1. \_\_\_\_\_\_\_\_ is NOT a commonly used contractual hedge against foreign exchange transaction exposure.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | Money market hedge |
|  |  | Options market hedge |
|  |  | Forward market hedge |
|  |  | All of the above are contractual hedges. |

1. Plains States Manufacturing has just signed a contract to sell agricultural equipment to Boschin, a German firm, for >1,250,000. The sale was made in June with payment due six months later in December. Because this is a sizable contract for the firm and because the contract is in Euros rather than dollars, Plains States is considering several hedging alternatives to reduce the exchange rate risk arising from the sale. To help the firm make a hedging decision you have gathered the following information.

∙ The spot exchange rate is $1.1740/>
∙ The six month forward rate is $1.1480/>
∙ Plains States' cost of capital is 12% per annum
∙ The Euro zone 6-month borrowing rate is 7% per annum (or 3.5% for 6 months)
∙ The Euro zone 6-month lending rate is 5% per annum (or 2.5% for 6 months)
∙ The U.S. 6-month borrowing rate is 6% per annum (or 3% for 6 months)
∙ The U.S. 6-month lending rate is 4.5% per annum (or 2.25% for 6 months)
∙ December put options for >625,000; strike price $1.18, premium price is 1.5%
∙ Plains States' forecast for 6-month spot rates is $1.19/>
∙ The budget rate, or the lowest acceptable sales price for this project, is $1,425,000 or $1.14/>

Plains States would be \_\_\_\_\_\_\_\_ by an amount equal to \_\_\_\_\_\_\_\_ with a forward hedge than if they had not hedged and their predicted exchange rate for 6 months had been correct.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | better off; $52,500 |
|  |  | worse off; $10,000 |
|  |  | better off; $10,000 |
|  |  | worse off; $52,500 |

1. Oregon Transportation Inc. (OTI) has just signed a contract to purchase light rail cars from a manufacturer in Germany for 25,000,000. The purchase was made in June with payment due six months later in December. Because this is a sizable contract for the firm and because the contract is in euros rather than dollars, OTI is considering several hedging alternatives to reduce the exchange rate risk arising from the sale. To help the firm make a hedging decision you have gathered the following information.

•         The spot exchange rate is $1.1740/

•         December contracts in CME currently trade at $1.1480/ and the margin requirement

        for the contract is $2,000.

•         OTI's cost of capital is 12% per annum

•         The Euro zone 6-month borrowing rate is 7% per annum (or 3.5% for 6 months)

•         The Euro zone 6-month lending rate is 5% per annum (or 2.5% for 6 months)

•         The U.S. 6-month borrowing rate is 6% per annum (or 3% for 6 months)

•         The U.S. 6-month lending rate is 4.5% per annum (or 2.25% for 6 months)

•         December call  options on Euro: strike price $1.15, premium price is 1.5% of the underlying amount

•         OTI's forecast for 6-month spot rates is $1.19/

•         The budget rate, or the highest acceptable purchase price for this project, is $29,750,000 or $1.19/

Assume that OTI treasurers buy a call option on 25m at strike price of 1.5% of the underlying currency .  If the spot rate is $1.25/  in December when the payment is due, what would  the effective dollar cost of OTI s payable.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | $29,750,000 |
|  |  | 28,309,750 |
|  |  | 29,190,250 |
|  |  | 29,216,665 |

1. Plains States Manufacturing has just signed a contract to sell agricultural equipment to Boschin, a German firm, for >1,250,000. The sale was made in June with payment due six months later in December. Because this is a sizable contract for the firm and because the contract is in Euros rather than dollars, Plains States is considering several hedging alternatives to reduce the exchange rate risk arising from the sale. To help the firm make a hedging decision you have gathered the following information.

∙ The spot exchange rate is $1.1740/>
∙ The six month forward rate is $1.1480/>
∙ Plains States' cost of capital is 12% per annum
∙ The Euro zone 6-month borrowing rate is 7% per annum (or 3.5% for 6 months)
∙ The Euro zone 6-month lending rate is 5% per annum (or 2.5% for 6 months)
∙ The U.S. 6-month borrowing rate is 6% per annum (or 3% for 6 months)
∙ The U.S. 6-month lending rate is 4.5% per annum (or 2.25% for 6 months)
∙ December put options for >625,000; strike price $1.18, premium price is 1.5%
∙ Plains States' forecast for 6-month spot rates is $1.19/>
∙ The budget rate, or the lowest acceptable sales price for this project, is $1,425,000 or $1.14/>

