

Lecture 1- Class

The questions are theoretical, quantitative/practical and multiple choice.

Theoretical questions

1. Why are financial markets important to the health of the economy?

Because they channel funds from those who do not have a productive use for them to those who do, thus resulting in higher economic efficiency.

2. When interest rates rise, how might businesses and consumers change their economic behaviour?

Businesses would cut investment spending because the cost of financing this spending is now higher, and consumers would be less likely to purchase a house or a car because the cost of financing their purchase is higher.

3. How can a change in interest rates affect the profitability of financial institutions?

A change in interest rates affects the cost of acquiring funds for financial institution as well as altering the income on assets such as loans, both of which affect profits. In addition, changes in interest rates affect the price of assets such as stock and bonds, that financial institutions own which can lead to profits or losses.

4. How can changes in foreign exchange rates affect the profitability of financial institutions?

Changes in foreign exchange rates change the value of assets held by financial institutions and thus lead to gains or losses on these assets. Also changes in foreign exchange rates affect the profits made by traders in foreign exchange who work for financial institutions.

5. What are the other important financial intermediaries in the economy besides banks?

Savings and loan associations, mutual savings banks, credit unions, insurance companies, pension funds, mutual funds and finance companies.

6. If you suspect that a company will go bankrupt next year, which would you rather hold, bonds or equities issued by the company? Why?

You would rather hold bonds, because bondholders are paid off before equity holders, who are the residual claimants.

7. Why might you be willing to make a loan to your neighbour by putting in a savings account earning 5% interest rate at the bank and having the bank lend her the funds at 10% interest rate rather than lend her the funds yourself?

The costs of making the loan to your neighbour are high (legal fees for a credit check and so on) you will probably not be able to earn 5% on the loan after your expenses even though it has a 10% interest rate. You are better off depositing your savings with a financial intermediary and earning a 5% interest.

In addition you are likely to bear less risk by depositing your savings at the bank rather than lending them to your neighbour

Multiple choice questions

1. Which of the below statements are true:
 - i. A financial intermediary is a financial institution that connects surplus and deficit agents
 - ii. A financial intermediary provides its services free of charge
 - iii. A mutual fund is not a financial intermediary
 - iv. A bank is a financial intermediary
 - a. i and ii
 - b. i and ii and iii
 - c. i and iv
 - d. i and ii and iii and iv

The answer is c

2. Who is the regulator in UK?
 - a. The Prudential Regulation Authority (PRA)
 - b. The Financial Conduct Authority (FCA)
 - c. Both the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA)
 - d. None of the above

The answer is c

Quantitative/practical questions

The following Bloomberg page dated 09/25/2013 shows the spot Currency Rates Matrix.

<HELP> for explanation, <MENU> for similar functions.

99 Actions Currency Rates Matrix (FXC)

Basket Majors Last Price Rate Spot Date 09/25/2013

Source BGN % Change Outrights Points

10) Spot 11) Forward 12) Fixing Heat Map

	USD	EUR	JPY	GBP	CHF	CAD	AUD	NZD	HKD	NOK	SEK
SEK	6.4192	8.6798	.06517	10.320	7.0582	6.2246	6.0077	5.2930	.82786	1.0690	-
NOK	6.0047	8.1193	.06097	9.6536	6.6024	5.8226	5.6197	4.9512	.77440	-	.93543
HKD	7.7539	10.485	.07873	12.466	8.5258	7.5189	7.2569	6.3936	-	1.2913	1.2079
NZD	1.2128	1.6399	.01231	1.9498	1.3335	1.1760	1.1350	-	.15641	.20197	.18893
AUD	1.0685	1.4448	.01085	1.7178	1.1749	1.0361	-	.88104	.13780	.17794	.16645
CAD	1.0313	1.3944	.01047	1.6579	1.1339	-	.96515	.85034	.13300	.17174	.16065
CHF	.90946	1.2297	.00923	1.4621	-	.88189	.85116	.74990	.11729	.15146	.14168
GBP	.62201	.84106	.00632	-	.68393	.60316	.58214	.51288	.08022	.10359	.09690
JPY	98.493	133.18	-	158.35	108.30	95.507	92.179	81.213	12.702	16.403	15.344
EUR	.73955	-	.00751	1.1890	.81318	.71714	.69215	.60981	.09538	.12316	.11521
USD	-	1.3522	.01015	1.6077	1.0996	.96969	.93590	.82456	.12897	.16654	.15578

% Change on Day Range

Below -2.5%	-0.5% to -2.5%	-0.05% to -0.5%	-0.05% to 0.05%	0.05% to 0.5%	0.5% to 2.5%	Above 2.5%
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Rates are from Composite where Bloomberg BGN is not available

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2013 Bloomberg Finance L.P.
SN 170878 BST GMT+1:00 H178-3539-0 25-Sep-2013 19:51:12

- What is the exchange rate between the CHF/GBP (Swiss francs per Pound sterling) on 09/25/2013?
It is 1.4621
- Suppose that another day (say 11/25/2013) the CHF/GBP (Swiss francs per Pound sterling) is 1.6750. If you want to exchange £100 to Swiss francs which day (if you ever had the choice) would you do the exchange: on 09/25/2013 or on 11/25/2013?
On 11/25/2013 at 1.6750
- What is the value of Swiss francs that you would get after you had exchanged the £100 on 09/25/2013? 146.21 Swiss francs
- What is the value of Swiss francs that you would get after you had exchanged the £100 on 11/25/2013? 167.50 Swiss francs