will be the effect of their departure on the unemployment rate in Hong Kong?

- A. The unemployment rate will increase.
B. The unemployment rate will decrease.
C. The unemployment rate will remain constant.
D. The effect cannot be determined.

2002/CE/11/29

	Number of Persons
Population aged 15 or above	10 000 000
Employed population	6 800 000
Unemployed population	1 200 000
Underemployed population	800 000

According to the above table, which of the following statements is/are correct?

- (1) The labour force amounts to 8 000 000.
 - (2) The underemployment rate is 10%.
 - (3) The unemployment rate is 12%.
- A. (3) only
B. (1) and (2) only
C. (1) and (3) only
D. (2) and (3) only

2002/CE/11/31

Which of the following are possible losses to a society caused by unemployment?

- (1) more government spending on public security due to a higher crime rate
 - (2) more unemployment assistance given by the government
 - (3) lower output level
 - (4) lower cost of living
- A. (1) and (3) only
B. (2) and (4) only
C. (1), (2) and (3) only
D. (2), (3) and (4) only

2003/CE/11/30

Study the following data about Hong Kong in the period of July 2002 to September 2002.

	Number of Persons
Employed Population	3 243 000
Underemployed Population	101 000
Unemployed Population	267 000

The unemployment rate in the period is

- A. 7.4%
B. 7.6%
C. 8.2%
D. 10.2%

2004/CE/11/33

	Number of Persons
Employed population	18 400
Unemployed population	1 600

Now there are 1 000 additional job seekers in the economy. If 90% of them succeed in finding a job, the unemployment rate

- A. will increase.
B. will decrease.
C. will remain unchanged.
D. may increase or decrease.

2005/CE/II/32

	Population
Aged 15 or above	10 000 000
Employed	6 800 000
Unemployed	1 200 000
Underemployed	1 600 000

According to the above data,

- A. the total labour force is 9 600 000.
- B. the underemployment rate is 20%.
- C. the unemployment rate is 12.5%.
- D. the unemployment rate is 16%.

2006/CE/II/30

Suppose the unemployed population of an economy is 500 000 while the unemployment rate is 5%. The employed population is

- A. 500 000
- B. 1 000 000
- C. 9 500 000
- D. 10 000 000

2007/CE/II/30

Unemployment is costly to society because

- A. the employed will pay more tax.
- B. the potential GDP will fall.
- C. the real output of the economy will fall.
- D. unemployment benefit is a burden to society.

2008/CE/II/30

Study the following figures of an economy.

	Number of Persons
Unemployed	20 000
Under-employed	60 000
Employed	480 000
Persons aged 15 or above	1 000 000

The unemployment rate of the economy is _____.

- A. 2.0%
- B. 3.7%
- C. 4.0%
- D. 4.17%

2009/CE/II/32

Labour force (persons)	600 000
Unemployment rate	10%
Underemployment rate	5%

According to the above information on an economy,

- A. the population aged 15 or above is 600 000.
- B. the employment rate is 85%.
- C. the employed population is 540 000.
- D. the number of unemployed takes up 10% of the population.

2010/CE/II/32

Below are the employment figures of a country.

	Number of Persons
Employment	18 000
Unemployment	2 000

Suppose there are new job seekers entering into the labour market after graduation but only 85% of them succeed in finding a job. The unemployment rate _____.

- A. will increase
- B. will decrease
- C. will remain unchanged
- D. may increase or decrease

2012/DSE/II/24

Many Hong Kong construction workers stay in Macau to work for several years. If they are attracted by the job opportunities offered by new infrastructure projects in Hong Kong and return to seek jobs, what will be the effect on the unemployment rate in Hong Kong?

- A. The unemployment rate will increase.
- B. The unemployment rate will decrease.
- C. The unemployment rate will remain unchanged.
- D. The effect on the unemployment rate cannot be determined.

2016/DSE/II/25

Which of the following will reduce the unemployment rate of a country?

- A. Some university graduates join the labour force.
- B. Some factories move to a neighbouring country with lower labour cost.
- C. Some unemployed workers give up seeking jobs.
- D. The government increases unemployment benefits.

2017/DSE/II/27

If some second-generation of Hong Kong permanent residents returned to Hong Kong to fill up the posts which have been vacant for a long time, Hong Kong's labour force would _____ and the unemployment rate would _____.

- A. rise remain unchanged
- B. rise fall
- C. fall remain unchanged
- D. fall fall

2019/DSE/1/24

The following table shows the data of an economy.

Population aged 15 or above	6 500 000
Labour force participation rate*	60%
Employed population	3 780 000
Underemployed population	100 000

*Labour force participation rate = proportion of labour force in population aged 15 or above

Based on the above data, the unemployment rate of the economy is _____.

- A. 1.85%
- B. 3.08%
- C. 3.38%
- D. 5.64%

2019/DSE/1/39

Which of the following results can be a negative number?

- A. gross investment *minus* net investment
- B. total exports *minus* re-exports
- C. money supply (M3) *minus* money supply (M2)
- D. employed population *minus* unemployed population

2020/DSE/1/24

24. The following table shows the employment data of Hong Kong from April to June in 2019.

	Number of persons ('000)
Population	7 524
Aged 15 or above	6 590
Employed persons	3 871
Unemployed persons	114
Underemployed persons	41

According to the above data, the underemployment rate is _____.

- A. 0.55%
- B. 0.62%
- C. 1.03%
- D. 1.06%

2021/DSE/1/25

Suppose the unemployment rate of an economy is 8%. Which of the following would increase the unemployment rate?

- (1) 15% of the new graduates could not find jobs successfully.
- (2) Some employers closed down their local businesses and migrated to other countries.
- (3) Some of the part-time workers lost their job due to automation of production.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

Macroeconomics by Topic
2 Unemployment & Inflation

Short & Structured Questions

1994/CE/1/10(a)(i)

What losses to an economy are caused by unemployment? Give **TWO** of them.

(4 marks)

1995/CE/1/6

Every summer, many school leavers start to look for jobs and this affects the unemployment rate in September. Explain why the rate may increase or decrease.

(5 marks)

2000/CE/1/7

A certain government announces that the unemployment rate has dropped but the number of unemployed has increased.

Explain why the number of unemployed can increase despite a fall in the unemployment rate.

(4 marks)

2003/CE/1/6

Suppose a number of civil servants retire under the government's voluntary retirement scheme. Explain whether this will increase the unemployment rate in Hong Kong.

(4 marks)

2004/CE/1/7

Give **TWO** losses to society caused by unemployment.

(4 marks)

2006/CE/1/9(c)

In the summer of last year, the growing business of many retail shops led to an increase in the employed population in Hong Kong. However, the unemployment rate during the same period of time remained unchanged.

Explain why the unemployment rate can still remain unchanged in spite of an increase in the employed population. (4 marks)

2007/CE/1/8(b)(i)

Suppose these top-quality Mainland students stay and work in Hong Kong after their graduation and the total number of job positions in Hong Kong remains unchanged.

Explain how this situation would affect the unemployment rate of Hong Kong.

(4 marks)

2012/DSE/1/6(a)

Rising unemployment is one of the phenomena which occurs during economic recession.

State **TWO** losses to society caused by unemployment.

(2 marks)

2013/DSE/1/11(b)(iii)

The government has launched the "Work Incentive Transport Subsidy Scheme", with the following objectives:

- (1) To relieve the burden of travelling expenses commuting to and from work on the part of low-income households with employed members
- (2) To promote sustained employment

Applicants must meet the monthly income and asset limits of the household (e.g. for a single person, the monthly income cannot exceed \$7 300 and the assets cannot exceed \$72 000) and work no less than 72 hours per month in order to apply for a subsidy of \$600 per month.

Discuss the effects of the scheme on the unemployment rate.

(3 marks)

2015/DSE/II/5

Macau has developed rapidly in recent years and some workers in Hong Kong have been attracted to work there. Suppose the number of job positions in Hong Kong is constant. What would be the effect of the above phenomenon on the unemployment rate in Hong Kong? Explain your answer. (4 marks)

2016/DSE/II/6

Below are the employment data of a country.

