

# CENTRAL UNIVERSITY COLLEGE



END-OF-FIRST SEMESTER EXAMINATION: 2012/2013

DEPARTMENT OF BANKING AND FINANCE

SBBF 309

INTERNATIONAL FINANCE (3 Credits)

LEVEL 300 (MATAHEKO & MIOTSO)

(MORNING, AFTERNOON/EVENING, & WEEKEND)

January 2013

2¼ Hours

STUDENT ID No.....

## INSTRUCTIONS

### SECTION A

Answer ALL questions from this section (Answers should be provided on the question paper)

### SECTION B

Answer TWO questions from this section (Answers should be provided in the booklet)

DO NOT TURN OVER THIS PAGE UNTIL YOU HAVE BEEN TOLD TO DO SO BY THE INVIGILATOR

CENTRAL UNIVERSITY COLLEGE - DEPARTMENT OF FINANCE  
FIRST SEMESTER 2012-2013 – END OF SEMESTER EXAMS  
INTERNATIONAL FINANCE SBBF 403 (MATAHEKO & MIOTSO L300 WEEKEND)  
EXAMINERS: GLORIA CLARISSA DZEHA & KENNETH OFORI

TIME ALLOWED: 2 HOURS, 45 MINUTES

STUDENT REGISTRATION NUMBER: .....

**SECTION A: Attempt ALL questions for 1 mark each. (60 marks)**

**True/False**

*Indicate whether the statement is true or false.*

- \_\_\_ 1. Counterparty risk is greater for exchange-traded derivatives than for over-the-counter derivatives.
- \_\_\_ 2. If exchange rates were fixed, investors and traders would be relatively certain about the current near future exchange value of each currency.
- \_\_\_ 3. Comparative advantage shifts over time as less developed countries become more developed and realize their latent opportunities.
- \_\_\_ 4. For firms competing in a world characterized by oligopolistic competition, strategic motives can be subdivided into proactive and defensive investments.
- \_\_\_ 5. Expenditures by Ghanaian business travellers in foreign countries for foreign goods or services are factored into Ghana's BOP calculations.
- \_\_\_ 6. The primary motive of foreign exchange activities by most central banks is profit.
- \_\_\_ 7. Typically, a "greenfield" investment abroad is considered a greater foreign investment having a greater foreign presence than a joint venture with a foreign firm.
- \_\_\_ 8. Joint ventures are a more common FDI than wholly owned subsidiaries.
- \_\_\_ 9. As a generalized rule, only realized foreign exchange losses are deductible for tax purposes.
- \_\_\_ 10. In efficient markets, interest rate parity should assure that the costs of a forward hedge and money market hedge should be approximately the same.



- \_\_\_ 11. Political risk may motivate parent firms to require foreign subsidiaries to remit all locally generated funds above that required to internally finance growth in sales and planned capital expansions.
- \_\_\_ 12. Because they are direct payments, dividends are among the most efficient way for foreign subsidiaries to remit funds back to the parent.

### Multiple Choice

Identify the choice that best completes the statement or answers the question.

- \_\_\_ 13. Other things equal, a firm would rather have \_\_\_\_\_ in a depreciating currency, and \_\_\_\_\_ in an appreciating currency.
- accounts receivable; accounts receivable
  - accounts receivable; accounts payable
  - accounts payable; accounts receivable
  - none of the above
- \_\_\_ 14. The theory of \_\_\_\_\_ states that the difference in the national interest rates for securities of similar risk and maturity should be equal to but opposite in sign to the forward rate discount or premium for the foreign currency, except for transaction costs.
- the law of one price
  - absolute PPP
  - interest rate parity
  - international Fisher Effect
- \_\_\_ 15. The maximum gain for the purchaser of a call option contract is \_\_\_\_\_ while the maximum loss is \_\_\_\_\_.
- unlimited; the value of the underlying asset.
  - the premium paid; unlimited.
  - unlimited; the premium paid.
  - unlimited; unlimited.
- \_\_\_ 16. A \_\_\_\_\_ is a shared ownership in a foreign business.
- greenfield investment
  - wholly-owned affiliate
  - joint venture
  - licensing agreement

