Exam Strategies

The following Q & A can be helpful in preparing for the HKCE Economics Examination:

Q ***What should I pay attention to in doing Paper 1?***

A

- Read the questions carefully.
- Look for the question commands, for example:
  define, state, find, point out, what is, list, identify, indicate, show, suggest, explain, give reason(s), give example(s), draw, distinguish, compare and calculate, ect.
- Circle or highlight the important words and key information in the questions.
- Do not rush to answering the questions without understanding what the questions really ask.
- Do not write unnecessary long answers with empty content. Students may refer to the mark of each question to determine the appropriate length of answers.
- Avoid using arrows or non-standardised symbols in the verbal answer.
- Mind the handwriting.
- Leave some blank lines between the answers to different questions.
- Do not attempt to write down all materials prepared or learnt in lessons. Always aim at directly answering the question with explanation.
- Do not overuse time in each question so that the time spent on each question is proportional to is mark.
- No need to start a new page for **EACH** question in Section A.
- For Section B, start each full question (not part of a question) on a new page.

Q ***What should I pay attention to in drawing diagrams?***

A

- The diagrams should be properly sized, i.e. not too big nor too small.
- Use pencil instead of pen.
- Use ruler in drawing straight lines.
- Label the axes properly without error.
- Label the lines and curves properly.
- Use lines to indicate and label the quantity or price level which are relevent in the explanation.
- Use arrow(s) to show the direction of relevant change.
- Make sure that the diagram drawn is clear, tidy and neat for the marker to read.

Learning Focus

- Measure GDP at current and constant market prices.
- Recognize the relationship among the growth rates of nominal GDP, real GDP, price levels, real GDP per-capita and population size.
- Interpret and recognize the uses of national income statistics.
- Explore the demand side and supply side factors affecting national income.
- Recognize the limitations of using national income statistics to measure living standard.

13.1 Nominal GDP and real GDP

Reminder
Nominal GDP is also called GDP at current market prices or nominal output.

- **Nominal GDP**（名義本地生產總值）measures the total market value of final output at the prices of current period.
- Because of the possible existence of inflation (deflation), an increase (a decrease) in nominal GDP does not necessarily imply more (less) real output. This is illustrated in the following example :

A. The problem caused by price movement

Reminder
Total market value of a good = Price × Quantity

- Suppose an economy produces only two goods: Good A and Good B. The following table shows their prices and quantities in 2003 and 2004 :

Year	Good A		Good B	
	Price	Quantity	Price	Quantity
2003	$200	200	$400	300
2004	$400	400	$800	600

Table 13.1 Price and quantity of goods A and B in 2003 and 2004

- $\text{Nominal GDP}_{2003} = P_{A\,(2003)} \times Q_{A\,(2003)} + P_{B\,(2003)} \times Q_{B\,(2003)}$
  $= \$200 \times 200 + \$400 \times 300$
  $= \$160\,000$
- $\text{Nominal GDP}_{2004} = P_{A\,(2004)} \times Q_{A\,(2004)} + P_{B\,(2004)} \times Q_{B\,(2004)}$
  $= \$400 \times 400 + \$800 \times 600$
  $= \$640\,000$
- As the nominal GDP in 2004 is 4 times that of 2003, it seems that the output that can be enjoyed in 2004 is also 4 times of that in 2003.
- However, this is misleading as the prices have increased in 2004. Hence, the **real GDP**（實質本地生產總值）in 2004 is calculated to remove such effect.

14 Business Cycle, Unemployment and Changes in the General Price Level

Concept Map

Business Cycle, Unemployment and

Unemployment

Conceptions

- **Labour force** = Employed population + Unemployed population
- **Employed population**: people aged 15 or above and working for payment or profit
- **Underemployed population**: employed people who want to work more.
- **Underemployment rate** = $\frac{\text{Number of underemployed persons}}{\text{Total labour force}} \times 100\%$
- **Unemployed population**: people aged 15 or above, not working but seeking work.
- **Unemployment rate** = $\frac{\text{Number of unemployed persons}}{\text{Total labour force}} \times 100\%$
- **Costs of unemployment**

To the unemployed	To society
– Fall in living standard	– Financial burden
– Loss of skills	– Loss of output
– Psychological problems	– Social problems

Demand-supply analysis

- Unemployment implies excess supply of labour.
- This may happen because:
  - workers are unwilling to accept lower wage rate, or
  - a minimum wage rate is set above the equilibrium wage rate.
- Analysis:

Unemployment ↑ when	Unemployment ↓ when
– Labour supply increases	– Labour supply decreases
– Labour demand decreases	– Labour demand increases
– Minimum wage rate increases	– Minimum wage rate decreases

Changes in the General Price Level

Changes in the general price level

- Inflation:
  A continuous increase in the general price level
- Deflation:
  A continuous decrease in the general price level

Economic effects of inflation and deflation

Effects on	Inflation	Deflation
Purchasing power of money	decreases	increases
Real income and living standard	Depends on the growth rate of nominal income and rate of price change	
Cost of living	increases	decreases
Income distribution	Debtors, banks, insurance companies, companies issuing bonds and employers gain	Creditors, depositors, insurance policy holders, bondholders and employees gain
Fixed income recipients	lose	gain
Government tax revenue	increases	decreases
Choice of wealth	physical form	money
Production cost and net exports	Cost increases and net exports decreases	Cost decreases and net exports increases

- Measurement of changes in the general price level
  - **CPIs**:
    Rate of change of general price level =
    $$\frac{\text{CPI current period} - \text{CPI in previous period}}{\text{CPI in previous period}} \times 100\%$$
  - **Implicit GDP deflator**:
    Rate of change of general price level
    $$\frac{\text{GDP deflator in current period} - \text{GDP deflator in previous period}}{\text{GDP deflator in previous period}} \times 100\%$$

