Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/MBA(N)/SEM-4 FT & 6 PT/FM-405/2011

2011

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) A manufacturing company buys foreign exchange from a Bank at the latter's

a) Buying rate
b) Selling rate
c) Repo rate
d) Plr.

ii) The best exchange rate that a customer can have access to is the

a) TT Rate
b) Bill rate
c) Currency rate
d) TC rate.

iii) The two legs of a large foreign exchange deal are settled

a) simultaneously across the counter

b) simultaneously at different locations

c) at different locations in different time zones

d) none of these.

iv) Between two currencies, the one with higher rate of interest will quote at

a) a forward premium b) a forward discount

c) at par (i.e. Forward rate = Spot rate).

v) If £ 1 = $ 1.50/1.55 and $ 1 = Rs. 46.00/46.50, £ 1 expressed in terms of INR is

a) [46.00* 1.50]/[46.50* 1.55]

b) [46.00* 1.55]/[46.50* 1.50]

c) [46.50* 1.50]/[46.00* 1.55]

d) none of these.

vi) Fundamental disequilibrium in the Bretton-Woods system is meant for

a) consistent balance of payments deficit

b) consistent devaluation

c) rising inflation rate in the country

d) none of these.

vii) International trade is based on the principle of

a) law of diminishing retum

b) law of comparative costs

c) PPP theory

d) none of these.

viii) U. S. company is seeking to lower its overall risk through overseas diversification. It is considering two alternatives : (1) produce goods in United Kingdom (U. K.) that would be ultimately sold in U.S.; or (2) produce goods in U.K. that ultimately be sold in U.K.

a) Both options are roughly equivalent when it comes to overall risk reduction because production is located in the same country under both options.

b) The first option holds the greater likelihood for lowering overall risk through overseas diversification.

c) The second option holds the greater likelihood for lowering overall risk through overseas diversification.

d) Both options are likely to actually increase overall risk rather than lower it.

ix) The forward exchange rate

a) is the rate today for exchanging one currency for another for immediate delivery

b) is the rate today for exchanging one currency for another at a specific future date

c) is the rate today for exchanging one currency for another at a specific location on a specific future date

d) is the rate today for exchanging one currency for another at a specific location for immediate delivery.

x) Which of the following is not an example of internal hedging ?

a) Lead b) Lag

c) Reinvoicing Centre d) Money Market.

xi) Portfolio Beta

a) is the risk of a diversified portfolio

b) is the weighted average of individual security betas, weights being the proportions of individual returns

c) is the weighted average of individual security beta, weights being the proportions of the investments in the respective securities

d) both (a) and (c).

xii) A short hedge occurs when

a) Hedgers seek to eliminate or control the risk exposure that arises due to changes in prices

b) Hedgers seek to eliminate or control the risk exposure associated with the quantity that will be bought or sold at some future date

c) A firm that owns or plans to purchase a cash commodity sells futures to hedge their cash position against declining prices

d) Hedging is caused out for a period of 3 to 6 months.

GROUP – B

(Short Answer Type Questions)

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

2. Explain the mechanisms for the following :

(a) GDR

b) ADR.

3. Find out the size of variation margin a Euro future can contract with the help of the following data :

a) 1 Euro Future contract

b) Spot Price is US$ 1.50/Euro

c) 0.0040 is standard deviation of daily changes in the price of future price

d) probability of exhaustion is 0.05

e) Number of days is 9 for which calculation is to be made.

4. Distinguish between contago and normal backwardation.

5. An Indian importer imports goods worth $ 62,500. He expects an appreciation of pound. So he goes for hedging the risk. The currency market has the following data : 5

   a) Spot rate on the date of the contract Rs. 68.00/£

   b) Three-month forward rate Rs. 68.50/£

   c) Strike rate in a three-month call option Rs. 68.60/£ with 5% Premium

   d) Strike rate in a three-month put option Rs. 68.80/£ with 5% premium

   e) Spot rate on the date of payment/maturity Rs. 68.90/£.

   Will he go for a hedge ? If so, which of the options he will select ?

6. What do you mean by interest rate parity ?

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. 3 × 15 = 45

7. a) A Japanese automobile company has decided to manufacture 10,000 motor cars per year in India with an initial investment of Rs. 500 crores. The price is Rs. 2 lakh and the variable cost including also the import cost of the spares is Rs. 1.30 lakh. The risk-free

interest is 10 per cent. The car is the lowest-price car in the market and so the demand is expected to rise from 10,000 cars in the first year to 12,000 cars in the second year and even more in the following years. On the other hand, the rupee is expected to depreciate vis-a-vis Yen and the variable cost is expected to rise fast from Rs. 1.30 lakh to Rs. 1.80 lakh. Find out what are the options avialable to the manufacturer.

b) Calculate the weighted average cost of capital when the capital structure shows as following :

i) Existing debt of \$ 5.0 million at 10 per cent for 6 years (tax rate is 30 per cent).

ii) New debt of \$ 3.0 million at 8 per cent for 10 years with a floating cost of \$ 200,000.

iii) Existing equity shares of \$ 7.0 million (\$ 15 per share), EPS \$ 4, growth rate of 5 per cent and dividend pay-out ratio of 50 per cent.

iv) Proposed equity share (100,000 shares) to be sold at \$ 15 with \$ 200,000 floatation cost.

c) Do you agree that the NPV rule is better than the IRR rule for international capital budgeting ?

