

CFA® SAMPLE QUESTION – LEVEL I Economics

Q: In the later stages of an economic expansion, the central bank is MOST LIKELY to:

CORRECT ANSWER:

(b) Sell government securities and/or increase the reserve requirements.

In the later stages of an economic expansion, low unemployment and rising productive capacity utilization will result in greater inflationary pressures.

In response, the central bank will most likely respond by tightening monetary policy. The central bank will attempt to do this through selling government securities to decrease the supply of circulating money. It may also simultaneously raise the policy rate to increase the cost of banks that borrow to meet overnight capital requirements. The central bank will then resort to increasing the reserve requirement if it targets a large decrease in the money supply.

Choice "a" is incorrect. If the central bank buys government securities, it will inject more money into the banking system. This is contradictory to tightening monetary policy that the central bank will use in the later stages of an expansion.

Choice "c" is incorrect. Decreasing the reserve requirements will create more money in circulation. This is contradictory to tightening monetary policy that the central bank will use in the later stages of an expansion.



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