NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF BANKING
MASTER OF SCIENCE IN BANKING AND FINANCIAL SERVICES

INTERNATIONAL BANKING - CBA 5203

FINAL EXAMINATION **DECEMBER 2009**

TIME: 3 HOURS

INSTRUCTIONS TO CANDIDATES

- The paper contains **SIX (6)** questions.
- Answer questions 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.

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 6 printed pages

[Turn over]

QUESTION 1

a) Clearly distinguish between the balance of payments approach and asset market approach in fundamental analysis currency forecasting. **[2marks]**

b) What facts and figures are frequently watched when carrying out a fundamental analysis using the balance of payments approach? **[8 marks]**

c) What forecasting methods would you recommend be used under the following situations? Give reasons for the recommendations:

(i) Short run : Fixed rate
Floating rate **[4 marks]**

(ii) Long run : Fixed rate
Floating rate **[4 marks]**

d) You are a junior currency dealer for XYZ Bank Limited. The spot rate this morning is ZW$13 per ZAR while the 60 day forward rate is quoted as ZW$ 18.5 per ZAR. The current 60 day interest rates in Zimbabwe and South Africa are 300% and 20% per annum respectively. Your boss believes an opportunity for making risk- less profit exists given the above rates

(i) Prove if indeed an opportunity for covered interest arbitrage exists. **[2 marks]**

(ii) In clear steps, show how much profit you can make given that you can borrow Z$ 1million or ZAR 1 million **[5 marks]**

TOTAL **[25 MARKS]**

QUESTION 2

a) Identify and explain in detail factors that account for interest rate differentials between the Euro currency markets and the domestic markets in particular as regards to both deposit and lending interest rates. **[9 marks]**

b) A local company has successfully negotiated a foreign currency based syndicated loan facility whose details are given below:

Principal	US$ 1 000 000 000
Maturity	5 years
Base interest rate	LIBOR
Spread	2%
Syndication fee	1 ½ %

(i) What would be the actual loan proceeds from the syndicated credit **[3 marks]**

(ii) What would be the effective annual cost of the funds for the first year assuming that LIBOR is 10.5% **[5 marks]**

c) Outline in detail a typical syndication procedure in issuing of Eurobonds. Describe the role of each participant. **[8 marks]**

TOTAL **[25 MARKS]**

QUESTION3

a) The British and the American governments established the International Monetary Fund (IMF), originally to police a system of fixed exchange rates that was universally known as the Bretton Woods system. The main commitment of the countries was to maintain convertibility and to maintain a fixed exchange rate. After the breakdown of the Bretton Woods System in 1973, the IMF remained in existence. Outline in clear detail the responsibilities of the IMF after 1973, giving practical examples to show how they have successfully carried out these duties. **[14 marks]**

b) Which three distinct areas does money laundering encompass? **[3marks]**

c) What efforts has the IMF done in order to combat the effects of typologies? **[8 marks]**

TOTAL **[25 MARKS]**

QUESTION 4

a) MM USA International is planning to raise funds by issuing a 5 year bond with a par value of US$1million. The company is not sure whether to use the Euro bond market or the USA domestic bond market for this purpose and has come to you for advice. You establish the following about the two markets.

	Euro bond market	USA domestic
Coupon rate %	7.5	7.4
Issuing fees %	0.5	0.7
Other related expenses	0.238	0.274
Compounding	annual	semi- annual

Advise the company on the market they should raise the funds from. Show all calculations.

[9 marks]

b) What major reason led to the emergence and subsequent development of the Euro currency market?

[6 marks]

c) Dot Com Plc is seeking to invest $100million short term. It has the choice between buying Euro Commercial Paper (Euro CP) yielding 6.34% annually and a US bank deposit yielding 6.36% annually, both maturing in 150 days. The Euro CP yield is calculated on a 360 day year, whereas the US bank deposit yield is calculated on a 365 day year.

(i) How much Euro CP in terms of face value will Dot Com's $100million buy?

[3 marks]

(ii) Assuming that all else is equal, what will be Dot Com's preferred investment? Give reasons for your answer. **[2 marks]**

(iii) What would the annual yield on the U S bank deposit be if it were quoted on a 360 day year? **[21/2Marks]**

(iv) What would the annual Euro commercial Paper yield if it were quoted on a 365 year? **[2 1/2Marks]**

TOTAL **[25 MARKS]**

QUESTION 5

What is counter-party risk in the interest rate and currency swap market and how has this phenomenon been handled in this market? **[5 marks]**

(a) Company X and Company Y both seek debt funding at the lowest possible cost. As a result of its stable financial condition, Company X prefers the floating rate loan while Company Y prefers a fixed rate loan. On enquiry, the two companies are quoted the following rates in the two segments of the debt market.

Details	**Company X**	**Company Y**
Credit rating	AAA	BBB
Cost of fixed rate loan (%)	10	13
Cost of floating rate loan (%)	LIBOR+ 0.5	LIBOR+1.00

(i) State, with reasons, the segment in which each company has a competitive advantage.

[5 marks]

(ii) Structure a swap transaction that will result in both companies benefiting equally from the maximum interest savings, given that they had initially borrowed where each a comparative advantage had and assuming that there is no intermediary. Assume the floating rate to be used in the swap is LIBOR. Illustrate using a diagram.

[9 marks]

(iii) Structure a swap transaction that will result in Company X getting 60% of the net saving after an intermediary has taken 50 basis points from the maximum possible saving the companies have shared in (ii) above, given that the other assumptions remain the same.

[6 marks]

TOTAL **[25 MARKS]**

QUESTION 6

(a) It is May 4 and the treasurer of a Swiss company has identified a net receipt of US$ 2million on 10 June. These dollars will need to be converted into Swiss francs (CHF). The treasurer has decided to use June US$ - Swiss franc futures contracts to hedge with. The futures contracts have the following details:

- New York board of trade (NYBOT) options and futures exchange
- Contract size $ 200 000
- Prices given in Swiss Francs per US$ (i.e. $1=….)
- Tick price CHF 0.0001 or CHF 20 per contract.

She opens the position on 4 May and closes it on 10 June. Spot and relevant futures prices are as follows:

Date	**Spot**	**Futures Price**
4 May	1.2160	1.2200
0 June	1.2750	1.2760

Calculate the financial position using the hedge described. **[10 marks]**

(b) (i) Clearly distinguish between netting and matching.

[2marks]

(ii) CBZ Commercial Bank, DatVest and CBZ Building society are three companies within the same group. ZB Bank is a company outside of the group. The following liabilities have been identified for the forth coming year.

Owed by	**Owed to**	**Amount (millions)**
CBZ Commercial	DatVest	R45
DatVest	CBZ Commercial	$10
DatVest	CBZ Building society	P10
CBZ Building society	CBZ Commercial	$20
CBZ Building Society	ZB bank	£10
ZB Bank	DatVest	R15
ZB Bank	CBZ Commercial	P10

The current spot rates are: $1= £0.5
$1=R0.75
$1 =P 1.25

Given that the local currency is valued in US $ establish the net external indebtedness that would require external hedging and the net intra group settlement required.

[11marks]

(iii) Which hedging strategy would you recommend that CBZ group use? State the reasons for your recommendations?

[2 marks]

TOTAL **[25 MARKS]**