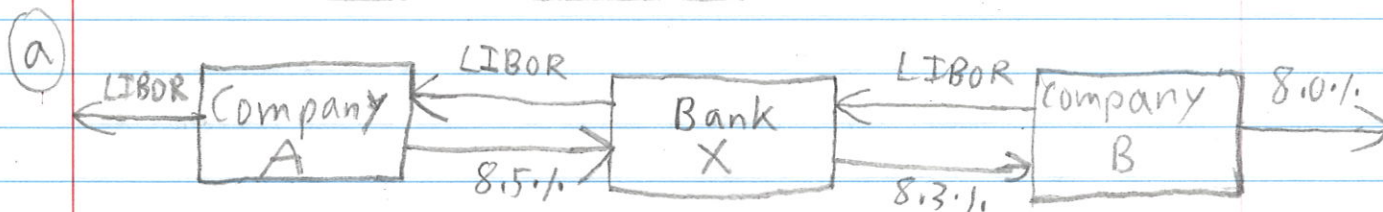


Danny Hong

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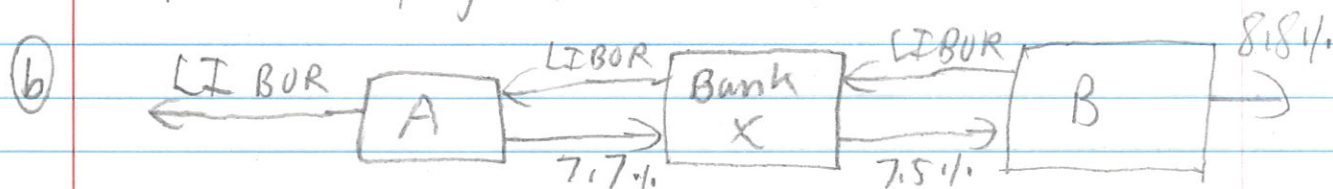
	Fixed Rate	Floating Rate
A	8.8%	LIBOR
B	8.0%	LIBOR



Δ Fixed rate = 0.8%

Δ Floating rate = 0%

Bank X receives $8.5 - 8.3 = 8.2\%$. Company A wants a fixed loan rate and receives a loan of 8.5% , which is 0.3% less than the original fixed loan rate of 8.8% and therefore 0.3% more attractive for them. Company B wants a floating loan rate and receives a loan of $\text{LIBOR} - 0.3\%$, which is also 0.3% more attractive for them than their original LIBOR rate.



The issue here is that it is impossible to design a swap in which company A and company B will both achieve a lower rate than their previous loan rates without the bank losing money. For instance, company A's rate can be 7.7% but this would mean that company B's rate is $\text{LIBOR} + 1.3\%$. As a result, it's impossible to have a comparative advantage for both parties, and so a swap does not make sense here.