

Unit 7

Balance of Payments

1. Which of the following describes a fixed exchange rate system?
 - a) The exchange rate is determined by market demand and supply.
 - b) The government pegs the currency value to a basket of foreign currencies or gold.
 - c) The value of the currency fluctuates freely in the market.
 - d) There is no exchange rate, as the currency is not traded internationally.

2. A flexible exchange rate system is determined by:
 - a) Government policies and regulations.
 - b) The supply and demand for foreign currencies in the market.
 - c) Central bank interventions.
 - d) The value of a currency pegged to another currency.

3. Which of the following is a merit of a fixed exchange rate system?
 - a) More policy independence for the government.
 - b) Greater stability in international trade.
 - c) Increased currency volatility.
 - d) Less demand for foreign exchange reserves.

4. What is a major demerit of a flexible exchange rate?
 - a) Greater stability in international trade
 - b) It can lead to currency volatility and instability
 - c) Automatic adjustment to trade balances
 - d) No need for government intervention

5. In a fixed exchange rate system, the government:
 - a) Allows market forces to determine the currency value.
 - b) Intervenes to maintain the currency's peg to a stable asset.
 - c) Does not intervene in currency markets.
 - d) Lets currency values fluctuate based on market demand.

6. What could be a disadvantage of a fixed exchange rate system?
 - a) Automatic adjustment to market conditions
 - b) Potential loss of monetary policy independence
 - c) Reduced exchange rate volatility
 - d) No requirement for foreign exchange reserves

7. Which of the following is NOT a factor that influences the demand for a currency in a flexible exchange rate system?
 - a) Interest rates in the domestic economy
 - b) Political stability of the country
 - c) The government's monetary policy
 - d) The number of goods imported by the country

8. What is a key advantage of a flexible exchange rate system?

- a) No risk of currency speculation
 - b) The exchange rate is determined by the government
 - c) No need for foreign exchange reserves
 - d) Higher stability in trade balances
9. Which of the following is recorded in the current account of the Balance of Payments?
- a) Foreign direct investment (FDI)
 - b) Exports and imports of goods and services
 - c) Changes in foreign exchange reserves
 - d) Borrowing from international institutions
10. A country's capital account in the Balance of Payments includes:
- a) Net exports and imports of goods and services
 - b) Income from investments abroad
 - c) Investments and loans made by foreigners in the country
 - d) Purchases and sales of financial assets such as stocks and bonds
11. The financial account in the Balance of Payments records:
- a) Exports and imports of services
 - b) Foreign direct investment (FDI) and foreign portfolio investment (FPI)
 - c) Transfers of foreign currency
 - d) Government borrowing and repayments
12. What would be recorded in the errors and omissions account of the Balance of Payments?
- a) Any discrepancy between the total debit and credit entries in the accounts
 - b) Government investments in foreign markets
 - c) Borrowing from foreign banks
 - d) Exports and imports of goods
13. Which of the following is an example of a current account transaction?
- a) Purchase of government bonds by foreign investors
 - b) Export of software services to another country
 - c) Foreign direct investment in local manufacturing
 - d) Loan repayment to the International Monetary Fund (IMF)
14. The balance of payments records:
- a) All economic transactions between a country and the rest of the world
 - b) Only the trade balance between imports and exports
 - c) Only government borrowing and lending
 - d) Only private sector transactions
15. If a country has a current account deficit, it must:
- a) Borrow from abroad to cover the deficit
 - b) Reduce its exports
 - c) Increase its domestic savings
 - d) Export more goods and services than it imports
16. Which of the following factors contributed to the volatility in exchange rates post-2020?

