

# STUDY SESSION

# 4

## Economics

### Microeconomics and Macroeconomics

Candidates should be familiar with the material covered in the prerequisite economics readings available in your Candidate Resources on the CFA Institute website:

- Demand and Supply Analysis: Introduction
- Demand and Supply Analysis: Consumer Demand
- Demand and Supply Analysis: The Firm

This study session provides an introduction to fundamental microeconomic and macroeconomic concepts relevant to investment management practice. The first reading in this study session covers selected concepts and tools of demand and supply analysis. The second reading describes revenues and cost structures associated with the different types of markets in which firms sell output. The third reading covers aggregate output and income measurement, aggregate demand and supply analysis, and the analysis of the factors affecting economic growth. The final reading explains the effects of business cycles on businesses and investment markets.

#### READING ASSIGNMENTS

<b>Reading 14</b>	Topics in Demand and Supply Analysis by Richard V. Eastin, PhD, and Gary L. Arbogast, PhD, CFA
<b>Reading 15</b>	The Firm and Market Structures by Richard G. Fritz, PhD, and Michele Gambera, PhD, CFA
<b>Reading 16</b>	Aggregate Output, Prices, and Economic Growth by Paul R. Kutasovic, PhD, CFA, and Richard G. Fritz, PhD
<b>Reading 17</b>	Understanding Business Cycles by Michele Gambera, PhD, CFA, Milton Ezrati, and Bolong Cao, PhD, CFA

**LEARNING OUTCOMES****READING 14. TOPICS IN DEMAND AND SUPPLY ANALYSIS**

The candidate should be able to

- a** calculate and interpret price, income, and cross-price elasticities of demand and describe factors that affect each measure;
- b** compare substitution and income effects;
- c** distinguish between normal goods and inferior goods;
- d** describe the phenomenon of diminishing marginal returns;
- e** determine and describe breakeven and shutdown points of production;
- f** describe how economies of scale and diseconomies of scale affect costs.

**READING 15. THE FIRM AND MARKET STRUCTURES**

The candidate should be able to:

- a** describe characteristics of perfect competition, monopolistic competition, oligopoly, and pure monopoly;
- b** explain relationships between price, marginal revenue, marginal cost, economic profit, and the elasticity of demand under each market structure;
- c** describe a firm's supply function under each market structure;
- d** describe and determine the optimal price and output for firms under each market structure;
- e** explain factors affecting long-run equilibrium under each market structure;
- f** describe pricing strategy under each market structure;
- g** describe the use and limitations of concentration measures in identifying market structure;
- h** identify the type of market structure within which a firm operates.

**READING 16. AGGREGATE OUTPUT, PRICES, AND ECONOMIC GROWTH**

The candidate should be able to:

- a** calculate and explain gross domestic product (GDP) using expenditure and income approaches;
- b** compare the sum-of-value-added and value-of-final-output methods of calculating GDP;
- c** compare nominal and real GDP and calculate and interpret the GDP deflator;
- d** compare GDP, national income, personal income, and personal disposable income;
- e** explain the fundamental relationship among saving, investment, the fiscal balance, and the trade balance;
- f** explain the IS and LM curves and how they combine to generate the aggregate demand curve;
- g** explain the aggregate supply curve in the short run and long run;

- h** explain causes of movements along and shifts in aggregate demand and supply curves;
- i** describe how fluctuations in aggregate demand and aggregate supply cause short-run changes in the economy and the business cycle;
- j** distinguish between the following types of macroeconomic equilibria: long-run full employment, short-run recessionary gap, short-run inflationary gap, and short-run stagflation;
- k** explain how a short-run macroeconomic equilibrium may occur at a level above or below full employment;
- l** analyze the effect of combined changes in aggregate supply and demand on the economy;
- m** describe sources, measurement, and sustainability of economic growth;
- n** describe the production function approach to analyzing the sources of economic growth;
- o** distinguish between input growth and growth of total factor productivity as components of economic growth.

## READING 17. UNDERSTANDING BUSINESS CYCLES

The candidate should be able to:

- a** describe the business cycle and its phases;
- b** describe how resource use, housing sector activity, and external trade sector activity vary as an economy moves through the business cycle;
- c** describe theories of the business cycle;
- d** describe types of unemployment and compare measures of unemployment;
- e** explain inflation, hyperinflation, disinflation, and deflation;
- f** explain the construction of indices used to measure inflation;
- g** compare inflation measures, including their uses and limitations;
- h** distinguish between cost-push and demand-pull inflation;
- i** interpret a set of economic indicators and describe their uses and limitations.