**MERU UNIVERSITY OF SCIENCE AND TECHNOLOGY**

**P.O. Box 972-60200 – Meru-Kenya**

**Tel: 020-2069349, 061-2309217. 064-30320 Cell phone: +254 712524293, +254 789151411**

**Fax: 064-30321**

**Website:** [**www.must.ac.ke**](http://www.must.ac.ke) **Email:** **info@must.ac.ke**

**University Examinations 2015/2016**

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE

OF

 BACHELOR OF COMMERCE

**BFC 3429: INTERNATIONAL FINANCE**

**DATE: APRIL 2016 TIME: 2 HOURS**

**INSTRUCTIONS:** *Answer question* ***one*** *and any other* ***two***questions.

**QUESTION ONE (30 MARKS)**

1. Discuss three types of exchange risk exposure to a multinational Company. (6 marks)
2. Briefly, discuss characteristics and participant of foreign exchange market. (4 marks)
3. Discuss the difference of between currency future contacts and currency forward contracts. (8 marks)
4. State and explain correction measures for the balance of payment disequilibrium. (8 marks)
5. Discuss the functions of foreign exchange market. (4 marks)

**QUESTION TWO (20 MARKS)**

1. Explain the factors that affect exchange rates (8 marks)
2. The following information relates to ZYX Company where the direct quote is DMI---0.5 while the general interest rate in US is 6% and general interest rate in Germany is 3%.

**Required:**

1. Compute the percentage change in direct quote and the new exchange rate (6 marks)
2. Explain what is meant by Financial Engineering (6 marks)

**QUESTION THREE (20 MARKS)**

1. Kaithe Ltd, a Kenyan Company, buys industrial machinery from Malaysian company at a price of 10 million Milayaan Ringgit (MYR). The machinery will be delivered and paid for in 6 months time . Kaithe Ltd seeks to establish its cost in Kenya shillings (ksh). The company decides to use the forward market to accomplish its objective. The following information is obtained from the bank.

Kenya Shillings Malaysian Ringgit

(Kshs) (MYR)

Interest Rate per annum 8% 9%

Spot exchange rate 2.041 Ksh/MYR MYR 0.49/Kshs

The bank will charge a commission of 0.25% on any transaction.

Required:

1. Advice the company whether or not to adopt a long or short forward strategy. (4 marks)
2. Compute the equilibrium forward rate for the Kenya Shillings (Kshs) under an indirect quote. (4 marks)
3. Determine the effect of the bank commission on the Malaysian Ringgit (MYR) value of the Kenya shillings (4 marks)
4. Compute the price in Kenya shillings (Kshs.) that the company can establish by using the forward market. (4 marks)
5. Explain how interest rate swaps and currency swaps may be used. (4 marks)

**QUESTION FOUR (20 MARKS)**

1. Explain two ways in which a firm can hedge against a currency transaction exposure

(6 marks)

1. Messy Importers Ltd, a company base in Kenya, has been a regular importer of goods from USA. The Kenyan currency is the shilling (Shs) while the USA Currency is the dollar ($).

On 1 June 2004 Messy Ltd imported a consignment of goods from a supplier in USA. The consignment cost $ 1000 and was payable on 1 September 2004. The spot rates on 1 June and 1 September 2004 were as follows:

 $/Shs.

1 June 0.007

1 September 0.006

September 2004 shilling futures were trading at $0.00625/shs. (Contract size Shs. 1,194,000) as at 1 June 2004.

**Required:**

1. Show how Messy Ltd could have used a futures contract as a hedging tool, indicating any hedging profit or loss. (9 marks)
2. How many futures contract would Messy Ltd have purchased if the contract size was shs. 2,000,000? (5 marks)

**QUESTION FIVE (20 MARKS)**

1. Explain the following terms
2. Location Arbitrage (3 marks)
3. Triangular Arbitrage (3 marks)
4. The following information is provided about the current spot exchange rate between the United States (US) dollar ($) and the British pound (£), inflation rates in Britain and the United States, and the real rate of interest.

Current spot rate = $1.4500/£

US inflation rate = 1.5% per year

British inflation rate = 2.0% per year

Real rate of interest = 2.5%

**Required:**

Using the parity conditions of international finance:

1. Compute the expected spot rate in one year’s time (5 marks)
2. Assuming that you could borrow $ 1,000,000 or £689,700 at the

risk free interest rate, demonstrate how you can make an arbitrage profit if you were offered the chance to sell or buy British pounds (£) forward (for delivery one year from now) at the current spot rate of $ 1.4500/£. (9 marks)