NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE

DEPARTMENT OF BANKING

BACHELOR OF COMMERCE HONOURS DEGREE IN BANKING

BANKING AND FOREIGN EXCHANGE

CBA 2202

FINAL EXAMINATION **AUGUST 2009**

TIME: 3 HOURS

INSTRUCTIONS TO CANDIDATES

- The paper contains **SIX (6)** questions.
- Answer any **FOUR (4)** questions.
- All questions carry equal marks **[25 marks].**
- Start the answer to each question on a fresh page of the answer sheet.
- Indicate on your answer booklet whether you are in the conventional or parallel programme.

INFORMATION FOR CANDIDATES

Questions may be written in any order, but must be legibly numbered.

The businesses in this question paper are intended to be fictitious.

This paper consists of 4 printed pages

Turn over]

QUESTION 1

Assume that Zimbabwe invests heavily in Government and Corporate Securities of Mozambique. In addition, residents of Mozambique invest heavily in Zimbabwe. Approximately US$ 10 billion worth of investment transactions occur between these two countries each year. The total dollar value of trade transactions per year is about US$8 million. This information is expected to also hold in the future.

Your client, Pombiyadonha Holdings exports goods to Mozambique. They require your bank to forecast the value of Mozambique's currency *(the meticas*), with respect to the dollar. Explain how each of the following conditions will affect the value of the *meticas*, holding other things equal.

a) Zimbabwe inflation has suddenly increased substantially, while Mozambique inflation remains low.
[5 marks]

b) Zimbabwe interest rates have increased substantially, while Mozambique's interest rates remain low. Investors of both countries are deemed rational. **[5 marks]**

c) Zimbabwe's income level has increased substantially, while Mozambique's income level has remained unchanged.
[5 marks]

d) Zimbabwe is expected to impose a small tariff on goods imported from Mozambique. **[5 marks]**

e) Combine all expected impacts to develop an overall forecast.
[5 marks]

TOTAL [25 MARKS]

QUESTION 2

A call option on Canadian dollars with a strike price of $, 60 is purchased by a speculator for a premium of $, 06 per unit. Assume there are 50 000 units in this option contract.

i) If the Canadian dollar spot rate is $, 65 at the time the option is exercised, what is the net profit per unit to the speculator?
[5 marks]

ii) What is the net profit for one contract? **[5 marks]**

iii) What would the spot rate need to be at the time of the option is exercised for the speculator to break even? **[5 marks]**

iv) What is the net profit per unit to the seller of this option? **[5 marks]**

v) What factors affect currency call option premiums? **[5 marks]**

TOTAL **[25 MARKS]**

QUESTION 3

Assume the Reserve Bank of Zimbabwe (RBZ) believes that the dollar should be weakened against the Mozambican *meticas.* Explain how the RBZ could use direct and indirect intervention to weaken the dollar's value with respect to the *meticas.* Assume that future inflation in Zimbabwe is expected to be low, regardless of the RBZ's actions. **[25 marks]**

TOTAL **[25 MARKS]**

QUESTION 4

a) Assume the following information:

	Bank Vuka	*Bank Donha*
Bid Price of New Zealand dollars	$, 401	$, 398
Ask Price of New Zealand dollars	$, 404	$, 400

Given this information, is arbitrage possible? If so explain the steps involved in locational arbitrage, and compute the profit from this arbitrage if you had $1 000 000 to use.

[12 marks]

b) You are further given the following information:

Spot rate of Canadian dollar	=$, 80
90 day forward rate of Canadian collar	=$, 79
90 day Canadian Interest rate	= 4%
90 day US interest rate	=2, 5%

Given this information, what would be the yield (percentage return to a US investor who used covered interest arbitrage? Assume an investment of $1 000 000. **[13 marks]**

TOTAL **[25 MARKS]**

QUESTION 5

a) Suppose that the spot quote on the Swiss Franc (CHF) is $, 3302-10 and the Spot quote on the Swedish kroner (SWK) is $, 1180-90.

i) What is the direct spot quote in Zurich? **[6 marks]**

ii) Compute the percentage bid-ask spread on the CHF and the SWK **[6 marks]**

iii) Compute the forward discount or premium for the CHF, given additional information that the 90 day forward rate is $, 3305 and the Spot rate is $, 3302. State whether your answer is a discount or a premium. **[7 marks]**

b) Assume Poland's currency, the zloty is worth $, 17 and the Japanese yen is worth $, 008. What is the cross rate of the zloty with respect to the yen? **[6 marks]**

TOTAL **[25 MARKS]**

QUESTION 6

Boeing Commercial Airplane Company manufactures all its planes in the US and prices them in USD even though 50% of its sales are destined for overseas i.e. non- US markets. Assess fully, Boeing's currency risks and in each instance, describe how Boeing can cope with currency risks. **[25 marks]**

TOTAL **[25 MARKS]**