

Chapter 01: Understand Personal Finance

True / False

1. Financial literacy is knowledge of facts, concepts, principles, and technological tools that are fundamental to being smart about money.

- a. True
- b. False

ANSWER: True

2. Being financially responsible is being knowledgeable about facts, concepts, principles, and technological tools that are fundamental to being smart about money.

- a. True
- b. False

ANSWER: False

3. Personal finance involves how people spend, save, protect, and invest their financial resources.

- a. True
- b. False

ANSWER: True

4. Financial success is defined as having high wealth.

- a. True
- b. False

ANSWER: False

5. Financial security is defined as having a high income.

- a. True
- b. False

ANSWER: False

6. People who save and invest are much more likely to have funds for future consumption.

- a. True
- b. False

ANSWER: True

7. Standard of living refers to an individual's level of spending and consumption.

- a. True
- b. False

ANSWER: False

8. Standard of living is what individuals or groups aspire to attain, and level of living is the level of wealth, comfort, materials goods, and necessities one is currently living with.

- a. True
- b. False

ANSWER: True

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9. Financial security or wealth requires you to spend less than you earn.

- a. True
- b. False

ANSWER: True

10. A business cycle is a wavelike pattern of economic activity that includes an expansion, peak, contraction, and trough.

- a. True
- b. False

ANSWER: True

11. The expansion phase is the preferred stage of the economic cycle.

- a. True
- b. False

ANSWER: True

12. As it is impossible to make precise forecasts about economic trends, we can ignore inflation and interest rates when planning our finances.

- a. True
- b. False

ANSWER: False

13. The typical U.S. recession is marked by an average economic decline of 2 percent.

- a. True
- b. False

ANSWER: True

14. The gross domestic product broadly measures the nation's economic health.

- a. True
- b. False

ANSWER: True

15. Procyclical economic indicators move in the same direction as the economy.

- a. True
- b. False

ANSWER: True

16. The index of leading economic indicators is a composite index reported monthly that suggests the future direction of the U.S. economy.

- a. True
- b. False

ANSWER: True

17. The index of leading economic indicators averages eight components of growth from various segments of the economy.

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- a. True
- b. False

ANSWER: False

18. Leading economic indicators are relied upon to measure the state of the economy at any point in time.

- a. True
- b. False

ANSWER: False

19. An example of inflation is an increase in the price of coffee, gasoline, or other commodities.

- a. True
- b. False

ANSWER: True

20. A steady rise in the general level of prices is called inflation.

- a. True
- b. False

ANSWER: True

21. Deflation is a period of declining prices.

- a. True
- b. False

ANSWER: True

22. Deflation occurs in an economy when there is an expansion in the money supply.

- a. True
- b. False

ANSWER: False

23. The amount of goods and services that one's income will buy is called purchasing power.

- a. True
- b. False

ANSWER: True

24. Retirees or others on fixed incomes suffer during times of moderate to high inflation.

- a. True
- b. False

ANSWER: True

25. NOMINAL INCOME is adjusted for inflation and thus reflects the actual purchasing power of one's income.

- a. True
- b. False

ANSWER: False

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26. In times of high inflation, personal incomes generally keep up with the inflation rate.

- a. True
- b. False

ANSWER: False

27. The consumer price index is a broad measure of price changes in all goods and services purchased for consumption by urban households.

- a. True
- b. False

ANSWER: True

28. When prices rise, the dollar's purchasing power declines by the same percentage.

- a. True
- b. False

ANSWER: False

29. The term interest refers to the price of money.

- a. True
- b. False

ANSWER: True

30. Interest rates on home mortgages and other loans tend to fall during high inflation.

- a. True
- b. False

ANSWER: False

31. All things considered, a saver who earns 4 percent interest on a savings account when the rate of inflation is 4 percent is losing real purchasing power.

