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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR FOUR**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 410**

**COURSE TITLE: INTERNATIONAL FINANCE**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 20/08/2021 TIME: 09.00-11.00 AM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of FOUR (4) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

1. What is arbitrage? **(1 mark)**
2. BMG FX Limited is an online forex trading company that wants to do a triangular arbitrage by exploiting an arbitrage opportunity resulting from a pricing discrepancy among three different currencies in the foreign exchange market. The current exchange rate of three currency pairs and cross rate is as follows:

$1: ksh 73.6835- 77.7825

£1: ksh 120.2335- 128.4255

£1: $ 1.4679- 1.5003

£1: $ 1.5458- 1.7429 (cross rate)

Assume you hold ksh. 1,200,000

1. how can you make arbitrage profits in this market? **(10 marks)**
2. how can you make arbitrage loss in this market by using an undervalued currency to an overvalued currency? **(10 marks)**
3. Various definition has been advanced for multinational corporations, apply the strategic focus approach to describe a multinational corporation **(9 marks)**

**QUESTION TWO**

1. Assume that the direct spot rate between the US Dollar and European pound is;

£1: $1.5

Inflation rate in the UK (UK)=6%

Inflation rate in the US (US)=10%

Required

1. Compute the percentage change in the direct quote and determine the new exchange rate **(2 marks)**
2. Compute the exchange rates at the end of years 1,2,3,4 and 5 **(10 marks)**
3. What are the advantages and disadvantages of a fixed exchange rate regime **(8 marks)**

**QUESTION THREE**

1. Assume that the spot rate: £1: $1.6365-1.6385

1 month forward: 0.005-0.0047 (premium)

3 months forward: 0.003-0.005 (discount)

**Required**

Compute the cost of the forward cover to customer who;

1. Buy pounds one month forward **(2 marks)**
2. Sells pounds one month forward **(2 marks)**
3. Buy pounds three month forward **(2 marks)**
4. Sells pounds three month forward **(2 marks)**
5. With reference to financial management in the global context, distinguish between the following terms:
6. A “Eurobond” and a “Euro note”. **(2 marks)**
7. An option being “in the money” and “out of the money”. **(2 marks)**
8. American option andEuropean option. **(2 marks)**
9. The bid rate and ask rate. **(2 marks)**
10. Direct quote and indirect quote. **(2 marks)**
11. A call option and A put option **(2marks)**

**QUESTION FOUR**

Assume that the foreign exchange rates are quoted as follows;

Spot rate £1: F 2156-2166

3-month spot rate £1: F 2207-2222

**Required:**

1. Determine the amount required is sterling pound to buy 2,000,000 foreign currencies;
2. At the spot rate **(3 marks)**
3. In 3 months’ time under the forward exchange contract **(3 marks)**
4. Compute the amount a customer would get if he was to sell 2,000,000 foreign currencies;
5. In the spot rate **(3 marks)**
6. In 3 months’ time under the forward exchange contract **(3 marks)**
7. Explain how inflation rates could be used to forecast exchange rates. **(8 marks)**

**QUESTIONS FIVE**

Analytical associates limited has delivered 500,000 electronic devices to an American company priced in America dollars at $50 each on a three-month credit window.

Given:

Interest rates

USA 15% p.a

Kenya 12% p.a

Exchange rates

Spot: $1: ksh 77.22-92

Three month forward $1: ksh 65.23-93

A three-month dollar call option is available at a premium of USD. 26,000 at exercise

Price of ksh. 67.53

A three-month dollar put option is available at a discount of USD. 11,000 at an exercise

Price of ksh. 66.60

**Required**

1. Using suitable computations, illustrate three strategies available to Analytical associates limited in managing the exposure and advice on the suitable technique. **(15 marks)**
2. Highlight the factors that have led to increase in international finance. **(5 marks)**