



THE UNIVERSITY OF THE WEST INDIES
CAVE HILL

EXAMINATIONS OF APRIL/MAY 2015

CODE AND NAME OF COURSE: MGMT3053 – INTERNATIONAL FINANCIAL MANAGEMENT

DATE AND TIME:

DURATION: 2 HOURS

INSTRUCTIONS TO CANDIDATES: This paper has 7 pages and 23 questions.

Section one is compulsory and has twenty questions worth 1 mark each. Section two has three questions from which candidates may answer any two (2) questions. Each question is worth 25 marks.

SECTION One

Answer all questions in this section.

1. A weak home currency may not be a perfect solution to correct a balance of trade deficit because:
 - A) it reduces the prices of imports paid by local companies.
 - B) it increases the prices of exports by local companies.
 - C) it prevents international trade transactions from being prearranged.
 - D) foreign companies may reduce the prices of their products to stay competitive.
2. Which of the following would likely have the *least* direct influence on a country's current account?
 - A) inflation.
 - B) national income.
 - C) exchange rates.
 - D) a tax on income earned from foreign stocks
3. If a currency's spot rate market is ____, its exchange rate is likely to be ____ to a single large purchase or sale transaction.
 - A) Liquid; highly sensitive
 - B) Illiquid; insensitive
 - C) Illiquid; highly sensitive
 - D) None of the above

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4. The equilibrium exchange rate of pounds is \$1.70. At an exchange rate of \$1.72 per pound:
- A) Demand for pounds would exceed the supply of pounds for sale and there would be a shortage of pounds in the foreign exchange market.
 - B) Demand for pounds would be less than the supply of pounds for sale and there would be a shortage of pounds in the foreign exchange market.
 - C) Demand for pounds would exceed the supply of pounds for sale and there would be a surplus of pounds in the foreign exchange market.
 - D) Demand for pounds would be less than the supply of pounds for sale and there would be a surplus of pounds in the foreign exchange market.
5. The 90-day forward rate for the euro is \$1.07, while the current spot rate of the euro is \$1.05. What is the annualized forward premium or discount of the euro?
- A) 1.9 percent discount.
 - B) 1.9 percent premium.
 - C) 7.6 percent premium.
 - D) 7.6 percent discount.
6. Which of the following is true?
- A) The futures market is primarily used by speculators while the forward market is primarily used for hedging.
 - B) The futures market is primarily used for hedging while the forward market is primarily used for speculating.
 - C) The futures market and the forward market are primarily used for speculating.
 - D) The futures market and the forward market are primarily used for hedging.
7. A firm will likely benefit *most* from diversifying if:
- A) the correlations between country economies are high.
 - B) the correlations between country economies are low.
 - C) the variability of all country economy levels is high.
 - D) the correlations between country economies are low AND the variability of all country economy levels is high.
8. Assume the bid rate of a New Zealand dollar is \$.33 while the ask rate is \$.335 at Bank X. Assume the bid rate of the New Zealand dollar is \$.32 while the ask rate is \$.325 at Bank Y. Given this information, what would be your gain if you use \$1,000,000 and execute locational arbitrage? That is, how much will you end up with over and above the \$1,000,000 you started with?
- A) \$15,385.
 - B) \$15,625.
 - C) \$22,136.
 - D) \$31,250.

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9. Assume zero transaction costs. If the 180-day forward rate is an accurate estimate of the spot rate 180 days from now, then the real cost of hedging receivables will be:
- A) positive.
 - B) negative.
 - C) positive if the forward rate exhibits a premium, and negative if the forward rate exhibits a discount.
 - D) zero

10. You have \$1,000,000 to invest:

Current spot rate of pound	=	\$1.60
90-day forward rate of pound	=	\$1.57
3-month deposit rate in U.S.	=	3%
3-month deposit rate in U.K.	=	4%

If you use covered interest arbitrage for a 90-day investment, what will be the amount of U.S. dollars you will have after 90 days?