Employed population	3 800 000
Underemployed population	800 000
Unemployed population	200 000

- (a) Calculate the unemployment rate of the country. (2 marks)
- (b) Suggest **THREE** losses to the society caused by unemployment. (3 marks)

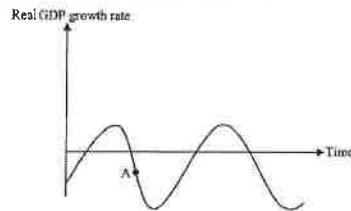
2018/DSE/II/5(b)

During peak flu seasons, there is not enough medical staff in public hospitals in Hong Kong.

In order to relieve the pressure of the medical staff, the government plans to recruit retired medical staff to re-join the public hospitals. Explain how the measure would affect the unemployment rate in Hong Kong. (4 marks)

2020/DSE/II/3

Below are the gross domestic product (GDP) data of a country.



- (a) Identify the phase of business cycle which point A is in. (1 mark)
- (b) Apart from increasing unemployment rate, list **TWO** general economic phenomena which occur at point A. (2 marks)
- (c) State **TWO** losses to society caused by unemployment. (2 marks)

MARKING SCHEME

1994/CE/II/37 D	1998/CE/II/24 A	2003/CE/II/30 B (44%)	2008/CE/II/30 C (63%)	2017/DSE/II/27 B (76%)
1995/CE/II/37 A	1998/CE/II/28 A	2004/CE/II/33 A (58%)	2009/CE/II/32 C (62%)	2019/DSE/II/24 B
1996/CE/II/33 D	1999/CE/II/52 A	2005/CE/II/32 B (55%)	2010/CE/II/32 A (61%)	2019/DSE/II/39 D
1997/CE/II/26 B	2002/CE/II/29 B (49%)	2006/CE/II/30 C (60%)	2012/DSE/II/24 D (53%)	2020/DSE/II/24 C
1997/CE/II/55 B	2002/CE/II/31 A (15%)	2007/CE/II/30 C (33%)	2016/DSE/II/25 C (48%)	2021/DSE/II/25 D

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

1994/CE/II/10(a)(i)

- GNP ↓ / living standard ↓
 - skill and experience of the unemployed ↓ / productivity ↓
 - social problems as other losses to society, e.g. higher crime rate, family problems
- [Mark the **FIRST TWO** points only.] (2@, max: 4)

1995/CE/II/6

- The newly graduated job seekers increase the labour force. (1)
- Unemployment rate (R) = $\frac{\text{Unemployed population (U)}}{\text{Labour force (L)}} \times 100\%$ (1)
- if a very high proportion of the new job seekers can find a job, then the unemployment rate will decrease; (2)
- and if quite a number of them cannot find a job, the unemployment rate will increase. (2)
- OR**
- whether the unemployment rate is higher or lower depends on the relative change of the labour force and the unemployed population. (4)
- OR**
- % change in U > % change in L ⇒ R ↑ (2)
- % change in U < % change in L ⇒ R ↓ (2)
- (max: 5)

2000/CE/II/7

- The no. of unemployed increases at a slower rate than the increase in the labour force. (4)
- [Show understanding of "unemployment rate = (no. of unemployed ÷ labour force) × 100%" without other elaboration - max: 1 mark]

2003/CE/II/6

- The unemployment rate would increase, because (1)
- an increase in the number of retired persons would not change the unemployed population, (1)
- but would reduce the size of labour force / employed population. (1)

Since unemployment rate = $\frac{\text{unemployed population}}{\text{labour force}}$

- OR**
- = $\frac{\text{unemployed population}}{\text{employed population} + \text{unemployed population}}$, (1)
- the unemployment rate would increase.
- [Mere mentioning of the formula of unemployment rate - max: 1 mark]

2004/CE/1/7

- productive resources will be left idle / output level will be lower
- political disorder / social unrest
- loss of skills

(2@, max: 4)

[Mark the **FIRST TWO** points only.]

2006/CE/1/9(c)

Unemployment rate = $(\text{unemployed population} \div \text{labour force}) \times 100\%$

(1)

The unemployed population increased, and

(1)

both the labour force and the unemployed population increased at the same rate / percentage.

(2)

2007/CE/1/8(b)(i)

Total labour force increases.

(1)

Unemployed population increases.

(1)

(Given total employment remains unchanged.)

increase in total labour force = increase in unemployed population

QR % increase in the unemployed population > % increase in the labour force

(1)

As a result, unemployment rate increases.

(1)

2012/DSE/II/6(a)

- loss of output
- loss of human capital
- political unrest

(1@, max: 2)

[Mark the **FIRST TWO** points only.]

2013/DSE/II/11(b)(iii)

The effect on the unemployment rate is uncertain.

The size of the labour force would increase as more people originally outside the labour force are induced to look for jobs.

But the total number of unemployed may also increase as some of these new workers may fail to get a job. The resulting rate of unemployment depends on the percentage increase in the unemployed population relative to that in the labour force. (3)

2015/DSE/II/5

Unemployment rate = $(\text{number of unemployed} \div \text{total labour force}) \times 100\%$

Since both total labour force and number of unemployed drop by an equal amount, the percentage decrease in the unemployed population is greater than the percentage decrease in the total labour force, implying a reduction in the unemployment rate.

(4)

2016/DSE/II/6

(a) The unemployment rate = $[200\,000 \div (3\,800\,000 + 200\,000)] \times 100\% = 5\%$

(2)

- (b) - loss of output
- loss of human capital
- political and social unrest

(1@, max: 3)

[Mark the **FIRST THREE** points only.]

2018/DSE/II/5(b)

Unemployment rate = $(\text{number of unemployed people} \div \text{the total labour force}) \times 100\%$

The number of unemployed people will not change while the labour force increases as the retired staff is not in the labour force originally. The unemployment rate will drop.

(4)

2020/DSE/II/3

3a Recession (1 mark)

b. Decrease of inflation rate

Lower RGDP growth rate

Decrease of consumption and investment confidence (2 marks)

c. Loss of human capital

Loss of real output

Social unrest (2 marks)

2.2 THE GENERAL PRICE LEVEL

Multiple Choice Questions

1991/CE/II/46

What will happen when there is inflation?

- A. The cost of living will fall.
- B. The budget deficit will decrease.
- C. The living standard will improve.
- D. The value of money will decrease.

1991/CE/II/48

Unexpected inflation will

- (1) increase government revenue.
 - (2) encourage exports.
 - (3) redistribute income.
 - (4) cause an inflow of short-term capital.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (4) only
 - D. (3) and (4) only

1991/CE/II/50

Year	1990	1991
Consumer price index	100	125

According to the table above, which of the following statements is true?

- A. The cost of living was lower in 1990.
- B. The standard of living was lower in 1990.
- C. The purchasing power of money was higher in 1991.
- D. The consumption expenditure was higher in 1991.

1993/CE/II/42

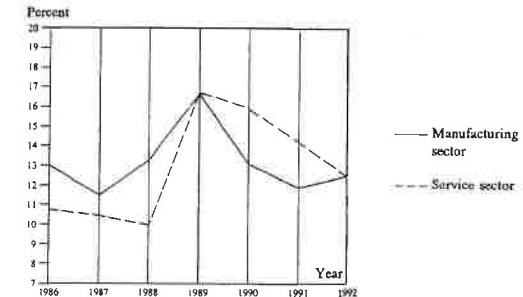
	November 1991	November 1992
Consumer Price Index (A)	117.7	128.5
Consumer Price Index (C)	118.7	129.9

The above table compares the indexes for November 1991 and November 1992. It shows that in November 1992, the _____ of the higher income group increased at a _____ rate than that of the lower income group.

- A. standard of living faster
- B. standard of living slower
- C. cost of living faster
- D. cost of living slower

1994/CE/II/20

The following diagram shows the percentage increase in the nominal wages of workers in the manufacturing and the service sectors of an economy



The above diagram shows that in the period 1986-92,

- A. manufacturing workers received higher total earnings than workers in the service sector.
- B. manufacturing workers had lower average labour productivity than workers in the service sector.
- C. if the inflation rate were below 10%, then real wages of workers in both sectors increased.
- D. there was a shortage of workers in the service sector.

