Oct/Nov 2016

Ban 2601

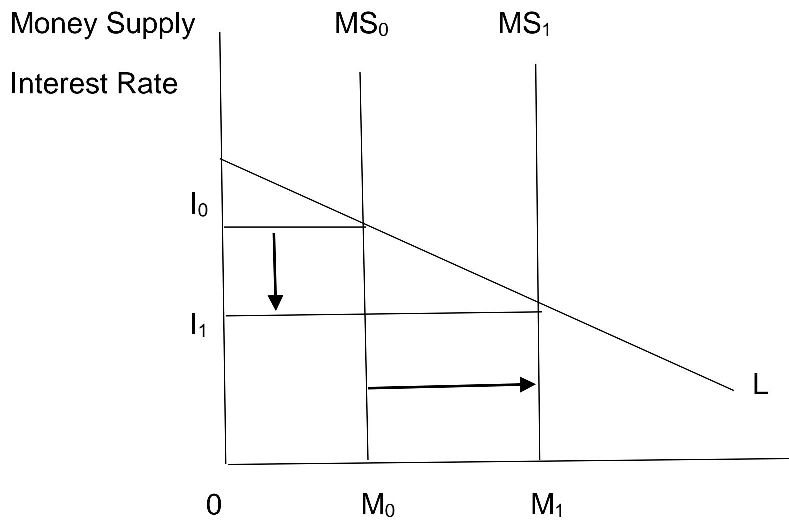
Question 1:

Identify and discuss any three types of Financial Institutions that operate in your economy and highlight their main contributions to the development of that particular economy (15)

1. Discount houses
   - Are the oldest of the money market players;
   - They play an intermediation role between issuers and consumers of financial instruments;
   - They are used by the central bank as a communication tool between the Central Bank and Commercial Banks;
   - Monetary policy issues and interest rates are communicated through DHs.
   - Central Banks issue instruments like TBs and other government stocks through DHs.
2. Commercial Banks
   - Banks such as ABSA, Standard Bank, FNB, Nedbank, etc. take deposits from the public and lend the same funds to borrowers.
   - Risk Transformational role.
   - Safe keeping role.
   - Payment role.
   - Advisory role.
   - Certification role.
   - Intermediation role.
3. Merchant Banks
   - International trade is financed through merchant banks.
   - Wholesale depositions.
   - Issue letters of credits and other off-shore funding arrangements.
   - Parastatals issue bonds and other financial instruments through merchant banks.
   - Examples of merchant banks in S.A is RMB, Rand Merchant Bank.
   - They have ability to international credit.
   - Instruments are normally used to fund the development of infrastructure and major construction projects.
4. Insurance Companies and Investment Banks

Question 2:

Discuss the main determinants of interest rates and comment on the behaviour of interest rates in your own country over the past three years (15)



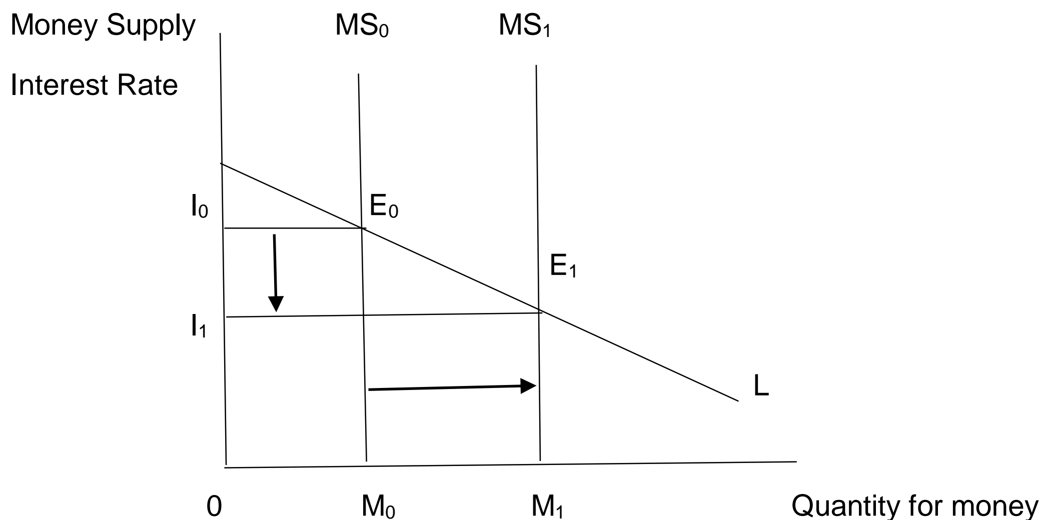
If Money supply increases from M_0 to M_1 interest rates will decrease from i_0 to i_1 and vice versa.