If Plains States locks in the forward hedge at $1.1480/>, and the spot rate when the transaction was recorded on the books was $1.174/>, this will result in a "foreign exchange loss" accounting transaction of \_\_\_\_\_\_\_\_.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | There is not enough information to answer this question. |
|  |  | $0 |
|  |  | $32,500 |
|  |  | This was not a loss; it was a gain of $32,500. |

* Plains States Manufacturing has just signed a contract to sell agricultural equipment to Boschin, a German firm, for >1,250,000. The sale was made in June with payment due six months later in December. Because this is a sizable contract for the firm and because the contract is in Euros rather than dollars, Plains States is considering several hedging alternatives to reduce the exchange rate risk arising from the sale. To help the firm make a hedging decision you have gathered the following information.
The spot exchange rate is $1.1740/>
* The six month forward rate is $1.1480/>
* Plains States' cost of capital is 12% per annum
* The Euro zone 6-month borrowing rate is 7% per annum (or 3.5% for 6 months)
* The Euro zone 6-month lending rate is 5% per annum (or 2.5% for 6 months)
* The U.S. 6-month borrowing rate is 6% per annum (or 3% for 6 months)
* The U.S. 6-month lending rate is 4.5% per annum (or 2.25% for 6 months)
* December put options for >62,500; strike price $1.18, premium price is 1.5% of the     underlying currency euro∙
* Plains States' forecast for 6-month spot rates is $1.19/>
* The budget rate, or the lowest acceptable sales price for this project, is $1,425,000 or $1.14/>

What is the cost of a put option hedge for Plains States' Euro receivable contract? (Note: Calculate the cost in future value dollars and assume the firm's cost of capital as the appropriate interest rate for calculating future values.)

Answer

|  |  |  |
| --- | --- | --- |
|  |  | $23,333 |
|  |  | >23,333 |
|  |  | $22,013 |
|  |  | >22,013 |

1. Each of the following is another name for operating exposure EXCEPT:

Answer

|  |  |  |
| --- | --- | --- |
|  |  | competitive exposure. |
|  |  | accounting exposure. |
|  |  | economic exposure. |
|  |  | strategic exposure. |

1. A US exporter is concerned about the depreciation of JPY against USD due to JPY receivables of JPY400,000,000 on February 1st ( in 167 days). To hedge (protect himself/herself) the position, exporter decides to use futures markets. Currently CME (Chicago Mercantile Exchange) JPY contracts (12,500,000 each) with closest maturity are traded at USD0.8350 per 100 JPY. Futures contract expires 18 days after on February 19th. . Suppose the exporter takes a futures position equal to 50% of its cash position (JPY200m) at USD0.8350. Also Company treasurer buys an over the counter put option for the JPY150m portion of the expected cash inflow at a strike price of JPY120, at 2% (2% is the cost of premium) and leaves JPY50m portion of the exposure uncovered. At the time the option was purchased, the spot rate was JPY117. On February 1st, Futures contract price is USD0.8130 per 100 JPY and the JPY/USD spot price is 122. Calculate the effective amount of USD company will clear on February 1st. What is the effective JPY cost of acquiring in USD? In other words, what is the net cash flow for all these hedges?

Answer

|  |  |  |
| --- | --- | --- |
|  |  | 4,321,477 |
|  |  | 5,236,477 |
|  |  | 3,317,539 |
|  |  | None of the above |

1. What type of international risk exposure measures the change in present value of a firm resulting from changes in future operating cash flows caused by any unexpected change in exchange rates?

Answer

|  |  |  |
| --- | --- | --- |
|  |  | operating exposure |
|  |  | accounting exposure |
|  |  | translation exposure |
|  |  | transaction exposure |

1. The stages in the life of a transaction exposure can be broken into three distinct time periods. The first time period is the time between quoting a price and reaching an actual sale agreement or contract. The next time period is the time lag between taking an order and actually filling or delivering it. Finally, the time it takes to get paid after delivering the product. In order, these stages of transaction exposure may be identified as:

Answer

|  |  |  |
| --- | --- | --- |
|  |  | billing, backlog, and quotation exposure. |
|  |  | quotation, backlog, and billing exposure. |
|  |  | backlog, quotation, and billing exposure. |
|  |  | quotation, billing, and backlog exposure. |

1. Plains States Manufacturing has just signed a contract to sell agricultural equipment to Boschin, a German firm, for >1,250,000. The sale was made in June with payment due six months later in December. Because this is a sizable contract for the firm and because the contract is in Euros rather than dollars, Plains States is considering several hedging alternatives to reduce the exchange rate risk arising from the sale. To help the firm make a hedging decision you have gathered the following information.