1994/CE/II/34

For Question No. 34, consider the following data of an economy producing only bread and shirts:

	Price in 1992 (\$)	Price in 1993 (\$)	Output in 1993 (units)
Bread	10	12	50
Shirts	20	25	20

The rate of inflation from 1992 to 1993 calculated by using the GNP deflator is:

- A. 18.2%
- B. 22.2%
- C. 33.3%
- D. 122.2%

1994/CE/II/38

Who will lose during an unanticipated inflation?

- A. Mrs Lee, who has hired a Filipino maid
- B. Mr Chan, who has bought ten coupons which can be exchanged for cakes at a bakery
- C. Mr Fu, who runs a restaurant
- D. Mr Wong, who has put all his money in his time deposit account

1995/CE/II/33

Year	1994	1995
GDP deflator	120	132

Based on the above data, we may conclude that from 1994 to 1995, the economy's

- A. nominal GDP increased by 12%.
- B. real GDP increased by 10%.
- C. rate of deflation was 12%.
- D. general price level increased by 10%.

1995/CE/11/36

Which of the following people will gain in times of unexpected inflation?

- (1) holders of long-term government bonds
 - (2) holders of certificates of deposits
 - (3) those who have used credit cards to buy goods
 - (4) shareholders of companies which have issued long-term fixed-interest debentures
- A. (1) and (2) only
 - B. (1) and (4) only
 - C. (2) and (3) only
 - D. (3) and (4) only

1996/CE/11/32

Study the following information about Country X:

Year	Nominal national income (\$mn)	Price index
1988	8 000	100
1989	10 000	120

Comparing the year 1988 with 1989, we can conclude that

- A. the cost of living increased by 20% in 1989.
- B. the living standard in 1989 is generally higher.
- C. the real GNP growth rate in 1989 is 25%.
- D. the price of all goods and services increased by 20% in 1989.

1997/CE/11/25

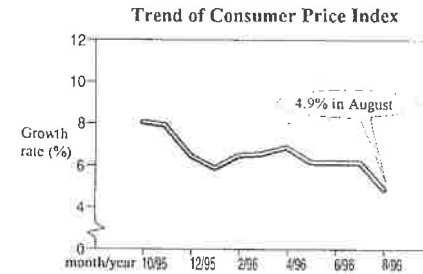


Source : *N.E. Asian Quarterly*, Standard Chartered, October 1996.

The above graph shows that in the first half of 1996,

- A. the high price of housing had led to a low consumption of the citizens.
- B. the living standard of Hong Kong people had improved.
- C. Hong Kong's property market was on the upswing.
- D. there was a lot of speculative activities in the property market of Hong Kong.

1997/CE/11/27



Source : *Hong Kong Economic Times*

The above data reflects that during this period,

- A. the consumption power of the people became weaker.
- B. the economy was on a downswing.
- C. the people consumed less but saved more.
- D. the increase in the cost of living had slowed down.

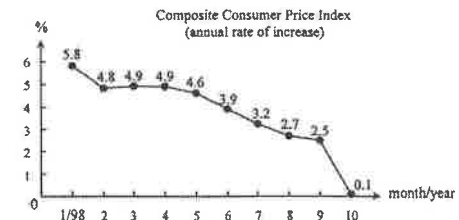
1997/CE/11/31

An increase in the GDP deflator from 100 to 110 in a certain year means that

- A. every household's cost of living has increased by 10%.
- B. the general price level has increased by 10%.
- C. the prices of all goods produced in the current year have increased by 10%.
- D. people's nominal incomes have increased by 10%.

1999/CE/11/33

Study the figure below concerning the changes in the Consumer Price Index.



From the figure, we can conclude that

- A. Inflation has stopped as prices go down.
- B. Wages have decreased.
- C. The cost of living has been rising at a slower rate.
- D. Some debtors who purchased mortgages on flats recently have suffered a loss.

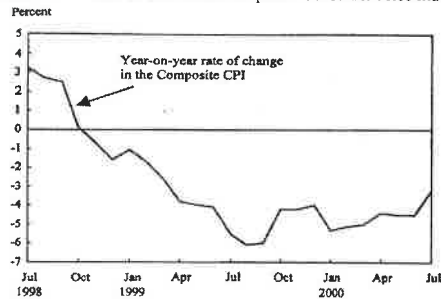
2000/CE/II/39

Mr A borrows money from a bank for a housing mortgage at a fixed interest rate of 7% p.a. After that the general price level falls continuously. In this event, Mr A loses and the bank gains. This is because.

- A. The value of the mortgaged house has been falling.
- B. Mr A's wage income has been falling.
- C. The bank can sell the house if Mr A fails to repay the loan.
- D. When the general price level keeps on falling, the purchasing power of a fixed amount of interest will increase.

2001/CE/II/31

Chart 1 Movements of the Composite Consumer Price Index



Based on the data in Chart 1, under what situation would Mr Chan have gained from July 1999 to July 2000?

- A. Before that period of time he had already borrowed a sum of money from a bank at a fixed interest rate.
- B. His salary remained unchanged during that period of time.
- C. He adjusted the rental charge to his tenant in a rental property according to the change in price level.
- D. He had a collection of antique vases.

2001/CE/II/32

Refer to the following data about an economy.

	Year 1	Year 2
GDP deflator	150	180

We can conclude that from Year 1 to Year 2,

- A. the purchasing power of money has decreased.
- B. the real national income has decreased.
- C. the average standard of living has gone down.
- D. the income distribution has become more uneven.

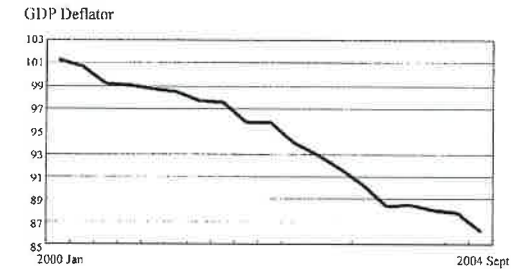
2005/CE/II/33

Which of the following would gain when unexpected inflation occurs?

- A. holders of fixed deposits with banks
- B. employees whose salaries are adjusted according to inflation
- C. people who receive a fixed amount of unemployment benefits
- D. a government which has issued bonds at fixed interest rates

2005/CE/IV/34

Refer to the following diagram about the GDP deflator of Hong Kong from January 2000 to September 2004.



Source: Hong Kong SAR Government

Based on the above diagram, we can conclude that during this period,

- A. the nominal GDP was decreasing.
- B. the real GDP was decreasing.
- C. the cost of living was increasing.
- D. the purchasing power of money was increasing.

2006/CE/II/31

The Consumer Price Index (A) of Hong Kong in the third quarter of 2005 has increased. This means that _____ in Hong Kong has increased.

- A. the price of all goods
- B. the price of imported goods
- C. the nominal national income
- D. the cost of living

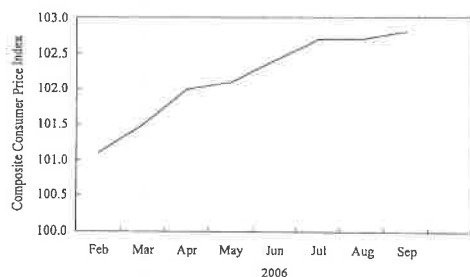
2007/CE/II/33

Which of the following statements about inflation is correct?

- A. A continuous increase in the price of a good is not inflation.
- B. During inflation, everyone suffers to the same extent.
- C. During inflation, incomes and prices increase at the same rate.
- D. Inflation may benefit some people, particularly those people whose incomes are fixed.

2007/CE/11/34

Refer to the following information about the composite consumer price index of Hong Kong.



Based on the above information, we can conclude that during this period in 2006,

- A. the nominal GDP was falling.
- B. the nominal GDP was increasing.
- C. the purchasing power of money was falling.
- D. the purchasing power of money was increasing.

2008/CE/11/31

Which of the following would lose during an unexpected inflation?

- A. a tenant who has signed a fixed rental contract before the unexpected inflation occurs
- B. an employer who has fixed the wage payment to his employees before the unexpected inflation occurs
- C. a creditor who has loaned out a sum of money at a fixed interest rate before the unexpected inflation occurs
- D. an insurer who is paying compensation, the amount of which was fixed before the unexpected inflation occurs

2008/CE/11/33

Year	Consumer Price Index (A)
2004	99.3
2005	100.3
2006	102.1

Based on the above table, we can conclude that during this period of time,

- A. the per capita nominal GDP has increased.
- B. the living standard has worsened.
- C. the cost of living has increased.
- D. All of the above are correct.

