



**PAMIBIA UNIVERSITY**  
OF SCIENCE AND TECHNOLOGY

**FACULTY OF MANAGEMENT SCIENCES**

**DEPARTMENT OF ACCOUNTING, ECONOMICS AND FINANCE**

<b>QUALIFICATION: BACHELOR OF ECONOMICS</b>	
<b>QUALIFICATION CODE: O7BECO</b>	<b>LEVEL: 7</b>
<b>COURSE CODE: MAB611S</b>	<b>COURSE NAME: MONEY AND BANKING</b>
<b>SESSION: JUNE 2019</b>	<b>PAPER: THEORY</b>
<b>DURATION: 3 HOURS</b>	<b>MARKS: 100</b>

<b>FIRST OPPORTUNITY EXAMINATION QUESTION PAPER</b>	
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<b>INSTRUCTIONS</b>
1. Answer ALL the questions. 2. Write clearly and neatly. 3. Number the answers clearly.

**PERMISSIBLE MATERIALS**

1. Pens/pencils/erasers
2. Calculator
3. Ruler

**THIS QUESTION PAPER CONSISTS OF 6 PAGES (Including this front page)**

**QUESTION 1****[25 Marks]**

Select the letter that best represents your choice.

- 1. The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of \$100 per year) is commonly referred to as the**
  - a) Inflation rate.
  - b) Exchange rate.
  - c) Interest rate.
  - d) Aggregate price level.
- 2. Everything else held constant, a decline in interest rates will cause spending on housing to**
  - a) Fall.
  - b) Remain unchanged.
  - c) Either rise, fall, or remain the same.
  - d) Rise.
- 3. An increase in interest rates might \_\_\_\_\_ saving because more can be earned in interest income.**
  - a) Encourage
  - b) Discourage
  - c) Disallow
  - d) Invalidate
- 4. A financial crisis is**
  - a) Not possible in the modern financial environment.
  - b) A major disruption in the financial markets.
  - c) A feature of developing economies only.
  - d) Typically followed by an economic boom
- 5. Banks are important to the study of money and the economy because they**
  - a) Channel funds from investors to savers.
  - b) Have been a source of rapid financial innovation.
  - c) Are the only important financial institution in the u.s. economy.
  - d) Create inflation.
- 6. Financial institutions that accept deposits and make loans are called**
  - a) Exchanges.
  - b) Banks.
  - c) Over-the-counter markets.
  - d) Finance companies.
- 7. The management of money and interest rates is called \_\_\_\_\_ policy and is conducted by a nation's \_\_\_\_\_ bank.**
  - a) Monetary; superior
  - b) Fiscal; superior

- c) Fiscal; central
  - d) Monetary; central
- 8. You can borrow \$5,000 to finance a new business venture. This new venture will generate annual earnings of \$251. The maximum interest rate that you would pay on the borrowed funds and still increase your income is**
- a) 25%.
  - b) 12.5%.
  - c) 10%.
  - d) 5%.
- 9. If the maturity of a debt instrument is less than one year, the debt is called**
- a) Short-term.
  - b) Intermediate-term.
  - c) Long-term.
  - d) Prima-term.
- 10. Which of the following statements about the characteristics of debt and equity is FALSE?**
- a) They can both be long-term financial instruments.
  - b) They can both be short-term financial instruments.
  - c) They both involve a claim on the issuer's income.
  - d) They both enable a corporation to raise funds.
- 11. Equity holders are a corporation's \_\_\_\_\_. That means the corporation must pay all of its debt holders before it pays its equity holders.**
- a) Debtors
  - b) Brokers
  - c) Residual claimants
  - d) Underwriters
- 12. Which of the following benefits directly from any increase in the corporation's profitability?**
- a) A bond holder
  - b) A commercial paper holder
  - c) A shareholder
  - d) A treasury bill holder
- 13. A financial market in which previously issued securities can be resold is called a \_\_\_\_\_ market.**
- a) Primary
  - b) Secondary
  - c) Tertiary
  - d) Used securities
- 14. A liquid asset is**
- a) An asset that can easily and quickly be sold to raise cash.