- \_\_\_ 17. Losses from \_\_\_\_\_ exposure generally reduce taxable income in the year they are realized. \_\_\_\_\_ exposure losses are not cash losses and therefore, are not tax deductible.
- transaction; Operating
  - accounting; Transaction
  - accounting; Operating
  - transaction; Translation
- \_\_\_ 18. Assume the current U.S. dollar-British pound spot rate is 0.6993£/\$. If the current nominal one-year interest rate in the U.S. is 5% and the comparable rate in Britain is 6%, what is the approximate forward exchange rate for 360 days?
- 0.6993£/\$
  - 0.7060£/\$
  - 1.43£/\$
  - 1.42£/\$
- \_\_\_ 19. A U.S. firm sells merchandise today to a British company for £100,000. The current exchange rate is \$2.03/£, the account is payable in three months, and the firm chooses to avoid any hedging techniques designed to reduce or eliminate the risk of changes in the exchange rate. If the exchange rate changes to \$2.05/£ the U.S. firm will realize a \_\_\_\_\_ of
- gain; £2000
  - gain; \$2000
  - loss; \$2000
  - loss; £2000
- \_\_\_ 20. The \_\_\_\_\_ is the mechanism by which participants transfer purchasing power between countries, obtain or provide credit for international trade transactions, and minimize exposure to the risks of exchange rate changes.
- LIBOR
  - federal open market
  - foreign exchange market
  - futures market
- \_\_\_ 21. Which of the following is NOT a part of the *Current Account* of BOP?
- Net portfolio investment.
  - Balance of Trade.
  - Net export/import of services.
  - Net export/import of goods.
- \_\_\_ 22. The two major concerns about foreign direct investment are:
- who controls the assets and who receives the profits.
  - national defense and taxes.
  - who pays the taxes and who receives the taxes.
  - who receives the profits and taxes.



- \_\_\_ 23. Covered interest arbitrage moves the market \_\_\_\_\_ equilibrium because \_\_\_\_\_ .
- away from; purchasing a currency on the spot market and selling in the forward market increases the differential between the two.
  - away from; demand for the stronger currency forces up interest rates on the weaker security.
  - toward; purchasing a currency on the spot market and selling in the forward market narrows the differential between the two.
  - toward; investors are now more willing to invest in risky securities.
- \_\_\_ 24. LIBOR is an acronym for
- London Interbank Offered Rate.
  - Large International Bank Offered Rate.
  - Least Interest Bearing: Official Rate.
  - Latest Interest Being Offered Rate.
- \_\_\_ 25. Blocked funds are cash flows that
- have been restricted in transfer out of a local country.
  - come in regular intervals in standardized amounts or blocks.
  - come from a certain sector or region of the world.
  - none of the above
- \_\_\_ 26. If the direct quote for a U.S. investor for British pounds is \$1.43/£, then the indirect quote for the U.S. investor would be \_\_\_\_\_ and the direct quote for the British investor would be \_\_\_\_\_
- £0.699/\$; £0.699/\$
  - £1.43/£; £0.699/\$
  - \$0.699/£; £0.699/\$
  - £0.699/\$; \$1.43/£
- \_\_\_ 27. If your company were to import and export textiles, the transactions would be recorded in the current account subcategory of \_\_\_\_\_ .
- current transfers
  - income trade
  - goods trade
  - services trade
- \_\_\_ 28. Which of the following led to the eventual demise of the fixed currency exchange rate regime worked out at Bretton Woods?
- DIFerential rates of inflation across member nations.
  - Several unexpected economic shocks to member nations.
  - Widely divergent national monetary and fiscal policies among member nations.
  - all of the above

- \_\_\_ 29. The IMF's exchange rate regime classification identifies \_\_\_\_\_ as the most rigidly fixed, and \_\_\_\_\_ as the least fixed.
- exchange arrangements with no separate legal tender; independent floating
  - currency board arrangements; independent floating
  - pegged exchange rates within horizontal bands; exchange rates within crawling pegs
  - crawling pegs; managed float
- \_\_\_ 30. Futures contracts require that the purchaser deposit an initial sum as collateral. This deposit is called
- margin.
  - collateralized deposit.
  - settlement.
  - marked market sum.
- \_\_\_ 31. The multinational phase of globalization for a firm may be described as one characterized by the
- imports from foreign suppliers and exports to foreign buyers.
  - potential for international competitors or suppliers even though all accounts are with domestic firms and are denominated in dollars.
  - requirement that all employees be multilingual.
  - ownership of assets and enterprises in foreign countries.
- \_\_\_ 32. A speculator that has \_\_\_\_\_ a futures contract has taken a \_\_\_\_\_ position.
- purchased; sold
  - purchased; short
  - sold; short
  - sold; long
- \_\_\_ 33. The price at which an option can be exercised is called the \_\_\_\_\_.
- premium.
  - commission.
  - strike price.
  - spot rate.
- \_\_\_ 34. It is characteristic of foreign exchange dealers to
- bring buyers and sellers of currencies together but never to buy and hold an inventory of currency for resale.
  - act as market makers, willing to buy and sell the currencies in which they specialize.
  - trade only with clients in the retail market and never operate in the wholesale market for foreign exchange.
  - All of the above are characteristics of foreign exchange dealers.