2009/CE/11/33

When inflation is expected,

- (1) creditors will charge the debtors a higher nominal interest rate.
 - (2) workers will request for a raise in their nominal wage rates.
 - (3) people will tend to hold more monetary assets instead of real assets.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

2009/CE/11/34

When the consumer price index of an economy increases from 100 to 110, it implies that

- A. the prices of all consumer goods involved in the calculation of the index have increased by 10%.
- B. the cost of living has increased.
- C. the standard of living has increased.
- D. people's nominal income has increased.

2012/DSE/1/32

The US government has accumulated a huge amount of debt, about US\$14 trillion in 2011. If there is unexpected inflation in the US, which of the following parties will most likely gain?

- A. Hong Kong residents holding cash in Hong Kong dollars under the linked exchange rate system
- B. US citizens holding time deposits
- C. countries holding a large amount of US government bonds, like China and Japan
- D. the US government

2013/DSE/1/34

Which of the following people will benefit from unanticipated inflation?

- A. A loan shark who lends out a sum of money at a floating interest rate
- B. A manager who receives a fixed salary with the period of a two-year contract
- C. A flat-owner who repays a fixed-rate mortgage loan
- D. A retired teacher who receives dividends from various listed companies

2014/DSE/1/40

Which of the following statements about inflation is/are correct?

- (1) Inflation occurs when the government handouts a large sum of cash to every citizen in a certain year.
- (2) Inflation redistributes wealth from lenders to debtors if it is anticipated.
- (3) People prefer holding real assets to cash under expected inflation.

- A. (1) only
- B. (2) only
- C. (3) only
- D. (1), (2) and (3)

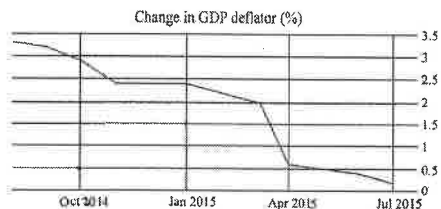
2015/DSE/1/36

When unanticipated deflation occurs, which of the following people will lose?

- A. people paying a fixed amount of rental payment
- B. people receiving interest from their savings deposits
- C. people repaying a mortgage loan at a floating interest rate
- D. people working under a fixed nominal wage contract

2016/DSE/1/24

Study the diagram below.



The diagram shows that during the period from October 2014 to July 2015,

- A. the nominal GDP was falling.
- B. the purchasing power of money was increasing.
- C. the growth rate of real GDP was higher than that of nominal GDP.
- D. the nominal interest rate was higher than the realised real interest rate.

2016/DSE/1/37

Which of the following people will gain in times of unexpected deflation?

- (1) holders of i-bonds issued by the Hong Kong Government
- (2) flat owners repaying floating rate mortgage loans
- (3) pensioners receiving fixed pensions

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2017/DSE/1/34

When there is unexpected inflation, which of the following individual(s) will lose?

- A. A firm owner paying his workers a fixed wage
- B. A flat owner charging a rental with adjustment according to the change in price level
- C. A retired civil servant receiving a fixed monthly pension
- D. All of the above individuals will lose because the purchasing power of money will be lower.

Short & Structured Questions

1990/CE/1/3(b)(ii)

Explain whether the following persons would gain or lose in times of inflation:

- (I) a businessman who has borrowed money from a bank at a fixed interest rate
- (II) a landlord whose premises have already been let at a fixed rent for the coming two years

(6 marks)

1993/CE/1/1(e)

Explain whether 'Yummy Yummy' will gain or lose if inflation occurs unexpectedly after

- (i) it has signed a contract with a hospital to supply a standardized lunch package to the patients at a fixed price for a year.
- (ii) it has deposited a sum of money with a bank at a fixed interest rate.

(6 marks)

1998/CE/1/1(a)

Define 'inflation'.

(2 marks)

1999/CE/1/1(c)

Some taxi-drivers buy taxis by borrowing from banks. If the general price level goes down unexpectedly, explain under what circumstances these taxi-drivers will

- (i) lose.
- (ii) have no gain or loss.

(6 marks)

2001/CE/1/9(d)

"If an import tax is introduced on all imports to Hong Kong, it would affect Hong Kong's general price level but would not necessarily lead to inflation in Hong Kong." Explain why this statement is correct.

(5 marks)

2003/CE/1/9(c)

Explain whether the following persons would gain or lose in times of unexpected deflation.

- (i) Suppose an individual has borrowed a housing mortgage loan from a bank at a fixed interest rate.
- (ii) Suppose a retired civil servant receives a fixed monthly pension from the government.

(6 marks)

2005/CE/1/7

Answer Questions 6 and 7 by referring to the following information about the Gross Domestic Product (GDP) of Hong Kong.

Table 1:

Year	Implicit price deflator of GDP	Per capita GDP at current market prices (HK\$)
2001	98.1	188 835
2002	94.6	183 790
2003	89.6	179 333

Suppose people did not expect any change in the price level. Explain whether the following persons would gain or lose when the change in the price level indicated in Table 1 occurred.

- (a) a businessman who obtained a bank loan in 2001 at a fixed interest rate for 2 years
- (b) a businessman whose premises were let in 2001 at a fixed rent for 2 years

(4 marks)

2007/CE/1/4(b)

The table below shows the gross domestic product (GDP) statistics of Hong Kong:

Year	(HK\$ million)		
	GDP at current market prices	GDP at constant (2000) market prices	GDP deflator
2003	1 233 983	1 390 610	88.7
2004	1 291 568	1 510 182	85.5
2005	1 382 052	1 619 984	A

Suppose people did not expect any change in the price level in years 2003 to 2005. Explain whether the following persons would gain or lose when the changes in the price level indicated in the above table occurred.

- a retired civil servant who receives a fixed monthly pension from the government
 - a person who borrowed a sum of money in 2003 from a bank at a fixed interest rate and repaid the loan in 2005
- (6 marks)

2009/CE/1/5

Refer to the following information on economy A.

Year	Growth rate of GDP deflator
2006	+ 5%
2007	+ 4%
2008	+ 2%

- What is inflation? (2 marks)
- Suppose people did not expect any change in the price level in years 2006 to 2008. In 2006, Phelps borrowed a housing mortgage loan from a bank at a fixed interest rate. Explain whether Phelps would gain or lose when the changes indicated in the above table occurred. (3 marks)

2012/DSE/II/11(a)

Read the following news extract.

Hong Kong's inflation rate rose to 7.9% last month - the sharpest jump in 16 years - confirming what many families already feared as they struggle to keep up with the runaway cost of food and rent

What is inflation? (2 marks)

2014/DSE/II/5

Study the following information about an economy.

Year	Consumer price index (CPI)
2012	120
2013	126

- Calculate the inflation rate in 2013. (1 mark)
- Explain ONE difference between using CPI and Gross Domestic Product (GDP) deflator to measure the change in the price level. (2 marks)
- Suppose people did not expect any change in the price level from 2012 to 2013. Explain whether each of the following persons would gain or lose when the change in the price level in the above table occurred.
 - In 2012, Kitman borrowed a housing mortgage loan from a bank at a fixed nominal interest rate. (2 marks)

2019/DSE/II/6

Study Tables 1 and 2 and answer the following questions.