- A) \$1,020,500.
 - B) \$1,045,600.
 - C) \$1,073,330.
 - D) \$1,094,230.
11. An argument for MNCs to have a debt-intensive capital structure is:
- A) they are well diversified.
 - B) foreign government tax rules may change over time.
 - C) exposure to exchange rate fluctuations.
 - D) exposure to fund blockage.
12. It has been argued that the exchange rate can be used as a policy tool. Assume that the government would like to reduce unemployment. Which of the following is an appropriate action given this scenario?
- A) weaken the dollar.
 - B) strengthen the dollar.
 - C) buy dollars with foreign currency in the foreign exchange market.
 - D) implement a tight monetary policy.
13. If interest rate parity exists, then ____ is not feasible.
- A) forward realignment arbitrage
 - B) triangular arbitrage
 - C) covered interest arbitrage
 - D) locational arbitrage

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14. Assume that interest rate parity holds. The U.S. five-year interest rate is 5% annualized, and the Mexican five-year interest rate is 8% annualized. Today's spot rate of the Mexican peso is \$.20. What is the approximate five-year forecast of the peso's spot rate if the five-year forward rate is used as a forecast?
- A) \$.131.
 - B) \$.226.
 - C) \$.174.
 - D) \$.140.
15. Which of the following forecasting techniques would best represent the use of today's forward exchange rate to forecast the future exchange rate?
- A) fundamental forecasting.
 - B) market-based forecasting.
 - C) technical forecasting.
 - D) mixed forecasting.
16. Economic exposure refers to:
- A) the exposure of a firm's international contractual transactions to exchange rate fluctuations.
 - B) the exposure of a firm's local currency value to transactions between foreign exchange traders.
 - C) the exposure of a firm's financial statements to exchange rate fluctuations.
 - D) the exposure of a firm's cash flows to exchange rate fluctuations.
17. Diz Co. is a U.S.-based MNC with net cash inflows of euros and net cash inflows of Swiss francs. These two currencies are highly correlated in their movements against the dollar. Yanta Co. is a U.S.-based MNC that has the same level of net cash flows in these currencies as Diz Co. except that its euros represent net cash outflows. Which firm has a higher exposure to exchange rate risk?
- A) Diz Co.
 - B) Yanta Co.
 - C) the firms have about the same level of exposure.
 - D) neither firm has any exposure.
18. Laketown Co. has some expenses and revenue in euros. If its expenses are more sensitive to exchange rate movements than revenue, it could reduce economic exposure by _____. If its revenues are more sensitive than expenses, it could reduce economic exposure by _____.
- A) decreasing foreign revenues; decreasing foreign expenses
 - B) decreasing foreign revenues; increasing foreign expenses
 - C) increasing foreign revenues; decreasing foreign revenues
 - D) decreasing foreign expenses; increasing foreign revenues

19. Depreciation of the euro relative to the U.S. dollar will cause a U.S.-based multinational firm's reported earnings (from the consolidated income statement) to _____. If a firm desired to protect against this possibility, it could stabilize its reported earnings by _____ euros forward in the foreign exchange market.
- A) be reduced; purchasing
 B) be reduced; selling
 C) increase; selling
 D) increase; purchasing
20. If a firm does not have foreign subsidiaries, it is not subject to _____.
- A) transaction exposure
 B) economic exposure
 C) A and B
 D) translation exposure

(Total 20 marks)

SECTION Two

*Choose two questions from this section.***Question 1**

- A) Four main schools of thought exist as to the relevance of exchange rate risk. The Multinational Corporation's treatment of exchange rate risk is a result of their thoughts on exchange rate risk. Discuss three schools of thought surrounding exchange rate risks, and the MNC's response to these arguments. (10 marks)
- B) Langford Inc. expects to pay S\$2,125,000 in one year on a loan. The existing spot rate of the Singapore dollar is \$.58. The one-year forward rate of the Singapore dollar is \$.62. Langford created a probability distribution for the future spot rate in one year as follows:

