The Co-operative University of Kenya

END OF SEMESTER EXAMINATION DECEMBER-2019

EXAMINATION FOR THE DEGREE OF BACHELOR OF CO-OPERATIVE BUSINESS

UNIT CODE: HOCB 2437

UNIT TITLE: INTERNATIONAL FINANCE

DATE: DECEMBER, 2019 **TIME:**

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

(a) Describe FOUR different players in the foreign exchange markets and their role (6 marks)

(b) Distinguish between comparative and competitive advantages (2 marks)

(c) Distinguish between spot and forward markets (2 marks)

(d) Describe the risks faced by multi-national corporations (4 marks)

(e) A Kenyan Manufacturing firm has invested in a subsidiary in India and intends to sell if after 2 years. At end of year 1 the value of the business was assessed to be Rupee.50 Million and at end of year 2 year a the value was expected to be Kshs 75 million. The exchange rate was expected to be shs 2: Rupee 1

Required:

Establish the value of the subsidiary in Kenyan Shillings at the end of years 1 and 2 and then estimate the operating exposure of the Kenyan subsidiary in Kenya Shillings (10 marks)

(f) Distinguish between the case and quote currency (2 marks)

(g) Suppose a trader Kshs 1. Million to invest in FOREX market and currently the Kshs/USD is trading at Kshs 102.4:$ 1 and is expected to be kshs 105:$1 and 3 months time

Required:

Establish the strategy that the trader can employ to profit from the opportunity and compute the amount of profit assuming that opportunity costs for the money is nil (10 marks)

QUESTION TWO

(a) The International Monetary System is complex system of international arrangements rules, institutions, policies in regard to exchange rates, international payment, capital flows. Explain three ways in which institutions, corporations and individuals can trade foreign currency (6 marks)

(b) The following are the exchange rates between three currencies; Deutsh Marks per US dollar DM 1.925/US Canadian dollars per US dollar C$ 1.264/US Deutsh Marks per Canadian dollar DM 1.5214/C$

Required:

i) Is there any opportunity for arbitration? What are the steps you would follow under triangular arbitrage (6 marks)

ii) How a German trader with DM 1,000,000 can use the amount to benefit from the inter market arbitration (3 marks)

iii) What will be the profit or loss for a German trader (1 mark)

iv) Using your own illustrations, explain the difference between a direct and indirect (4 marks)

QUESTION THREE

(a) The purchasing Power Parity is the key theory that explains relationship between currencies; in essence it claims that a change in relative inflation must result in a change in exchange rates in order to keep prices of goods in two countries fairly similar. Explain FIVE main uses of the purchasing power parity theory (10 marks)

(b) A Kenyan importer buys goods from the United States for $20,000 with payment due in 30 days. The spot rate is kshs 78 for one US dollar. The shilling is expected to depreciate in value relative to the dollar. The Kenyan importer enters into a forward contract which stipulates that it can buy US dollars after 30 days at Kshs 8- per dollar. What will be the cash liability for the Kenyan importer (4 marks)

(c) Highlight THREE advantages and THREE disadvantages of a strengthening Kenyan shilling from a Kenyan perspective (6 marks)

QUESTION FOUR

(a) What is interest rate parity? What would happen if interest rate parity is violated? What would investors do if the forward rate were the same as the sport rates (4 marks)

(b) Boeing Corporation, a U.S FIRM, EXPORTS A 787, a dream liner, to British Airways, invoice is for £10m, payable in one year. Interest rates and foreign exchange rates are:

US interest rate (one year) = 6.10%
UK interest rate (one year) = 9.00%
S=$1.50/£
F_1=$ 1.46/£ (one-year forward rate)

Without a hedge, Boeing is exposed to currently risk. Explain how Boeing wold hedge its foreign exchange rate risk using

i) A forward contract assuming that the pound can depreciate to $1.40/£ (4 marks)
ii) A money market hedge (6 marks)
iii) Explain THREE types of exposures to foreign currency risk that a company may face (6 marks)

QUESTION FIVE

(a) Describe the types of trading blocs (8 marks)

(b) Describe the determinants of FOREX movements (12 marks)