

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: FINANCIAL MARKETS 1 (IOBM – D203)**

**Date: Thursday, 18th May 2017**

**Time Allocated: 3 hours (13:30 – 16:30 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

**QUESTION 1**

1. Explain, by clearly indicating roles played, in the flow of funds and financial intermediation in an economic environment. **(Total 15 marks)**

**QUESTION 2**

1. Give **four** ways how preference shares differ from common shares? *(8 marks)*
2. Mtendere PLC paid a dividend this year of $3,000,000. The company expects the dividend to rise by 2% a year in perpetuity. This expectation is shared by the investors in the stock market. The current return expected by investors from shares in the same industry as Mtendere is 11%.

**Required:**

* + 1. What would you expect the total market value of the shares of Mtendere PLC to be? *(3 marks)*
    2. If it is now rumored in the stock market that interest rates are about to rise and shareholders will want to earn extra 1% on their shares. What change would expect in the value of the shares of Mtendere PLC. *(4 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. XYZ Enterprises is a Malawian business which is involved in wholesale business. It both sells local and imported merchandise. On January 1, 2017 it imported goods from USA of which half of the goods were paid instantly while the remainder was to be settled at a later date probably in three months as the seller understood the forex shortage in the importer’s country.

**Required:**

What types of foreign exchange rates are involved in this kind of business transaction? *(5 marks)*

1. Describe the Fischer effect and calculate the real rate if nominal rate is 17.50% and inflation rate is 8.80%? *(5 marks)*
2. Define liquidity risk *(5 marks)*

**(Total 15 marks)**

**QUESTION 4**

Describe **five** factors that determine the interest rate pattern? (*3 marks each*)

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer ANY **TWO** questions from this section

**QUESTION 5**

1. Define forward exchange contracts. *(4 marks)*
2. XYZ plc a UK based company wants to enter into a forward contract but it has been warned of the precautions for not delivering the contractual terms. What would be some of the reasons that would arise for XYZ plc not to satisfy his obligations under the forward contract? *(6 marks)*
3. XYZ plc arranges on 01 January with a US supplier for the delivery of a consignment of goods costing $96,000. XYZ will have to pay for the goods in six months’ time, on 1 July. XYZ therefore arranges a forward exchange contract for its bank to sell it $96,000 six month hence.

In the event the size of the consignment is reduced and on 1 July XYZ only needs $50,000 to pay the supplier. The bank will therefore arrange to close out the forward exchange contract for the $46,000 which XYZ does not need. This is called a partial close out.

Exchange rates between the US and sterling are as follows:

**1 Jan**

Spot $1.5145 – 1.5155

6 months forward 0.95 – 0.85c pm

**1 July**

Spot $1.5100 – 1.5110

**Required:**

Compute the cost to XYZ of the whole transaction, ignoring commission.

*(6 marks)*

1. What would the bank do if a customer like XYZ who arranged for the forward contract fails to deliver the currency for the bank to buy and what would happen if the contract was for the bank to sell XYZ currency? *(4 marks)*

**(Total 20 marks)**

**QUESTION 6**

You are the Managing Director (MD) of ABC Investments Corporations. It has been operating in overdrafts with several banks due to mismanagement of liquidity. The board of directors of the company took action in a recent meeting in which the Finance Director (FD) who was also a member of the board was fired. You have recruited a new FD who has vast experience in money markets and all over sudden the company is not experiencing overdrafts but rather its cash balance is always in surplus. For instance, cash surplus for the month ending June 2011 was MK15million 300% higher than any cash surplus hence since commencement of the company.

The new FD advised you that it will be necessary if the funds are invested in the money markets to improve the current working capital needs of the entity. He further advised that the surplus MK15m could be invested either in Treasury bills, NCDs or repurchase agreements.

As the Managing Director (MD) who is also a member of the board, you have briefed the board chairman the situation the situation on the ground before the next boarding meeting. In his response the board chair has advised that at a caucus meeting of the board, it was agreed that if the company have surplus cash it should be invested in cooking oil refinery machinery which is to be purchased online from United Arab Emirates (UAE). However, despite that a proforma invoice was sent the directors are not sure if the machinery would be delivered as this is the first time when the company purchases item online.

Further to his response, the board chairman has advised you that none of the board members have knowledge and expertise on the money markets.

**Required:**

1. Write a brief summary on money markets to be presented to the board of directors of ABC Investments. *(10 marks)*
2. Write a report to the board of directors on the most preferred money market investment outlined by the FD *(10 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. Differentiate demand pull inflation from cost push inflation? *(4 marks)*
2. Illustrate the causes of inflation and their policy control methods used to reduce the effects. *(16 marks)*

**(Total 20 marks)**

**QUESTION 8**

Economic environment of the world comprises of the debt market and equity market. In Malawi there very few listed companies on the local bourse. However, a lot of market players need special advice on how to diversify their investments. Many believe that money markets remain the only perfect market and that they have a belief that investing in equity is a total madness as experience has shown that people lose everything. Reserve Bank of Malawi has organized a sensitization campaign called **financial literacy week** with an aim of educating the public with a topic on equity. You have been approached, as a dealer, to prepare and make a presentation on Equity.

**Required:**

With reference to the equity market you are required to make a presentation to the general public on a layman’s understanding. **(Total 20 marks)**

**END OF EXAMINATION PAPER**