

# ch14

Student: \_\_\_\_\_

1. An FI can eliminate its currency risk exposure by matching its foreign currency assets to its foreign currency liabilities.  
True False
2. To a U.S. trader of foreign currencies, a direct quote indicates U.S. dollars received for each one unit of the foreign currency.  
True False
3. As the U.S. dollar appreciates against the Japanese yen, U.S. goods become less expensive to Japanese consumers.  
True False
4. As the U.S. dollar appreciates against the Japanese yen, Japanese goods sold in the U.S. become less expensive to the U.S. consumer.  
True False
5. The exposure to foreign exchange risk by U.S. FIs has decreased with the growth of the various derivative markets.  
True False
6. The spot foreign exchange market is where forward and futures contracts and swap agreements are transacted.  
True False
7. The market in which foreign currency is traded for future delivery is the forward foreign exchange market.  
True False
8. Forward contracts in FX are typically written for periods exceeding 6 months.  
True False
9. The greater the volatility of foreign exchange rates given any net exposure position, the greater the fluctuations in value of the foreign exchange portfolio.  
True False
10. U.S. pension funds invest approximately one percent (1%) of their portfolios in foreign securities.  
True False
11. U.S. life insurance companies generally hold less than ten percent (10%) of their portfolios in foreign securities.  
True False
12. State regulation of the U.S. insurance industry has an effect on the ability of insurance companies to invest in foreign securities.  
True False
13. Most nonbank FIs have foreign exchange risk exposure that is smaller than the exposure of the large U.S. money-center banks.  
True False
14. The underlying cause of foreign exchange volatility reflects fluctuations in the demand and supply of a country's currency.  
True False

15. A positive net exposure position in FX implies an FI has purchased more foreign currency than it has sold.  
True False
16. A positive net exposure position in FX implies the FI is net short in a currency.  
True False
17. As of March 2009, U.S. banks were net short British pounds.  
True False
18. Most profits or losses on foreign trading come from taking an open position in currencies.  
True False
19. The FX markets of the world have become one of the largest of all financial markets.  
True False
20. Average daily turnover in the FX market has recently been as high as \$4 trillion.  
True False
21. FX trading risk exposure continues into the night until all FI operations are closed.  
True False
22. FX trading income is derived only from profit (or loss) on the FI's speculative currency positions.  
True False
23. The reason an FI receives a fee when purchasing foreign currencies to allow customers to complete international transactions is because the FI assumes some FX risk.  
True False
24. Profits in foreign exchange trading have grown despite the decreased volatility in FX rates in European countries.  
True False
25. The total FX risk for a domestic bank that is making a one-year loan in a foreign currency is that the interest income expected on the loan is exposed to a depreciation of the foreign currency.  
True False
26. An FI can control its FX risk exposure by on-balance-sheet and off-balance-sheet hedging.  
True False
27. Off-balance-sheet hedging involves taking a position in FX forward or other derivative securities even though no FX assets or liabilities are on the balance sheet.  
True False
28. On-balance-sheet hedging involves making changes in the on-balance-sheet assets and liabilities to protect FI profits from FX risk without the use of derivative securities.  
True False
29. Directly matching foreign asset and liability books in the same FX currency will allow an FI to hedge or lock in a profit spread regardless of future changes in exchange rates.  
True False
30. The use of an exchange rate forward contract assures the FI of the opportunity to buy (or sell) the foreign currency at a future time at a known price.  
True False
31. Interest rate parity implies that the discounted spread between interest rates in two currencies should equal the percentage spread between forward and spot exchange rates.  
True False