- a) Global trade tensions
 - b) Changes in oil prices
 - c) Central bank policies during the COVID-19 pandemic
 - d) All of the above
17. The introduction of digital currencies like Bitcoin could potentially impact:
- a) The Balance of Payments of countries
 - b) The value of traditional fiat currencies
 - c) The demand for physical currency
 - d) All of the above
18. Which of the following is a challenge when dealing with exchange rate volatility?
- a) Increased predictability in trade prices
 - b) Risk of currency devaluation or overvaluation
 - c) Higher foreign investment
 - d) Stabilized international trade
19. A currency crisis typically occurs when:
- a) A government raises its interest rates to attract foreign investment
 - b) A country's currency depreciates rapidly, causing economic instability
 - c) A country's exports exceed imports significantly
 - d) A country's central bank injects more money into the economy
20. To stabilize an exchange rate, a central bank can:
- a) Allow the currency to fluctuate freely
 - b) Intervene by buying or selling the currency in the market
 - c) Increase interest rates permanently
 - d) Increase government debt
21. A country's exchange rate is most likely to appreciate if:
- a) Its interest rates fall relative to other countries
 - b) Its exports decrease significantly
 - c) The demand for its currency rises in the foreign exchange market
 - d) Foreign investors pull out of the market
22. In a fixed exchange rate system, the government may use:
- a) High interest rates to encourage capital inflows
 - b) Large foreign exchange reserves to maintain the peg
 - c) Market forces to determine the currency's value
 - d) A floating exchange rate
23. Which of the following is a merit of a flexible exchange rate system?
- A) It reduces the risk of currency speculation.
 - B) It allows the central bank to control inflation.
 - C) It automatically adjusts to changes in the economy.
 - D) It stabilizes the currency value in the long run.
24. What is the major demerit of a fixed exchange rate?
- A) The central bank has to use its reserves to maintain the rate.

- B) There is no fluctuation in the currency value.
 - C) Currency speculation is high.
 - D) Inflation is automatically controlled.
25. Under which of the following exchange rate systems does the currency value fluctuate freely based on demand and supply?
- A) Fixed exchange rate
 - B) Managed float
 - C) Flexible exchange rate
 - D) Pegged exchange rate
26. Which of the following can lead to a depreciation of the Indian Rupee in a flexible exchange rate system?
- A) Increase in India's export demand
 - B) Increase in India's foreign exchange reserves
 - C) Higher inflation in India compared to trading partners
 - D) Strong economic growth in India
27. What does the Balance of Payments (BOP) of a country represent?
- A) The total debt of the country.
 - B) The total value of goods and services produced.
 - C) The record of all economic transactions between the country and the rest of the world.
 - D) The monetary reserves of the central bank.
28. Which of the following is included in the current account of India's Balance of Payments?
- A) Foreign Direct Investment (FDI)
 - B) Exports and imports of goods and services
 - C) Borrowing from international institutions
 - D) Foreign exchange reserves
29. What does the capital account in the Balance of Payments reflect?
- A) The income earned by a country from abroad.
 - B) The inflow and outflow of financial assets.
 - C) The imports and exports of goods and services.
 - D) The foreign exchange reserves held by the central bank.
30. Which of the following is an example of a transaction in the financial account of the BOP?
- A) A foreign loan taken by the government.
 - B) The export of Indian software services.
 - C) The remittance sent by an Indian migrant to his family.
 - D) Payment for imported crude oil.
31. Which of the following is NOT part of the current account in the BOP?
- A) Trade balance (exports and imports)
 - B) Foreign direct investment
 - C) Net income from abroad

