**NMIMS**

**International banking**

**Internal Assignment for June 2020 Examination**

**1. Mumbai Ltd. is an Indian company, they are in process of raising a US dollar loan and are negotiating rates with City Bank. The Company has been offered a fixed rate of 7% p.a with a proviso that should they opt for a floating rate, the interest rate is likely to be linked to the bench mark rate of 60 basis points over the 10 year US T Bill Rate, with interest refixation on a three monthly basis. The expectations of Mumbai Ltd. are that the dollar interest rates will fall, and are inclined to have a flexible mechanisms built into their interest rates. On enquiry they find that they could go for swap arrangement with Chennai India Ltd. who have been offered a floating rate of 120 basis points over 10 year US T Bill Rate, as against a fixed rate of 8.20%. Describe the swap on the assumption that the swap differential is shared between Mumbai Ltd. and Chennai India Ltd. in the proportion of 2: 1**.

**Answer**: Mumbai Ltd. expects that interest rate will fall so they should opt for floating interest. Swap arrangement can be as under:

The rates are identified:

|  |  |  |
| --- | --- | --- |
| Company | Fixed | Floating |
| Mumbai Limited | 7% | Bench Mark+ 60 basis points |
| Chennai India Limited | 8.20% | Bench Mark+120 points |

**The net differential of the two types of interest rates between the two companies are:**

Fixed Interest differential: 8.20-7.00 = 1.20

Floating interest differential: 1.20-0.60 = 0.60

Net differential: 0.60\*

\* This gain as per

**2. XYZ Ltd. Is planning to import a multi-purpose machine from Japan at a cost of 3400 lakhs yen. The company can avail loan at 18% interest per annum compounded quarterly with which it can import the machine. However, there is an offer from Tokyo branch of an India based bank extending credit of 180 days at 2% per annum against opening of an irrevocable letter of credit. Other information: -**

**Present exchange rate Rs. 100 = 340 yen**

**180 days forward rate Rs. 100 = 345 yen**

**Commission charges for letter of credit at 2% per 12 months.**

**Advise whether the offer from the foreign branch should be accepted?**

**Answer**: **Option I (To finance the purchase by availing loan at 18% per annum):**

Cost of machine Rs. in lakhs

3,400 lakh yen as Rs.100 = 340 yen = 1,000.00

Add: Interest at 4.5% I Quarter = 45.00

Add: Interest at 4.5

Its half solved sample only

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**3. Nitrogen Ltd, a UK company is in the process of negotiating an order amounting to €4 million with a large German retailer on 6 months credit. If successful, this will be the first time that Nitrogen Ltd has exported goods into the highly competitive German market. The following three alternatives are being considered for managing the transaction risk before the order is finalized.**

**i. Invoice the German firm in Sterling using the current exchange rate to calculate the invoice amount.**

**ii. Alternative of invoicing the German firm in € and using a forward foreign exchange contract to hedge the transaction risk.**

**iii. Invoice the German first in € and use sufficient 6 months sterling future contracts (to the nearly whole number) to hedge the transaction risk.**

**Following data is available:**

**Spot Rate € 1.1750 - €1.1770/£**

**6 months forward premium 0.55-0.60 Euro Cents**

**6 months future contract is currently trading at €1.1760/£**

**6 months future contract size is £62500**

**Spot rate and 6 months future rate €1.1785/£**

**Required:**

**a. Calculate to the nearest £ the receipt for Nitrogen Ltd, under each of the three proposals.**

**b. In your opinion, which alternative would you consider to be the most appropriate and the reason thereof**.

**Answer**: Assuming that 6 month forward premium is considered as discount, because generally premium is mentioned in ascending order and discount is mentioned in descending order.

i) Receipt under three proposals

a) Invoicing in pound sterling: € 40,00,000/1.1770= £ 33,98,471

b) Use of