**Seat No.: __________** **Enrolment No.____________**

# GUJARAT TECHNOLOGICAL UNIVERSITY

## MBA Semester –IV Examination Dec. - 2011

**Subject code: 840202** **Date: 16/12/2011**

**Subject Name: International Finance**

**Time: 02.30 pm – 05.30 pm** **Total Marks: 70**

**Instructions:**

1. **Attempt all questions.**
2. **Make suitable assumptions wherever necessary.**
3. **Figures to the right indicate full marks.**

**Q.1** **(a)** In an integrated world financial market, a financial crisis in a country can be quickly transmitted to other countries, causing a global crisis. What kind of measures, would you propose to prevent the recurrence of an Asia-type crisis? **07**

**(b)** Assume you are a trader with Deutsche Bank. From the quote screen of your computer terminal, you notice that RBS is quoting € 0.7627/$ and Credit Suisse is offering SF 1.1806/$. You learn that UBS is making a direct market between Swiss franc and the euro, with a current €/SF quote of 0.6395. Show how you can make a triangular arbitrage profit by trading at these prices. (Ignore bid-ask spread for this problem.) Assume you have $ 50, 00,000 with which to conduct the arbitrage. What happens if you initially sell dollars for Swiss franc? **07**

**Q.2** **(a)** Explain the difference between Monetary/Non-monetary and Temporal method in the translational process. **07**

**(b)** Omni Advisors, an international pension fund manager, plans to sell equities denominated in Swiss franc (CHF) and purchase an equivalent amount of equities denominated in South African rand (ZAR). Omni will realize net proceeds of 3 million CHF at the end of 30 days and wants to eliminate the risk that the ZAR will appreciate relative to the CHF during the 30 day period. The following are the exchange rates between CHF, ZAR and U.S. Dollar (USD). **07**

| | ZAR/USD | | CHF/USD | |
|---|---|---|---|---|
| **Maturity** | **Bid** | **Ask** | **Bid** | **Ask** |
| Spot | 6.2681 | 6.2789 | 1.5282 | 1.5343 |
| 30 day | 6.2538 | 6.2641 | 1.5226 | 1.5285 |
| 90 day | 6.2104 | 6.2200 | 1.5058 | 1.5115 |

Describe the currency transaction that Omni should undertake to eliminate currency risk over the 30 day period. Also calculate the current value of Omni's Swiss equity portfolio in ZAR.

**OR**

**(b)** Explain Purchasing power parity, both the absolute and relative versions. What causes deviations from purchasing power parity? **07**

**Q.3** **(a)** What are the approaches available to an internationally active bank for valuing its credit risk under Basel II? **07**

**(b)** The current spot exchange rate is $ 1.95/£ and three month forward rate is $1.90/£. On the basis of your analysis of the exchange rate, you are pretty confident that the spot exchange rate will be $1.92/£ in three months. Assume that you would likely to buy or sell £10,00,000. **07**

1. What action do you need to take to speculate in the forward market?

What is the expected dollar profit from speculation?

2. What would be your speculative profit in dollar terms if the spot exchange rate actually turns out to \$1.86/£.

**OR**

**Q.3** **(a)** Briefly discuss the various types of international banking offices. **07**

**(b)** You plan to visit Geneva, Switzerland, in three months to attend an international conference. You expect to incur a total cost of SF 50,000 for lodging, meals, and transportation during your stay. As of today, the spot exchange rate is \$ 0.6/SF and the three-month forward rate \$0.63/SF. You can buy the three month call option on SF with an exercise price of \$0.64/SF for the premium of \$0.05/SF. Assume that your expected future spot exchange rate is the same as the forward rate. The three month interest rate is 6 % p.a. in the United States and 4% p.a. in Switzerland. **07**

1. Calculate your expected dollar cost of buying SF50,000 at maturity, if you choose to hedge by a call option on SF.
2. Calculate the future dollar cost of meeting the SF obligation if you decide to hedge using a forward contract.
3. At what future spot exchange rate will you be indifferent between the forward and option market hedges?

**Q.4** **(a)** Briefly define each of the major types of international bond market instruments, noting their distinguishing characteristics. **07**

**(b)** While you were visiting London, you purchased a Jaguar for £35,000, payable in three months. You have enough cash at your bank in New York City, which pays 0.35% interest per month, compounding monthly, to pay for the car. Currently, the spot exchange rate is \$1.45/£ and the three-month forward exchange rate is \$1.40/£. In London, the money market interest rate is 2.0% for a three-month investment. There are two alternative ways of paying for your Jaguar. **07**

1. Keep the funds at your bank in the U.S. and buy £35,000 forward.
2. Buy a certain pound amount spot today and invest the amount in the U.K. for three months so that the maturity value becomes equal to £35,000.

Evaluate each payment method. Which method would you prefer? Why?

**OR**

**Q.4** **(a)** What operational and financial measures can a MNC take in order to minimize the political risk associated with a foreign investment project? **07**

**(b)** Explain the random walk model for exchange rate forecasting. Can it be consistent with technical analysis **07**

**Q.5** **(a)** Discuss the strategies for managing Operating Exposure. **07**

**(b)** What three basic documents are necessary to conduct a typical foreign trade transaction? Briefly discuss the purpose of each. **07**

**OR**

**Q.5** **(a)** Explain Vernon’s product life cycle theory of FDI. What are the strengths and weaknesses of the theory? **07**

**(b)** Write short notes on the following (any two): **07**

1. Countertrade
2. EXIM Bank of India
3. Forfaiting
4. Export credit insurance.

************