UNIVERSITAT DE BARCELONA

Universidad de Barcelona

3rd course: Financial Management *Professor: Altina Sebastián González*

Exercises Topic 9: Currency Risk Management (II)

1. **You are the bank manager today**
   A client asks you about the price for an Exchange Rate Insurance. He will receive 100.000 CAD in a 90-days term.
   Today's exchange rate is 0,7034 EUR/CAD
   CAD libor 3 months: 1,18%
   Euribor 3 months: 0,9%
   To set the price of the ERI, will you borrow CAD and lend EUR, or will you borrow EUR and lend CAD? Which is this ERI price? (use 2 decimal positions for amounts, 4 decimal positions for the exchange rate).

2. You are doing a project in Switzerland which has an initial cost of $100,000. All other things being equal, you have the opportunity to obtain a one-year Swiss loan (in francs) at 6% or a one-year US loan (in dollars) at 6,8%. The spot rate is 1.0723 chf/$1 The one-year forward rate is 1.0643 chf/$1. Which loan will you prefer and why? Ignore transaction costs.

3. Honda builds a new car in Japan for a cost + profit of 1,715,000 yen. At an exchange rate of 94,705Y/$1 the car sells for $18,109 in Indianapolis. If the dollar rises in value against the yen to an exchange rate of 134Y/$1, what will be the price of the car?

4. A US company buy textiles from England with payment of ₤ 1 million due in 90 days.
   The spot exchange rate is $1,71/₤, but the payment is due 90 days after and in the meantime the ₤ may rise against the $. In this case, the US company would have to face a higher dollar cost of the textiles. To protect itself from the currency risk, the US company asked its bank to negotiate a 90-day forward contract at a price of, say, $1,72/₤.
   If in 90 days the spot exchange rate is $1,70/£, which of the following sentences is **TRUE**:
   A. The US Company will suffer an implicit loss on the forward contract
   B. The US Company will enjoy an implicit profit on the forward contract
   C. A consultant should suggest the US Company not to hedge this currency risk
   D. None of the above is true

5. The Brazil real spot price is 2.5218 real per dollar, and the 3-month forward rate is 2.5874 real per dollar. What is the premium or discount relationship?

6. You have the opportunity to invest $1,000 for one year in the U.S. at 5%. Ruritanian peso deposits are offering 15.5%. All other things being equal, the spot rate is RUP 50/$1. The one-year forward rate is RUP 55/$1.
   Which bond will you prefer and why?