AFRICA
UNIVERSITY
(A United Methodist-Related Institution)
"Investing in Africa's Future"

COLLEGE OF BUSINESS, PEACE, LEADERSHIP& GOVERNANCE

COURSE TITLE: **MEC 402- INTERNATIONAL FINANCE**

SEMESTER 2: **FINAL EXAMINATION MAY 2018**

LECTURER: **MR. L. NGENDAKUMANA**

TIME: **3 HOURS**

INSTRUCTIONS

Answer **all questions in section A and TWO questions in section B.**
Total possible mark is **100.**

Start **each** question on a new page in your answer booklet.

The marks allocated to **each** question are shown at the end of the section.

Show all your workings.

Credit will be awarded for logical, systematic and neat presentations.

SECTION A

Question One

a. Using grammatical tools and the concept of floating exchange rates, explain 2 factors which can cause a shift in the foreign currency demand curve. **[8]**

b. Use the answer in (a) to explain the concepts of appreciation and depreciation of currencies. [4]

c. Explain how a government can intervene in the foreign exchange market when it implements:

(i) a devaluation of its currency [4]

(ii) a revaluation of its currency [4]

Use diagrammatical tools in your explanations.

Question Two

Briefly explain the following concepts:

a. Foreign exchange market [2]
b. Balance of payments [3]
c. Hedging [3]
d. "Twin deficit" hypothesis [3]
e. Purchasing power Parity [3]
f. Arbitrage [3]
g. Marshall- Lerner condition [3]

Question Three

a. Domestic investor is considering investing in international financial assets. Use numerical examples and your knowledge on:
i. The annualized interest rates on domestic and foreign country's bonds of your choice;
ii. The current spot and the future spot exchange rates of the two countries' currencies, to advise the investor in which country to invest [5]

b. Using the information in (a), explain the concept of the rate of appreciation of one of the 2 currencies, and compute the annualized rate of appreciation/depreciation as a percentage [3]

c. You are an advisor to a U.S based investor who is considering investing into international financial money markets instruments. Using the following markets' data:
the annualized interest rate on 180 day- dollar denominated bonds is 6 percent; the annualized interest rate on 180 day- pound denominated bonds is 9 percent; the current spot exchange rate is £0.625/$ and the current 180 day forward exchange rate is £0.667/$:

i. Is the pound at a forward premium or discount? [3]

ii. Should a U.K based investor make a covered investment in pound denominated 180 day bonds rather than investing in 180 day dollar denominated bonds? [3]

iii. Should a U.S based investor make a covered investment in pound denominated 180 day bonds rather than investing in 180 day dollar denominated bonds? [3]

iv. Distinguish between covered and uncovered international investments [3]

SECTION B

Question Four

a. "Some currencies tend to appreciate in the long run while others tend to depreciate". Assess this statement using the various economic factors and adequate theories **[10]**

b. Use concrete illustrations to distinguish between activities which involve the demand and supply of foreign currencies in the spot foreign exchange market. Give 2 examples in each case. **[10]**

Question Five

What does perfect capital mobility mean for the effectiveness of monetary and fiscal policies under flexible exchange rates? **[20]**

Question Six

a. How does the intersection of the IS and LM curves relate to the concept of internal balance? [7]

b. A natural disaster wipes out a large part of a country's production capability. According to the monetary approach, this will tend to result in an appreciation of the country's currency". Assess this statement using solid justifications [8]

c. Is it possible for a country to have a current account deficit at the same time it has a surplus in its balance of payments? [5]

End