COOPERATIVE UNIVERSITY OF TECHNOLOGY
2018/2019 ACADEMIC YEAR
SCHOOL OF BUSINESS

BACHELOR OF COMMERCE

HBF: INTERNATIONAL FINANCE

FINAL EXAMINATION AUGUST 2019

ANSWER QUESTION1 AND ANY OTHER 2 QUESTIONS

TIME ALLOWED 2 HOURS

QUESTION 1

(a) Discuss the benefactors of a strong currency and weak currency **(8 marks)**

(b) Describe the types of currency exchange systems **(4 marks)**

(c) The beginning of year consumer price index (CPI) of Kenya and Uganda are as follows: in Kenya 167 and in Uganda 158. After 2 years the CPI in Kenya is expected to be 180 while in Uganda it is expected to be 165. The spot rate between the two countries is Ush.33.1/Ksh.

Required:

(i) Compute the inflation rates in Kenya and Uganda **(3 marks)**

(ii) Determine the future spot rate **(3 marks)**

(d) Describe non-contractual or internal methods of hedging against transaction exposure **(4 marks)**

(e) Describe the law of one price and its impediments with regard to smuggling of goods at border points **(4 marks)**

(f) Discuss the merits and demerits of globalization of firms with respect to Kenyan blue chip firms **(4 marks)**

(Total 30 marks)

QUESTION 2

(i) Suppose the exchange rate today is Ksh.140/£ and an investor has Ksh.500,000 at his /her disposal and expects that the exchange will be Ksh.145/£ after 3 months

Required: describe the strategy that the investor can employ to yield profits and compute the profits **(4 marks)**

(ii) Distinguish between absolute and relative purchasing power parity **(2 marks)**

(iii) Distinguish between money market hedge and currency forward contract **(2 marks)**

(iv) Suppose in UK the interest rates prevailing are 1.5% and those in Kenya are 11.5%. The spot exchange rate between the Sterling poundand the Kenya Shilling is Ksh.145/£. An investor has £1 million to invest for a period of 3 months and wishes to exploit the high interest rates in Kenya without risking FOREX losses

Required: advice the investor on the strategy to employ and exactlyhow to profit from the interest rates differential **(6 marks)**

(v) Suppose the spot exchange rates at the beginning of July 2019 were as follows in Bank A: Ksh.78.1/CAD and Tsh.1824.1/CAD while in Bank B the spot exchange rate is Tsh.22.7/Ksh. and investor has Tsh.15 million

Required: advice the investor on the strategy to employ and exactly how to profit from the mispricing opportunity **(6 marks)**

(Total 20 marks)

QUESTION 3

(a) Distinguish between money market hedge and forward currency contract **(2 marks)**

(b) Describe the international fisher effect **(2 marks)**

(c) Suppose the interest rates in Kenya are 12% and in Tanzania are 15% while the spot rate is Tsh.25.7/Ksh

Required: compute the expected spot rate and the end of 2 years **(4 marks)**

(d) Suppose there are 2 commercial banks A and B with the following exchange rates:

	Bid	**Ask**
Bank A	Ksh.100.9/$	Ksh.101.9/$
Bank B	Ksh.102.5/$	Ksh.103.2/$

Required:

Advice an investor who has Ksh.500,000 about the strategy and exactly how he or she can generate profits **(6 marks)**

(e) With the aid of an example, distinguish between a direct quote and indirect quote **(2 marks)**

(f) With the aid of an example, distinguish between a base currency and quote currency **(2 marks)**

(g) Distinguish between short selling of stocks and short sellingof currency **(2 marks)**

(Total 20 marks)

QUESTION 4

ABC Ltd a SA. firm purchased a plant from XYZ ltd a US firm on 1st April 2019 and was invoiced is £800,000 payable in one-year. Interest rates and foreign exchange rates of the 2 countries were as follows:

	Deposit	**Borrowing**
U.S. interest rate	= 6.40%	7.2%
SA. interest rate	= 9.05%	10.5%

Spot rate =	\$1.59/£ - \$1.60/£
Forward rate =	\$1.55/£ - \$1.56/£

A call option with a strike price of \$1.48 and premium of \$0.03 expires in 365 days. The expected spot rates as follows:

Possible outcomes	**Probabilities**
\$1.43	0.2
\$1.46	0.7
\$1.52	0.1

Required: advice on the best hedging technique for ABC Ltd **(20 marks)**

QUESTION 5

(a) Using relevant examples describe 5 determinants of exchange rates **(6 marks)**

(b) In Kenya the cost of a machine is Ksh.3.2 million while in UK the machine costs GBP.23,940 and in the US the car costs USD.36,700

Required:

Compute the exchange rates between Ksh./USD, Ksh./GBP and USD/GBP from the above prices of the machine **(4 marks)**

(c) Distinguish between speculation and arbitrage **(2 marks)**

(d) Describe the types of arbitrage **(2 marks)**

(e) With the aid of an example, distinguish between a direct quote and indirect quote **(2 marks)**

(f) With the aid of an example, distinguish between a base currency and quote currency **(2 marks)**

(g) Distinguish between short selling of stocks and short selling of currency **(2 marks)**

(Total 20 marks)