8. a) Find out the transaction gain/loss on the basis of the following data pertaining to India's foreign trade :

	US $ million	*Japanese Yen, million*	*British Pound, million*
Import	1250	650	800
Export	1150	625	850
Pre-Change Rate	Rs. 45/US$	Rs. 0.40/Yen	Rs. 70/Pound
Post Change Rate	Rs. 47/US$	Rs. 0.41/Yen	Rs. 68/Pound

b) A company expects cash flow from its new project to the extent of $ 5,000; $ 6,500 and $ 6,000 respectively during the first three years of its operation. However, due to changes in exchange rate/inflation rate, the cash flow is affected and it will change to $ 4,000, $ 5,800 and $ 5,200. Find the magnitude of the possible real operating exposure during the initial year of operation assuming a discount rate of 10 per cent.

c) What is balance sheet hedge ?

d) Find out the translation gain/loss on the basis of the following data supplied by the Indian subsidiary to its parent unit in the USA.

(Amount., Rs. in Million)

Liabilities	*Amount*	*Assets*	*Amount*
Current Liabilities	400	Cash	100
Share Capital	1000	Marketable Securites	100
Bonds	600	Debtors	200
Retained Earnings	400	Inventory	300
		Land & Building	600
		Plant & Machinery	800
		Furniture & Fixture	300

Historical Rate = Rs. 40/US $;

Current Rate = Rs. 46/US $.

9. A US MNC is planning to install a manufacturing unit to produce 5,00,000 units of an automobile component in India. Setting up of the manufacturing plant will involve an investment outlay of Rs. 50 million. The plant is expected to have a useful life of 5 years with Rs. 10 million salvage value. MNC will follow the straight-line method of depreciation. To support the running of business, working capital of Rs. 5 million will have to be invested; variable cost of production and sales will be Rs. 20 per unit. Additional fixed cost per annum is estimated at Rs. 2 million. The forecasted selling price is Rs. 70 per unit. The MNC will subject to 40% tax rate in India and its required rate of return is 15%.

It is forecasted that the rupee will depreciate in relation to US dollar @ 3% per annum, with an initial exchange rate of Rs. 48/\$.

Accordingly, the exchange rates for the relevant 5-year period of the project will be as floows :

Year	**0**	**1**	**2**	**3**	**4**	**5**
Exchange Rate	**Rs. 48/\$**	**Rs. 49.44/\$**	**Rs.50.92/\$**	**Rs.52.45/\$**	**Rs.54.02/\$**	**Rs.55.64/\$**

Advise the MNC regarding the financial viability of the proposal.

10. Companies ABC and XYZ have been offered the following rates per annum on a Rs. 50 lakh five year loan :

Company	**Fixed Rate**	**Floating Rate**
ABC	9.0%	Mibor + 0.3%
XYZ	10.8%	Mibor + 0.8%

Company ABC requires a floating rate loan. Company XYZ requires a fixed rate loan.

a) How can the two companies enter into a swap arrangement in which each benefit equally ?

b) What risk could this arrangement generate ?

11. a) The returns, in percentage, for international security markets are as follows :

Year	*France*	*Germany*	*Japan*	*UK*	*USA*
2001	28.00	25.00	27.00	5.00	10.00
2002	23.75	28.30	– 2.50	7.50	9.75
2003	4.85	10.75	21.06	5.25	11.56
2004	– 3.56	– 10.75	23.75	– 5.70	11.57
2005	– 25.00	– 50.00	37.82	– 6.80	25.39
2006	10.00	28.00	– 5.50	3.00	– 5.26
2007	15.50	23.00	– 10.23	4.50	– 3.18
2008	13.23	21.00	15.00	3.85	6.78

i) Compute the variation of returns over the period for each country.

ii) Compute the correlation between the returns for all the possible equally weighted two country combinations over the period.

b) What factors one has to consider while investing internationally ?

12. Write short notes any *three* of the following :

a) Special Drawing Right

b) Purchasing Power Parity

c) Asian Development Bank

d) Foreign Exchange Market

e) Uncovered Interest Arbitrage.