

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCE DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: FINANCIAL MARKETS 2 (IOBM – AD320)**

**Date: Sunday, 13th May 2018**

**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)**

Answer **ALL** questions from this section

**QUESTION 1**

1. i) Mention **two** strategies that could be used by an investor to limit the exposure to interest rates volatility. *(3 marks)*

ii) List **three** problems that the strategies may have. (6 *marks)*

1. Define the following:
   * 1. Default risk. *(2 marks)*
     2. Risk structure of interest rates. *(2 marks)*
     3. Reinvestment risk. *(2 marks)*

**(Total 15 marks)**

**QUESTION 2**

The Reserve Bank of Malawi through its Open Market Operations (OMO) implements monetary control measures to control liquidity in the market by using instruments such as repurchase agreements.

**Required**

1. Define Repo rate. *(2 marks)*
2. Discuss how OMO work through use of repo rates? *(11 marks)*
3. What advantage does a change in Repo rate and use of OMO have? *(2 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. Define the **Put** call parity relationship. *(2 marks)*
2. The current share price of **Chipo Investments** is MK2.90. The risk-free rate of interest is 6% and the variance of the rate of return on the shares has been 15%.

**Required**

Estimate the value of a call option on the share of the company, with an exercise price of MK2.60, and 6 months to run before it expires. *(13 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. Distinguish between forward exchange rate and real exchange rate. *(4 marks)*
2. In January 2017 and June 2017, the rate of exchange of Malawi Kwacha per US Dollar was K350.00 and K420.00 respectively. During the same period, Consumer Price Index in Malawi moved from 124.55 to 154.65 while in United States of America, movement was from 109.26 to 115.92.

**Required**

* + 1. Calculate real exchange rate of Malawi Kwacha per US dollar in January 2017. *(3 marks)*
    2. Using Relative Purchasing Power Parity theory, calculate the percentage by which the Malawi Kwacha was over or under valued in June 2017. *(8 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer ANY **TWO** questions from this section

**QUESTION 5**

Discuss the following monetary control instruments of portfolio constraints:

a) Reserve requirements

b) Special deposits

c) Supplementary special deposits

d) Moral suasion

e) Direct control

**(Total 20 marks)**

**QUESTION 6**

1. Define the term intrinsic value of an option. *(2 marks)*
2. Explain **six** factors that influence the price of an option. *(18 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. Define the term Collective Investment Scheme as per Capital Development Act definition. (*6 marks)*
2. John invested his funds in a Collective Investment Scheme and periodically he receives financial statements. He then received his statement as at 31st December 2017 which showed the following information:

|  |  |
| --- | --- |
| Market value of stock | K200,000,000.00 |
| Market value of bonds | K100,000,000.00 |
| Cash | K20,000,000.00 |
| Total assets | K320,000,000.00 |
| Liabilities | K35,000,000.00 |
| Company’s net worth | K285,000,000.00 |

The number of shares outstanding as at 31st December 2017 was as follows:

Preference shares 16,500,000

Ordinary shares 30,000,000

1. Calculate the Net Asset Value given the above information. *(2 mark*)
2. Assume the value of stock held in his portfolio decreases by 18% and the value of the bond increases by 10% and that the liabilities increases by 25%. A rights issue was exercised of 1 for every 25 ordinary shares held.

**Required**

Calculate the new Net Asset Value taking into consideration the changes above. *(12 marks)*

**(Total 20 marks)**

**QUESTION 8**

1. Mention **five** items that a collective investment scheme is required by law to maintain in the account files of its individual customers. *(5 marks)*
2. The Finance Director (FD) of ABC Ltd, a company in Hospitality industry, wishes to increase the number of rooms in one of their lakeshore resorts in a tourist attraction area. After receiving the board’s approval, they have issued 9% bonds, which are redeemable at par in three years’ time. Investors into this bond require an interest yield of 10% to be paid in order to be compensated for it.

**Required**

1. Calculate the current market value of MK1000 of bond? *(10 marks)*
2. Discuss why it is important for financial managers to always inspect the current yield curve when deciding the terms of borrowing or deposits. *(5 marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**