International Islamic University Chittagong (IIUC)

Department of Economics & Banking

Final Examination: Autumn-2018 Program: B.S.S. (Honor's)

Course Title: International Finance and Banking ; Course Code: BNKG-4706

Time: 2.5 Hours Full Marks: 50

Answer any Five of the following questions. All parts of a question must be answered sequentially. Figures in the right margin indicate full marks.

01. (a)What is option price? 01
(b)The 1-year interest rate in Australia is 10 percent. The 1-year interest rate in the United States is 6 percent. The spot rate of the Australian dollar (A$) is $.70 and the forward rate of the A$ is $.66. Assume zero transaction costs. 03
Based on this information, dictate whether interest rate parity exist or not.
(b) Explain the factors to be considered by MNC in taking Capital Budgeting Decision 06

02. (a) "Profit of an option contract seller is limited to option premium only."- Evaluate this statement 04
(b) Explain the term withholding tax to be considered by MNC in calculating cash flows to be generated from foreign investment 02
(c) "Speculators often sell currency futures when they expect the underlying currency to depreciate, and vice versa"- Explain this statement with example 04

03. (a) Explain the components of CAPM 02
(b) Explain the basic distinctions among locational, triangular and covered interest arbitrage. 04
(c) Excel Co. is based in the United States. It finances its operations with 40 percent equity and 60 percent dollar-denominated debt. It borrows its funds from a U.S. bank at an interest rate of 9 percent per year. The long-term risk-free rate in the United States is 6 percent. The stock market return in the United States is expected to be 13 percent annually. Excel's stock price typically moves in the same direction and by the same degree as the U.S. stock market. Its earnings are subject to a 20 percent corporate tax rate. Estimate the cost of capital to Excel Co. 04

04. (a) "Covered interest arbitrage requires tie up of fund for a certain period."- explain this statement 02
(b)"Transaction exposure is a subset of economic exposure of exchange rate risk."-Evaluate this statement with example 03
(c)Assume that Spot rate of Mexican peso $.100. 180-day forward rate of Mexican peso $.098. 180-day Mexican interest rate 6%. 180-day U.S. interest rate 5%. 05
Given this information, is covered interest arbitrage worthwhile for Mexican investors who have pesos to invest? Explain your answer