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**University Examinations 2015/2016**

FOURTH YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE

**BFC 3429: INTERNATIONAL FINANCE**

 **DATE: AUGUST 2016 TIME: 2HOURS**

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

**QUESTION ONE (30MARKS)**

1. How is International Financial Management different from domestic financial management? (5 Marks)
2. Discuss the role of financial markets in the global economic system. (5 Marks)
3. Discuss the role of IMF in international trade and financial transactions. (6 Marks)
4. Discuss the advantages and disadvantages of Direct Foreign Investments to the host country. (8 Marks)
5. Explain the following terms of forecasting exchange rates.
6. Purchasing power parity
7. Interest rate parity
8. International fisher effect. (6 Marks)

**QUESTION TWO (20 MARKS)**

1. A French tourist arrived in Kenya with Euros 45,000 in travelers cheques. He changed his travelers cheques into Kshs. At the spot rate of 78.140/1Euro. The bank charged him 1%. He spent Kshs.300,000 and left for France. He converted the outstanding amount into Euros at the spot rate of Kshs.80/Euro. How much money did he take home? (6 Marks)
2. Explain the following types of foreign currency risk exposure:
3. Transaction exposure (3 Marks)
4. Translation exposure (3 Marks)
5. Explain two broad ways in which a firm can hedge against a currency transaction exposure. (8 Marks)

**QUESTION THREE (20 MARKS)**

1. Distinguish between direct currency quote and indirect currency quote. (6 Marks)
2. Assume the following information:

Spot rate of pound =$1.70

180 day forward rate of pound = $1.75

180 day British interest rate =5% (absolute)

180 day USA interest rate =4%(absolute)

Based on the above information, does covered interest arbitrage (hedged interest arbitrage) hold? Assume there are no transaction costs, and that you start with $1,000,000. (7 Marks)

1. Assume the following information:

Spot rate of French francs = $0.100

180 day forward rate of French francs = $0.12

180 day French interest rate =6% (absolute)

180 day USA interest rate = 5% (absolute)

You have also learnt the transaction cost of the US investor is $100. Assume that the USA investor has $ 500,000 to invest. Does hedged interest arbitrage exist? (7 Marks)

**QUESTION FOUR (20 MARKS)**

1. A United States firm has concluded a deal to sell heavy earth moving equipment to a British company for pound sterling (£)1,000,000. The chief finance officer of the United States firm has collected the following financial and market data for the analysis of her currency exposure.

Spot exchange rate: $1.7640/£

 Three month forward rate:1.7540/£

 United State firm’s cost of capital: 12%

 United Kingdom three month borrowing interest rate: 10% p.a.

 United Kingdom three month investment interest rate: 8% p.a

 United State three month borrowing interest rate: 8% p.a

 United State three month investment interest rate: 6% p.a

The United State company’s foreign exchange advisory service forecasts that the spot rate in 3 months will be $ 1.76/£

Required:

Use the following techniques to hedge the United States firm’s against foreign exchange exposure:

1. Forward market (7 Marks)
2. Money market (9 Marks)
3. Explain the difference between “futures contracts” and “forward contracts”. (4 Marks)

**QUESTION FIVE (20 MARKS)**

1. Discuss the theories that encourage MNCs to expand their business internationally. (8 Marks)
2. Explain three methods that a firm can use to hedge against transaction exposure risk. (7 Marks)
3. Explain the following phrases as used in international banking:
4. Consortium banking. (2 Marks)
5. Correspondent banking. (3 Marks)