Q10

Which one of the following is likely to be the most inflationary in its effects? (a) Repayment of public debt (b) Borrowing from the public to finance a budge deficit (c) Borrowing from the banks to finance a budget deficit (d) Creation of new money to finance a budget deficit Official key: D.

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Explanation

(a)

Repaying public debt. Extinguishes a liability; not new high-powered money.

(b)

Borrowing from the public. Transfers deposits; relatively less inflationary.

(c)

Borrowing from banks. Can expand credit, but still not printing.

(d) Official key

Creating new money to finance the deficit. Monetisation - the most inflationary of the four.

Summary

Official key is (d). Financing a deficit by creating new money (monetisation) is the most inflationary route. Public borrowing recycles existing saving; bank borrowing is in between; repayment is not stimulus of that kind.

Related possible facts

These can be asked in a future Prelims paper.

Deficit monetisation
Central bank prints to buy government paper.

Gilt-financed deficit
Sold to the public - crowding-in of saving, less new money.