

BAN2601 Suggested Solutions

May/June 2015

1. Qualities of money. [6]

Durability – valuable and not easily hit by rust.

Portability – easy to carry.

Uniformity – have the same features.

Etc.

2. Intermediary role.

Channeling funds between SSUs and DFUs

Risk Transformation role

Payment role

Certification role

Advisory role

Maturity transformation

Convenience denomination

- ✓ Cost advantage over direct lending/borrowing
 - ✓ Market failure protection
 - ✓ Reconciling conflicting preferences of lender and borrowers
 - ✓ Risk aversion: Intermediaries help spread out and decrease the risks
 - ✓ Economies of scale
 - ✓ Scope
- Any of the above well explained

3. Roles played by Discount houses, Merchant Banks and Insurance Companies in the intermediation process. [15]

Discount houses

- ✓ Are used by the Capital banks as the vehicle of communication between the central bank and commercial banks as well as investing public at large.
- ✓ Central banks also communicate critical monetary policy issues on interest rates through discount houses.

- ✓ Central banks also issue instruments such as Treasury Bills and government stocks through the discount houses.
- ✓ Discount houses take short term money from commercial banks and recycle it into short term investments.

Insurance Companies

- ✓ They pick up deposits from ordinary households in the form of insurance premiums and repackage for consumption by large corporations and government.

Risk management role

4. Monetary policy instruments:

- i. Open Market Operations
- ii. Repo rate policy
- iii. Use of the exchange rate

5. (i) Maintaining a stable exchange rate [1]

Explanation [2]

(ii) Achieve acceptable levels of economic growth [1]

Explanation [2]

(iii) Equitable distribution of income [1]

Explanation [2]

(iv) Maintain price stability [1]

Explanation [2]

(v) Achieve and maintain a positive balance of payments [1]

Explanation [2]

6. Any five instruments:

- (i) Notes and coins (both local and foreign)
- (ii) Nostro balances
- (iii) Treasury bills with a tenure not more than one year
- (iv) Government stock with a tenure not more than one year.

(v) Balances in accounts with central banks

(vi) Other stocks as specified by the Central Bank