1. Repo rate
   - If the repo rate increases interest rate will also increase and vice versa. There is a direct relationship between the two.
2. The Central Bank determines the repo rate thereby influencing the interest rates.
3. Other investment players.
4. The market forces of demand for money and supply for money. Equilibrium interest rate in the market is determined where M_s = L as shown above.

Question 3

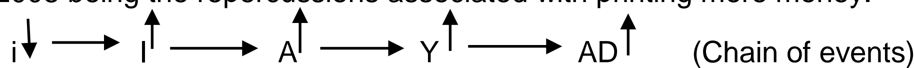
What are the effects of an increase in the supply of money on interest rates, prices and output?

What are the effects of a decrease in the supply of money on interest rates, prices and output? Do these effects occur simultaneously? (20)



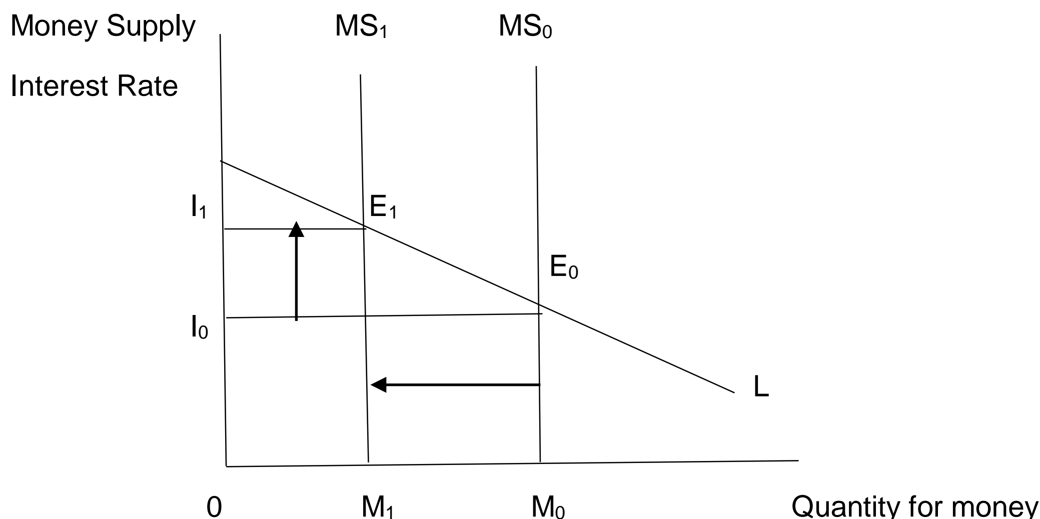
If the central bank increases money supply the M_s curve will shift to the right from Ms_0 to Ms_1 thereby decreasing interest rates from i_0 to i_1 as shown above formulating a new equilibrium point of E_1 where the demand for money curve (L) meets Ms_1.

Prices of goods and services will increase as a result of a lot of money circulating in the economy thereby causing inflation. However this can be used by the central bank as a tool to stimulate economic growth although it is inflationary as witnessed in Zimbabwe during the year 2008 being the repercussions associated with printing more money.



(Chain of events)

If interest rates decrease investments will increase, autonomous aggregate spending will go up thereby increasing the equilibrium level of income and ultimately shifting the aggregate demand curve to the right thereby increasing the national output.



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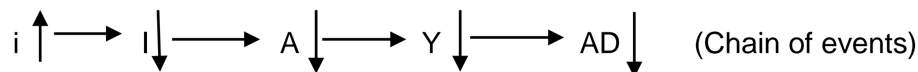
Prices of goods and services will decrease as a result of a lot of money circulating in the economy thereby causing deflation. However this can be used by the central bank as a tool to stimulate economic growth by reducing hyperinflation as witnessed in Zimbabwe during the year 2008 being the repercussions associated with printing more money.



If interest rates increase investments will decrease, autonomous aggregate spending will go down thereby decreasing the equilibrium level of income and ultimately shifting the aggregate demand curve to the left thereby decreasing the national output.