35. \_\_\_\_\_ is the process that cancels via offset all, or part, of the debt owed by one entity to another related entity.
- Centralized depositing
  - Syndicated banking
  - Multilateral netting
  - Debt cancellation
36. Other things equal, and assuming efficient markets, if a Honda Accord costs \$21,375 in the U.S. then at an exchange rate of \$1.98/£, the Honda Accord should cost \_\_\_\_\_ in Great Britain.
- £42,322
  - £18,365
  - £10,795
  - £21,375
37. \_\_\_\_\_ is an investment where the investor has no control whereas the \_\_\_\_\_ is an investment where the investor has control over the asset.
- direct investment; indirect investment
  - portfolio investment; direct investment
  - portfolio investment; indirect investment
  - direct investment; portfolio investment
38. Polaris Corporation (US) has bid a price on a project for a Korean firm, but the Korean firm has not yet placed an order. This portion of the operating cycle is best described as the
- cash conversion cycle.
  - quotation period.
  - accounts payable cycle.
  - input sourcing period.
39. The OLI paradigm is an attempt to create a framework to explain why MNEs choose \_\_\_\_\_ rather than some other form of international venture.
- foreign direct investment
  - joint ventures
  - strategic alliances
  - licensing
40. From the viewpoint of a British investor, which of the following would be a direct quote in the foreign exchange market?
- SF2.40/£
  - \$1.50/£
  - \$0.90/€
  - £0.55/€

41. The L in OLI refers to an advantage in a firm's home market that is a
- longevity in a particular market.
  - liability in the domestic market.
  - location-specific advantage.
  - none of the above.
42. Under the gold standard of currency exchange that existed from 1879 to 1914, an ounce of gold cost \$20.67 in U.S. dollars and £4.2474 in British pounds. Therefore, the exchange rate of pounds per dollar under this fixed exchange regime was
- unknown because there is not enough information to ANSWER this question.
  - always changing because the price of gold was always changing.
  - £4.8665/\$.
  - £0.2055/\$.
43. The financial account consists COMPLETELY of which three components?
- Mutual fund investment, portfolio investment, and stock investment.
  - Stock investment, bond investment, and mutual fund investment.
  - Direct investment, stock investment, and bond investment.
  - Direct investment, portfolio investment, and other asset investment.
44. \_\_\_\_\_ allows a multinational firm to recover funds from subsidiaries without offending host country sensitivities over large dividend drains.
- Unbundling funds
  - Bundling funds
  - Coordinating funds
  - none of the above
45. The post WWII international monetary agreement that was developed in 1944 is known as the \_\_\_\_\_.
- United Nations.
  - Bretton Woods Agreement.
  - League of Nations.
  - Yalta Agreement.
46. In its approximate form the Fisher effect may be written as \_\_\_\_\_. Where:  $i$  = the nominal rate of interest,  $r$  = the real rate of return and  $\pi$  = the expected rate of inflation.
- $i = (r)(\pi)$
  - $i = r + 2\pi$
  - $i = r + \pi$
  - $i = r + \pi + (r)(\pi)$



- \_\_\_ 47. \_\_\_\_\_ exposure deals with cash flows that result from existing contractual obligations.
- Translation
  - Economic
  - Transaction
  - Operating
- \_\_\_ 48. \_\_\_\_\_ exposure measures the change in the present value of the firm resulting from unexpected changes in exchange rates.
- Accounting
  - Operating
  - Transaction
  - Translation
- \_\_\_ 49. The theory that suggests specialization by country can increase worldwide production is \_\_\_\_\_.
- the theory of working capital management
  - the international Fisher effect
  - the theory of foreign direct investment
  - the theory of comparative advantage
- \_\_\_ 50. A U.S firm has an accounts payable denominated in UK pounds due in 6 months. To protect itself against unexpected changes in the dollar/pound exchange rate the firm should \_\_\_\_\_.
- sell a pound call option.
  - buy a pound call option.
  - buy a pound put option.
  - sell a pound put option.
- \_\_\_ 51. A firm with variable-rate debt that expects interest rates to rise may engage in a swap agreement to \_\_\_\_\_.
- pay floating rate interest and receive fixed rate interest.
  - pay fixed-rate and receive floating rate.
  - pay fixed rate and receive fixed rate.
  - pay floating rate and receive floating rate.
- \_\_\_ 52. \_\_\_\_\_ make money on currency exchanges by the difference between the \_\_\_\_\_ price, or the price they offer to pay, and the \_\_\_\_\_ price, or the price at which they offer to sell the currency.
- Brokers; ask; bid
  - Dealers; ask; bid
  - Dealers; bid; ask
  - Brokers; bid; ask

