FIN 480: Exam 1 Fall 2017

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Due: 10/6/2017

Instructions:

By end-of-day on Friday upload your completed exam files to Dropbox under 'Exam 1'. You should complete the short answer questions in Word (or some other word processing software), and either upload a Word or PDF file with these answers to Dropbox. You should complete the computation questions in Excel, and also upload the Excel file with these answers to Dropbox.

Be sure to show your work to get at least partial credit. If you get the correct answer, but show no work, you will receive no credit. Showing good work toward an answer is more important than the answer itself.

Do not try to email me questions regarding the exam. If you have a question, post it to the 'Exam 1' discussion board. If you don't receive an answer there, just answer the question as best you can.

You may use spreadsheets you have created for your homework, or any other spreadsheet that you have created yourself.

You may not use any part of a short-answer or spreadsheet created by someone else, and you may not use the internet to assist you during the exam. If any part of your answer or spreadsheet is not your original work, or if there is evidence you have used information from the internet (googled questions for example), you will receive a 0 on the exam. You may consult your textbook during the exam.

By sending me your completed exam you are affirming that it is solely your work, and you have not received any outside assistance.

1 Short Answer

All questions can be successfully answered in no more than a couple of sentences. Answers which are too long (say exceed a paragraph) will receive a lower score. If you include incorrect information in an otherwise correct answer, the answer will be marked incorrect. The **ceteris paribus** (all else constant) assumption applies to the questions.

1. Do you think the cost of capital is greater for multinational corporations (MNCs) or purely domestic firms? Give a few reasons in support of your answer.

2. What is the difference between direct foreign investment and portfolio investment? If you were the citizen of a small developing country, which would you prefer?

3. What mechanism ensures that the balance of payments balances? Think about what an out-of-balance balance of payments would imply for cash flows between countries.

4. All else constant, if inflation in the US becomes lower relative to inflation in other countries, what will be the effect on the US current account (and why)?

5. If Icelandic interest rates and inflation both increase by 2% relative to US interest rates and inflation, do you think the Icelandic Krona will increase, decrease, or stay the same versus the US Dollar? Briefly explain why.

6. Assume U.S. inflation increased relative to Canadian inflation, all else constant. How would this affect the U.S. demand for Canadian dollars? Briefly explain why.

7. Assume U.S. interest rates increased relative to British interest rates. Also assume all other things are held equal (**ceteris paribus**). How would this affect the supply of GBP for sale? Briefly explain why.

2 Computation

Be sure your spreadsheet answers are organized, and the answer is easily seen. Hardcode as little as possible.

Currency tickers: EUR euro, GBP British Pound; JPY Japanese Yen; USD United States Dollar. The notation USD 1.2 / EUR means it costs 1.5 USD for each EUR. The notation USD 1 is equivalent to $1.

1. The direct quote for the EUR is USD 1.5 / EUR. What is the indirect quote for EUR?

2. If it is USD 1.5 / GBP, how many USD does it take to buy GBP 100,000?

3. If it is USD 1.5 / GBP, and JPY 106 / USD, then how many JPY does it take to buy one GBP?

4. A year ago the euro was worth $1.60 and the peso was worth $0.15. Today the euro is worth $1.50 and the peso is worth $0.12. By what percent did the peso appreciate/depreciate against the euro?

5. A year ago the British pound spot rate was $1.20 per pound. Today the spot rate is $1.25 per pound. What was the percent change in the value of the pound over the year?

6. Baylor Bank believes the New Zealand dollar will appreciate over the next year from $.50 to $.56. The following annual interest rates apply:

Currency	Lending Rate	Borrowing Rate
US $	9.50%	10.00%
New Zealand (NZ) $	6.00%	6.50%

   If Baylor Bank is correct, what percent return would the bank earn on each US or NZ dollar borrowed? That is, Baylor Bank will borrow in one currency and and invest in another. What is the percent return on the amount borrowed?