

(iii) Forward rate if swap points are given

Swap points (Ascending order) = 25/35 Added to spot Rate

Swap points (Descending order) = 45/40 Reduced from spot Rate

(4) COVER DEAL

Banks sell currency to customer & Covered from Inter Bank market is called cover deal. It is cross rates question.

(5) Exchange rate Determinants

(i) Interest rate parity

$$FR = SR_{\text{₹}} \times \frac{1+r_{\text{₹}}}{1+r_{\$}}$$

(ii) purchasing power parity

$$ESR = SR_{\text{₹}} = \frac{1+i_{\text{₹}}}{1+i_{\$}}$$

(iii) Covered Interest arbitrage

Calculate premium in \$ & interest rate difference & invest in higher side. If premium in \$ is high then invest in \$ & borrow from India. If interest rate difference is higher, then Invest in India & borrow from US

SR ₹/\$ 60 India = 12%

1 YEAR FR ₹/\$ 61.50 USA = 8%

premium in \$ = 2.5%, Interest rate difference = 4%

Borrow from USA & Invest in India

6 Foreign currency Exposure

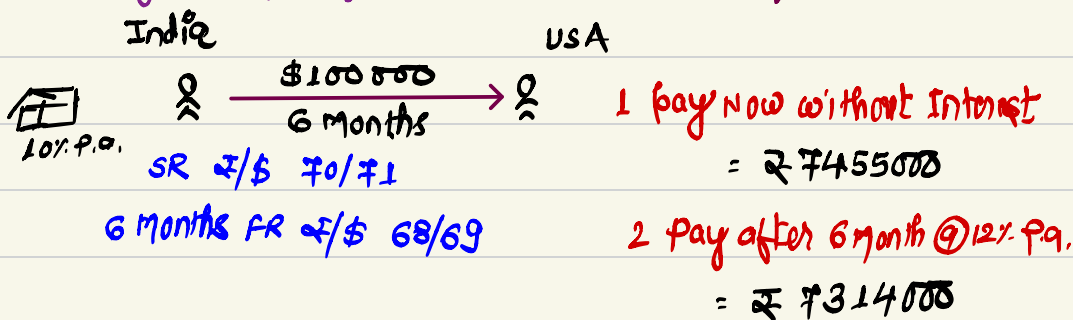
1 Transaction Exposure

2 Translation Exposure

3 Economic Exposure

Hedging of Transaction Exposure

1 Leading & Lagging [Immediate v/s Delay]



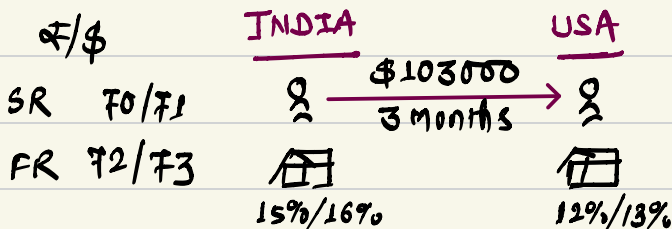
2. Money Market cover

For Importer

MMC

payable = Liability

then Asset bank = Investment



Step 1 Amount to be invested in USA = $\frac{\$103,000}{1.03} = \$100,000$

Step 2 Buy \$ at SR = $\$100,000 \times ₹1 = ₹71,00,000$

Step 3 Borrow ₹71,00,000 @ 16% p.a.

Cash Outflows = $₹71,00,000 \times 1.04 = ₹73,84,000$

For Exporter

Receivables = Asset

Liability creat = Borrowings

₹/\$

$$\text{Person} \leftarrow \frac{\$106000}{16 \text{ months}} \rightarrow \text{Person}$$

SR 70/71

FR 68/69



8% / 11%



10% / 12%

Step 1 Amount borrow from US = $\frac{\$106000}{1.06} = \100000

Step 2 Sell \$ at SR = $\$100000 \times 70 = ₹7000000$

Step 3 Investment in India = $₹7000000 \times 1.04 = ₹7280000$

3. Currency future

\$/₹

$$\text{SR } 0.0142 \quad \text{Person} \xrightarrow[\text{3 months}]{\$100000} \text{Person}$$

3M FR = 0.0137

Currency future [\$/₹]

3 month future rate = 0.0138

Contract size = ₹652000

margin = ₹1500 Rate = 10% p.a.

Step 1 position → on ₹ [short position at \$/₹ 0.0138]

Step 2 No. of Contracts → change Exposure Amt = $\frac{\$100000}{0.0138}$

$$\text{No. of Contracts} = \frac{7246377}{652000} = 11 \text{ Contracts short [Normal rounding off]}$$

Step 3 Cash Flows

• Gain on position $(\$0.0138 - \$0.0132) \times ₹652000 \times 11 = \4303.20

• Outflows $[\$100000 - \$4303.20] \div 0.0137 = ₹6985168$

(+) Opp. cost on margin $(₹1500 \times 11 \times 10\% \times \frac{3}{12}) = ₹412.50$