

FOREX CLASS 14

CLASS WORK COVERAGE

To streamline our learning process, I've categorized the questions we'll tackle in class into four distinct groups:

1. **Classic:** *These questions are exactly as presented in your book, providing a familiar foundation.*
2. **Transformed:** *Here, we've converted book questions into multiple-choice format to enhance your analytical skills.*
3. **Adapted:** *These are similar to book questions but with altered numbers or names, presented as multiple-choice questions for varied practice.*
4. **Original:** *These are entirely new questions not found in your book, designed to challenge and expand your understanding.*

This structure will help us navigate through a range of problems, ensuring a comprehensive grasp of the material. Looking forward to our next session!

Q. No	Type	Book	Page No.
37	Classic	CW Q BOOK	14
96	Classic	CW Q BOOK	41

PART II: REGULATORY STUFF

Topic 12 NOSTRO ACCOUNT

Question 37: SSEI CW Book Page No. 14

You as a dealer in foreign exchange have the following position in GBP on 31st October, 2019:

	GBP
GBP Balance in the Nostro A/c Credit	2,00,000
Opening Position Overbought	1,00,000
Purchased a bill on London	1,60,000
Sold forward TT	1,20,000
Forward purchase contract cancelled	60,000
Remitted by TT	1,50,000
Draft on London cancelled	60,000

Decide the steps would you take, if you are required to maintain a credit Balance of GBP 65,000 in the Nostro A/c and keep as oversold position on GBP 20,000?

(Source: ICAI)

ANSWER:

Exchange Position:

Particulars	Purchases (GBP)	Sales (GBP)
Opening Balance Overbought	1,00,000	
Bill on London	1,60,000	
Forward Sales – TT		1,20,000
Cancellation of Forward Contract		60,000
TT Sales		1,50,000
Draft on London cancelled	60,000	-
	3,20,000	3,30,000
Closing Balance Oversold	10,000	-
	3,30,000	3,30,000

Cash Position (Nostro A/c)

	Credit	Debit
Opening balance credit	2,00,000	—
TT sales	—	1,50,000
	2,00,000	1,50,000
Closing balance (credit)	—	50,000
	2,00,000	2,00,000

The Bank has to buy spot TT GBP 15,000 to increase the balance in Nostro account to GBP 65,000. This would bring the overbought position on GBP to 5,000.

Since the bank requires an oversold position of GBP 20,000, it has to sell forward GBP 25,000.

PART VII: AMBIGUOUS

Question 96: SSEI CW Book Page No. 41

Drilldip Inc. a US based company has won a contract in India for drilling oil field. The project will require an initial investment of ₹ 500 crore. The oil field along with equipments will be sold to Indian Government for ₹ 740 crore in one year time. Since the Indian Government will pay for the amount in Indian Rupee (₹) the company is worried about exposure due exchange rate volatility.

You are required to:

- Construct a swap that will help the Drilldip to reduce the exchange rate risk.
- Assuming that Indian Government offers a swap at spot rate which is $1\text{US\$} = ₹ 50$ in one year, then should the company should opt for this option or should it just do nothing. The spot rate after one year is expected to be $1\text{US\$} = ₹ 54$. Further you may also assume that the Drilldip can also take a US\$ loan at 8% p.a.

(Source: ICAI)

ANSWER:

i. The following swap arrangement can be entered by Drilldip.

- Swap a US\$ loan today at an agreed rate with any party to obtain Indian Rupees (₹) to make initial investment.
- After one year swap back the Indian Rupees with US\$ at the agreed rate. In such case the company is exposed only on the profit earned from the project.

ii. With the swap

	Year 0 (Million US\$)	Year 1 (Million US\$)
Buy ₹ 500 crore at spot rate of $1\text{US\$} = ₹ 50$	(100.00)	----
Swap ₹ 500 crore back at agreed rate of ₹ 50	----	100.00
Sell ₹ 240 crore at $1\text{US\$} = ₹ 54$	----	44.44
Interest on US\$ loan @8% for one year	----	(8.00)
	(100.00)	136.44

Net result is a net receipt of US\$ 36.44 million.

Without the swap

	Year 0 (Million US\$)	Year 1 (Million US\$)
Buy ₹ 500 crore at spot rate of 1US\$ = ₹ 50	(100.00)	----
Sell ₹ 740 crore at 1US\$ = ₹ 54	----	137.04
Interest on US\$ loan @8% for one year	----	(8.00)
	(100.00)	129.04

Net result is a net receipt of US\$ 29.04 million.

Decision: Since the net receipt is higher in swap option the company should opt for the same.