Table 1: Change in composite consumer price index (CCPI)

Year 2016	Year 2017
+2.3%	+1.7%

Table 2: Minimum wage rates per hour

Year 2016	Year 2017
\$32.5	\$34.5

- Based on Table 1, state the change in the general price level in 2017. (1 mark)
- On 1 January 2017, Siu Keung expected a +2.3% change of the CCPI in that year, and he lent a sum of money to Kitman at 5% interest rate per annum. On 31 December 2017, Kitman repaid the sum plus the interest to him. With reference to Table 1, explain whether Siu Keung would gain or lose. (3 marks)
- Kitman has been receiving the minimum wage rate per hour. With reference to Tables 1 and 2, explain how her real wage rate would change in 2017. (3 marks)

2018/DSE/II/10(b)

Who, the employers or the foreign domestic helpers, will suffer a loss if there is an unexpected inflation in the contractual period? Explain. (2 marks)

MARKING SCHEME

1991/CE/II/46 D	1995/CE/II/33 D	2000/CE/II/39 D	2007/CE/II/34 C (59%)	2014/DSE/II/40 C (66%)
1991/CE/II/48 B	1995/CE/II/36 D	2001/CE/II/31 B	2008/CE/II/31 C (69%)	2015/DSE/II/36 A (72%)
1991/CE/II/50 A	1996/CE/II/32 A	2001/CE/II/32 A	2008/CE/II/33 C (71%)	2016/DSE/II/24 D (37%)
1993/CE/II/42 C	1997/CE/II/25 C	2005/CE/II/33 D (51%)	2009/CE/II/33 A (66%)	2016/DSE/II/37 B (65%)
1994/CE/II/20 C	1997/CE/II/27 D	2005/CE/II/34 D (46%)	2009/CE/II/34 B (69%)	2017/DSE/II/34 C (85%)
1994/CE/II/34 B	1997/CE/II/31 B	2006/CE/II/31 D (61%)	2012/DSE/II/32 D (68%)	
1994/CE/II/38 D	1999/CE/II/33 C	2007/CE/II/33 A (55%)	2013/DSE/II/34 C (82%)	

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

1990/CE/I/3(b)(ii)

- (I) The businessman would gain, because the value of the loan / interest payments decreases in real terms during inflation. (1)
(2)
- (II) The landlord would lose, because the value of the rent decreases in real terms / the purchasing power of the fixed rent drops in times of inflation. (1)
(2)

1993/CE/II/1(c)

- (i) Lose, because the real value of the receipt will decrease during inflation. (1)
OR
the cost of supplying the lunch package will increase during inflation. (2)
- (ii) Lose, because the real value of the sum of money and/or the interest income will decrease during inflation. (1)
(2)

1998/CE/II/1(a)

A continuous rise in the general price level (2)

1999/CE/II/11(c)

- (i) Under fixed interest rates, the payment of hire and purchase remains the same. (2)
OR
Under floating interest rates, the fall in nominal interest rate is less than the fall in the general price level. (2)
However, the value of payment to bank for hire purchase will increase since the purchasing power of the payment increase. (2)
- (ii) Under floating interest rates, if the adjustment of the interest rates is fast enough to catch up with the fall in the general price level, there will be no loss nor gain. (2)

2001/CE/II/9(d)

Effect on the general price level
Most foodstuffs, daily necessities and industrial raw materials are imported. (1)
∴ introduction of the tax would lead to a rise in the general price level (1)

Result in inflation?

If the introduction of the tax only results in an ~~once-and-for-all~~ rise in the general price level, then it would not bring forth an inflation. (3)
[Only put down the definition of inflation as "a persistent or continuous rise in the general price level" without other elaboration - max: 2 marks]

2003/CE/II/9(c)

- (i) Lose, because the fixed amount of loan repayment and the fixed amount of loan interest payment both have a higher purchasing power than that before unexpected deflation occurs. (1)
(2)
- (ii) Gain, because the fixed pension has a higher purchasing power than that before the unexpected deflation occurs. (1)
(2)

2005/CE/II/7

- (a) He would lose, because he repays a fixed amount of money, the purchasing power of which has increased because of unexpected deflation. (1)
(1)
- (b) He would gain, because he receives a fixed amount of money, the purchasing power of which has increased because of unexpected deflation. (1)
(1)

2007/CE/II/4(b)

- The table indicates a decrease in the general price level. (2)
- (i) He would gain, because the fixed amount of pension has a higher purchasing power (in times of unexpected deflation). (1)
(1)
- (ii) He would lose, because the real value of the repayment will increase (during unexpected deflation). (1)
(1)

2009/CE/II/5

- (a) Inflation is a continuous rise in the general price level. (2)
- (b) He would gain, because the real value of his loan repayment will decrease. (1)
(2)

2012/DSE/II/11(a)

Persistent increase in the general price level (2)

2014/DSE/11/5

(a) $[(126 - 120) / 120] \times 100\% = 5\%$ (1)

(b) CPI only includes consumer goods while GDP deflator includes both consumer goods and producer goods.

OR

CPI calculates a fixed basket of goods and the weighting will be revised every 5 years while GDP deflator has variable baskets of goods for each year. (2)

(c) (i) Kitman would gain, because (1)
the unexpected inflation would lower the real value (purchasing power) of the loan repayment. (1)

2018/DSE/11/10(b)

The foreign domestic helpers will lose under unexpected inflation, as the purchasing power of their fixed wage would drop. (2)

2019/DSE/11/6

(a) Increased (+1.7%). (1)

(b) He would gain because when the actual inflation rate (1.7%) was lower than the expected inflation rate (2.3%), the actual real interest rate received (3.3%) was higher than the expected real interest rate (2.7%). OR the purchasing power of the interest received was higher than expected. (3)

(c) Real wage rates increased because the increase in the nominal wage rate 6.2% was higher than the inflation rate 1.7%. (3)

2.3 BUSINESS CYCLE

Multiple Choice Questions

1994/CE/11/35

According to the data below, what do we call the phase of the business cycle that the economy was in 1991?

Year	1989	1990	1991	1992	1993
Real GDP growth rate (%)	1.5	0.0	2.1	2.8	3.5

- A. recovery
- B. peak
- C. recession
- D. through

1994/CE/11/36

During recession,

- (1) the growth rate of national income is steady.
- (2) the general price level begins to rise.
- (3) the unemployment rate increases.
- (4) the production level declines.

- A. (1) and (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (3) and (4) only

1995/CE/11/35

Which of the following will happen in times of recession?

- (1) The total demand for goods and services will decrease.
- (2) The budget deficit will decrease.
- (3) The unemployment rate will increase.
- (4) The balance of payments deficit will increase.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

1996/CE/11/59

Which of the following is **NOT** a characteristic of the phase of recession in a business cycle?

- A. The consumption expenditure decreases.
- B. The investment expenditure decreases.
- C. The unemployment rate increases.
- D. The government suffers from fiscal deficit as her tax revenue decreases and expenditure increases.

1997/CE/II/30

An economy is experiencing the following: the unemployment rate is declining, prices have stopped falling and started rising, and investment expenditure is expanding. It is in the _____ phase of a business cycle.

- A. recovery
- B. peak
- C. recession
- D. trough

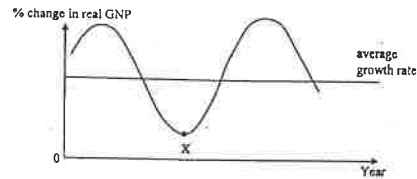
1998/CE/II/27

Which of the following indicates that the economy is beginning to recover from depression?

- A. decreasing price level
- B. increasing government fiscal deficit
- C. decreasing balance of payments deficit
- D. increasing employment rate

1999/CE/II/27

In the diagram below, X is situated in a certain phase of the business cycle. Which of the following is a characteristic of the phase?



- A. The real GNP has a zero growth rate.
- B. The nominal GNP is higher than the real GNP.
- C. The investment expenditure of the economy is zero.
- D. The unemployment rate is high.

1999/CE/II/28

According to the government, Hong Kong experienced a recession in 1998 because three consecutive quarters, there was

- A. An increase in the unemployment rate.
- B. A fall in the average wage rate.
- C. A fall in the general price level.
- D. A negative growth rate of real gross domestic product (GDP)

2000/CE/II/37

The following phenomena are observed in an economy:

- (1) Industrial output on an upward trend
- (2) Increasing imports and exports
- (3) Growth of retail receipts
- (4) Forecast of economic growth being revised upwards.

Which phase of the business cycle is the economy in?

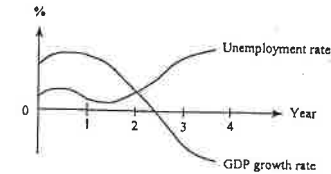
- A. peak
- B. recession
- C. trough
- D. recovery

2001/CE/II/38

If Hong Kong is in the stage of recovery in the business cycle,

- A. government expenditure will increase.
- B. the proportion of tax revenue in total government revenue will decrease.
- C. government revenue from direct taxes will increase.
- D. there will be a budgetary surplus for the government.

2002/CE/II/28



The information above shows that the economy is in a stage of _____ in Year 3.

