# **Fitch**Learning



2-4 questions

## 2. Cash and Cash Equivalents

#### Money markets: background

• Cash deposits and loans out to 12 months

#### Inter-bank market

- LIBOR: London inter-bank offered rate
- · LIBID: London inter-bank bid rate

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### 2. Cash and Cash Equivalents

#### **Government bills**

UK Treasury bills (UK T-bills)



1. DMO issues a 90 day T Bill with a face value of £100,000



 Investor pays £98,500 for the bill (after deducting a £1,500 discount, which is approx 3 month's interest at 6 % p.a)

4. Investor redems T Bill and receives the full face value. The difference between this and the £98,500 originally paid is the investor's return:

£100,000 - £98,500 = £1,500

 $\frac{£1,500}{£98,500} \times \frac{12}{3} = 6.1 \%$ 

Investor holds the T
Bill for the entire 90 day
period

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### **Hints**

Commercial paper is the corporate version of a T-Bill.



# **Keeping on target**

A 6 month T-bill is purchased for £97,000, the quoted yield is:

- A. 3.00%
- B. 6.19%
- C. 6.28%
- D. 12.37%



# **Keeping on target**

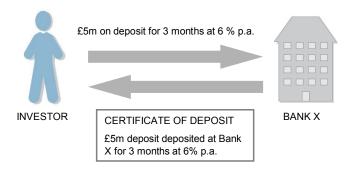
A 3 month T-bill is purchased for £95,000, what is the yield to redemption on an annual compound basis?

- A. 25.53%
- B. 22.77%
- C. 643%
- D. 526%



### 2. Cash and Cash Equivalents

#### Certificates of deposit



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#### Answers to the questions on the previous slide:

В

The quoted yield would be an annualised yield rather than a compound yield.

$$\frac{£100,000 - £97,000}{£97,000} x2 = 0.0619 \text{ (or 6.19\%)}$$

В

This question explicitly asks for a compound yield.

$$\left(\frac{£100,000}{95,000}\right)^4 - 1 = 0.2277 \text{ (or } 22.77\%)$$