- a. True
- b. False

ANSWER: True

32. Smart investors recognize that inflation risk is higher for long-term lending than for short-term lending.

- a. True
- b. False

ANSWER: True

33. When forecasting long-term inflation rates for financial planning purposes, it is better to err on the low side rather than on the high side.

- a. True
- b. False

ANSWER: False

34. Interest rates earned on short-term investments are generally lower than those earned on longer-term investments.

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- a. True
- b. False

ANSWER: True

35. The rate of interest and the inflation rate generally move in the same directions; when one goes up, the other also goes up.

- a. True
- b. False

ANSWER: True

36. When one forgoes buying a new TV because they spend the money on college books, the TV is the opportunity cost of buying the books.

- a. True
- b. False

ANSWER: True

37. By considering opportunity costs, we can optimize our financial decisions.

- a. True
- b. False

ANSWER: True

38. The opportunity cost of a decision is the value of the next best alternative that must be foregone and addresses the personal consequences of choices.

- a. True
- b. False

ANSWER: True

39. Marginal cost is the additional cost of one more unit of something.

- a. True
- b. False

ANSWER: True

40. According to economic theory, people will seek additional utility if marginal utility exceeds marginal cost.

- a. True
- b. False

ANSWER: True

41. Most financially successful taxpayers must pay federal income taxes at the 22 percent marginal tax rate.

- a. True
- b. False

ANSWER: True

42. Financially successful people often pay U.S. federal income taxes at the 22 percent, or higher, marginal tax rate.

- a. True

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b. False

ANSWER: True

43. One's average federal income tax rate is generally equal to one's marginal tax rate.

a. True

b. False

ANSWER: False

44. Taxes on tax-sheltered income are avoided, whereas taxes on tax-exempt income are postponed.

a. True

b. False

ANSWER: False

45. Tax-exempt income has a greater tax advantage when compared to tax-sheltered income.

a. True

b. False

ANSWER: True

46. Simple interest is the interest computed on the principal only, without adding the interest to the principal to determine future interest.

a. True

b. False

ANSWER: True

47. The simple-interest formula assumes that interest earned is withdrawn each year annually.

a. True

b. False

ANSWER: True

48. Compounding occurs when interest earned is added to the principal so that, from that moment on, the added interest also earns interest.

a. True

b. False

ANSWER: True

49. Simple interest will produce larger investment values than compound interest.

a. True

b. False

ANSWER: False

50. Simple interest is based on time value of money considerations.

a. True

b. False

ANSWER: False

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51. Earning interest on interest is the effect of compounding.

- a. True
- b. False

ANSWER: True

52. Compounding is the basis for all time value of money considerations.

- a. True
- b. False

ANSWER: True

53. Future value is the valuation of an asset at some future date.

- a. True
- b. False

ANSWER: True

54. Present value is also known as direct value.

- a. True
- b. False

ANSWER: False

55. Present value is the current value of an asset (or stream of assets) of a future value (or stream of assets) to be received on a future date.

- a. True
- b. False

ANSWER: True

56. The present value of an annuity is the future worth of a stream of payments to be received in the future.

- a. True
- b. False

ANSWER: False

57. Obsolete knowledge is what we believe may have been valid at one time.

- a. True
- b. False

ANSWER: True

58. Financial well-being is a state in which a person can feel secure in their financial future.

- a. True
- b. False

ANSWER: True

59. Capitalism defines the U.S. economy.

- a. True
- b. False

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ANSWER: True

60. The sharing economy refers to P2P access to goods and services.

- a. True
- b. False

ANSWER: True

Multiple Choice

61. What aspect or aspects does the study of personal finance entail?

- a. How people spend their financial resources
- b. How people save their financial resources
- c. How people invest their financial resources
- d. All of these

ANSWER: d

62. Drew and Alex are saving monthly to buy a home, but they are currently renting an apartment. What is the apartment considered to be a part of?

