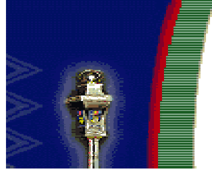

National University of
Science and Technology
Think in Other Terms

FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV – 1st SEMESTER SUPPLEMENTARY EXAMINATION - AUGUST 2011
INTERNATIONAL FINANCE I [CFI 4102]
TIME ALLOWED: 3 HOURS

Instructions

1. Attempt any **FOUR** questions
2. Each Question carries a total of **25 marks.**
3. Write neatly and legibly

Question One

(a) Suppose that the one year interest rate on the South African rand is 15% and that on the US dollar is 5%. The spot exchange rate is ZAR/USD = 7.2000.

i. Calculate the expected future exchange rate using the IFE. [3 marks]

ii. If a change in expectations regarding future South African inflation causes the expected future spot rate to rise to 7.4000, what should happen to South African interest rates? [3 marks]

(b)The interest rate on pounds is 12% p.a in London and the rate on a comparable dollar investment in New York is 7% p.a. the spot rate between the pound and the dollar is $/£ = 1.7500 and the one year forward rate is $/£ = 1.6800.

i. Showing all relevant calculations, determine whether an arbitrage opportunity exists. [4 marks]

ii. Stating all relevant assumptions, show how an arbitrageur would profit based on $1million capital given the information above. [8 marks]

(c)Distinguish between the balance of payments (BOP) and the asset market approaches to forecasting exchange rates. [7 marks]

Total [25 marks]

Question Two

(a) Define the following terms as applied to international trade:

i. Bill of exchange [2 marks]
ii. Forfaiting [2 marks]
iii. Countertrade [2 marks]
iv. Consular invoice [2 marks]

(b) Discuss any **FIVE**types of bills of lading. [10 marks]

(c)Identify and explain **THREE** factors that explain differences in optimal financial structures between MNCs and domestic firms. [7 marks]

Total [25 marks]

Question Three

(a)Discuss the lessons that can be drawn from the Purchasing Power Parity Theory (PPP).

[6 marks]

(b)Evaluate the empirical evidence on the PPP theory. [10 marks]

(c)Distinguish between the Interest Rate Parity Theory (IRP) and the International Fischer Effect (IFE). [6 marks]

(d)Briefly outline the process that restores equilibrium in the foreign exchange markets according to the IRP. [3 marks]

Total [25 marks]

Question Four

(a) Explain how the following instruments and methods are used in financing exports:

i. Banker's Acceptances [3 marks]
ii. Trade Acceptances [2 marks]
iii. Factoring [3 marks]
iv. Bill discounting [2 marks]

(b) Evaluate the use of letters of credit (LCs) in the financing of international trade. In your answer, highlight the benefits to both the exporter and the importer. [15 marks]

Total [25 marks]

Question Five

(a) For each of the following six scenarios, say whether the value of the dollar will appreciate, depreciate, or remain the same relative to the Japanese yen. Explain each answer. Assume that exchange rates are freely floating and that all other factors are held constant.

i. The growth rate of national income is higher in the US than in Japan.
ii. Inflation is higher in the US than in Japan.
iii. Prices in Japan and the US are rising at the same rate.
iv. Real interest rates become higher in the US than in Japan.
v. The US imposes new restrictions on the ability of foreigners to buy American companies and real estate.
vi. US wages rise relative to Japanese wages, and American productivity falls behind Japanese productivity. [12 marks]

(b)Compare and contrast transaction exposure and economic exposure. [4 marks]

(c)With the aid of an example, explain why the cash flows of purely domestic firms may be exposed to foreign exchange rate fluctuations. [4 marks]

(d)Evaluate the use of diversification of production, marketing and financing as strategies to manage economic exposure. [5 marks]

Total [25 marks]

Question Six

(a) Ibu Ltd is the Nigerian subsidiary of a US manufacturer. Its local balance sheet is shown below. The current exchange rate is 20 naira to the US dollar.

Figures in million nairas

Shareholders' funds	42	Fixed Assets	36
Long-term debt	9	Debtors	12
Current liabilities	3	Cash	6
	54		**54**

Required

i. Translate the naira balance sheet of Ibu Ltd into dollars at the current exchange rate of 20 naira to the dollar. [2 marks]

ii. If Ibu's balance sheet remained as above but the naira moved to 25 naira to the dollar, what would be the translation gain/loss using the monetary/non-monetary translation method and the current rate translation method? [4 marks]

iii. If the naira moved to $0.06, what would be the translation gain/loss according to the two translation methods used above? [4 marks]

iv. What is Ibu's translation exposure under the two translation methods? [3 marks]

(b)Assume that Madzae Ltd has net payables of ZAR200,000 in 180 days. The ZAR interest rate on deposits is 7% over 180 days (effective) and the spot rate of the ZAR is $0.10. Suggest how Madzae Ltd could implement a money market hedge. [4 marks]

(c)If interest rate parity were to prevail, would a forward market hedge be more favourable, equally favourable, or less favourable than a money market hedge on ZAR payables in (b) above? [3 marks]

(d)Foreign exchange exposure hedging is a waste of resources. Discuss. [5 marks]

Total [25 marks]