

QUESTION - 24

ABC Co. have taken a 6 month loan from their foreign collaborators for US Dollars 2 millions. Interest payable on maturity is at LIBOR plus 1.0%. Current 6-month LIBOR is 2%. Enquiries regarding exchange rates with their bank elicit the following information:

Spot USD 1 ₹ 48.5275

6 months forward ₹ 48.4575

- (i) What would be their total commitment in Rupees, if they enter into a forward contract?
- (ii) Will you advise them to do so? Explain giving reasons.

(Study Material & PM)

(Page No. 46)

(i) Total Cash outflow (₹)

Borrow = \$ 2000000

$$\begin{aligned} \text{Int} &= \text{LIBOR} + 1 \\ &= 2 + 1 = 3\% \text{ p.a.} \end{aligned}$$

Cash outflows (\$)

$$\begin{aligned} &\$ 2000000 \times 1.015 \\ &= \$ 2030000 \end{aligned}$$

Cash outflow (₹)

$$\begin{aligned} &\$ 2030000 \times 48.4575 \\ &= ₹ 98368725 \end{aligned}$$

(ii) If Expected SR is more than FR then forward Cover is better & if Expected SR is less than FR then No hedging is better.

If No Idea about Expected SR then it is better to Hedge Risk

QUESTION – 25

XYZ has taken a six-month loan from its foreign collaborator for USD 2 millions. Interest is payable on maturity @ LIBOR plus 1%. The following information is available:

Spot Rate	INR/USD	68.5275
6 months Forward rate	INR/USD	68.4575
6 months LIBOR for USD	2%	
6 months LIBOR for INR	6%	

You are required to :

- (i) Calculate Rupee requirements if forward cover is taken.
- (ii) Advise the company on the forward cover.

What will be your opinion if spot rate of INR/USD is 68.4275 ?

(Exam Jan-2021)

(Page No. 47)

classwork

H.W.

3. International Fisher Effect

As per IFE, Real Rate of Interest will be equal in two countries but nominal rate of Interest may not be equal due to Inflation.

Hence Expected SR (FR) shall be same as per IRP & as per PPP.

EXAMPLE – 61

Real Rate of Interest = 10%

Inflation Rate = 5%

Calculate Nominal Rate of Interest

15.5%

(Page No. 12)

EXAMPLE – 62

Real Rate of Interest = 8% p.a.

Inflation Rate = 6% p.a.

Nominal Rate = ?

(Page No. 12)

14.48%.

EXAMPLE – 63

Nominal Rate of Interest = 15.5%

Inflation rate = 5%

Real Rate of Interest = ?

(Page No. 13)

10%

EXAMPLE - 64

Suppose

	India	USA
Real Rate	3%	3%
Inflation Rate	8%	5% [PPP]
Nominal Rate	11.24%	8.15% [IRP]

$$SR = ₹/\$ = ₹70$$

Calculate:

- (i) FR as per Interest Rate Parity.
- (ii) FR as per Purchasing Power Parity.

(Page No. 13)

SR ₹/\$ 70

India


REAL 3%
Infla 8%
11.24%

USA


3%
5% (PPP)
8.15% [IRP]

IRP

$$F = S \times \frac{1+i}{1+r} \\ = 70 \times \frac{1.1124}{1.0815} = ₹72$$

PPP

$$70 \times \frac{1.08}{1.05} = ₹72$$

6. Currency Exposure

```
graph TD; A[6. Currency Exposure] --> B[1. Transaction Exposure]; A --> C[2. Translation Exposure or Accounting Exposure]; A --> D[3. Economic Exposure or operating Exposure];
```

1. Transaction Exposure

- Direct Exposure
- faced by firm having f. currency payable or receivable
- Easy to Hedge

2. Translation Exposure or Accounting Exposure

- Notional Exposure
- faced by firm having f. Branch or f. sub.
- Need not to be Hedged

3. Economic Exposure or operating Exposure

- Indirect Exposure
- faced by All firm
- Can't be Hedged

Methods of Hedging

```
graph TD; A[Methods of Hedging] --> B[Internal Hedging]; A --> C[External Hedging]; B --> B1[1. Leading & Lagging]; B --> B2[2. Invoicing]; B --> B3[3. Netting]; C --> C1[1. forward Cover]; C --> C2[2. Money Market Cover]; C --> C3[3. future Hedging]; C --> C4[4. option Hedging];
```

Internal Hedging

1. Leading & Lagging
2. Invoicing
3. Netting

External Hedging

1. forward Cover
2. Money Market Cover
3. future Hedging
4. option Hedging

1 Leading & Laggings

Lead means payment now & Lag means delay payment.

- Lead the payable if foreign currency ^{will} is appreciate.
- Lag the Receivable if f.c. will appreciate
- Lead the Receivable if f.c. will depreciate
- Lag the payable if f.c. will depreciate.