- a. Their standard of living
- b. Their level of living
- c. Their savings
- d. Personal inflation rate

ANSWER: b

63. To achieve one's financial objectives, it is necessary to restrain from which of the following?

- a. Current consumption
- b. Savings
- c. Investment
- d. Future earnings

ANSWER: a

64. How is financial success defined?

- a. As the achievement of a financially secure retirement
- b. As the achievement of desired, planned, or attempted financial aspirations
- c. As the achievement of vast wealth
- d. As the achievement of a comfortable lifestyle

ANSWER: b

65. Which of the following should be the easiest for a person to forecast?

- a. Interest rates
- b. Inflation
- c. Income
- d. Economic growth

ANSWER: c

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66. Which of the following is the preferred phase of the economic cycle?

- a. Expansion
- b. Peak
- c. Trough
- d. Contraction

ANSWER:

a

67. Which of the following is high during a period of expansion?

- a. Unemployment
- b. Inflation
- c. Interest rates
- d. Retail sales

ANSWER:

d

68. Which economic phase makes it easy for consumers to buy homes, cars, and other goods?

- a. Expansion
- b. Trough
- c. Peak
- d. Contraction

ANSWER:

a

69. Interest rates and inflation rise at what phase of the economic cycle?

- a. Expansion
- b. Peak
- c. Contraction
- d. Trough

ANSWER:

b

70. Which of the following statements is correct?

- a. Long-term interest rates are generally higher than short-term interest rates.
- b. Stock market investors are positively affected when inflation rises.
- c. The degree of inflation risk is higher for short-term lending.
- d. During times of high inflation, interest rates for cars, home loans, and credit cards fall.

ANSWER:

a

71. The Great Recession began in 2007. How long did it last?

- a. 18 months
- b. 12 months
- c. Four years
- d. Continues to this day

ANSWER:

a

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72. Stock prices tend to be lower, making it a good time to invest in stocks, when the economy is

- a. in the prosperity of the expansion stage.
- b. in the trough of a recession.
- c. in a depression.
- d. entering the recovery stage.

ANSWER:

b

73. Which of the following helps to understand the future direction of the economy?

- a. Interest rates and inflation
- b. Interest rates and the gross domestic product
- c. The consumer confidence index and the index of leading economic indicators
- d. Inflation and the index of leading economic indicators

ANSWER:

c

74. Which of the following measures the value of all goods and services produced in the United States?

- a. Consumer price index
- b. Index of leading economic indicators
- c. Federal funds rate
- d. Gross domestic product

ANSWER:

d

75. Which of the following economic indicators tends to move in the opposite direction of where the economy is headed?

- a. Procyclical indicators
- b. Employment rate
- c. Gross domestic product
- d. Countercyclical indicators

ANSWER:

d

76. Cameron Palmer received a \$2,500 raise this year. This raise increased his salary as an associate TV producer from \$50,000 to \$52,500. What percentage increase in nominal income did Cameron receive?

- a. 2.5 percent
- b. 5.9 percent
- c. 5.0 percent
- d. 7.8 percent

ANSWER:

c

77. Jeremiah and Jasmine's family income increased from \$60,000 to \$63,600 in the past year. Inflation was 2 percent over the same time period. Which of the following is true regarding Jeremiah and Jasmine's income?

- a. Their nominal income increased 6 percent.
- b. Their nominal income increased 5 percent.
- c. Their real income decreased 2 percent.
- d. Their real income decreased 5 percent.

ANSWER:

a

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78. Jeremiah and Jasmine's family income increased from \$60,000 to \$63,600 in the past year. Inflation was 2 percent over the same time period. How much is Jeremiah and Jasmine's real income after the \$3,000 increase in income?

- a. \$62,353
- b. \$61,765
- c. \$60,000
- d. \$58,824

ANSWER:

a

79. If your income increased from \$21,000 to \$26,000 during a period when the rate of inflation was 4 percent, your real income after the raise was

- a. \$23,000.
- b. \$24,000.
- c. \$25,000.
- d. \$26,000

ANSWER:

c

80. Makayla, a college teaching assistant, received a raise of \$800 from \$18,000 to \$18,800 this year. If inflation was 3 percent over the same period, which of the following is true?

