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]

SUPPLEMENTARY EXAMINATION **AUGUST 2011**

TIME: 3 HOURS

INSTRUCTIONS TO CANDIDATES

- Answer any **FOUR (4)** questions.
- Start the answer to each full question on a fresh page of the answer sheet.
- All calculations are to be presented in good style and workings should be shown.
- Questions may be written in any order, but must be legibly numbered.

INFORMATION FOR CANDIDATES

- **The businesses in this question paper are intended to be fictitious**
- **The paper contains SIX (6) questions.**
- **All questions carry equal marks [25 marks].**

This paper consists of 4 printed pages

QUESTION 1

a) If the Peso is worth US$0.14 and the Canadian dollar (C$) is worth US$0.05, calculate the value of the Peso to the Canadian dollar (C$). **[5 marks]**

b) Stevenson Bank quotes a bid rate of $0.784 for the Australian dollar and an ask rate of $0.080. Compute the bid/ask percentage spread. **[5 marks]**

c) Briefly explain the following terms:

(i)	Foreign Exchange Regime	**[3 marks]**
(ii)	Fixed rate mechanism	**[3 marks]**
(iii)	Managed float	**[3 marks]**
(iv)	Target zone arrangement	**[3 marks]**
(v)	Free float	**[3 marks]**

TOTAL **[25 MARKS]**

QUESTION 2

a) Assume the Reserve Bank believes that the dollar should be weaker against the South African rand. Critically analyze how the Reserve Bank could use direct and indirect intervention to weaken the value of the dollar with respect to the rand. **[15 marks]**

b) What would motivate the Reserve Bank to attempt to weaken the dollar? **[10 marks]**

TOTAL **[25 MARKS]**

QUESTION 3

a) Assume that the following spot exchange rates exist today:

£ = $1, 40

C$ = $0, 70

£ = C$2

Assume no transaction cost. Based on these exchange rates, can triangular arbitrage be used to earn a profit? Explain your answer. **[12 marks]**

b) Assume the following information:

Spot rate of the £ = $1, 60

180-day forward rate of the £ = $1, 56

180-day British interest rate = 4%

180-day US interest rate = 3%

Based on this information, is covered interest arbitrage by US investors feasible? Explain your answer **[13 marks]**

TOTAL [25 MARKS]

QUESTION 4

a) Define exposure, differentiating between accounting and economic exposure. **[5 marks]**

b) Under what circumstances might multinational firms be less subject to exchange rate risk than purely domestic firms in the same industry? **[5 marks]**

c) What factors influence a firm's transaction exposure? For each factor, explain the desirable characteristics that would reduce transaction exposure. **[6 marks]**

d) Identify **3** participants in the forward exchange market and explain fully, each of their roles. **[9 marks]**

TOTAL [25 MARKS]

QUESTION 5

a) Discuss the factors that determine exchange rates in the foreign exchange markets. **[15 marks]**

b) Assume that Divine Banking Corporation can borrow $5 million at 6 percent annualized. The bank use the proceeds to invest in Canadian dollars at 9 percent annualized over a six-day period. The Canadian dollar is worth $0, 95 and is expected to be worth $0, 94 in six days. Based on this information, should Divine Banking Corporation borrow United States dollars and invest in Canadian dollars? What would be the gain or loss in United States dollars? **[10 marks]**

TOTAL [25 MARKS]

QUESTION 6

a) The Purchasing Power Parity (PPP) theory is one of the most popular and controversial theories in international finance. Evaluate this theory, clearly indicating its application and any deviations from the theory in the real world. **[12 marks]**

b) Discuss the Interest Rate Parity (IRP) theory. **[8 marks]**

c) What are some of the limitations of using technical forecasting to predict exchange rates? **[5 marks]**

TOTAL **[25 MARKS]**