∙ The spot exchange rate is $1.1740/>
∙ The six month forward rate is $1.1480/>
∙ Plains States' cost of capital is 12% per annum
∙ The Euro zone 6-month borrowing rate is 7% per annum (or 3.5% for 6 months)
∙ The Euro zone 6-month lending rate is 5% per annum (or 2.5% for 6 months)
∙ The U.S. 6-month borrowing rate is 6% per annum (or 3% for 6 months)
∙ The U.S. 6-month lending rate is 4.5% per annum (or 2.25% for 6 months)
∙ December put options for >625,000; strike price $1.18, premium price is 1.5%
∙ Plains States' forecast for 6-month spot rates is $1.19/>
∙ The budget rate, or the lowest acceptable sales price for this project, is $1,425,000 or $1.14/>

Plains States could hedge the Euro receivables in the money market. Using the information provided how much would the money market hedge return in six months assuming Plains States reinvests the proceeds at the U.S. investment rate?

Answer

|  |  |  |
| --- | --- | --- |
|  |  | $1,449,777 |
|  |  | $1,502,947 |
|  |  | $1,250,000 |
|  |  | $1,460,411 |

1. A U.S. firm with no subsidiaries presently has sales to Brazil amounting to R200 million, while its Real -denominated expenses amount to R100 million. If it shifts its material orders from its Brazilian suppliers to U.S. suppliers, it could reduce Real-denominated expenses by R20 million and increase dollar-denominated expenses by $15 million. This strategy would \_\_\_\_\_\_\_ the firm's exposure to changes in the Real's movements against the U.S. dollar. Regardless of whether the firm shifts expenses, it is likely to perform better when the Real is valued \_\_\_\_\_\_\_ relative to the dollar.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | reduce; high |
|  |  | reduce; low |
|  |  | increase; low |
|  |  | increase; high |

1. Firm "M" is a U.S. company that has exposure to the Swiss francs (SF) and Danish kroner (DK). It has net outflows of SF200 million and net inflows of DK500 million. The present exchange rate of the SF is about $.40 while the present exchange rate of the DK is $.20. Firm "M" has not hedged these positions. The SF and DK are highly correlated in their movements against the dollar. If the dollar weakens:

Answer

|  |  |  |
| --- | --- | --- |
|  |  | firm "M" will benefit, because the dollar value of its SF position exceeds the dollar value of its DK position |
|  |  | firm "M" will benefit, because the dollar value of its DK position exceeds the dollar value of its SF position. |
|  |  | firm "M" will be adversely affected, because the dollar value of its SF position exceeds the dollar value of its DK position. |
|  |  | firm "M" will be adversely affected, because the dollar value of its DK position exceeds the dollar value of its SF position |

1. \_\_\_\_\_\_\_\_ occur as a result of changes in the value of currency, whereas \_\_\_\_\_\_\_\_ occur as a result of ongoing business activities.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | Translation gains or losses; operating gains or losses |
|  |  | Swap losses; translation gains or losses |
|  |  | Operating gains or losses; translation gains or losses |
|  |  | all of the above |

1. A US exporter is concerned about the deppreciation of Euro against USD due to Euro receivables of EUR10,000,000 in three months. To hedge (protect himself/herself) the position, exporter decides to use futures markets. Currently CME (Chicago Mercantile Exchange) EURO contracts (125,000 each) are traded at USD1.2814. Spot rate is EUR/USD1.2751-2756 (USDs per EURO). Suppose the exporter takes an equal futures position to its cash market position (EUR10m) at $1.2814. Provided that futures contract price and spot rates are $1.2850/Euro and $1.2935/Euro respectively when the hedge is liquidated, what should be the unit receipt per EURO for the US exporter in USD terms.

Answer

|  |  |  |
| --- | --- | --- |
|  |  | 1.2899 |
|  |  | 1.2971 |
|  |  | 1.2814 |
|  |  | 1.2935 |

1. Brimmo Motorcycles Inc., a U.S.-based firm, manufactures and sells electric motorcycles both domestically and internationally. A sudden and unexpected appreciation of the U.S. dollar should allow sales to \_\_\_\_\_\_\_\_ at home and \_\_\_\_\_\_\_\_ abroad. (Assume other factors remain unchanged.)

Answer

|  |  |  |
| --- | --- | --- |
|  |  | decrease; decrease |
|  |  | increase; decrease |
|  |  | decrease; increase |
|  |  | increase; increase |