



RONGO
UNIVERSITY

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LR12,13,17

OFFICE OF THE DEPUTY VICE CHANCELLOR- ACADEMICS AND STUDENTS AFFAIRS

UNIVERSITY EXAMINATIONS

2019/2020 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER EXAMINATION

FOR

DEGREE

IN

BACHELOR OF ARTS IN ECONOMICS

COURSE CODE: ECO 325

COURSE TITLE: FINANCIAL ECONOMICS

DATE: 5/11/2020

TIME: 9.00AM-12.00PM

INSTRUCTIONS TO CANDIDATES

- Answer question ONE and any other THREE questions
- Do not write on the question paper
- Marks are shown at the end of each question
- Show workings in the answer booklet for award of full marks
- Mobile phones are not allowed in the examination venue
- Each question should begin on a fresh page
- Duration is 3 hours

THIS PAPER CONSISTS (3) PRINTED PAGES

PLEASE TURN OVER

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- Answer question **ONE** and any other **THREE** questions
- Duration for this paper is **THREE** hours
- Do not write on the question paper.

Question One

- a. For your short time financial need of 10000, two lending institutions are available. One offering you a loan with 1% interest rate compounded every month but the whole amount is payable once while the other will charge you 1300 flat rate within one year. If you want to pay after one year which is the cheaper option (show your justification). (15 Marks)
- b. Distinguish between an Option and a Future. (5 Marks)
- c. Justify the importance of financial market to an economy. (5 Marks)

Question Two

An individual who can afford to pay Ksh. 170,000 per month for mortgage is intending to take a Ksh. 10 Million loan from a bank that charges interest rate of 12.5% and has a maximum repayment period of 10 years. Demonstrate whether the individual can be allowed to take the loan. (15 Marks)

Question Three

An individual has decided to invest in two assets A and B that have the following details:

	A	B
E(R)	0.25	0.35
σ	0.3	0.35

If the person decides to invest 40% of the capital on A, Compute:

- the return on the portfolio;
- The risk;
- The correlation of the two assets.

(15 Marks)

Question Four

The cost of capital is given as 15%, compute internal rate of return for an investment with the following cash flow: (15 Marks)

Year	Cash flow
0	-9000
1	-1000
2	2000
3	11000
5	20000
6	-1000
7	3000

Question Five

Portfolio X consist of 1 – year zero coupon bond with a face value of 2000 and a 10 – year zero-coupon bond with a face value of 6000. Portfolio Y consists of a 5.95 – year zero-coupon bond with face value of 5000. The current yield for all bonds is 10%. Show the duration of each portfolio. (15 Marks)