32. Violation of the interest rate parity theorem would allow arbitrage profits.  
True False
33. Long-term violations of the interest rate parity relationship may occur if imperfections in the international financial markets are allowed to exist.  
True False
34. The real interest rate reflects the underlying real sector demand and supply for funds in denominated in the domestic currency.  
True False
35. Which of the following is NOT a source of foreign exchange risk?  
A. Trading foreign currencies.  
B. Making domestic-currency loans to foreign corporations.  
C. Buying foreign-issued securities.  
D. Issuing foreign currency-denominated debt.  
E. Making foreign currency loans.
36. The market in which foreign currency is traded for immediate delivery is the  
A. spot market.  
B. forward market.  
C. futures market.  
D. currency swap market.  
E. London capital market.
37. The FI is acting as a FX market agent for its customers when it  
A. buys or sells currency to balance the FI's net exposure.  
B. takes a nonzero net position in a particular currency.  
C. processes an exporter's transaction in a foreign currency.  
D. makes a market in a currency.  
E. advises customers on their international business.
38. A positive net exposure position in FX implies that the FI is  
A. net long in a currency and exposed to depreciation of the foreign currency.  
B. net short in a currency and exposed to depreciation of the foreign currency.  
C. net long in a currency and exposed to appreciation of the foreign currency.  
D. net short in a currency and exposed to appreciation of the foreign currency.  
E. neither long nor short in a currency.
39. A negative net exposure position in FX implies that the FI is  
A. net long in a currency and exposed to depreciation of the foreign currency.  
B. net short in a currency and exposed to depreciation of the foreign currency.  
C. net long in a currency and exposed to appreciation of the foreign currency.  
D. net short in a currency and exposed to appreciation of the foreign currency.  
E. neither long nor short in a currency.
40. The reasons nonbank FIs have less FX risk than major money center banks include  
A. Smaller asset sizes.  
B. Prudent person concerns.  
C. Regulations.  
D. All of the above.  
E. Answers A and C only.

41. U.S. pension funds hold approximately \_\_\_\_\_ of their assets in foreign securities, while British pension funds have traditionally invested approximately \_\_\_\_\_ of their funds in foreign assets.
- A. 20 percent; 5 percent
  - B. 5 percent; 20 percent
  - C. 0 percent; 30 percent
  - D. 30 percent; 10 percent
  - E. 20 percent; 20 percent
42. The FI is acting as a hedger when it
- A. buys or sells currency to balance the FI's net exposure.
  - B. takes a nonzero net position in a particular currency.
  - C. processes an exporter's transaction in a foreign currency.
  - D. makes a market in a currency.
  - E. advises customers on their international business.
43. FX risk exposure of an FI essentially relates to this type of activity.
- A. Purchase and sale of foreign currencies to allow customers to participate in and complete international commercial trade transactions.
  - B. Purchase and sale of foreign currencies to allow customers to take positions in foreign real and financial investments.
  - C. Purchase and sale of foreign currencies for hedging purposes to offset customer exposure in any given currency.
  - D. Purchase and sale of foreign currencies for speculative purposes through forecasting or anticipating future movements in FX rates.
  - E. None of the above.
44. When purchasing and selling foreign currencies to allow customers to take positions in foreign real and financial investments, the FI
- A. acts defensively as a hedger.
  - B. acts aggressively as a speculator.
  - C. assumes the FX risk itself.
  - D. acts as an agent.
  - E. acts as a market maker.
45. Which of the following factors help explain the decline in FX trading in the early years of this century?
- A. Introduction of the euro.
  - B. Consolidation in the banking industry.
  - C. Growth of electronic brokering.
  - D. Mergers in the corporate sector.
  - E. All of the above.
46. The FI is acting as a speculator when it
- A. buys or sells currency to balance the FI's net exposure.
  - B. takes a nonzero net position in a particular currency.
  - C. processes an exporter's transaction in a foreign currency.
  - D. makes a market in a currency.
  - E. advises customers on their international business.
47. The decrease in European FX volatility during the last decade has occurred because of
- A. the stabilizing force of the euro.
  - B. reduction in inflation rates in European countries.
  - C. the reduced volatility in many emerging-market countries.
  - D. the greater volatilities of Asian currencies.
  - E. Answers A and B only.

