**International Finance**

**June 2022 Examination**

**Q1. Define interest rate parity (IRP) and explain with US and India example, when IRP does not hold good, how the opportunities for covered interest arbitrage arise. (10 Marks)**

**Ans 1.**

**Introduction:**

Globalization has made trade among the countries very accessible and affordable. Now, items are being transferred from one country to the opposite. This is how we are witnessing an upward thrust inside the wide variety of products to be had in the market and the growing dwelling requirements of people living in that society. Globalization and liberal thoughts of change have also given rise to many new start-ups and groups which want cash and capital to grow their

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**Q2. Explain International Fisher Effect (IFE), forward expectation parity (FEP) and summarise the relation through an appropriate diagram. (10 Marks)**

**Ans 2.**

**Introduction:**

In this globalized international, whenever one tries to take investment or raise some capital, it has to dilute its assets or undergo certain liabilities in terms of the mortgage. They have to pay particular interest on that loan quantity which is maximum instances is uniform in a selected territory. But what is to be mentioned is that there are possibilities of incurring either more excellent or lower interest rates when you boost the price range from the worldwide marketplace.

**Q3. Mr.Suresh Bhonsle is treasury head in India of a multi-national bank. In his individual capacity he is an investor of stocks. Over the years he has built up a robust portfolio by investing in stocks of companies of various sectors. In Airlines industry he has investment in 1000 shares in Indigo ( InterGlobe Aviation Ltd.). The sector got badly hit during Covid 19. Mr. Bhonsle (being MBA finance from NMIMS and FRM and treasury head of a bank) goes through the financial statement of the company thoroughly. He notes, as a result of Covid Pandemic - Indigo suffered a net loss of Rs.58298 million during the financial year 2020-21 of which around 9% (Rs 5230 million) is attributable to foreign exchange loss. He further notes that the effect of exchange rate change (loss) on cash and cash equivalents held in foreign currency is Rs.177.28 million. ‘Notes on accounts’ further reveals that there is considerable foreign currency outgo resulting from loan repayment. The profit/ loss arises mainly on exchange difference in repayment of foreign currency loan. Despite foreign currency transaction exposure there does not seem to be in place proper ‘hedging’ of currency risk.**

 **Currency risk can be hedged using forward contract with a multinational bank at the same future rate prevailing in the market. Alternatively, the company can deploy money market hedge. Among other loan repayments as per various schedules, suppose indigo has to pay Rs. 5 million (INR) at the yearend 2020-21 without hedging taking spot rate as USD 1 = 76 (or 1 INR= $0.0131). The market condition in 2020-21 was as under-**

|  |  |
| --- | --- |
| **Indian 1 year T-bill rate**  | **5.50% per annum** |
| **U.S 1 year bond yield**  | **1.00%** |
| **Spot exchange rate**  | **Rs.76/$1** |
| **Forward (future)exchange rate at the beginning of 2020-21**  | **Rs.74/$/1** |

**Required:**

**a. Compute the impact of hedging if forward rate route (forward hedge) is taken. (5 Marks)**

**Ans 3a.**

**Introduction:**

Forward market hedging helps hedge exposure within the forward forex, interest rate, and economic asset markets. It includes the use of forex contracts or FX forwards. Under this hedging technique, a coin is rightly bought at a forward trade rate. The hedge may be affected by

oving the impact of change in foreign money rate fluctuations.

**Q3b. Compute the impact of money market hedge and compare with forward hedge (a) to arrive at logical conclusion as to hedging strategy the company should follow. (5 Marks)**

**Ans 3b.**

**Introduction:**

Hedging is when the dealer attempts to take a few protecting measures to avoid changes inside the currency market because of a few unstable events or information. Below this hedging approach, a coin is out rightly purchased at a forward exchange charge. The hedge may be