AFRICA UNIVERSITY

A United Methodist-Related Institution

COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

Money and Capital Markets/Money and Banking:MAC207/MEC205

END OF SEMESTER EXAMINATION

April/May 2018

LECTURER: (Mr. Gabriel Muzah)

DURATION:(3 HRS)

INSTRUCTIONS

The paper contains **25** questions.

Answer **ALL** Questions

Write your answer clearly. Use numbered headings or subheadings to show which part of your answer refers to which question. Example: Question 2 (a).

Section A: True/False Questions: [20 Marks]

Determine whether the statement is true of false.

1. Economists define money as currency in circulation plus reserves.

2. Present value calculations allow us to compare assets with differing time dimensions.

3. In the market for loanable funds, the "buyer" is the borrower.

4. The nominal interest rate equals the sum of the real rate plus the expected rate of inflation.

5. The law of one price says the same tradeable goods will sell for the same price in different markets—allowing for differences in transportation costs.

6. Short-selling causes a stock's price to fall faster and farther than if the practice were banned.

7. Interest rates and bond prices tend to move together in the same direction over the long run.

8. Banks never hold excess reserves because if they did, they would forego earning interest on those funds.

9. Dr. Mangudya heads the Reserve Bank of Zimbabwe.

10. The Federal Reserve was created in response to the Great Depression.

Section B: Multiple Choice Questions [20 Marks]

11. When people expect interest rates to fall in the future, the -------- curve for bonds shifts to the --------.

(a) demand; right

(b) supply; left

(c) supply; right

(d) demand; left

12. A decrease in the expected rate of inflation will -------- the expected return on bonds relative to that on -------- assets.

(a) reduce; financial

(b) reduce; real

(c) raise; financial

(d) raise; real

13. Commercial paper is issued by

(a) money market mutual funds.

(b) small businesses.

(c) commercial banks.

(d) corporations.

14. Technical analysis applied to foreign exchange markets is based on the idea that

(a) future changes in exchange rates should be zero.

(b) trends and regular cycles in exchange rates should allow profitable trading opportunities.

(c) use of public information about exchange rates will not allow profitable trading opportunities.

(d) expected future changes in exchange rates should be zero.

15. Which of the following are reported as assets on a bank's balance sheet?

(a) bank capital

(b) loans

(c) borrowings

(d) only (a) and (b) of the above

1. Which of the following is an example of a barter transaction?

a. An individual pays her electric bill with a check.

b. An individual pays her electric bill with currency.

c. An individual provides three light bulbs to her neighbor in exchange for two gallons of milk.

d. An individual deposits three twenty-dollar bills in her checking account.

17. If, while you are holding a coupon bond, the interest rates on other similar bonds fall, you know that

a. the coupon payments on your bond will fall.

b. the market price of your bond will rise.

c. the market price of your bond will fall.

d. the par value of your bond will rise.

18. Assets with greater liquidity

a. also have greater returns.

b. are generally tax-free.

c. help savers smooth spending over time.

d. are avoided by rational people.

19. The adverse selection problem in financial markets creates a profit opportunity because

a. it opens a gap between the cost of short-term funds and the cost of long-term funds.

b. savers are willing to pay for information about the quality of potential borrowers.

c. it results in the value of a company's stock being well below the value of the company's assets.

d. it makes bond-financed projects cheaper than stock-financed projects.

20. The moral hazard problem in financial markets

a. Is difficult if not impossible to solve.

b. Results in inefficient pricing of financial assets.

c. Is a type of information cost that may result in the borrower pledging assets as collateral.

d. All of the above.

Section C: Essay Questions [0 Marks]

21. There are three goods produced in an economy by three individuals:

Good Producer

Apples Orchard owner

Bananas Banana grower

Chocolate Chocolatier

If the orchard owner likes only bananas, the banana grower likes only chocolate, and the chocolatier likes only apples, will any trade among these three persons take place in a barter economy? How will introducing money into the economy benefit these three producers? **[10 Marks]**

22. In order to enhance business confidence and credibility under the 'Zimbabwe is open for business' narrative, Discuss proposed policy measures to enhance financial stability and promote business confidence in the Zimbabwean economy? **[20 Marks]**

23. How can the existence of asymmetric information provide a rationale for government regulation of financial markets? **[10 Marks]**

24. When can a decline in the value of a country s currency exacerbate adverse selection and moral hazard problems? Why? **[10 Marks]**

25. What role does weak financial regulation and supervision play in causing financial crises? **[10 Marks]**

TOTAL [100 MARKS]

END OF EXAM