Logical Reasoning Questions for CLAT Exam

Logical Reasoning Quiz 5

Directions: Study the following information carefully and answer the questions given beside.

As businesses deal with the prospect of a sudden stop in their cash flows, the most exposed are a relatively new generation of companies that already struggle to pay their loans. This class includes the “zombies” - companies that earn too little even to make interest payments on their debts, and survive only by issuing new debt.

The longer the pandemic lasts, the greater the risk that the sharp downturn morphs into a financial crisis with zombie companies triggering a chain of defaults, the way subprime mortgages did in 2008.

Over the last century, recessions have almost always been started by a sustained period of higher interest rates. Never a virus: The damage such contagions inflicted on the world economy typically lasted no more than three months. Now this once-in-a century pandemic is hitting a world saddled with record levels of debt.

Central banks around the world are realising that a crunch could beget another financial crisis. As the Fed pushes aggressive easing measures straight out of its 2008 playbook, in an effort to stem market panic, its worth examining why the financial system feels so vulnerable again.

Around 1980, the world’s debts started rising fast as interest rates began falling and deregulation made it easier to lend. Debt tripled to a historic peak of more than three times the size of the global economy on the eve of 2008 crisis. Debt fell during the crisis, and central banks around the world subsequently dropped rates to new record lows in hopes of stimulating recovery.

[Extracted from editorial Ruchir Sharma “ Debt in the time of Coronavirus]

1. According to the passage “Zombie companies” are

A. Companies that earn little and hardly can pay their interests on debt.
B. Companies that are floated to transfer illegal cash.
C. Companies that invest in government bonds only
D. All of the above

2. According to the passage recessions are triggered by

A. Sustained period of Low interest rates
B. Sustained period of High interest rates
C. A virus
D. None of the above

3. According to the passage what prompted the world's debt to rise fast around 1980's

A. Falling of interest rates
B. Deregulation of procedure to lend
C. Easy availability of cheap money
D. All of the above

4. Consider the following statements from the passage and answer accordingly

Assertion (A) : Zombie companies triggering a chain of defaults, the way subprime mortgages did in 2008.

Reason (R) : Businesses deal with the prospect of a sudden drop in their cash flows, the most exposed are a relatively new generation of companies that already struggle to pay their loans.

A. A is true but R is false
B. A is false but R is true
C. Both A and R are true and R is the correct explanation of A
D. Both A and R are true and R is not the correct explanation of A

5. What according to the author is pushing the world into financial crisis

A. Cash crunch
B. Record levels of debt
C. Presence of zombie companies
D. All of the above

Correct Answers:

1	2	3	4	5
A	A	D	C	D

Explanations :

1. According to the lines 3-4 the companies that earn a bit less to manage their debts are zombie companies.

So option A is the answer.

2. According to the passage line 8-9 suggest that recession have been triggered by a sustained period of higher interest rates.

So clearly option A is the answer. The author clearly disregards virus as the reason for recessions to start.

3. According to the passage all the three factors contributed to the world's debt to rise. As the cheap credit was available in the market, additionally the deregulation prompted the world's debt to rise more than the size of the economy.

Hence, option D is correct.

4. According to the passage the reason behing the zombie companies defaulting is a drop in their cash flow.

Therefore the answer is option C.

Both are true statements and R) explains A).

5. The author mentions all the factors and consecutive actions followed by the factors of economic indicators as cash crunch, already debted market and presence of zombie companies which will push the market into recession and ultimately financial crisis.

So option D is the answer.