StudentBounty.com

UNIVERSITY OF BRADFORD

INTERNATIONAL FINANCE (MSC)

MAN4271M

16 May 2013 **16:00 – 17:30 hours**

Main

This is a **CLOSED BOOK** examination

Answer **Two** questions
(One Question from each section)
All questions carry equal weighting

www.StudentBounty.com

SECTION A

Answer ONE question from this section.
All questions carry equal weighting.

Question 1

Assume that the annual interest rate is 5% in the United States and 7% in Britain. The spot exchange rate is $1.83/£.

a) In the absence of arbitrage opportunities what should be the one year forward currency rate?

(10 marks)

b) If the quoted one year forward currency rate is $1.8023/£ is there an arbitrage opportunity and if so what is the arbitrage risk free gain? Do your calculation for £1000 or its equivalent in USD.

(20 marks)

c) Using the relative purchase power condition and the International Fisher effect calculate the expected annual rate of appreciation/depreciation on the dollar if the inflation rate and the real rate of return in the United States are expected to be respectively 3%and 1.9417% (both annual rates) for the next two years.

(25 marks)

d) Explain the purchasing power conditions, both the absolute and the relative versions. What causes deviations from purchasing power parity and what are the implications of these deviations for countries' competitive positions?

(25 marks)
(26

e) Describe and explain the main functions of Foreign Exchange Markets, their main features, participants and type of transactions.

(20 marks)
(Total 100 marks)

www.StudentBounty.com

Question 2

a) Explain the convergence property of futures prices and why futures contracts have virtually no default risk.

(10 marks)

b) Explain what basis risk is and how it can impact on perfect hedging with futures contracts.

(10 marks)

c) One month ago an American exporter decided to use Futures contracts to hedge a receivable of €4.2m which was scheduled for the 2nd Friday of May. Assume that it is now the 2nd Friday of May. Each Futures contract is for €20,000. The spot and future rates are:

d)

	Spot	Futures
1 month ago	\$1.5663/€	\$1.3388/€
Today (date of receivable)	\$1.5661/€	\$1.4921/€

Considering both the spot and futures positions calculate the effective exchange rate at which the Euros are sold today and comment on the effectiveness of the hedging strategy.

(30 marks)

e) Explain what currency options are, their determinants and how and why these determinants affect value.

(20 marks)

f) The table below presents the spot bid and ask spreads quoted by Bank X

Bid	Ask
INR 72.4741/€	INR 72.5734/€
AUD 1.3124/€	AUD 1.7113/€

Using mid rates on the bid and ask spreads calculate the implicit spot cross rate for the INR/AUD. If the quoted spot rate is INR 49.3210/AUD is there an arbitrage opportunity? If yes, illustrate how a trader could profit from such opportunity. Do your calculations assuming that the trader starts with €2m.

(30 marks)

(Total 100 marks)

www.StudentBounty.com

SECTION B
Answer ONE question from this section.
All questions carry equal weighting.

Question 3

a) What does the OLI Paradigm propose to explain? Define each component and provide an example of each.

(10 marks)

b) What is a free-trade zone? Provide examples of free-trade zones and explain how firms and countries can benefit from having free-trade zones.

(20 marks)

c) What is the impact on the firm with if it always invoices their customers in hard currencies?

(30 marks)

d) What would you expect to happen to the risk-free rate and equity returns when a segmented country opens its capital markets to foreign investment?

(40 marks)
(Total 100 marks)

Question 4

a) Explain how political risk and exchange rate risk increase the uncertainty of international projects for the purpose of capital budgeting.

(20 marks)

b) As more global investors shift investment funds to emerging markets, what factors will drive expected returns?

(40 marks)

c) In deciding where to invest your money, you read that Italy looks like it is well positioned to capitalize on the opening of Central Europe after these countries joined the European Union. On the other hand, the U.K. is experiencing weak growth high interest rates, and high inflation. Which of the two countries (UK or Italy) would be more attractive to invest in? Explain.

(40 marks)
(Total 100 marks)

www.StudentBounty.com