**Name: ___________________________________**

**Quiz 1**
**International Finance Management**
**C45.0030.001**

09/23/03

Total points: 20, Time: 20 min

**Q I. (4 points)** (answer **only one** of the two questions):

**1. The mobility of international capital flows is causing emerging market nations to choose between a free-floating currency exchange regime and a currency board (or dollarization). Describe shortly how each of the regimes would work.**

**2. Define Interlocking Directorates. Why are they favored outside of the US?**

**Q II. (4 points)** (answer <u>only one</u> of the two questions):

1. Classify the following two transactions in the BOP of the foreign country & of the US:

    a) American opens a bank account in Mumbai, India?

    **b)** The U.S. subsidiary of Credit Suisse pays dividends to its parent in Switzerland?

2. What would be the effect of an undervalued currency on the current account?

**Q III. (4 points)** (answer only one of the two questions):

1. Define international Fisher effect. How is it related to the theory of purchasing power parity?

2. BMW of Germany produces BMW cars and exports them to the United States. Last year the exchange rate was 0.90 $/EUR and BMW charged EUR 40,000 per BMW imported in US. Currently the spot exchange rate is 1.10 $/EUR and BMW is charging US$ 40,000 for the same vehicle. Determine the price of BMW in US$ last year & then determine what is degree of pass through by BMW? Note: no need for exact answer, just set up the way to obtain it, & show where to plug the provided info.

**Q IV. (4 points)** (answer only one of the two questions):

1. What is “yen carry trade” example of – covered interest arbitrage or uncovered interest arbitrage? Define both concepts & give a sketch of yen carry trade.

2. A U.S. investor has 100,000$ and has to make choice between a risk-free one-year U.S. security with an annual return of 4%, and a comparable British security with a return of 5%. If the spot rate is $1.43/Pound, the forward rate is $1.45/Pound, and there are no transaction costs, is there any arbitrage opportunity? If yes, describe it. If no, why?

**Q V. (4 points)**

Money and foreign exchange markets in Frankfurt and New York are very efficient. The following information is available:

| | ***Frankfurt*** | ***New York*** |
|---|---|---|
| Spot exchange rate | $1.10/Euro | $1.10/Euro |
| One-year treasure bill rate | 5.00% | 3.00% |
| Expected inflation rate | **Unknown** | 2.00% |

<u>Answer only one of the two questions:</u>

1. What do financial markets expect inflation to be in Europe next year? <u>Note:</u> you do not need to give exact numerical answer but you need to set up the way to obtain it & show where to plug the provided info.

2. Estimate today's one-year forward exchange rate between the dollar and the euro. Is Euro trading at a one-year forward premium or discount? <u>Note:</u> no need to give an exact numerical number, full credit will be given if you set up the calculation (formulas) & show where shall we plug the provided info.