<u>Future Spot Rate</u>	<u>Probability</u>
\$.57	30%
.60	35
.65	35

Assume that one-year put options on Singapore dollars are available, with an exercise price of \$.64 and a premium of \$.04 per unit. One-year call options on Singapore dollars are available with an exercise price of \$.59 and a premium of \$.03 per unit. Assume the following money market rates:

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Question 1 (cont'd)

	<u>U.S.</u>	<u>Singapore</u>
Deposit rate	8%	5%
Borrowing rate	9	6

Required:

- (i) Given this information, determine whether a forward hedge, money market hedge, or a currency options hedge would be most appropriate. (10 marks)
- (ii) Calculate the effective exchange rate that Langford would lock in on its payables position if it used a money market hedge. (2 marks)
- (iii) Compare the most appropriate hedge to an unhedged strategy, and decide whether Langford should hedge its payables position. (3 marks)

Question 2

- A) Explain what is meant by the term "Quantitative Easing". Give examples of two countries which have used this technique and discuss whether or not it was successful, and state with supporting arguments whether or not you believe this question would be appropriate for Caribbean countries. (20 marks)
- B) Stacey is a currency speculator. She believes that the Euro will fluctuate widely against the U.S. dollar in the coming month. Currently, one-month call options on Euro are available with a strike price of \$1.10 and a premium of \$.025 per unit. One-month put options on Euro are available with a premium of \$.017 per unit. One option contract on Euro contains 500,000 Euro.

Required:

- i) What type of derivative should Stacey enter into? Explain why she should choose this type of derivative. (2 marks)
- ii) Construct a contingency graph representing Stacey's expected payoff on her chosen type of derivative if she takes a long position in this derivative. (in (i) above). (3 marks)

Question 3

JanaeCo is a U.S. firm conducting a financial plan for the next year. It has no foreign subsidiaries, but more than half of its sales are from exports. Its foreign cash inflows to be received from exporting and cash outflows to be paid for imported supplies over the next year are shown in the following table:

Currency	Total Inflow	Total Outflow
Canadian dollars (C\$)	C\$32,000,000	C\$2,000,000
New Zealand dollars (NZ\$)	NZ\$5,000,000	NZ\$1,000,000
Mexican pesos (MXP)	MXP11,000,000	MXP10,000,000
Singapore dollars (S\$)	S\$4,000,000	S\$8,000,000

The spot rates and one-year forward rates as of today are:

Currency	Spot Rate	One-Year Forward Rate
C\$	\$.90	\$.93
NZ\$.60	.59
MXP	.18	.15
S\$.65	.64

Required:

- A) Based on the information provided, determine the net exposure of each foreign currency in dollars. (5 marks)
- B) Assume that today's spot rate is used as a forecast of the future spot rate one year from now. The New Zealand dollar, Mexican peso, and Singapore dollar are expected to move in tandem against the U.S. dollar over the next year. The Canadian dollar's movements are expected to be unrelated to movements of the other currencies. Since exchange rates are difficult to predict, the forecasted net dollar cash flows per currency may be inaccurate. Do you anticipate any offsetting exchange rate effects from whatever exchange rate movements do occur? Explain. (7 marks)
- C) Given the forecast of the Canadian dollar along with the forward rate of the Canadian dollar, compute the expected increase or decrease in dollar cash flows that would result from hedging the net cash flows in Canadian dollars and advise if you hedge the Canadian dollar position. (5 marks)
- D) Assume that the Canadian dollar net inflows may range from C\$20,000,000 to C\$40,000,000 over the next year. Explain the risk of hedging C\$30,000,000 in net inflows, and suggest ways in which JanaeCo can avoid these risks. (8 marks)

END OF EXAMINATION PAPER