Question 4

Rank the following financial instruments in terms of their safety and liquidity and justify your rankings in all instances. (20)

a) Government Treasury bills

a. Government Treasury Bills are liquid, safe and secured as the government's risk of default on payments is very low.

b) Negotiable certificates of deposits

b. Negotiable certificates of deposits are money market instruments which are short term. They are more liquid than a Bond and TBs.

c) Mortgage Bonds.

c. Mortgage Bond is the most illiquid and long term in nature although safe and secured.

d) Commercial paper

d. Commercial paper – is traded in the money markets and has lower risk as it is short term in nature and mature within a year.

May/June 2016

Question 1

Identify and discuss any three types of Financial Institutions that operate in your economy and highlight their main contributions to the development of that particular economy [15]

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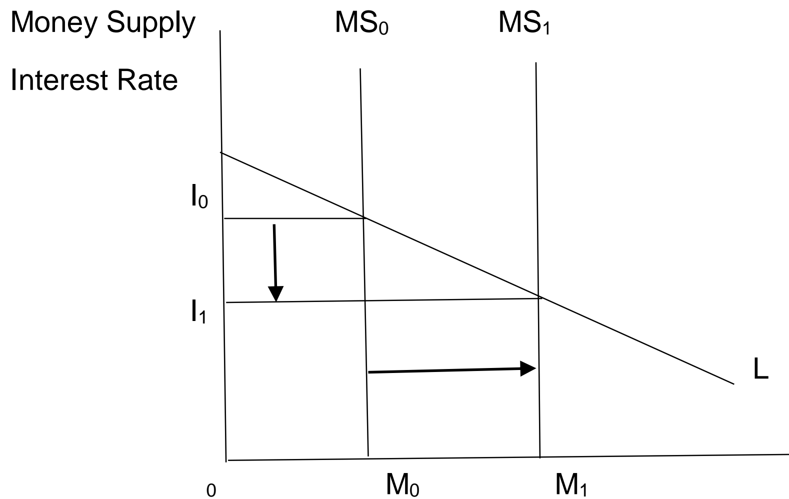
Question 2

Discuss the main determinants of interest rates and comment on the behaviour of interest rates in your own country over the past three years [15]



If Money supply increases from M_0 to M_1 interest rates will decrease from i_0 to i_1 and vice versa.

a. Repo rate

   - If the repo rate increases interest rate will also increase and vice versa. There is a direct relationship between the two.

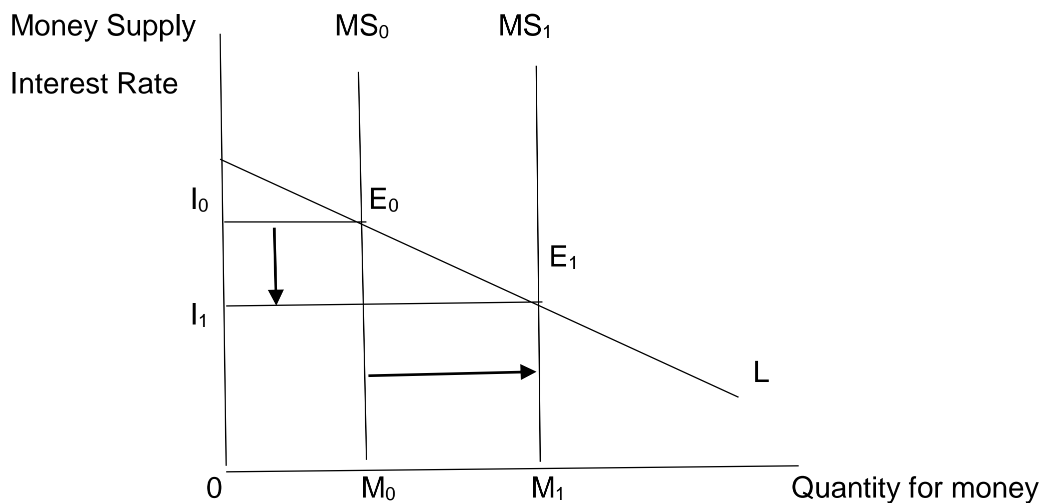
b. The Central Bank determines the repo rate thereby influencing the interest rates.
c. Other investment players.
d. The market forces of demand for money and supply for money. Equilibrium interest rate in the market is determined where $M_s = L$ as shown above.

