NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE

DEPARTMENT OF INSURANCE AND ACTUARIAL SCIENCE

HONORS BACHELOR OF COMMERCE

INTRODUCTION TO FINANCIAL MARKETS AND INSTITUTIONS – CIN 2210

FINAL EXAMINATION: MAY/JUNE 2011

EXAMINATION DURATION: 3 HOURS

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INSTUCTIONS TO CANDIDATES

- **Answer any FIVE of the seven questions.**

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INFORMATION FOR CANDIDATES

- **Each question carries 20 marks.**

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QUESTION 1. [20 MARKS]

(a) A current account deficit in the balance of payments may be viewed either negatively or positively as far as a country's economy is concerned. Explain. (4 marks)

(b) If the financial account has a negative balance, what is the implication? (4marks)

(c) Discuss the entries in the balance of payments for each of the following scenarios.

(i) A Zimbabwean company "A" made a cash investment of $10 million in Nigeria, and earned a return on investment of $3 million per annum for five years, after which the initial investment was disposed of, by way of sale. (6 marks)

(ii) Another Zimbabwean company "B" bought land and constructed residential buildings at a total cost of $100 million cash in Gaborone, Botswana. The return on investment is $10 million per annum. (6 marks)

QUESTION 2. [20 MARKS]

Aleck bought a European call option from Brenda. The premium was $100 000 and the strike price is $2 million. The underlying asset is a house in the suburbs. The exercise date is 30 September 2011.

(a) Draw clearly labeled graphs, with headings, to show the risk/return profiles for the two parties in the contract. (10 marks)
(b) What are Aleck's expectations and what are Brenda's expectations about the prices of houses on the exercise date? (4 marks)
(c) If the price of the underlying asset on the exercise date were to be $1.8 million, how would Aleck react and what would be his profit or loss? (3 marks)
(d) If the price of the underlying asset on the exercise date were to be $2.3 million, what would be Brenda's profit or loss, and how would this arise? (3 marks)

QUESTION 3. [20 MARKS]

Assuming that all other variables remain unchanged, explain what impact each of the following would have on a company's stock value;

(a) The firm's beta increases, (5 marks)
(b) The firm's required rate of return decreases, (5 marks)
(c) The dividend expected in the following year decreases, and (5 marks)
(d) The rate of growth in dividends is expected to increase. (5 marks)

QUESTION 4. [20 MARKS]

(a) The capital market acts as a source of funds with maturities longer than three years. Besides using the term structure, discuss how else the capital market can be analyzed. (12 marks)
(b) Discuss, with examples, the differences between fixed interest rate securities and variable interest rate securities. (8 marks)

QUESTION 5. [20MARKS]

(a) Banks actively provide a service to individual clients and corporate bodies. Explain how the demand and supply of foreign exchange arises? (6 marks)
(b) How do banks make profits from changes in exchange rates? (4 marks)
(c) USD/ZAR 6.5530/6.5560 is a (hypothetical) exchange rate for the rand against the dollar. Explain the concept of bid and offer in this exchange rate. (4 marks)
(d) A bank active in international business has to maintain sufficient working balances in all major currencies for conducting international payments and such a bank may find itself in a "long" or "short" position. How do these two positions arise? (6 marks)

QUESTION 6. [20 MARKS]

(a) Discuss the investment services offered by investment firms. (8 marks)
(b) Which types of firms are not defined as investment companies? (6 marks)
(c) Explain why these firms are specifically excluded. (2 marks)
(d) What are the differences between risks faced by securities firms and those faced by banks? (4 marks)

QUESTION 7. [20 MARKS]

(a) Discuss the significance of a secondary market for negotiable certificates of deposit. (10 marks)
(b) Discuss the conditions of transfer of negotiable certificates of deposit. (4 marks)
(c) Government bonds issued on tap or by tender may be issued at a discount, at par or at a premium. Explain these three terms. (6 marks)

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