Name: _____

Quiz 2
International Finance Management
C45.0030.001

10/07/03

Total points: 20, Time: 25 min

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

1. As we have seen in past crises, sometimes exchange rate of a country gets devalued by more than one would predict based on parity condition. This is referred to as overshooting devaluation of exchange rate. Why overshooting is higher/ more important for currencies of countries w/ lots of foreign debt?

2. If we are to use the monetary approach to exchange rate determination, what will be the predicted effect on the exchange rate of domestic currency if domestic real income increases? Why? Using the same theory, what would be the effect on exchange rate if domestic interest rate increases? Why?

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

1.
   a. List three participants in the foreign exchange market. Briefly say why are they in the forex market (e.g. profit, hedging, etc).
   b. What is a non-deliverable forward? Is this a spot, forward, or swap transaction?

2.
   a. According to the flow (BOP) approach to exchange rate determination, what can a country w/ managed floating exchange rate regime do in order to cope w/ a deficit in its BOP?
   b. Do governments in countries w/ fixed exchange rate regimes have the responsibility to maintain BOP close to 0? What will happen if they run persistent BOP deficits?

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

1. Suppose you have the following quotations

Bank	***Quotation***
Sumitomo Bank, Tokyo	¥120/$
Bank of New York, New York	RUR 30/ $
Mosbank, Moscow	¥ 4.5 / RUR

Assume that you have Russian Rubles RUR 1,000,000. What is the cross-rate of ¥/RUR? Compare it w/ the Mosbank's ¥/ RUR quote. Is there any triangular arbitrage opportunity? If yes, sketch it briefly, if no, explain why.

2.

a. What is the difference between a call and a put option?
b. If a 3-month European put on the British pound has a strike price of $ 1.59/Pound, and current spot price is $ 1.48/ Pound, is this option in-the-money, out-of-money, or at-the-money?

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

Please answer only one of the two questions.

1.

a. List three differences b/n futures and forward contracts.
b. Briefly, what is the difference between futures contracts and option contracts?

2. Suppose you wish to speculate on the Australian dollar (A$) futures, traded @ Chicago Mercantile Exchange. The following quotations are available:

Australian Dollar Futures, US$/ A$ *Contract =100,000 Australian $*

Maturity	**Settlement price (10/06/03)**
Dec'03	$ 0.6792/ A$
Mar'04	$ 0.6728/ A$

a. If you are long ten (10) Dec'03 A$ futures contracts, and the spot rate @ maturity is $0.69/A$, what is the value of your position at maturity?
b. If you are short fifteen (15) Mar'04 A$ futures contracts, and the spot price @ maturity is $0.66/A$, what is the value of your position at maturity?

Q V. (4 points) (please answer **only one** of the two questions)

For the following questions you may use the formulas for forward premium/discount: For direct quotes, $f^{FOREIGN} = \frac{Forward - Spot}{Spot} \times \frac{360}{days} \times 100$. *For indirect quotes,* $f^{FOREIGN} = \frac{Spot - Forward}{Forward} \times \frac{360}{days} \times 100$.

1. You receive the following quotes on the Swiss franc against US $ for the spot, and 3 month forward rate:

	Bid	***Ask***
Spot	SF 1.6075/$	SF 1.6085/$
3-month forward	14	22

Note that forward rate is expressed in points quote, where 1 point is equal to SF 0.0001/$.

a. What is the outright bid and ask 3-month forward quote?
b. Using the mid-rate (i.e. the average of the bid & ask rate) for spot and 3-month forward, compute the percentage forward premium or discount on Swiss Franc.

2. Suppose you have $ 1,000,000 and wish to speculate on the Swiss Franc. Current 90-day forward rate is SF 1.60/$. You believe that spot in 90-days will be SF 1.65/$.

a. Can you make an arbitrage profit? If yes, show how. If no, explain why.
b. Is the Swiss franc traded at a 90-day forward premium or discount? Show how to compute forward premium/ discount.