



STRATHMORE UNIVERSITY BUSINESS SCHOOL
BACHELOR OF FINANCIAL SERVICES
END OF SEMESTER EXAMINATION
BFS 1201: MONETARY AND FINANCIAL SYSTEMS

DATE: Mon, 11th March 2024

TIME: 13:00 – 15:00

Instructions:

Answer Question 1 and any other 2 questions

Question 1

Section A Multiple Choice Questions

(1 mark each)

1. Inflation in an under-developed economy generally sets in
 - (a) Before the point of full employment
 - (b) After the point of full employment
 - (c) At the point of full employment level
 - (d) All of the above
2. In the equation $MV = PY$, V represents
 - (a) Value of money
 - (b) Velocity of circulation of money
 - (c) Variation of national income
 - (d) All of the above
3. In the equation $MV = PY$, M represents
 - (a) Money supply
 - (b) Money demand
 - (c) Maximum output
 - (d) Minimum output
4. Which of the following measure is adopted to reduce inflation?
 - (a) Reduction in bank rate
 - (b) Reduction in Repo rate
 - (c) Increase in government expenditure
 - (d) Cuts in government spending
5. According to the monetarists, inflation is caused by
 - (a) Supply shocks
 - (b) Expansionary fiscal policies

- (c) Expansionary monetary policies
 - (d) Government regulations
6. Demand-pull inflation arises when
- (a) Policymakers set a very high unemployment target
 - (b) A persistent budget deficit is financed by money creation
 - (c) The deficit is financed by selling bonds to the public
 - (d) All of the above
7. Which of the statements below is true?
- (a) M3 is the most liquid money supply measure
 - (b) M2 is the most liquid money supply measure
 - (c) M1 is the most liquid money supply measure
 - (d) All of the statements are true
8. Which of the following is not true?
- (a) Term deposits aren't legal currency
 - (b) Wheat is not legal tender
 - (c) Demand deposits are not legal tender
 - (d) Issued currency notes are not legal tender
9. Which one of the below is not a central bank function?
- (a) Lending to commercial banks
 - (b) Banking facilities for public
 - (c) Financial services to the government
 - (d) Lending to government
10. What happens when margin requirements are increased.
- (e) It decreases borrowing capacity and money supply
 - (f) It increases borrowing capacity and money supply
 - (g) It encourages people to borrow more, resulting in a rise in the money supply.
 - (h) There is no change in the money supply
11. The central bank can boost the availability of credit in a number of ways, including:
- (a) Selling government securities
 - (b) Buying government securities
 - (c) Raising reverse repo rate
 - (d) Raising repo rate
12. The term bank liquidity implies
- (a) Management of cash
 - (b) Creation of credit
 - (c) The capacity of the bank to give cash on demand in exchange
 - (d) All of the above
13. What is known as the most profitable asset of a commercial bank?
- (a) Investment at call and short-notice
 - (b) Loans and advances to its customers
 - (c) Accepting deposits
 - (d) None of the above
14. Which is not a fundamental function of a commercial bank?

- (a) Acceptance of deposits
 - (b) Advancing loans
 - (c) Issuing bank draft
 - (d) Printing bank notes
15. Loans and investment of a commercial bank constitute its
- (a) Assets
 - (b) Liabilities
 - (c) Secondary deposits
 - (d) All of the above
16. A bank can increase the supply of money by
- (a) printing notes
 - (b) Creating credit
 - (c) Issuing cheques
 - (d) None of the above
17. Functions of a central bank does not include:
- (a) Lending money to individual borrowers
 - (b) Bank of last resort
 - (c) Banker of government
 - (d) Banker of international institutions
18. Central bank does not regulate the following institutions –
- (a) Commercial banks
 - (b) FOREX bureaus
 - (c) Insurance companies and brokers
 - (d) Credit reference bureaus
19. What is the Reserve Deposit Ratio?
- (a) The proportion of money RBI lends to commercial banks
 - (b) The proportion of total deposits commercial banks keep as reserves
 - (c) The total proportion of money that commercial banks lend to the customers
 - (d) None of the above
20. Which of the statements below is true?
- (a) M3 is the most liquid money supply measure
 - (b) M2 is the most liquid money supply measure
 - (c) M1 is the most liquid money supply measure
 - (d) All of the statements are true

(Total 20 marks)

Question 1 section B (10 marks)

- (i) ABC Ltd issued 12%, 500,000 term bonds of sh.100 each (par) on 1/1/19 for a period of 4 years. The bonds had a yield(discounting) rate of 14%.

Required: compute the present value of bonds and premium or discount if any. (4 marks)

- (b) Plot and explain the normal yield curve, inverted yield curve and humped yield curve (6 marks)

(Total 30 marks)

Question 2

- (a) Describe **Five** disadvantages of barter trade. (6 marks)

- (b) Given that the quantity of money in an economy is shs.5M, its velocity of circulation is 30 and the number of transactions made are 200.

Required: Calculate the general price level in an economy based on the quantity theory of

money (4 marks)

- (c) Distinguish between the following terms:

- (i) Common shares and debentures (2 marks)
(ii) Commercial banks intermediation and bank agent facilitation (2 marks)
(iii) Stockbroker and the investment bank (2 marks)
(iv) Narrow money and broad money (2 marks)
(v) Treasury bills and Treasury bonds (2 marks)

(Total 20 marks)

Question 3

- (a) Explain **Seven** factors that influence liquidity preference in an economy. (7 mark)

- (b) Describe **Seven** Objectives of monetary policy (7 marks)

- (c) Explain **Six** determinants of money supply in an economy (6 marks)

(Total 20 marks)

Question 4

- (a) Describe and plot the liquidity trap concept (6 marks)

- (b) Explain the functions of central bank (7 marks)

- (c) Explain the monetary policy tools (7 marks)

(Total 20 marks)

Question 5

- (a) K deposited Ksh.100,000 (nominal CF) with a bank for a period of 1 year expecting to earn 10% interest at year end (nominal rate). Inflation rate prevailing was 5%

Required:

- (i) compute the nominal interest amount and real interest amount after the 1 year (maturity values) **(3 marks)**
(ii) if the inflation rate is at 12% p.a and other information remains unchanged

Required: compute the real interest amount after the 1 year (maturity values) **(3 marks)**

(b) Describe 4 methods of floatation of securities in a primary market **(4 marks)**

(c) Explain the roles of (i) brokers (ii) jobbers (iii) bulls and (iv) bears in a capital market. **(4 marks)**

(d) Company X buys 1-year T-Bill with par value of sh.100,000 and pays sh.96,000.

Required:

- (i) If Company X holds T-Bill till maturity, compute the yield **(1.5 marks)**
(ii) Suppose Company X holds T-Bill for only two months, then sells it in secondary market for sh.98,000,

Required: compute the yield rate **(1.5 marks)**

(e) Explain 3 forms of stock market efficiency **(3 marks)**

(Total 20 marks)

NOTE:

$$N = (1 + r) (1 + i) - 1$$

$$A = P (1+r)^n$$

$$r = (P1 - P0) / P0 * (365 \text{ days} / \text{bill holding period})$$

$$PVIF = 1 / (1+r)^n$$

$$PVAF = (1 - 1 / (1+r)^n) / r$$