D) Remittances

32. What happens when the demand for foreign currency exceeds its supply in the forex market?
- A) The value of the domestic currency appreciates.
 - B) The value of the domestic currency depreciates.
 - C) The domestic currency stays stable.
 - D) The central bank intervenes to control the situation.
33. Which of the following factors does NOT influence the demand for a currency?
- A) Interest rate differentials between countries.
 - B) Government policies and regulations.
 - C) Speculation about future currency movements.
 - D) Changes in weather patterns.
34. If India's export sector grows rapidly, what is likely to happen to the value of the Indian Rupee?
- A) The Indian Rupee will appreciate.
 - B) The Indian Rupee will depreciate.
 - C) The value of the Rupee will remain unchanged.
 - D) The Indian Rupee will become more volatile.
35. In a flexible exchange rate system, if the supply of a currency exceeds the demand, it results in:
- A) Currency appreciation
 - B) Currency depreciation
 - C) Stable exchange rate
 - D) Fixed exchange rate adjustment
36. What was a major reason for the depreciation of the Indian Rupee in recent years?
- A) Increased exports
 - B) High inflation and widening current account deficit
 - C) Strong capital inflows
 - D) Decrease in foreign investments
37. What measure did the Reserve Bank of India (RBI) take to stabilize the Rupee during the 2013 crisis?
- A) Increasing interest rates
 - B) Selling dollars in the forex market
 - C) Purchasing gold reserves
 - D) Devaluing the Rupee deliberately
38. The Indian government's "Make in India" campaign is likely to have which impact on the BOP?
- A) It will decrease exports and worsen the current account deficit.
 - B) It will increase foreign direct investment and improve the current account.
 - C) It will increase imports and decrease exports.
 - D) It will have no significant impact on the BOP.

39. What was the key factor in the recent strengthening of the Indian Rupee (2024)?
- A) Increased oil prices
 - B) Growth in foreign exchange reserves
 - C) Declining export revenues
 - D) Large-scale government borrowing
40. Which global event contributed to a recent surge in capital inflows to India, thus strengthening the Rupee?
- A) COVID-19 pandemic recovery
 - B) Brexit referendum
 - C) U.S. Federal Reserve interest rate hikes
 - D) Geo-political tensions in the Middle East
41. A country with a consistent trade deficit is likely to experience:
- A) Appreciation of its currency
 - B) Depreciation of its currency
 - C) A stable currency
 - D) An increase in foreign reserves
42. The capital account in India's Balance of Payments generally includes:
- A) Merchandise exports
 - B) Net remittances
 - C) Foreign direct investment (FDI)
 - D) Income from services
43. Which of the following factors will NOT lead to a depreciation of the Indian Rupee?
- A) Increase in India's foreign exchange reserves
 - B) High inflation in India compared to other countries
 - C) A decrease in the demand for Indian exports
 - D) High foreign portfolio investment outflows
44. The Indian government's policy to promote exports is likely to:
- A) Lead to a depreciation of the Indian Rupee.
 - B) Lead to an appreciation of the Indian Rupee.
 - C) Have no impact on the Rupee.
 - D) Increase India's current account deficit.
45. Which of the following is an example of a foreign exchange intervention by the RBI?
- A) Raising domestic interest rates
 - B) Buying or selling US dollars to manage Rupee fluctuations
 - C) Changing tax policies to control capital flows
 - D) Banning foreign investment in India
46. Which of the following describes the managed floating exchange rate system?
- A) Exchange rates are completely determined by market forces.
 - B) The government strictly fixes the exchange rate.
 - C) Exchange rates are largely determined by market forces, with some intervention by the government.

D) There is no exchange rate system in place.

47. In India's BOP, an increase in foreign direct investment will likely lead to a(n):
- A) Increase in the current account deficit
 - B) Increase in the capital account surplus
 - C) Decrease in foreign exchange reserves
 - D) Decrease in capital inflows
48. A country with a high level of foreign exchange reserves can:
- A) Maintain a fixed exchange rate system
 - B) Avoid the need for currency intervention
 - C) Finance trade deficits in the short term
 - D) Reduce inflation to zero
49. In a floating exchange rate system, which of the following factors can directly lead to a currency's depreciation?
- A) Higher domestic interest rates
 - B) Increased government spending
 - C) A decline in foreign investments
 - D) Higher export growth
50. Which of the following is likely to improve India's current account balance?
- A) Increase in foreign portfolio investments
 - B) Decrease in imports of crude oil
 - C) A rise in domestic inflation rates
 - D) A fall in India's foreign exchange reserves