Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA (N)/SEM-4 (FT)/FM-405/2010

2010

INTERNATIONAL FINANCE

Time Allotted : 3 Hours *Full Marks :* 70

The figures in the margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternatives for any *ten* of the following : 10 × 1 = 10

   i) In a flexible exchange rate regime, a current account deficit is likely to be corrected by

      a) drawing down on forex reserves

      b) depreciation of home currency

      c) appreciation of home currency

      d) higher inflation.

   ii) Which of the following system collapses is related to Triffin Paradox ?

      a) Gold standard

      b) Bretton Woods

      c) Exchange rate mechanism in 1992

      d) Both (a) & (b).

iii) The common currency in Europe is

a) ECU b) Kroner

c) British Pound d) Euro.

iv) The tenability of a fixed exchange rate system depends on

a) the size of the country

b) quantum of exports made by the country

c) quantum of imports made by the country

d) monetary discipline.

v) If imports from a particular country are totally banned by the home country, it is called

a) anti-dumping duty

b) quota

c) embargo

d) exchange control.

vi) The value of special drawing rights (SDRs) fluctuates in accordance with value of all of the following currencies *except*

a) the Japanese Yen

b) the Swiss Franc

c) the British Pound

d) the U.S. Dollar.

vii) Which exchange rate system is best described as an exchange rate system where a home currency's value is fixed to a foreign currency but moves in line with that foreign currency against other currencies ?

a) Fixed b) Freely floating

c) Managed float d) Pegged.

viii) Exchange rate system where the central bank intervenes to smoothen out exchange rate fluctuations is known as

a) free float b) clean float

c) dirty float d) pegged.

ix) Which of the following is a capital account transaction in a country's balance of payments account ?

a) Import of cosmetics b) Import of automobile

c) Import of computers d) IMF borrowings.

x) When the strike price of an option is equal to the spot price of the underlying asset at the expiration date/exercise date, then the option is said to be

a) deep-in-the-money

b) in-the-money

c) out-of-the-money

d) at-the-money.

xi) A modest risk taking speculator who expects wide variation in the exchange rates can

a) buy a call option b) buy a straddle

c) buy a put option d) sell a call option.

xii) The date on which the parties agree to swap is called

a) trade date b) effective date

c) reset date d) maturity date.

xiii) When a swap gives the holder the right to terminate the swap any time before its maturity, it is called

a) forward swap b) callable swap

c) deferred swap d) basis swap.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. Explain the mechanisms for

   a) GDR

   b) ADR.

3. Compare forward and future contracts.

4. Compare between the following :

   a) Put option and call option

   b) Direct quote and indirect quote.

5. Define leading and lagging.

6. Define straddles and strangles.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. $3 \times 15 = 45$

7. Discuss in detail the role of Bretton Woods conference in setting up the international monetary system.

8. Explain with example how a company can use the various external hedging strategies, viz., money market hedge, options market hedge & future market hedge to manage translation exposure.

9. Suppose a U.S. MNC wants to finance a £ 10,000,000 expansion of a British plant. They could borrow dollars in the U.S. where they are well known and exchange for dollars for pounds.

   This will give them exchange rate risk financing a sterling project with dollars. They could borrow pounds in the international bond market, but pay a premium since they are not as well known abroad.

   If they can find a British MNC with a mirror-image financing need they may both benefit from a swap.

   If the spot exchange rate is S0($/£) = $ 1·60/£, the U.S. firm needs to find a British firm wanting to finance dollar borrowing in the amount $ 16,000,000. Find out a possible currency swap solution.

10. Saj Dhajke Garments manufactures men's shirts both for the Indian markt and exports to the U.S. present exchange Rs. 45/USD rate. The firm faces significant competition both at home and in the US market, from Indian firms as well as foreign brands. Over the next year, inflation in India is expected to be around 15% and that in the US around 5%. About one-third of material inputs are imported.

Now consider the three alternative exchange rate scenarios :

Scenario I : The rupee will depreciate to Rs. 47·00. Price for home sales will be raised by 10% while the foreign currency price for US buyers will be raised by 5%. There will be loss of sales at home of 3% while US sales will remain unchanged. Labour costs will increase by 10%, domestic material costs by 15% and costs of imported materials by 5%.

Scenario II : We now assume that the rupee depreciates to 50·00. The firm lowers its dollar price for US sales by 5% (from \$ 20 to \$ 19). The price for home sales is raised to Rs. 950, equivalent to the foreign price at the new exchange rate. Export sales volume increases by 6% while home sales volume by 5%. Assumptions regarding costs are same as in Scenario I except the cost of imported materials, which is projected to increase by 10%.

Scenario III : Finally we consider the case where the rupee actually appreciates in nominal terms to 42·00. This could happen if there is surge in capital inflows and the central bank does not prevent the dollar from falling. The firm raises dollar prices for US sales by 8% and loses 10% of sales volume. At home rupee prices are left unchanged from the base case scenario but still there is a loss of 2% in domestic sales. There is no change in the rupee cost of imported materials, domestic material costs increase 15%, labour by 8%.

Do a scenario analysis to explain the economic exposure of the firm.

Exhibit : P & L A/c. of Saj Dhajke Garments.

	Units	Rates per Unit	Total
Home sales	1,00,000	900	90,000,000
Export sales	50,000	900	45,000,000
Costs of sales (per unit)			
Labour		150	
Domestic		200	
Imported materials		100	
Total operating cost		450	67,500,000
Operating income			67,500,000
Fixed cash operating cost			8,00,000
Depreciation			10,000,000
Interest			10,000,000
Pre-tax profit			39,500,000
Tax @ 40%			15,800,000
PAT			23,700,000
Add Depreciation			10,000,000
Operating cash flow			33,700,000

11. Write short notes on any *three* of the following : 3 × 5

a) IMF

b) World Bank

c) ADB

d) Spot and forward transactions

e) Financial derivatives.

12. Given the following data :

Spot rate : Rs. 42·0010 = $ 1

6 m forward rate : Rs. 42·8020 = $ 1

Annualized interest rate on 6 m rupee = 12%

Annualize interest rate on 6 m $ = 8%

Calculate arbitrage possibilities.