48. The decline in European FX volatility during the last decade has been offset in part by
- A. the greater volatilities of Asian currencies.
  - B. a reduction in inflation rates in European countries.
  - C. the fixing of exchange rates among European countries.
  - D. the replacement of domestic currencies with the euro.
  - E. None of the above.
49. If foreign currency exchange rates are highly positively correlated, how can a FI reduce its exchange rate risk exposure?
- A. By taking net long positions in all currencies.
  - B. By taking net short positions in all currencies.
  - C. By taking opposing net short and net long positions in different currencies.
  - D. By maximizing net FX exposure in each currency, independently.
  - E. By minimizing net FX exposure in each currency, independently.
50. Which of the following FX trading activities is used to hedge FX risk?
- A The purchase and sale of foreign currencies for the purpose of profiting from forecasting or anticipating . future movements in FX rates.
  - B The purchase and sale of foreign currencies to allow customers to partake in and complete international . commercial trade transactions.
  - C. The purchase and sale of foreign currencies for the purpose of offsetting customer exposure in any given currency.
  - D. The purchase and sale of foreign currencies to allow customers to take positions in foreign real and financial investments.
  - E. None of the above.
51. Which of the following FX trading activities is used for purposes of speculation?
- A The purchase and sale of foreign currencies for the purpose of profiting from forecasting or anticipating . future movements in FX rates.
  - B The purchase and sale of foreign currencies to allow customers to partake in and complete international . commercial trade transactions.
  - C. The purchase and sale of foreign currencies for the purpose of offsetting customer exposure in any given currency.
  - D. The purchase and sale of foreign currencies to allow customers to take positions in foreign real and financial investments.
  - E. None of the above.
52. In which of the following FX trading activities does the FI not assume FX risk?
- A The purchase and sale of foreign currencies for the purpose of profiting from forecasting or anticipating . future movements in FX rates.
  - B The purchase and sale of foreign currencies to allow customers to partake in and complete international . commercial trade transactions.
  - C. The purchase and sale of foreign currencies for the purpose of offsetting customer exposure in any given currency.
  - D. The purchase and sale of foreign currencies to allow customers to take positions in foreign real and financial investments.
  - E. Answers B and D only.
53. As of 2009, which of the following FX "markets" is the largest?
- A. London.
  - B. New York.
  - C. Tokyo.
  - D. Hong Kong.
  - E. Zurich.

54. Most profits or losses on foreign trading for FIs come from
- open positions or speculation.
  - market making.
  - acting as agents for retail customers.
  - acting as agents for wholesale customers.
  - hedging activities.
55. Deviations from the international currency parity relationships may occur because of
- free capital movements across national boundaries.
  - barriers to cross-border financial flows.
  - perfect rationality of market participants.
  - differences in each country's productive capacity.
  - Basel capital regulations.
56. The nominal interest rate is equal to the
- real interest rate minus the inflation premium.
  - real interest rate minus the trailing inflation rate.
  - real interest rate plus the expected interest rate increase.
  - real interest rate plus the expected inflation rate.
  - real interest rate plus the interest rate volatility.
57. Which of the following is an example of interest rate parity?
- The Japanese yen trades at the same exchange rate as the Swiss franc.
  - U.S. dollar rates on one year U.S. Treasury securities equal 1 year Japanese government bond rates.
  - U.S. dollar rates on one year U.S. Treasury securities equal 1 year Japanese government bond rates, restated in dollars.
  - British pound 2 year forward rates equal 2 year Swiss franc forward rates.
  - All currency exchange rates and interest rates move in unison.
58. According to PPP, foreign currency exchange rates between two countries adjust to reflect changes in each country's
- unemployment rates.
  - export competitiveness.
  - inflation rates.
  - foreign exchange reserves.
  - reserve requirements.

**The following are the net currency positions of a U.S. FI (stated in U.S. dollars).**

Currency	Assets	Liabilities	FX Bought	FX Sold
British pound	24,600	70,000	170,400	321,000
Yen	31,000	20,400	250,000	220,000
Swiss franc	10,200	9,800	8,000	10,800

59. What is the FI's net exposure in British pounds?
- 45,400.
  - 150,600.
  - 196,000.
  - +105,200.
  - +196,000.
60. What is the FI's net exposure in the Japanese yen?
- +30,000.
  - +40,600.
  - 19,400.
  - 40,600.
  - +20,600.

