



COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

**COURSE TITLE: MEC205 MONEY AND BANKING
MAC207 MONEY AND CAPITAL MARKETS**

END OF FIRST SEMESTER EXAMINATIONS

NOVEMBER/DECEMBER 2017

LECTURER: MR KAZOMBA.S

DURATION: 3 HRS

INSTRUCTIONS

Answer **ALL** Questions from this paper

Start **each** question on a new page in your answer Booklet.

The marks allocated to **each** question are shown at the end of the question.

Show all your workings.

Credit will be awarded for logical, systematic and neat presentations.

Question One (25 points)

- a. Briefly explain the following financial instruments and classify them as capital or money market instruments:
- (i) Negotiable certificate of deposit (3 points)
 - (ii) Bankers' acceptance (3 points)
 - (iii) Repurchase agreement (3 points)
 - (iv) Stock (3 points)
- b. Suppose you have an opportunity to deposit \$100 into a risk free account paying 5% annual interest. What is the future value at the end of:
- (i) 1 year (2 points)
 - (ii) 2 years (3 points)
- c. Jane Doe has the following assets:
- 1. \$100 in her wallet
 - 2. \$800 in her cheque account
 - 3. \$1000 in her savings account
 - 4. A \$20 traveller's cheque from her last business trip to China
 - 5. A \$300 in a small certificate of deposit.
- (i) Identify which are M1 and M2 (5 points)
 - (ii) Suppose she takes the \$100 in her wallet and deposits it in her cheque account. What is the change in M1 and M2? (1 point)
- d. What is financial intermediation? (2 points)

Question Two (25 points)

- a. Suppose an investor has 3 stocks, namely DELTA, NBS and NORKAZ and the Zimbabwean economy can turn out to be strong, normal, moderate or weak depending on the outcome of the political and economic developments in the country. The return on each of the stocks depends on the state of the economy as outlined in the following probability distribution table.

State of the Economy	Probability of State of Economy	DELTA Stock	NBS Stock	NORKAZ Stock
Strong	0.10	25%	5%	100%
Normal	0.35	15%	10%	29%
Moderate	0.30	4%	19%	15%
Weak	0.25	0%	35%	(70%)

- (i) Calculate the expected return, for each of the stocks (12 points)
- (ii) Risk premium is the additional return offered on more risky investments relative to safer ones. Outline the main risk premiums that used to compensate investors for taking risky investments (5 points)
- (iii) What is the relationship between risk and return? (3 points)

- (iv) Define risk attitude and outline any four factors that influence an investor's risk attitude. (5 points)

Question Three (25 points)

- a. With the aid of a flow diagram briefly explain how funds flow through the financial system clearly distinguishing between direct and indirect finance. What is asymmetric information in financial systems? Explain the major problems that arise due to asymmetric information in financial markets. Explain the role of financial intermediaries in reducing these problems. (15 points)
- b. Briefly explain the difference between:
- (i) Primary and secondary markets (2 points)
 - (ii) Money and Capital markets (2 points)
 - (iii) Stand alone risk and portfolio risk (2 points)
 - (iv) Risk averse and risk-indifferent investors (2 points)
 - (v) Ordinary annuity and annuity due (2 points)

Question Four (25 points)

- a. A manager of a financial institution is holding 25% of a portfolio in a bond with five year duration and 75% in a bond with ten-year duration. What is the duration of the portfolio? (4 points)
- b. Why is inflation harmful to an economy? (5 points)
- c. Identify three roles and two types of money (5 points)
- d. Why are financial markets important to the health of the economy? (6 points)
- e. Explain required reserves and excess reserves. (5 points)

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