Question 3 [20]

a) Explain the effects of an increase in the supply of money on interest rates, prices and output (8)
b) Explain how a decrease in the supply of money affects interest rates, prices and output (8)
c) Evaluate whether the effects occur simultaneously (4)

a. If the central bank increases money supply the Ms curve will shift to the right from Ms0 to Ms1 thereby decreasing interest rates from i0 to i1 as shown above formulating a new equilibrium point of E1 where the demand for money curve (L) meets Ms1.

   Prices of goods and services will increase as a result of a lot of money circulating in the economy thereby causing inflation. However this can be used by the central bank as a tool to stimulate economic growth although it is inflationary as witnessed in Zimbabwe during the year 2008 being the repercussions associated with printing more money.



$i \downarrow \longrightarrow I \uparrow \longrightarrow A \uparrow \longrightarrow Y \uparrow \longrightarrow AD \uparrow$ (Chain of events)

If interest rates decrease investments will increase, autonomous aggregate spending will go up thereby increasing the equilibrium level of income and ultimately shifting the aggregate demand curve to the right thereby increasing the national output.

b. If the central bank decreases money supply the M_s curve will shift to the left from Ms_0 to Ms_1 thereby increasing interest rates from i_0 to i_1 as shown above formulating a new equilibrium point of E_1 where the demand for money curve (L) meets Ms_1.

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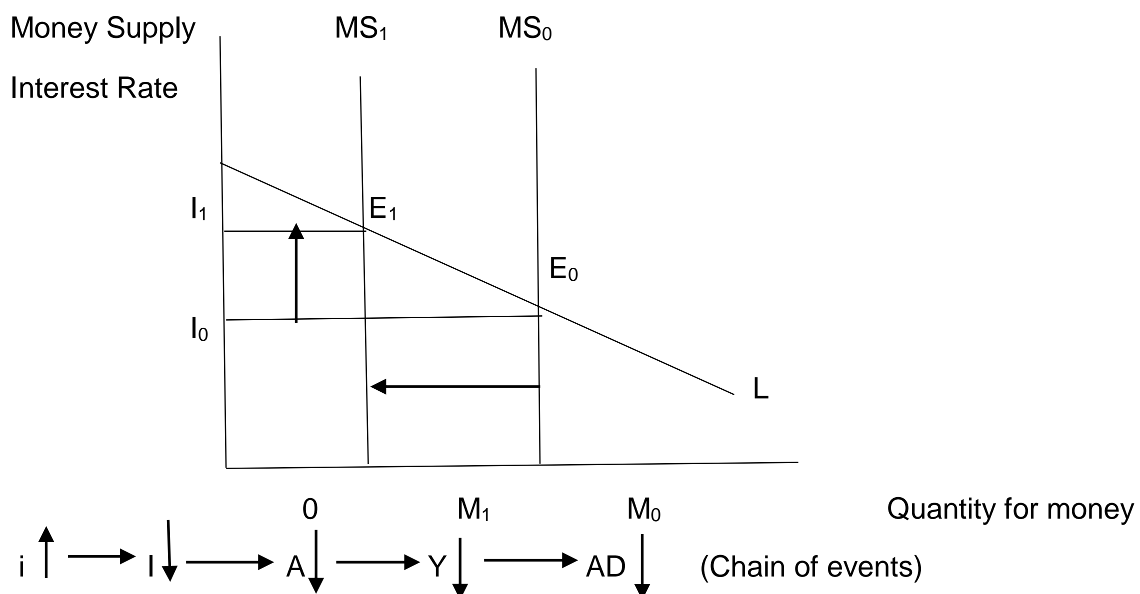

If interest rates increase investments will decrease, autonomous aggregate spending will go down thereby decreasing the equilibrium level of income and ultimately shifting the aggregate demand curve to the left thereby decreasing the national output.

Question 4 [20]

a) What are the main functions of money? (16)
b) Justify your answer in (a) (4)

i. Medium of exchange

- Generally acceptable means of payment
- It allows us to move beyond barter economy
- It prevents double coincidence of wants
- Monetary economics are much better

ii. Unit of account

- It enables comparison as a common measure of the cost
- Also allows us to work GDP
- Can lose value due to inflation.

iii. Money as a store of value

- That is for holding savings, which is convenient and easy to use at a later date.
- Can also have assets through which you are better off at times of inflation
- However money is not the only store of value

iv. Standard of deferred payment

- You pay back a loan in Rand.
- It is also the means by which credit is granted.

The end!!!