**International Finance**

**September 2022 Examination**

**Q1. The largest trading partner of India is the USA. If the inflation in India is higher than that of the – explain how it will impact the value of Indian rupee against USD under free floating exchange system. Will the US consumers continue to buy Indian products under such situation? (10 Marks)**

**Ans 1.**

**Introduction**

In the year 2019, the India Gross Domestic Product (GDP) was estimated at $ 2.95 trillion at the current market exchange rates. The real GDP stood at approximately 4.2%, and the population was around 1.4 billion people as by the IMF report.

In the same year, U.S. and India traded goods and services estimated at $ 146.1 billion. India exports were valued at around $ 58.6 billion and the imports valued at around $ 87.4 billion. U.S. trade shortfall with India stood at $ 29.7 billion in

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**Q2. Assume the following information :**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Particulars** | | | | | **Quoted Price** |
| **Value of Canadian Dollars (C$) in terms of** | | | | | **$0.90** |
| **US dollars ($)** | | | | |
| **Value of New** | **Zealand** | **(NZ$)** | **in** | **US** | **$ 0.30** |
| **Dollars($)** |  |  |  |  |
| **Value of Canadian dollar (C$) in New** | | | | | **NZ$3.02.** |
| **Zealand dollar (NZ$)** | | | | |

**Based on the above information please answer the following question –**

**a) Is triangular (three-point) arbitrage possible?**

**b) If the answer to question (a) is affirmative, please explain the steps that would result in arbitrage profit if you have $1 million. Quantify the arbitrage profit.**

**c) How the market forces will act to eliminate triangular arbitrage. (10 Marks)**

**Ans 2.**

**Introduction**

Arbitrage trading in Financial Markets refers to the opportunity whereby similar assets are bought and sold simultaneously at different price for profit. An investors buys a cheap asset and sell at a higher price in order to profit, without cash flows. In theory, this process involves no capital nor risk.

The efficient markets hypothesis states that a triangular arbitrage does not exist during the normal conditions of market and trade when price communication is moving toward equilibrium levels across the markets. At this occasion, moneys can be disvalued because of the irregular information on the price quotation amongst the market participants.

**Question 3.**

**G Co Ltd- a famous US based firm requires 10 million pound (GBP) by way of loan to finance a new venture in UK. But the firm being unknown to British investors is unable to get financing from UK debt market nor any UK bank. Hence, the firm decides to raise fund from US debt market through dollar-denominated 3 years’ bond at annual coupon of 10% PA. It will then convert the dollar ($) into GBP at prevailing spot rate of GBP/ $ = $1.70.**

**Over the each of next 3 years it plans to use the revenue earned in GBP from UK market out of new business to make its annual debt payment. G Co engages in currency swap agreement with a counter-party in which it will convert GBP to USD at an exchange rate of $1.70 per GBP at the end of each of next 3 years.**

**Answer the following questions –**

1. **How many dollars should G Co Ltd borrow initially to support new UK venture?**

**Understanding and usageof the formula**

**Ans 3a.**

**Introduction**

The Dollar to Pound exchange rate got to as high as $2.648 on 6th, March 1972. That remains the robust level the Dollar has been against Pound since it was freely drifted in 1971. Before the year 1970s, the Dollar to Pound exchange rate was fixedby the British government.

**Ans 3b.**

**Introduction**

How many pound should G specify in the swap agreement that will swap over each of the

next 3 years in exchange of USD so that it can make its annual coupon payment to the US