CHUKA UNIVERSITY

UNIVERSITY EXAMINATIONS

SECOND YEAR EXAMINATION FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION

MBAD 835: INTERNATINAL FINANCE

STREAMS: MBAD (Y1S2) TIME: 3 HOURS

DAY/DATE: FRIDAY 07/12/2018 2.30 P.M. – 5.30 P.M.

INSTRUCTIONS: Attempt ALL questions

QUESTION ONE

(a) Explain any four dimensions that distinguish international finance from domestic finance [6 marks]

(b) A current spot exchange rate is \$1.50/£ and the three month forward exchange rate is \$1.52/£. The three month interest rate is 8.0 percent per annum in the U.S and 5.8 percent per annum in the U.K . Assume that you can borrow as much as \$1,500,000 or £1,000,000.

Required:

(i) Determine whether interest rate parity is currently holding [2 marks]

(ii) If IRP is not holding, determine the arbitrage profit [6 marks]

(c) You have been provided with the following series of exchange rates

1\$ = SwFr 1.6639 – 1.6646

1 € = \$0.9682 – 0.9686

1 € = SwFr 1.6410 – 1.6423

Assume that you have \$1,000,000 in cash

Required:

Demonstrate how you could take advantage of these exchange rates to obtain arbitrage gain [6 marks]

(d) ABC Plc expects to receive $1,200,000 in the next three months to 31 December 2016

The current spot rate is $/£ 1.5020 – 1.5110

The current future price on a contract size of £62,500 is $/£1.5035

The spot exchange rate in December is forecast at $/£62,600 is $/£1.5035

The spot exchange rate in December is forecast at $/£1.5100 – 1.5190 while the December 2016 futures is selling at $/£1.5120

Required: The outcome of the futures contract hedge [5 marks]

QUESTION TWO

(a) Using an illustration, distinguish between a direct exchange rate quote and indirect exchange rate quote [4 marks]

(b) Centre ltd is a medium sized company whose ordinary shares are all owned by the members of one family. It has recently begun exporting to a European country and expects to receive €500,000 in six months' time

The company could put cash on deposit in the European country at an annual interest rate of 3% per year, and borrow at 5% per year. The company could put cash on deposit in its home country at an annual interest rate of 4% per year, and borrow at 6% per year. Inflation in the European country is 3% per year, while inflation in the home country of centre ltd is 4.5% per year.

The following exchange rates are currently available to centre ltd

Current spot exchange rate	2.000 euro per $
Six month forward exchange rate	1.990 euro per $
One year forward exchange rate	1.981 euro per $

Required:

Calculate whether a forward exchange contract or a money market hedge would be financially preferred by Centre ltd to hedge its future euro receipt [10 marks]

(c) Delta 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, 4000, 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 rateis ZAR/USD = 3.75

Required:

Advise if the project should be accepted [11 marks]

QUESTION THREE

(a) 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 [7 marks]

(b) Distinguish between the following concepts in international finance

(i) Bilateral cash netting and multilateral netting [4 marks]

(ii) Correspondent bank and relationship bank [4 marks]

(c) Describe the following international financial markets

(i) International money market [5 marks]

(ii) International bond market [5 marks]

QUESTION FOUR

(a) Most developed financial markets are considered to be integrated. However, it is sometimes claimed that international financial markets are not integrated because of various impediments.

Required:

Explain any five causes of capital markets segmentation [10 marks]

(b) Bright PLC is a large multinational company based in the UK with a number of subsidiary companies around the world. Currently, foreign exchange exposure as a result of transactions between Bright PLC and its subsidiary companies is managed by each company individually. Bright PLC is considering whether or not to manage the foreign exchange exposure using multilateral netting from the UK, with the Sterling Pound (£) as the base currency.

The following cash flows are due in three months between Bright PLC and one of its subsidiary SGL ltd, based in the United States (currency US$).

Owed by	Owed to	Amount
Bright PLC	SGL ltd	US$4.5 million
SGL Ltd	Bright PLC	US$2.1 million

Exchange rates available to Bright PLC:

	US$/£1
Spot	1.5938-1.5962
3-month forward	1.5996 – 1.6037

Currency options available to Bright PLC:

Contract size £62,500, exercise price quotation: US$/£1, Premium: cents per £1

	Call options		Put options	
Exercise price	3-month	6-month	3-month	6-month
1.60	1.55	2.25	2.08	2.23
1.62	0.98	1.58	3.42	3.73

Required:

Advice Bright PLC on, and recommend, an appropriate hedging strategy for the cash flows it is due to receive or pay in three months from the subsidiary. [15 marks]
