



# **KIBABII UNIVERSITY**

**UNIVERSITY EXAMINATIONS  
2021/2022 ACADEMIC YEAR**

**SPECIAL/SUPPLEMENTARY EXAMS**

**FOURTH YEAR SECOND SEMESTER EXAMINATIONS**

**FOR  
BACHELOR OF COMMERCE**

**COURSE CODE: BCF430**

**COURSE TITLE: INTERNATIONAL FINANCE**

**DATE: 12<sup>TH</sup> JANUARY, 2022 TIME: 2.00PM - 4.00PM**

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## **INSTRUCTIONS TO CANDIDATES**

1. Answer Question One and any Other Two Questions

### QUESTION ONE

- a) Under management of transaction exposure as regards foreign exchange explain the following
- i. Forward exchange contract (1mk)
  - ii. Money market hedge (1mk)
  - iii. Currency option (1mk)
- b) What is your understanding of the term euro bond (3mks)
- c) What are the motives of investing in foreign markets (3mk)
- d) What are the merits of fixed exchange rates (3mk)
- e) Distinguish between absolute form of purchasing power parity and relative form of purchasing parity. (3mk)
- f) Equity bank quotes a bid rate of £0.62 for the US dollars and an ask rate of £0.64 what is the bid rate percentage spread (2mks)
- g) Give three reason as to why exchange rate risk may be considered irrelevant by some economists (6mks)
- h) What are the cost related motives of foreign direct investment (3mks)
- i) Highlight on the factors affecting exchange rate (6mks)

### QUESTION TWO

- (a) Why do firms forecast exchange rates? (10 marks)
- (b) What are the main motives of borrowing in foreign markets. (5marks)
- (c) Assume that the direct quote between \$ and £ is £1:\$ 1.5 and the inflation rate in UK is 10% and inflation rate in the US is 6%.

Required: compute the % age change in the direct quote and determine the new exchange rate (5marks)

**(Total 20 marks)**

### QUESTION THREE

- a) Consider the following regression model out of historical data.

$$Y_t = B_0 + B_1 T_t + B_2 F_{t-1} + E$$

When  $Y_t$  the % age change in the exchange rate of the Kenyan shilling in period t

$T_t$  = Average real interest rate differential ( UK rate less Kenyan interest rate)

$F_{t-1}$  Inflation differentials (UK inflation rates less Kenyan inflation rate) for pension period

$B_0, B_1, B_2$  are regression coefficients.

If the regression coefficients were estimated as follows

$B_0 = 0.00, B_1 = 0.9, B_2 = 0.8$  and the inflation differentials in the most recent period was 4%.

The real interest rate differentials in the ensuing period is predicted as:

Interest rate differentials	0%	2%	3%
Probability	35%	55%	10%

Required: What will be the probability distribution of the shilling percentage change over the upcoming period? (10mks)

b) ABC Ltd a UK firm has been invited to tender for a contract in BlueLand with the local currency of Blues (B). The company thinks that the contract should cost \$ 1850,000 and is prepared to price contract at \$ 2 million. The currency exchange rate for Blues and \$ is \$ 1: B2.80. The company therefore bids for B 5.6 million. The contract will not be awarded until after six months. A six month currency option to sell B 5.6 million at an exchange rate of \$ 1: B 2.8 is current costing \$ 40,000.

ABC Limited can either buy the option or enter into forward exchange contract at a rate of \$ 1: B 2.8

Assume that the company fails to win the contract and the spot rate in six months time is B 2.50

**Required:** Advice the company on which alternative is better.

#### QUESTION FOUR

- (a) An international project will cost company X £ 35 million. The cash flows for four years before a withholding tax of 10% is given below

Year	1	2	3	4
£millions	7	13	18	22

If the required rate of return is 12% determine the net present value of the project and its internal rate of return (10 marks)

- (b) Highlight the limitations of fundamental forecasting. (10 marks)

**(Total 20 marks)**