- \_\_\_ 53. In January 2002, the Argentine Peso changed in value from Peso1.00/\$ to Peso1.40/\$, thus, the Argentine Peso \_\_\_\_\_ against the U.S. dollar.
- remained neutral
  - weakened
  - strengthened
  - all of the above
- \_\_\_ 54. The twin agency problems limiting financial globalization are caused by these two groups acting in their own self-interests rather than the interests of the firm.
- Corporate insiders and rulers of sovereign states.
  - Attorneys and unsavory customs officials.
  - Corporate insiders and attorneys.
  - Rulers of sovereign states and unsavory customs officials.
- \_\_\_ 55. is the risk that the host government will take specific steps that prevent the foreign affiliate from exercising control over the firm's assets.
- Business income risk
  - Expropriation
  - Inconvertibility
  - None of the above
- \_\_\_ 56. Terrorism, cyber attacks, and the anti-globalization movement are each examples of \_\_\_\_\_ risks.
- global-specific
  - country-specific
  - institutional
  - firm-specific
- \_\_\_ 57. If an identical product can be sold in two different markets, and no restrictions exist on the sale or transportation costs, the product's price should be the same in both markets. This is known as
- the law of one price.
  - relative purchasing power parity.
  - equilibrium.
  - interest rate parity.
- \_\_\_ 58. An in-house bank
- is a separate bank chartered to operate within a business firm.
  - assesses the credit standing of the bank's customers.
  - is in fact a set of functions performed by the firm's existing treasury department.
  - provides banking services for employees.



59. A \_\_\_\_\_ hedge refers to an offsetting operating cash flow such as a payable arising from the conduct of business.
- futures
  - natural
  - contractual
  - financial
60. In the foreign exchange market, \_\_\_\_\_ seek all of their profit from exchange rate changes while \_\_\_\_\_ seek to profit from simultaneous exchange rate differences in different markets.
- wholesalers; retailers
  - dealers; brokers
  - central banks; treasuries
  - speculators; arbitragers

**SECTION B: Attempt TWO QUESTIONS ONLY from this section. (40 marks)**

**QUESTION 1 (20 marks)**

- a) John Bisaba, a foreign exchange trader for a bank in Chicago, can invest \$6 million or the equivalent in Danish Kroner (Kr) of the bank's short term funds, in a covered interest arbitrage between the US dollar and the Danish Kroner. John faces the quotes in the following table:

Spot exchange rate	Kr 7.1800/\$
Three-month forward exchange rate	Kr 7.220/\$
Three-month U.S. interest rate	4.000% p.a. (1.0000% per quarter)
Three-month Danish interest rate	6.800% p.a. (1.700% per quarter)

- Use the Arbitrage Rule of Thumb or other means to show that John Bisaba can make an arbitrage profit.
  - In which currency should he invest, and which should he borrow?
  - Show how the covered interest arbitrage would be executed.
  - Calculate John Bisaba's rate of return on the transaction on an annual basis.
- (14 marks)
- b) Compare and contrast foreign currency options and futures. Identify situations when you may prefer one vs. the other when speculating on foreign exchange. (6 marks)

QUESTION 2 (20 marks)

- a) What are some of the reasons central banks and government treasuries enter the foreign exchange markets, and in what important ways are they different from other foreign exchange participants? (5 marks)
- b) How does counterparty risk influence a firm's decision to trade exchange-traded derivatives rather than over-the-counter derivatives? (5 marks)
- c) Your firm is faced with paying a floating rate debt obligation. How would you hedge your position using interest rate futures? Explain the position outcome if interest rates go up, and if interest rates go down. (5 marks)
- d) List and explain the five main strategic motives that could drive a firm's decision to initiate foreign direct investment (FDI). (5 marks)

QUESTION 3 (20 marks)

- a) With respect to the relationship between exchange rates and interest rates in the eurocurrency markets, determine the 90-day forward exchange rate of GHS/\$, if the current spot exchange rate is GHS2.050/\$ and the 90-day 'Eurocedi' deposit rate and the 90-day Eurodollar deposit rates are 10% and 4% respectively. Decide whether the Ghana cedi will be sold forward at a premium or at a discount, and by what percentage.

*For this question use a day count convention of 360 days per year.*

(8 marks)

- b) Define spot, forward, and swap transactions in the foreign exchange market and give an example of how each could be used. (6 marks)
- c) What does the OLI Paradigm propose to explain? Define each component and provide an example of each. (6 marks)