- A. recession
- B. depression
- C. recovery
- D. prosperity

2004/CE/II/32

When an economy is in the recovery stage,

- (1) retail receipts will increase.
- (2) the government will have a budget surplus.
- (3) the unemployment rate will fall.
- (4) the balance of payments deficit will decrease.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

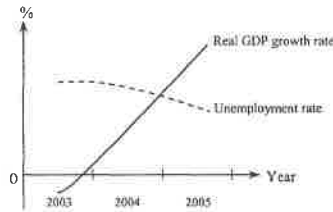
2005/CE/II/31

The following is observed in an economy: the unemployment rate is decreasing, the price level is no longer falling but rising instead, and the investment expenditure is increasing.

In which phase of the business cycle is the economy situated?

- A. recovery
- B. peak
- C. recession
- D. trough

2006/CE/11/27

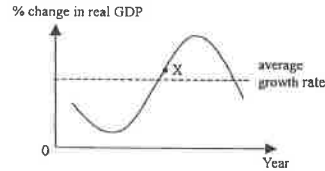


According to the above information, the economy is in a stage of _____ in 2004.

- A. recovery
- B. prosperity
- C. recession
- D. depression

2007/CE/11/31

In the diagram below, X is situation in a certain phase of the business cycle. Which of the following is a characteristic of this phase?



- A. The general price level is falling.
- B. The consumption expenditure is falling.
- C. The balance of payments surplus is increasing.
- D. The level of investment is increasing.

2008/CE/11/29

In the stage of economic _____, the percentage change in real GDP _____.

- A. recession could be negative
- B. recovery is equal to the inflation rate
- C. prosperity will be constant
- D. depression will be zero

2009/CE/11/31

The following phenomena are observed in an economy:

- ♦ Total sales value at the retail level is decreasing.
- ♦ Bankruptcy petitions are increasing.
- ♦ The inflation rate is falling.
- ♦ The forecast of economic growth has been revised downward.

Which phase of the business cycle is the economy in?

- A. peak
- B. recession
- C. trough
- D. recovery

2010/CE/11/31

The following phenomena are observed in an economy:

- ♦ Retail receipts are increasing.
- ♦ The employment of the manufacturing sector is increasing.
- ♦ The stock prices are increasing.
- ♦ The forecast of the real GDP growth rate has been revised upward.

Which phase of the business cycle is the economy in?

- A. peak
- B. recession
- C. trough
- D. recovery

2010/CE/11/44

Which of the following will increase in times of economic recovery?

- A. trade surplus
- B. budget deficit
- C. government expenditure
- D. direct tax revenue

2013/DSE/1/33

The following phenomena are observed in an economy:

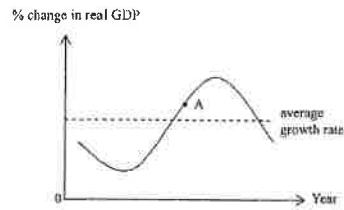
- (1) The unemployment rate is increasing.
- (2) The inflation rate is no longer rising but falling instead.
- (3) The inventories of producers are accumulating.
- (4) The forecast of economic growth is revised downward.

The economy is in the _____ phase of a business cycle.

- A. recession
- B. trough
- C. recovery
- D. peak

2014/DSE/1/39

In the diagram below, A is situated in a certain phase of the business cycle.



At Point A, there will be an increase in _____ in the economy.

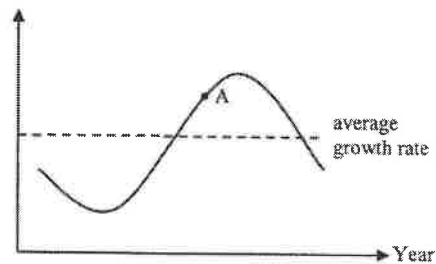
- (1) the labour employment level
- (2) the general price level
- (3) the sales of firms
- (4) transfer payments

- A. (1) and (2) only
- B. (3) and (4) only
- C. (1), (2) and (3) only
- D. (1), (2), (3) and (4)

2021/DSE/1/39

Study the following diagram.

Percentage change in real GDP



Which of the following are the features of an economy when it is operating at point A?

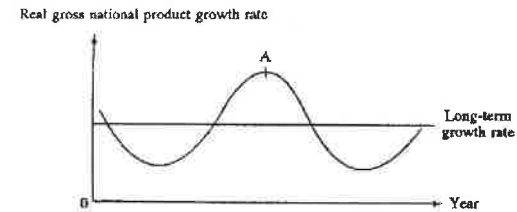
- (1) Labour supply is increasing.
- (2) Purchasing power of money is decreasing.
- (3) Government expenditure is increasing.
- (4) Business confidence of companies is increasing.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

Short & Structured Questions

1995/CE/1/7

Look at the business cycle shown below. Identify the phase which point A is in. Indicate **THREE** general economic phenomena which occur in this phase.



(4 marks)

1995/CE/1/6(a)

Study the following data about Hong Kong.

Year	Quarter	Year on year % change in real gross domestic product (GDP)	Unemployment rate (%)	Composite consumer price index
1998	2 nd	-5.1	4.4	119.2
	3 rd	-6.8	5.0	118.6
	4 th	-5.7	5.7	116.1
1999	1 st	-3.4	6.2	115.6

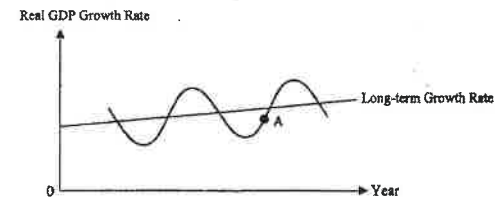
Identify the phase of business cycle the economy was in during the above period of time. Give the **THREE** economic phenomena of this phase as indicated by the above data.

(4 marks)

2008/CE/1/5

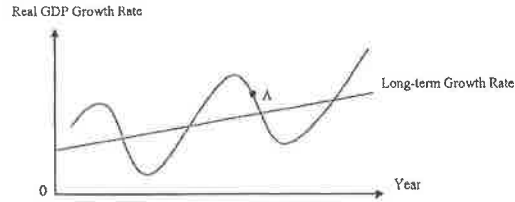
Refer to the business cycle shown below. Identify the phase which point A is in. Apart from the information about the real gross domestic product (GDP) growth rate in this phase, give **TWO** general economic phenomena which occur in this phase.

(3 marks)



2010/CE/1/7

Refer to the business cycle shown below.



- (a) Point A is in the _____ phase of the business cycle. (1 mark)
- (b) Apart from the change in the real gross domestic product (GDP) growth rate, give **TWO** general economic phenomena which occur in this phase. (2 marks)

2012/DSE/II/6(b)

Rising unemployment is one of the phenomena which occurs during economic recession.

Other than rising unemployment, give **TWO** other economic phenomena which would occur during economic recession. (2 marks)

2016/DSE/II/6(c)

Suppose the country is in the phase of recovery. Apart from the reduction in unemployment rate, give **TWO** general economic phenomena during recovery. (2 marks)

MARKING SCHEME

1994/CE/II/35 A	1998/CE/II/27 D	2002/CE/II/28 A (65%)	2008/CE/II/29 A (64%)	2014/DSE/I/39 C (60%)
1994/CE/II/36 D	1999/CE/II/27 D	2004/CE/II/32 A (76%)	2009/CE/II/31 B (91%)	2021/DSE/I/39 D
1995/CE/II/35 A	1999/CE/II/28 D	2005/CE/II/31 A (94%)	2010/CE/II/31 D (89%)	
1996/CE/II/59 D	2000/CE/II/37 D	2006/CE/II/27 A (87%)	2010/CE/II/44 D (65%)	
1997/CE/II/30 A	2001/CE/II/38 C	2007/CE/II/31 D (70%)	2013/DSE/II/35 A (91%)	

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

1995/CE/1/7

- Peak / boom / economic prosperity (1)
- high employment rate / low unemployment rate / full employment or close to full employment
 - high consumption level / investment level
 - high production level / national income level
 - price level ↑ / wage rate ↑
 - interest rate ↑
- [Mark the **FIRST THREE** points only.] (1@, max: 3)

1995/CE/1/6(a)

- Recession (1)
- negative GDP growth rate / GDP or output decreases (1)
 - increasing unemployment rate (1)
 - falling cost of living (1)
- [Mark the **FIRST THREE** points only.] (1)

2008/CE/1/5

- Recovery (1)
- employment increases
 - aggregate demand increases / private consumption expenditure increases / investment increases
 - general price level increases
- [Mark the **FIRST TWO** points only.] (1@, max: 2)

2010/CE/1/7

- Recession / contraction (1)
- unemployment (rate) increases
 - aggregate demand decreases / private consumption expenditure decreases / investment decreases
 - inflation rate decreases / deflation / general price level decreases
- [Mark the **FIRST TWO** points only.] (1@, max: 2)

2012/DSE/II/6(b)

- falling or even negative real GDP growth
 - low / falling inflation or even deflation
 - falling business confidence, levels of investment, consumption
- [Mark the **FIRST TWO** points only.] (1@, max: 2)

2016/DSE/II/6(c)

- rising real GDP growth rate
 - rising inflation / lower deflation
 - rising levels of investment / consumption
- [Mark the **FIRST TWO** points only.] (1@, max: 2)

2.4 DISINFLATION, NOMINAL AND REAL INTEREST RATES

Multiple Choice Questions

1990/AL/II/11

Which of the following statements about inflation are correct?

