



(Knowledge for Development)

KIBABII UNIVERSITY
UNIVERSITY EXAMINATIONS
2022/2023 ACADEMIC YEAR
SECOND YEAR FIRST SEMESTER

MAIN EXAMS

**FOR THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION**

COURSE CODE: MBA 831

COURSE TITLE: FINANCIAL ECONOMICS

DATE: 1ST FEBRUARY, 2023

TIME: 9.00AM - 12 NOON

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other THREE (3) Questions in Section B
2. Question **one** carries **40**marks and each of the other THREE questions carry **20** marks each

TIME: 3 Hours

KIBU observes ZERO tolerance to examination cheating

This Paper Consists of Printed Pages. Please Turn Over.

QUESTION ONE (COMPULSORY 40 MARKS)

a) Briefly describe the and explain the following building blocks of Financial Economics (10 Marks)

- i. Foreign exchange markets
- ii. The bond markets
- iii. Money markets
- iv. The derivative market
- v. Share/equity market

b) Explain the benefits that are enjoyed by investors because of the existence of organized security exchanges (8 marks)

c) Discuss the various steps of book building process in the primary markets and its contribution to the activities of the primary markets (8 Marks)

d) Given the following

$C = 100 + 0.8Y_d$ – Consumption function

$I = 10 - 10r$ - Investment function

$L = Y - 100r$ – Real money demand

$G = 10$ – Government purchases

$T = 0.25$ – Tax rate

$MS = 295$ – Real money supply

Suppose equilibrium income increases by 200, by how much must real money stock increase for the new level of income to be in equilibrium

[8 Marks]

(e) Discuss the role of interest rates in the financial markets [6 marks]

QUESTION TWO [20 MARKS]

a) In Kenya, assets and liabilities of commercial banks matter as far as operations, existence of these banks is concerned, and therefore their (assets and liabilities) management is pivotal in determining their growth and progress. In view of this statement, discuss the various ways in which management of assets and liabilities of these banks is done. [10 marks]

b) List and explain five factors that should be taken into account by a business man when making the choice between financing by short term and long time sources [10 Marks]

QUESTION THREE [20 MARKS]

(a) i) Explain the difference between primary and secondary markets [6 marks]

ii) Discuss the intermediaries that play an important role in the development of primary markets [6 marks]

(b) Explain the difference between money markets and capital markets. What types of financial instruments are traded on each [8 marks]

QUESTION FOUR [20 MARKS]

The currencies in circulation (C) together with reserves (R) constitute monetary base or high-powered money (MB)

$$MB=C+R$$

The central bank controls the monetary base through its purchase or sale of government securities in the open market operations (OMO) and through its extension of loans to banks

a) i) Derive the money multiplier and explain its application in economic analysis [6 Marks]

b) If money supply in a given economy equals 500 while the velocity and price equals 8 and 2 respectively. Determine the number of transactions [4 Marks]

ii) Give two reasons why institutions like banks prefer to hold short term rather than long term bonds [4 marks]

c) Discuss the quantity theory of money outlining its major assumptions [6Marks]

QUESTION FIVE [20 MARKS]

a) Monetary policy aim to stabilize the economy by promoting price stability and maximum sustainable employment. Discuss [10marks]

b) Explain the roles played by the central bank [10 marks]