THE UNIVERSITY OF THE WEST INDIES

CAVE HILL CAMPUS

EXAMINATIONS OF APRIL/MAY 2008

CODE AND NAME OF COURSE: MGMT 3053 – ***INTERNATIONAL FINANCIAL MANAGEMENT***

DATE AND TIME: APRIL/MAY 2008 *DURATION: 2 HOURS*

INSTRUCTIONS TO CANDIDATES: This exam paper has 3 pages with a total of four questions. Section one is compulsory and has one question worth 40 marks. Section two has three questions from which candidates may answer any one question. Each question is worth 20 marks.

SECTION 1

1 a) List the factors that influence foreign exchange rates and briefly explain how they affect the foreign exchange rates. (8 marks)

b) Explain what is meant by the cross exchange rate. In addition, assume the zloty is worth $0.17 and the Japanese yen is worth $0.008. What is the cross rate of the zloty with respect to the yen? (4 marks)

c) List and explain the various methods of forecasting and the limitations of each type. In addition, briefly explain four main reasons why MNC's embark on some type of forecasting exercise. (9 marks)

d) Compare and contrast forward and futures contracts. (5 marks)

e) Mr. Donald sold a put option on Canadian dollars for $0.03 per unit. The strike price was $0.75 and the spot rate at the time the option was exercised was $0.72. Assume Mr. Donald immediately sold off the Canadian dollars when the option was exercised. Also assume that there are 50,000 units in a Canadian dollar option. What was Mr. Donald's net profit on the put option? (4 marks)

f) Compare and contrast the three types of exchange rate systems, listing the advantages and disadvantages of each type. (6 marks)

g) Explain how a central bank can use direct intervention to change the value of a currency. If a central bank decides to directly in a foreign exchange market and floods the market with its home currency, explain how the value of the home currency will change as a result of this action. (4 marks)

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SECTION 2

2. (a) Explain the concept of interest rate parity and provide the rationale for its possible existence. (4 marks)

(b) Assume the following information:

	CBD Bank	Yardle Bank
Bid price of New Zealand dollar	$0.401	$0.398
Ask price of New Zealand dollar	$0.404	$0.400

Given the above, is locational arbitrage possible? If so, compute the profit from this arbitrage if you had $1,500,000 to use. What market forces would occur to eliminate any further possibilities of locational arbitrage? (7 marks)

(c) Assume the following information:

	Quoted price
Value of Canadian dollar in US dollars	$0.90
Value of New Zealand dollar in US dollars	$0.30
Vale of Canadian dollar in New Zealand dollars	NZ $3.02

Given the above, is triangular arbitrage possible? If so, compute the profit from this arbitrage if you had $1,500,000 to use. What market forces would occur to eliminate any further possibilities of triangular arbitrage? (9 marks)

3. (a) Briefly explain the theories of Purchasing Power Parity and the International Fisher Effect (5 marks)

(b) Assume the following information is available for the United States and Europe:

	U.S	Europe
Nominal Interest rate	4%	6%
Expected inflation	2%	5%
Spot rate	-	$1.12
One-year forward rate	-	$1.09

i) Does IRP hold? Why?

ii) According to PPP, what is the expected spot rate of the Euro in 1 year?

iii) According to IFE, what is the expected spot rate of the Euro in 1 year?

(4 marks)

P.T.O

(c) Assume Trinidad has a 1 year interest rate which is higher than the Barbados 1 year interest rate. Assume also that you believe in the theories of interest rate parity and the International Fisher effect.

Lisa is based in Barbados and intends to speculate by purchasing TT dollars, and investing them in the Trinidad market and then converting the back to Barbados dollars at the end of the year. Lisa will not be covering her position in the forward market.

Ed is based in Trinidad and attempts covered interest arbitrage by purchasing Bds dollars and simultaneously selling Bds dollars 1 year forward. He then will invest the Bds dollars for 1 year and covert the Bds dollars back to TT dollars at the end of 1 year.

Will the rate of return on Lisa's investment be higher than, lower than, or the same as the rate of return on Ed's investment? Explain. (4 marks)

(d) Assume that you believe in purchasing power parity. The spot rate of the British pound is \$1.80. The spot rate of the Swiss franc is 0.4 pounds. You expect that the one-year inflation rate is 8% in the United Kingdom, 5% in Switzerland, and 1 % in the United States. The one-year interest rate is 6% in the United Kingdom, 2% in Switzerland and 4% in the United States. What is the expected spot rate of the Swiss franc in 1 year with respect to the U.S. dollar? Show your work. (7 marks)

4. (a) Compare the theories of Purchasing Power Parity, the International Fisher Effect and Interest Rate Parity. (5 marks)

(b) List and explain the four scholarly arguments that have been proposed against exchange rate risk relevance (8 marks)

(c) List and explain the three types of foreign exchange exposure. In addition, briefly explain whether you think translation exposure is relevant. (7 marks)

END OF QUESTION PAPER