

ACF305

International Financial and Risk
Management

Week 2 tutorial

Question 1

Complete the following transaction of the Canadian BOP

A professor at UBC tenders 10m shares in an acquired Canadian firm, valued at CAD 77m, to a U.S. acquirer ... and receives 2m shares of the acquirer in return.

Question 1

Table 2.6. Six records in Canada's theoretical BOP.

Transaction	Use (–) or source (+)	Credit	Debit
1. StarDucks Canada, a Canadian firm, imports CAD 100m worth of coffee from Ghana AraCoff...	Current (–), (merchandise)		–100m
...and pays for it by transferring CAD 100m from its account at CIBC (a Canadian bank) to AraCoff's account with the Bank of Nova Scotia	Financial (+), (CAD liquidities)	+100m	
2. StarDucks uses the services of Accra Stevedoring, worth 10m...	Current (–), (services)		–10m
...and pays for it by transferring USD 7.5m (CAD 10m, after translation) from its account at CIBC to Stevedoring's account with CIBC	Financial (+), (USD liquidities)	+10m	
3. The University of Brunswick at Colomba (UBC) sells 15m worth of bonds to a London broker	Financial (+), (securities)		–15m
...and receives CAD 15m into its account at Brunswick Bank, from the broker's account with Bank of Toronto	Financial (–), (CAD liquidities)	+15m	
4. A professor at UBC tenders 10m shares in an acquired Canadian firm, valued at CAD 77m, to a U.S. acquirer...			?
...and receives 2m shares of the acquirer in return			
5. StarDucks exports 1m worth of coffee mugs to the Dutch Antilles...			
...in return for a trade bill accepted by the customer, payable 90 days			

Solution

Table 2.6 (p. 39):

The professor sells his shares in the acquired firm to the bidding firm and thus needs to be paid for giving up his shares. Therefore, the first leg of the transaction is a source of funds (+), which will be credited in the “securities sold” account of the “capital and financial account”.

What does the professor do with the money? He invests it into shares of the bidding firm. This is a use (–) of funds, which will be debited in the “securities bought” account of the “capital and financial account”.

Question 2

For the following two questions, assume that Antarctica is the home country, and its currency is the Antarctica dollar (AAD), and Greenland is the foreign country and its currency is the Greenland crown (GRK). Choose the correct answer.

2.1. All else being equal, an increase in income in Greenland leads to:

- a) An increase in consumption in Antarctica, and therefore an increase in imports, resulting in an appreciation of the AAD.
- b) A decrease in consumption in Antarctica, and therefore an increase in exports, resulting in a depreciation of the AAD.
- c) An increase in consumption in Greenland, and therefore an increase in imports, resulting in an appreciation of the AAD.
- d) An increase in consumption in Greenland, and therefore an increase in imports, resulting in a depreciation of the AAD.

Solution

Income can be consumed or saved by the private sector, transferred abroad or paid to the taxman (recall: $Y = C_p + S_p + Tr + Tx$). It is thus reasonable to assume that more income implies an increase in consumption in Greenland, both through local consumption (C_p) and through imports from abroad (Tr). More imports create a higher demand for the foreign currency, the AAD, which pushes the value of this currency up relative to the GRK. As a result, the correct answer is (c).

Question 2

2.2. All else being equal, a decrease in prices in Greenland leads to:

- a) An increase in exports to Antarctica, and therefore an appreciation of the AAD.
- b) An increase in exports to Antarctica, and therefore a depreciation of the AAD.
- c) An increase in consumption in Greenland, and therefore an increase in imports, resulting in an appreciation of the AAD.
- d) A decrease in consumption in Greenland, and therefore a decrease in imports, resulting in a depreciation of the AAD.

Solution

A decrease in prices makes Greenland more competitive, i.e., both consumers from Greenland and Antarctica now want to buy more products and services from Greenland. The higher demand from abroad will create exports from Greenland to Antarctica. As products from Greenland need to be paid for with the GRK, there is now increased demand for the GRK, which pushes its value up relative to the AAD. An appreciation of the GRK means a depreciation of the AAD, so the correct answer is (b).

Question 3

2. The data below are taken from the BOP of Switzerland. Based on these data, decide whether the following statement is true or false and explain your answer.

“From 1979 to 1982, foreigners have been net issuers of SF-denominated bonds in the Swiss capital markets.”

Capital account	1979	1980	1981	1982
Portfolio investment (in billions \$)	-11.8	-11.8	-11.9	-32.2

Solution

We can conclude that, on balance, capital flowed out of Switzerland, but:

- This need not be because of Swiss purchases of securities. Possibly, Swiss banks granted loans to foreigners, or Swiss residents paid back bank loans that they had made abroad in the past.
- If the transactions do reflect Swiss purchases of securities, the securities need not be bonds. For example, Swiss residents may have bought stocks originally held by foreigners including stocks that were issued, in the past, by Swiss companies.
- If the transactions relate to bonds, these need not be bonds newly issued by foreigners. The bonds bought by Swiss residents could also be old bonds including bonds originally issued abroad by Swiss companies.

Question 4

You have been hired by the IMF to design a program to improve the current account balance.

How should your program influence the following variables (increase/decrease):

- a. Taxes;
- b. Government spending;
- c. Private savings

Solution

You should recall that: $CA = [S_p - I_p] + [T_x - C_g - I_g]$. The answer is now straightforward:

(a) increase taxes, (b) decrease government spending and (c) increase private savings.

The first two measures are jointly called austerity.