- (1) Inflation can exist in a barter economy.
- (2) In times of inflation, income will be redistributed from the general public to the government.
- (3) The nominal interest rate will be greater than the real interest rate when inflation is fully anticipated.
- (4) Inflation can be eliminated by price control.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

1990/AL/II/24

The inflation rate and the real interest rate were expected to be 5% and 4% respectively. In reality, the actual inflation rate turned out to be 7%. What was the real interest rate?

- | | |
|-------|-------|
| A. 1% | B. 2% |
| C. 3% | D. 9% |

1992/AL/II/21

If the nominal rate of interest is 10% but the real rate of interest is only 6%, the real return on holding cash will be

- | | |
|---------|----------|
| A. 0%. | B. -4%. |
| C. -6%. | D. -10%. |

1993/AL/II/29

If the sum of the real interest rate and the anticipated inflation rate is greater than the nominal interest rate, which of the following will be **FALSE**?

- A. Nobody likes to lend money to others.
- B. People want to borrow money for consumption.
- C. People want to make investments themselves.
- D. The anticipation inflation rate will fall.

1995/AL/II/19

If the inflation rate falls and remains positive,

- A. the economy is experiencing unemployment.
- B. the price level is falling at a fixed rate.
- C. the price level increases and then decreases.
- D. the price level is rising.

1996/AL/II/21

When inflation occurs, the opportunity cost of holding money is equal to

- A. the nominal rate of interest.
- B. the expected rate of inflation.
- C. the actual rate of inflation.
- D. None of the above.

1999/AL/II/17

The inflation rate in an economy was 10% in 1996 and dropped to 5% in 1997. Which of the following must be true about the economy in the above period?

- A. There was a fall in the standard of living.
- B. There was a deflation in the year 1997.
- C. There was a rise in the prices of all goods.
- D. None of the above.

1999/AL/II/18

The expected inflation rate and the real rate of interest rate are 10% and 4% respectively. If the actual inflation rate turns out to be 9% only, the cost of holding cash is _____ and the real rate of return on holding cash is _____.

- | | |
|------------------|-------------------|
| A. 4% -5% | B. 4% -9% |
| C. 14% -9% | D. 14% -10% |

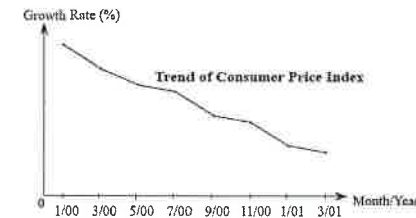
2002/AL/II/22

The nominal interest rate and the expected inflation rate are 10% and 7% respectively. If the actual inflation rate returns out to be 12%, then the realized real rate of interest will be _____ and the real rate of return on holding cash will be _____.

- | | |
|-------------------|-------------------|
| A. -2% -12% | B. -2% -10% |
| C. 3% -12% | D. 3% -10% |

2002/AL/II/26

Study the diagram below.



The diagram shows that during the period,

- A. deflation occurred.
- B. the growth rate of money stock was greater than the growth rate of nominal output.
- C. the purchasing power of money was rising.
- D. the general price level was rising.

2003/AL/II/21

The real rate of return on holding non-interest-earning cash is positive if

- A. the rate of inflation is falling.
- B. the interest rate is falling.
- C. prices are falling.
- D. the velocity of circulation of money is falling.

2004/AL/11/15
Disinflation means that

- A. the inflation rate is at a disequilibrium level.
- B. inflation destabilizes the economy.
- C. the deflation rate is rising.
- D. the price level is increasing at a slower rate.

2004/AL/11/18
Suppose individuals can only choose to hold bonds or cash. The cost of holding cash is

- A. the real interest rate because the return from holding bonds will not be affected by a change in the price level.
- B. the real interest rate because it reflects the rate of return from investment.
- C. the nominal interest rate because it is the return from bonds.
- D. the nominal interest rate only when inflation rate can be accurately anticipated.

2005/AL/11/22
When there is deflation,

- A. the real interest rate will be negative.
- B. the nominal interest rate will be negative.
- C. the real interest rate will be higher than the nominal interest rate.
- D. All of the above.

2006/AL/11/08
If the nominal interest rate on one-year bond is 8% and the expected inflation rate is 3%, the nominal rate of return and the expected real rate of return of holding money are _____ and _____ respectively.

- A. 0% -3%
- B. 0% -5%
- C. -8% -3%
- D. -8% -5%

2006/AL/11/21
The real interest rate will be higher than the nominal interest rate if

- A. the actual inflation rate is lower than the expected inflation rate.
- B. the expected inflation rate is falling.
- C. the nominal interest rate is falling.
- D. the price level is expected to fall.

2006/AL/11/23



The above diagram shows that during the period

- A. there is disinflation in the economy.
- B. the growth rate of money stock is positive.
- C. the general price level is falling.
- D. the standard of living is falling.

2008/AL/11/21
The nominal interest rate is the same as

- A. the real interest rate when people expect no change in the general price level.
- B. the real interest rate when the central bank holds the interest rate constant at a target level.
- C. the real return of holding monetary assets.
- D. the real interest rate plus the actual inflation rate.

2008/AL/11/23
When there is inflation,

- A. net monetary debtors will gain because the real value of interest payments will fall.
- B. the cost of holding money is the real interest rate instead of the nominal interest rate.
- C. a positive growth rate of real income implies a positive growth rate of nominal income.
- D. a positive nominal interest rate necessarily implies a positive real interest rate.

2010/AL/11/19
Suppose the nominal interest rate on a one-year bond is 3% and the expected deflation rate is 2%. However, the general price level turns out to rise by 3%. The nominal rate of return and the actual real rate of return of holding the bond are _____ and _____ respectively.

- A. 3% 5%
- B. 3% 0%
- C. 0% 5%
- D. 0% 0%

2011/AL/11/18
Suppose the market rate of interest is 5% and the expected inflation rate is 3%. The opportunity cost of holding money is _____, and the real rate of return on holding money is _____.

- A. -5% 2%
- B. 2% -3%
- C. 5% 3%
- D. 5% -3%

2012/AL/11/21
The nominal interest rate and the expected inflation rate are 8% and 5% respectively. If the actual inflation rate is 10%, the real rate of return on holding cash will be _____.

- A. -10%
- B. -8%
- C. -5%
- D. -3%

2014/DSE/1/32
The nominal interest rate of a one-year bond and the expected inflation rate are 8% and 3% respectively. If the actual inflation rate is 6%, then the actual real interest rate is _____ and the actual rate of return of holding cash is _____.

- A. 2% -6%
- B. 2% -8%
- C. 5% -6%
- D. 5% -8%

2015/DSE/1/31
If the nominal interest rate is 5% and the expected inflation rate is 3%, the cost of holding money is _____, the nominal return of holding money is _____ and the expected real interest rate is _____.