- a. Makayla's increase in real income was \$800.
- b. Makayla's increase in real income was 4.4 percent.
- c. Makayla's increase in real income was \$252.
- d. Makayla's decrease in real income was \$252.

ANSWER:

c

81. The U.S. government measures inflation using which of the following?

- a. Gross domestic product
- b. Index of leading economic indicators
- c. Consumer confidence index
- d. Consumer price index

ANSWER:

d

82. If the consumer price index was 259 in 2020 and 297 in 2022, how much did prices increase during this time period?

- a. 4.9 percent
- b. 1.2 percent
- c. 16 percent
- d. 15 percent

ANSWER:

d

83. If the consumer price index was 100 in 1984 and 297 in 2022, how much did prices increase during this period?

- a. 36 percent
- b. 72 percent
- c. 144 percent
- d. 197 percent

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ANSWER:

d

84. If the consumer price index was 100 in 1984 and 297 in 2022, the purchasing power of the dollar

- a. fell 144 percent.
- b. fell 66 percent.
- c. rose 144 percent.
- d. rose 59 percent.

ANSWER:

b

85. What is the rate of increase in prices of items purchased by a particular individual called?

- a. Personal inflation rate
- b. Consumer confidence index
- c. Federal funds rate
- d. Consumer price index

ANSWER:

a

86. Rashad earned \$48,000 in 2021. If inflation was 3.5 percent that year and continued at that rate, how long would it take for the purchasing power of that level of income to be cut in half?

- a. 57 years
- b. 24 years
- c. 20 years
- d. 10 years

ANSWER:

c

87. A rising inflation rate is good news for which of the following groups?

- a. Stock investors
- b. Borrowers
- c. Savers
- d. Lenders

ANSWER:

b

88. Which interest rate is important to focus on when trying to forecast interest rate trends in the future?

- a. Prime rate
- b. Federal funds rate
- c. Discount rate
- d. Mortgage rate

ANSWER:

b

89. Which of the following explains why rising interest rates generally depress stock prices?

- a. Businesses have to pay higher interest rates to borrow money, thus reducing their profits.
- b. Stock investors tend to take their money out of the stock market and invest in interest-paying investments.
- c. Future earnings will not be worth as much as today.
- d. All of these

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ANSWER:

d

90. Jamal spent \$300 on some new clothes rather than using this money to go to his college team's away game last weekend. The benefits of attending the game are which type of cost?

- a. Marginal
- b. Utility
- c. Opportunity
- d. Present

ANSWER:

c

91. Braxton and Kaih are shopping for their first home. They have found two houses that are nearly identical except for their locations. One house costs \$250,000 and is 15 miles from their places of employment. The second house costs \$275,000, but it is within five miles of their work. Now Braxton and Kaih are trying to decide if living 10 miles closer to their workplaces is worth the extra \$25,000 in the house cost. Which decision-making concept are they using?

- a. Opportunity cost
- b. Marginal analysis
- c. Time value of money
- d. Total utility

ANSWER:

b

92. Brandon is going to purchase a hi-def, flat-screen TV. He has decided on everything except the screen size. The unit with the 50-inch screen costs \$300, while the unit with the 55-inch screen costs \$450. In making this decision, which concept should Brandon use?

- a. Marginal utility
- b. Time value of money
- c. Total utility
- d. Marginal tax rates

ANSWER:

a

93. Daniel just received a \$2,000 end-of-year bonus from his employer. Suppose he pays a 22 percent marginal tax rate for federal income taxes. In that case, his state income tax is 5 percent, and the Social Security tax rate is 7.65 percent. Approximately, how much of the \$2,000 bonus will Daniel have left to spend on holiday gifts?

