Daily Subject wise Quiz Day 58 Economy VIII (Online Prelims Test)

1) Consider the following statements with respect to Inflation

1. If the money supply increases than the economy's ability to produce goods and services, then inflation will also increase.
2. During the high inflation period, the government can reduce the spending to decrease the money circulation in the country.

Which of the above statements is/are correct?

a. 1 only

b. 2 only

c. Both 1 and 2

d. Neither 1 nor 2

Answer : c

Inflation

- Inflation refers to the general increase in the prices of goods and services in an economy over a period of time.
- If the money supply increases than the economy's ability to produce goods and services, then inflation will also increase.
- During the high inflation period, the government can reduce the spending to decrease the money circulation in the country.
- Therefore decreased money circulation helps in controlling inflation.
- Sterilization is the process under which the RBI absorbs excess liquidity in the economy.
- Reserve Bank of India is the authority to control inflation through monetary policies which it does by increasing bank rates, repo rates, cash reserve ratio, buying dollars, regulating money supply and availability of credit.

2) Which of the following statements is/are correct about Devaluation?

1. When there is upwards market pressure on the currency to appreciate, the central bank will artificially devalue.
2. Devaluation of currency means fixing the value of currency is in conjunction with the value of a basket of predetermined currency.

Select the correct answers using the codes given below

a. 1 only

b. 2 only

c. Both 1 and 2

d. Neither 1 nor 2

Answer : a

Devaluation

- Devaluation occurs when a country intentionally reduces the value of its currency relative to one or more foreign countries.
- When the country follows a fixed exchange rate regime the government constantly has to revalue and devalue the currency to maintain the pegged exchange rate.
- When there is upwards market pressure on the currency to appreciate, the central bank will artificially devalue the currency by buying up foreign reserves.
- Devaluation of currency means reduction in the Value of a currency vis-à-vis major internationally traded currencies

3) Which of the following statements is/are correct about Currency Depreciation

1. Currency depreciation is a fall in the value of a currency in a floating exchange rate system.
2. Macroeconomic policies and Equity market are some of the factors that influence the value of a currency.

Select the correct answers using the codes given below

a. 1 only

b. 2 only

c. Both 1 and 2

d. Neither 1 nor 2

Answer : c

Currency Depreciation

- Currency depreciation is a fall in the value of a currency in a floating exchange rate system.
- In a floating exchange rate system, market forces (based on demand and supply of a currency) determine the value of a currency.
- Rupee depreciation means that the rupee has become less valuable concerning the dollar.
- It means that the rupee is now weaker than it used to be earlier.
- For example, USD 1 used to equal Rs. 70, now USD 1 is equal to Rs. 76, implying that the rupee has depreciated relative to the dollar i.e. it takes more rupees to purchase a dollar.
- Currency depreciation can occur due to factors such as economic fundamentals, interest rate differentials, political instability, or risk aversion among investors.
- Some of the factors that influence the value of a currency:

1. Inflation
2. Interest rates
3. Trade deficit
4. Macroeconomic policies
5. Equity market

4) Which of the following statements is/are correct about Adjustable Peg

1. It is an exchange rate policy in which a currency is pegged or fixed to a major currency such as the U.S. dollar.
2. It is a hybrid system seeks to take advantage of the benefits from both a fixed peg and freely floating currency.

Select the correct answers using the codes given below

a. 1 only

b. 2 only

c. Both 1 and 2

d. Neither 1 nor 2

Answer : c

Adjustable Peg

- An adjustable peg is an exchange rate policy in which a currency is pegged or fixed to a major currency such as the U.S. dollar or euro, but which can be readjusted to account for changing market conditions or macroeconomic trends.
- An adjustable peg describes a currency regime where a country allows its currency's value to float on the market, but only within a narrow band before the central bank intervenes to restore the peg.
- Typically, the currency is allowed to fluctuate within a narrow band before the peg is restored; however, the peg itself can be reviewed and adjusted according to economic conditions and macro trends.
- The adjustable peg is a hybrid system seeks to take advantage of the benefits from both a fixed peg and freely floating currency.
- An example of managed currency or "dirty float", these periodic adjustments are usually intended to improve the country's competitive position in the export market and world financial stage.
- A crawling peg is a system of exchange rate adjustments in which a currency with a fixed exchange rate is allowed to fluctuate within a narrow band of rates.

5) Consider the following statements with respect to Consumer Price Index (CPI)

1. It is a theoretical Index that measures relative cost of living over times or region
2. The percentage change in this index over a period of time gives the amount of inflation over that specific period.

Which of the above statements is/are correct?

a. 1 only

b. 2 only

c. Both 1 and 2

d. Neither 1 nor 2

Answer : b

Consumer Price Index (CPI)

- Consumer price index (CPI) is a detailed measure used for the estimation of price changes in a basket of goods and services representative of consumption expenditure in an economy.
- It measures changes in the price level of a market basket of consumer goods and services purchased by households.
- The CPI is released by The National Statistical Organisation (NSO), Ministry of Statistics and Programme Implementation. The CPI for every month is released in the succeeding month.
- CPI is used to measure Inflation, The percentage change in this index over a period of time gives the amount of inflation over that specific period, i.e. the increase or decrease in prices of a basket of goods or services consumed.