CHUKA UNIVERSITY

UNIVERSITY SUPPLEMENTARY/SPECIAL EXAMINATIONS.

EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF COMMERCE

BCOM 432/434: INTERNATIONAL FINANCE

STREAMS: BCOM **TIME: 2 HOURS**

DAY/DATE: TUESDAY 24/07/2018 **2.30 P.M - 4.30 P.M**

INSTRUCTIONS:

- Attempt **Question ONE and any other TWO Questions**
- Do not write anything on the Question paper.

(a) Define a letter of credit and briefly explain its importance in international trade. [4 Marks]

(b) Assume that in the sport market 1$ = € 1.12

Required:

(i) The forward market rate in one year, of Dollar depreciates by 10%. [2 Marks]
(ii) The forward market rate in one year, if Euro appreciates by 10%. [2 Marks]
(Note that the appreciation and depreciation of the two transactions above are independent)

(c) Distinguish between "integration of financial markets" and "segmentation of financial markets". [4 Marks]

(d) A company whose home currency is the dollar ($) expects to receive 500,000 pesos in six month's time from a customer in a foreign country.

The following interest rates and exchange rates are available to the company:

Dollar Spot rate quote	15.00 peso
Dollar six-month forward rate quote	15.30 peso

	Home country	Foreign Country
Borrowing interest rate	4% per year	8% per year
Lending interest rate	3% per year	6% per year

Required:

Six-month dollar value of the expected receipt using a money-market hedge. [6 Marks]

(e) Suppose that the Pound Sterling is bidding at $1.9724 in New York and the Euro at $1.3450 in Frankfurt. At the same time, London banks are offering the Pound Sterling at €1.4655.

Required:
Show the steps that an astute trader would follow to earn riskless profit assuming that the trader has €1,000,000 [8 Marks]

(f) The services and operations of international banks are a function of the regulatory environment in which the bank operates and the type of banking facility established. Distinguish between a Correspondent Bank and a representative office. [4 Marks]

QUESTION TWO

(a) Distinguish between 'multilateral cash netting' and 'bilateral cash netting'. [4 Marks]

(b) Briefly describe 'foreign currency transaction risk' and explain three internal methods which could be used by MNCs to manage foreign currency transaction. [6 Marks]

(c) SGL Company, a U.S. MNC, is contemplating making a foreign capital expenditure in South Africa. The initial cost of the project is ZAR 10,000. The annual cash flows over the five-year economic life of the project in ZAR are estimated to be 3,000, 4,000, 5,000, 6,000 and 7,000. The parent firm's cost of capital in dollars is 9.5 percent. Long-run inflation is forecasted to be 3 percent per annum in the United States and 7 percent in South Africa. The current spot foreign exchange rate is ZAR/USE = 3.75.

Required:
Advise if the project should be accepted. [10 Marks]

QUESTION THREE

(a) Briefly explain the role played by International Bank for Reconstruction and Development. (IBRD) [5 Marks]

(b) A US Company expects to pay its German supplier €1.2 million in 90 day's time. The Current spot rate quote for the Euro is $1.2582 and the 90-day forward rate is $ 1.2636. A call option on the Euro expiring in 90 days has an exercise price of $1.26 and a premium of $0.0098. The option is only exercisable at the end of the period. The forecast of the future spot rate is $1.25.

Required:
Evaluate how much the US Company will pay its German supplier under each of the following alternatives.

(i) No hedging takes place [2 Marks]
(ii) Arranging a forward contract hedge [2 Marks]
(iii) Arranging an option hedge. [5 Marks]

(c) Briefly explain any four factors that influence the Bid-ask spread on currency quotations. [6 Marks]

QUESTION FOUR

(a) Describe any six main causes of capital markets segmentation. [6 Marks]

(b) A current spot and forward exchange rates for Franc are as follows:

Spot rate	(FF/$): 5.9375-5.9405
One-month Franc forward	74 - 100 pips

Required:

Outright forward quotation. [4 Marks]

(c) Explain the major dimensions that distinguish international finance from domestic finance. [6 Marks]

(d) Consider the following:

Spot Rate: $0.65/DM
German 1-yr interest rate:9%
US 1-yr interest rate: 5%

Required:

The arbitrage gain on $100 million, if one year forward rate was quoted at $ 0.60/DM. [4 Marks]

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