- b) A share of an ocean resort.
  - c) Difficult to resell.
  - d) Always sold in an over-the-counter market.
- 15. Equity instruments are traded in the \_\_\_\_\_ market.**
- a) Money
  - b) Bond
  - c) Capital
  - d) Commodities
- 16. Because these securities are more liquid and generally have smaller price fluctuations, corporations and banks use the \_\_\_\_\_ securities to earn interest on temporary surplus funds.**
- a) Money market
  - b) Capital market
  - c) Bond market
  - d) Stock market
- 17. Collateral is \_\_\_\_\_ the lender receives if the borrower does not pay back the loan.**
- a) A liability
  - b) An asset
  - c) A present
  - d) An offering
- 18. Bonds that are sold in a foreign country and are denominated in a currency other than that of the country in which it is sold are known as**
- a) Foreign bonds.
  - b) Eurobonds.
  - c) Equity bonds.
  - d) Country bonds.
- 19. The concept of diversification is captured by the statement**
- a) Don't look a gift horse in the mouth.
  - b) Don't put all your eggs in one basket.
  - c) It never rains, but it pours.
  - d) Make hay while the sun shines.
- 20. The problem created by asymmetric information before the transaction occurs is called \_\_\_\_\_, while the problem created after the transaction occurs is called \_\_\_\_\_.**
- a) Adverse selection; moral hazard
  - b) Moral hazard; adverse selection
  - c) Costly state verification; free-riding
  - d) Free-riding; costly state verification
- 21. Adverse selection is a problem associated with equity and debt contracts arising from**
- a) The lender's relative lack of information about the borrower's potential returns and

- risks of his investment activities.
- b) The lender's inability to legally require sufficient collateral to cover a 100% loss if the borrower defaults.
  - c) The borrower's lack of incentive to seek a loan for highly risky investments.
  - d) The borrower's lack of good options for obtaining funds.
- 22. Financial intermediaries are better equipped than individuals to screen out bad credit risks from good ones, thus reducing losses due to**
- a) Adverse selection.
  - b) Moral hazard.
  - c) Free-riding.
  - d) Economies of scope.
- 23. Which of the following is NOT a goal of financial regulation?**
- a) Ensuring the soundness of the financial system
  - b) Reducing moral hazard
  - c) Reducing adverse selection
  - d) Ensuring that investors never suffer losses
- 24. \_\_\_\_\_ is used to make purchases while \_\_\_\_\_ is the total collection of pieces of property that serve to store value.**
- a) Money; income
  - b) Wealth; income
  - c) Income; money
  - d) Money; wealth
- 25. The difference between money and income is that**
- a) Money is a flow and income is a stock.
  - b) Money is a stock and income is a flow.
  - c) There is no difference—money and income are both stocks.
  - d) There is no difference—money and income are both flows.

**QUESTION 2 [25 Marks]**

1. What do we call a credit market instrument that provides the borrower with an amount of funds that must be repaid at the maturity date along with an interest payment? (1)
2. Calculate the yearly coupon payment if a N\$1000 face value coupon bond has a coupon rate of 8.75 percent. (2)
3. Calculate the amount to be repaid for a 3-year simple loan of N\$10,000 at 10 percent. (3)
4. If a N\$10,000 face-value discount bond maturing in one year is selling for N\$7,000, then what is its yield to maturity? (3)
5. If the interest rate is 5%, what is the present value of a security that pays you N\$1,050

- next year and N\$1,102.50 two years from now? (4)
6. Briefly discuss and illustrate with a diagram how the bond market would respond to an increase in the expected rate of inflation. (12)

**QUESTION 3 [25 Marks]**

1. Why is it important to understand the bond market? (3)
2. What crucial role do financial intermediaries perform in an economy? (3)
3. Distinguish between direct finance and indirect finance. (4)
4. A local economist makes a statement in the newspaper that interest rate rise is bad for everyone. Do you agree with the statement? Explain. (4)
5. Your bank has the following balance sheet:

Assets (in Millions N\$)		Liabilities (in millions N\$)	
Reserves	50	Checkable Deposits	200
securities	50		
Loans	150	Bank Capital	50

If the required reserve ratio is 10%, what actions should the bank manager take if there is an unexpected deposit outflow of N\$50 million? (11)

**QUESTION 4 [25 Marks]**

1. Briefly discuss three goals a bank pursues in managing its assets. (6)
2. Why do equity holders care more about ROE than about ROA? (5)
3. State any three players in the money supply process. (3)
4. If the central bank sells N\$1 million of bonds and commercial banks reduce their borrowings from the central bank by N\$1 million, predict what will happen to the money supply. (7)
5. List the four factors that determine money demand under the portfolio theory. (4)

**TOTAL = 100 MARKS**