- a. \$2,000
- b. \$1,400
- c. \$1,307
- d. \$753

ANSWER:

c

94. Demarcus is a college student who has \$5,000 in savings that he earned from his summer job. He plans to leave the \$45,000 in a 6 percent certificate of deposit (CD) for three years, but his banker has asked Demarcus whether he wants the interest earned on the CD mailed to him at the end of each year or reinvested in the CD. Approximately how much more will Demarcus earn if he decides to reinvest the interest rather than withdraw the interest income each year?

- a. \$154
- b. \$5,544
- c. \$15,544

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d. \$340

ANSWER:

b

95. Grandma Wiley has just put \$10,000 into an investment earning 6 percent a year for her grandson's college education. How much will be in the account in 10 years, assuming all the interest remains in the account?

- a. \$19,200
- b. \$21,490
- c. \$17,908
- d. \$21,259

ANSWER:

c

96. Diamond and Roberto just won \$10,000 in the Pennsylvania state lottery. They now decide to spend \$3,000 and put the remaining \$7,000 in an investment earning 8 percent compounded annually. If they use the money in that investment for a vacation in five years, approximately how much will they have available to spend on that vacation?

- a. \$14,693
- b. \$10,342
- c. \$10,285
- d. \$9,800

ANSWER:

c

97. Housing values are appreciating at a rate of 3 percent a year. How much will your \$100,000 house be worth in 10 years if this appreciation rate continues?

- a. \$134,390
- b. \$146,320
- c. \$155,080
- d. \$174,410

ANSWER:

a

98. Sanjay invested \$10,000 in a security that will double in value in eight years. Approximately what annual rate of return is this investment making?

- a. 9.0 percent
- b. 7.2 percent
- c. 6.3 percent
- d. 5.8 percent

ANSWER:

a

99. The price of houses has been increasing at an annual rate of 6 percent nationally. How many years will it take for costs to double at this rate?

- a. 7
- b. 12
- c. 15
- d. 18

ANSWER:

b

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100. Alyssa has the opportunity to receive \$15,000 now or \$18,000 in four years. If Alyssa can earn 6 percent on her investments, what is the present value of the \$15,000 payment?

- a. \$15,000
- b. \$13,785
- c. \$11,881
- d. \$14,258

ANSWER: d

101. What is the current value of an asset to be received in the future?

- a. Present value
- b. Future value
- c. A benefit
- d. Inflation

ANSWER: a

102. Which of the following describes the present value of a stream of payments?

- a. Inflated
- b. Estimated
- c. Future
- d. Current

ANSWER: d

103. What is stagnant economic growth and high unemployment accompanied by rising prices called?

- a. Stagflation
- b. Deleveraging
- c. Implosion
- d. Inversion

ANSWER: a

104. Which of the following terms describes a period when credit usage shrinks?

- a. Leveraging
- b. Deleveraging
- c. Compounding
- d. Tax-sheltering

ANSWER: b

105. Occasionally, the economy will dip into recession, emerge from the recession with a brief period of growth, then fall back into recession. What is this phenomenon called?

- a. Depression
- b. Recession
- c. Double dip recession
- d. Stagflation

ANSWER: c

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106. What is a method that compares cash flows across time, either as what a future cash flow is worth today (present value) or what an investment made today will be worth in the future (future value) called?

- a. Time-value of money
- b. Compounding
- c. Simple interest
- d. Marginal analysis

ANSWER:

a

107. Tyler's pay raise was \$3,500 in the past year. Inflation was 4 percent over the same time period. How much is Tyler's pay raise in real income?

- a. \$3,500
- b. \$3,365
- c. \$4,015
- d. \$835

ANSWER:

b

108. Jackson Corporation's 2019 sales were \$5 million. If sales increase by 10 percent per year, what will sales be in 2024?

- a. \$8.053 million
- b. \$13.75 million
- c. \$11.52 million
- d. \$10 million

ANSWER:

a