Business cycle

	Real GDP growth rate	Inflation rate	Unemployment rate
Prosperity	high	high	low
Recession	falling	falling	rising
Depression	low (may be negative)	low (may be negative)	high
Recovery	rising	rising	falling

Exam Question Analysis

Exam Question Distribution

Topics	Short and Structured Questions (Year)	Multiple-choice Questions (Year)
Labour force and the unemployed population	–	94 (37), 96 (33), 98 (24, 28)
Unemployment rate	95 (A: 6), 00 (A: 7), 03 (A: 6)	97 (26), 98 (28), 99 (32) , 02 (29), 04 (33)
Supply-demand Analysis of unemployment	96 (B: 12a), 97 (A: 2), 99 (B: 10a)	–
Costs of unemployment	94 (B: 10ai)	95 (37) , 02 (31)
Identifying / Measuring inflation or deflation	98 (A: 7a), 01 (B: 9d), 04 (A: 5b)	94 (34), 95 (33), 96 (32), 97 (25, 27, 31)
Economic effects of price changes	96 (A: 6), 98 (A: 7b), 99 (B: 11c), 02 (B: 12bii), 03 (B: 9c)	94 (38), 95 (36), 97(25), 99 (33), 00 (39) , 01 (31, 32)
Business cycle	95 (A: 7), 00 (B: 6)	94 (35, 36), 95 (35), 96 (59), 97 (30), 98 (27), 99 (27, 28), 00 (37), 01 (38), 02 (28), 04 (32)

Errors and Improvement

Wrong concepts / Common errors	Correct concepts
On labour force 1. All people aged 15 or above are included in the labour force. 2. Unpaid family workers are excluded from the labour force. 3. The underemployed people are unemployed.	*On labour force* 1. Full-time housewives and students (without any part-time job), retired people, permanently disabled, prisoners and illegal immigrants are excluded from the labour force. 2. Unpaid family workers are classified as the employed in the labour force. 3. The underemployed people are employed.
On unemployment rate 1. If total labour force increases, unemployment rate must decrease. 2. If the (absolute) increase in total labour force and the number of unemployed are the same, then unemployment rate is constant.	*On unemployment rate* 1. If the extra labour force cannot find jobs, so that the percentage increase in the number of unemployed is greater than that of total labour force, unemployment rate will increase. 2. As the percentage increase in the number of unemployed is greater than that of total labour force, unemployment rate will increase.

Reminder

CDs may be returned by depositors to the banks, RLBs or DTCs. When the returned CDs are kept within the monetary sector, they do not represent any store of value of the depositors. Thus CDs held inside the monetary sector are not money.

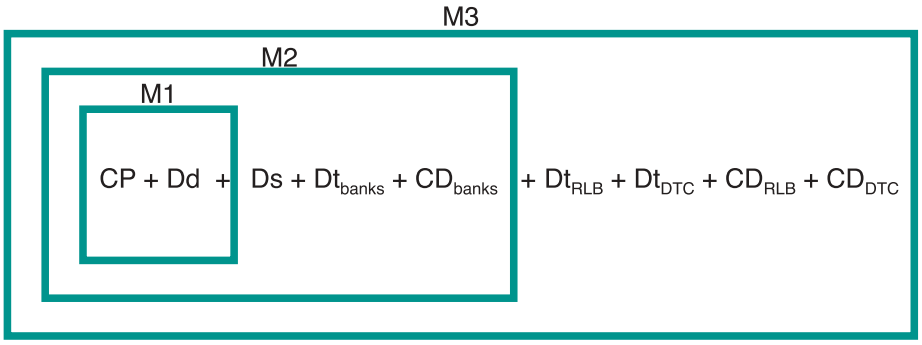

Figure 15.1 The relationships among M1, M2 and M3

Concept Explorer 15.2

Cash vs money

Is there anything money but not cash? Is there anything cash but not money? Is there anything both money and cash?

Solution

When cash is possessed by the public, it is money. This is because the cash held will be used as a medium of exchange in market transaction.

However, when the public deposit cash, the cash will be kept by banks as reserves ¡] x‡ ˇ ¡ ^. Banks do not use these reserves for their own expenses. They will either pay the reserves to the public who withdraw deposits, or lend them to other borrowers. Since both are not market transactions of final output, the reserves are not used as a medium of exchange. Therefore, cash reserves kept inside banks are not money.

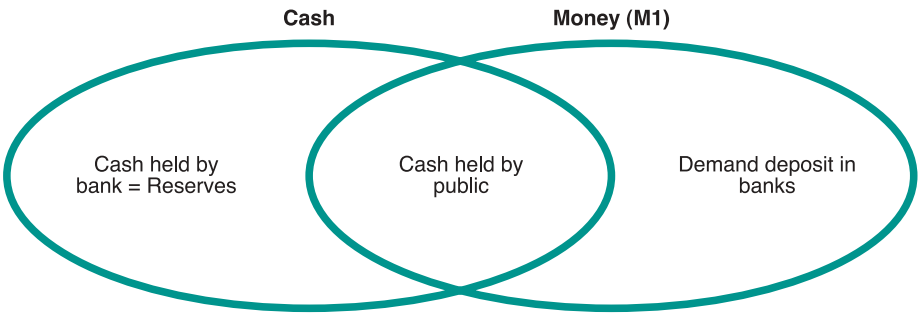

Figure 15.2 The relationship between cash and money