- A. 5% -3% 2%
- B. 5% 0% 2%
- C. 8% -3% 3%
- D. 8% 0% 3%

In times of inflation, suppose the nominal interest rate of a bond is higher than the expected inflation rate. If the actual inflation rate turns out to be higher than the expected inflation rate,

- (1) the actual inflation rate will be higher than the nominal interest rate of the bond.
 - (2) the expected real rate of return of the bond will be greater than the actual real rate of return.
 - (3) the actual real rate of return of the bond may be negative.
 - (4) the real rate of return of holding cash will be higher than zero.
- A. (1) and (2) only
 - B. (1) and (4) only
 - C. (2) and (3) only
 - D. (3) and (4) only

2019/DSE/1/37

Under unexpected deflation, which of the following persons will lose?

- (1) Ms Mok holds a time deposit of one million dollars in a deposit taking company.
 - (2) Mr Lo receives interest from Silver Bond of which the rate of return is linked to the inflation, subject to a minimum return of 3%.
 - (3) Mr Chan signs a two-year contract with an online TV company to subscribe to its service by a fixed monthly payment.
- A. (1) only
 - B. (2) only
 - C. (3) only
 - D. (2) and (3) only

2020/DSE/1/34

When there is unexpected inflation, which of the following persons will gain?

- A. a landlord who adjusts his rental according to the price index
- B. a creditor who has loaned out a sum of money at a floating interest rate
- C. an employer who signs a fixed nominal wage contract with his employees
- D. a retired civil servant who receives a fixed monthly pension

2018/DSE/1/34

Assume that the real interest rate is 6% and the expected inflation rate is 3%. If the actual inflation rate is 5%, the cost of holding money will be _____.

- A. 4%
- B. 6%
- C. 9%
- D. 11%

Short & Structured Questions

1994/AL/II/2

Explain why people reduce their cash holdings and savings deposit balances in banks when there is high inflation. (8 marks)

2003/AL/II/2

- (a) What is meant by deflation? Is it the same as a fall in the inflation rate (i.e., disinflation)? (2 marks)
- (b) What is the relation between the nominal and real interest rates when people expect deflation? Will the nominal rate be higher or lower than the real rate? (4 marks)

2007/AL/II/1(a)

Name one similarity and one difference between the terms in each of the following pairs: deflation; disinflation. (3 marks)

2012/DSE/II/11(a)

To relieve the effect of inflation on citizens, the government has issued inflation-linked bonds (ibonds) with interest paid to bondholders every six months. The interest rate is positively related to the actual inflation rate of the last half-year period.

- (c) What is the opportunity cost of holding cash instead of ibonds? (2 marks)
- (d) Explain how ibonds would relieve the effect of inflation on their holders. (2 marks)

2013/DSE/II/3

- (a) What is the relationship between nominal interest rate and real interest rate? (2 marks)
- (b) “When there is actual deflation, the nominal interest rate will be lower than the real interest rate.” Do you agree? Explain. (3 marks)

2014/DSE/II/5(c)(ii)

Study the following information about an economy.

Year	Consumer price index (CPI)
2012	120
2013	126

Suppose people did not expect any change in the price level from 2012 to 2013. Explain whether each of the following persons would gain or lose when the change in the price level in the above table occurred.

- (ii) In 2012, Marlene invested in a project with an expected nominal rate of return of 12% per year. In 2013, she discovered that the actual nominal rate of return was 15% per year. (3 marks)

- (a) What is the opportunity cost of holding money? Explain.

MARKING SCHEME

1990/AL/II/11 C	1996/AL/II/21 A	2003/AL/II/21 C	2006/AL/II/21 D (50%)	2011/AL/II/18 D (67%)
1990/AL/II/24 B	1999/AL/II/17 D	2004/AL/II/15 D (71%)	2006/AL/II/23 A (66%)	2012/AL/II/21 A (62%)
1992/AL/II/21 B	1999/AL/II/18 C	2004/AL/II/18 C (53%)	2008/AL/II/21 A (66%)	2014/DSE/I/32 A (57%)
1993/AL/II/29 D	2002/AL/II/22 A (47%)	2005/AL/II/22 C (73%)	2008/AL/II/23 C (33%)	2015/DSE/I/31 B (52%)
1995/AL/II/19 D	2002/AL/II/26 D (39%)	2006/AL/II/08 A (26%)	2010/AL/II/19 B (61%)	2018/DSE/I/34 C (39%)
2019/DSE/I/32 C	<i>Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.</i>			
	2019/DSE/I/37 C	2020/DSE/I/34 C		

1994/AL/II/2

Whether an asset will be held depends on its real rate of returns which equals nominal rate minus the inflation rate. The nominal interest returns to cash holding is zero. With high inflation rate, the real rate of return is 'very' negative, which explains why people reduce cash holding.

Though interests are paid on saving deposits, the rate is usually less than the inflation rate. This is particularly so if the inflation rate is high. Thus the real rate of returns to saving balances is still negative. People will switch to other assets with positive real rates.

2003/AL/II/2

- (a) Deflation (or negative inflation) is a sustained fall in the general price level.
Disinflation is a reduction in the inflation rate (i.e., a slower rise in the general price level).
- (b) According to the Fisher equation, the nominal interest rate is equal to the sum of the real interest rate and the expected inflation rate.
Since expected deflation equals the negative of expected inflation, we can express the nominal rate as the real rate *less* expected deflation. Hence, the real rate will exceed the nominal rate when people expect deflation.

2007/AL/II/1(a)

- S*: Change in the general price level over time.
D: Negative inflation (sustained fall in the price level) vs. reduction in the inflation rate (sustained increase in the price level at a slower rate).

2012/DSE/II/1(a)

- (c) The opportunity cost is the nominal return of the ibonds. (2)
- (d) The ibonds help preserve the purchasing power of the invested sum of money because the interest return of ibonds will increase at the same rate as actual inflation (i.e. the real interest rate on ibonds is virtually fixed by the government). (2)

2013/DSE/11/3

(a) Nominal interest rate (R) = expected inflation rate + real interest rate (r) (2)

(b) No, R will be lower than r only when the expected inflation rate is negative. But the existence of actual deflation does not imply that the deflation is expected.

OR

Yes, because people may expect deflation beforehand and an expected deflation will result in a nominal interest rate being lower than real interest rate.

OR

Yes, because the realized (actual) real interest rate will be higher than the nominal interest rate when there is actual deflation. (3)

2014/DSE/11/5(c)(ii)

Marlene would lose, because (1)

given the 15% rate of actual nominal return and the 5% rate of actual inflation, her actual real rate of return equals 10% (= 15% - 5%), which falls short of her expected real rate of return (12%). (2)

2020/DSE/11/5a

5 a. Nominal interest rate. Since money is a non income generating asset (nominal return = 0), holding money will give up nominal interest rate as income.

b) During inflation, the real value / purchasing power will decrease of the coupon.

Or

The coupon is not generally acceptable as medium of exchange.

SECTION 3: GOVERNMENT BUDGET

3.1 PRINCIPLES OF TAXATION

Multiple-Choice Questions

QUESTION 1

In Hong Kong, salaries tax is normally paid by taxpayers and direct payment can be made through the bank. This practice agrees with the _____ principle of taxation.

- A. equity
- B. certainty
- C. simplicity
- D. convenience

QUESTION 2

A Japanese entrepreneur from products sold with his products in Hong Kong. Therefore, he had to pay profits tax to the Hong Kong government. Hong Kong is applying the _____ principle of taxation.

- A. equity principle
- B. residence principle
- C. world principle
- D. convenience principle

QUESTION 3

Which of the following descriptions of Hong Kong's taxation system is true?

- A. Only income derived from Hong Kong are taxable taxes.
- B. Rent is a deductible.
- C. Import duties are imposed on foreign goods in an attempt to protect local industries.
- D. The profit tax rate of corporations is the same as the standard tax rate.

QUESTION 4

The payment of salaries tax and profits tax can be made for the Payment by Cheque Service (PACS) by which taxpayers can transfer money from their bank accounts to the government. This practice reflects the _____ principle of taxation.

- A. equity
- B. certainty
- C. simplicity
- D. equity

QUESTION 5

Suppose the government of an economy announces that the people will have to pay a general sales tax of 20% of the selling price when they purchase any goods and services. The government also launches a series of programmes to reassure that the public will accept the new tax. Which of the following taxation principles is illustrated by the above measure of the government?

- A. equity
- B. certainty
- C. simplicity
- D. convenience