61. What is the FI's net exposure in the Swiss franc?
- +2,400.
  - +400.
  - 2,800.
  - 2,400.
  - +3,200.
62. How would you characterize the FI's risk exposure to fluctuations in the British pound to dollar exchange rate?
- The FI is net short in the British pound and therefore faces the risk that the British pound will rise in value against the U.S. dollar.
  - The FI is net short in the British pound and therefore faces the risk that the British pound will fall in value against the U.S. dollar.
  - The FI is net long in the British pound and therefore faces the risk that the British pound will fall in value against the U.S. dollar.
  - The FI is net long in the British pound and therefore faces the risk that the British pound will rise in value against the U.S. dollar.
  - The FI has a balanced position in the British pound.
63. How would you characterize the FI's risk exposure to fluctuations in the yen/dollar exchange rate?
- The FI is net short in the yen and therefore faces the risk that the yen will rise in value against the U.S. dollar.
  - The FI is net short in the yen and therefore faces the risk that the yen will fall in value against the U.S. dollar.
  - The FI is net long in the yen and therefore faces the risk that the yen will fall in value against the U.S. dollar.
  - The FI is net long in the yen and therefore faces the risk that the yen will rise in value against the U.S. dollar.
  - The FI has a balanced position in the Japanese yen.
64. How would you characterize the FI's risk exposure to fluctuations in the Swiss franc/dollar exchange rate?
- The FI is net short in the franc and therefore faces the risk that the franc will rise in value against the U.S. dollar.
  - The FI is net short in the franc and therefore faces the risk that the franc will fall in value against the U.S. dollar.
  - The FI is net long in the franc and therefore faces the risk that the franc will fall in value against the U.S. dollar.
  - The FI is net long in the franc and therefore faces the risk that the franc will rise in value against the U.S. dollar.
  - The FI has a balanced position in the Swiss franc.

**The following are the net currency positions of a U.S. FI (stated in U.S. dollars).**

*Note: Net currency positions are foreign exchange bought minus foreign exchange sold restated in U.S. dollar terms.*

Currency	Net Position
Canadian Dollar	+US \$1,200
Euro	-US\$ 245,900
Japanese Yen	+US\$ 505,000
Swiss Franc	-US\$ 36,700
British Pound	+US\$ 447,900

65. What is the FI's total FX investment?
- US\$671,500.
  - US\$1,236,700.
  - US\$671,500.
  - US\$1,236,700.
  - 0

66. How would you characterize the FI's risk exposure to fluctuations in the Euro to dollar exchange rate?
- The FI is net short in the Euro and therefore faces the risk that the Euro will rise in value against the U.S. dollar.
  - The FI is net short in the Euro and therefore faces the risk that the Euro will fall in value against the U.S. dollar.
  - The FI is net long in the Euro and therefore faces the risk that the Euro will fall in value against the U.S. dollar.
  - The FI is net long in the Euro and therefore faces the risk that the Euro will rise in value against the U.S. dollar.
  - The FI has a balanced position in the Euro.
67. What is the portfolio weight of the Euro in this FI's portfolio of foreign currency?
- +0.18 percent.
  - 36.62 percent.
  - +75.20 percent.
  - 5.47 percent.
  - +66.70 percent.
68. How would you characterize the FI's risk exposure to fluctuations in the yen/dollar exchange rate?
- The FI is net short in the yen and therefore faces the risk that the yen will rise in value against the U.S. dollar.
  - The FI is net short in the yen and therefore faces the risk that the yen will fall in value against the U.S. dollar.
  - The FI is net long in the yen and therefore faces the risk that the yen will fall in value against the U.S. dollar.
  - The FI is net long in the yen and therefore faces the risk that the yen will rise in value against the U.S. dollar.
  - The FI has a balanced position in the Japanese yen.
69. What is the portfolio weight of the Japanese yen in this FI's portfolio of foreign currency?
- +0.18 percent.
  - 36.62 percent.
  - +75.20 percent.
  - 5.47 percent.
  - +66.70 percent.

Assets		Liabilities	
\$10 million	U.S. loans (10 percent)	\$20 million	U.S. CDs (9 percent)
\$10 million	U.K. loans (16 percent ) (loans made in sterling)		

A U.S. FI is raising all of its \$20 million liabilities in dollars (one-year CDs) but investing 50 percent in U.S. dollar assets (one-year maturity loans) and 50 percent in U.K. pound sterling assets (one-year maturity loans). Suppose the promised one-year U.S. CD rate is 9 percent, to be paid in dollars at the end of the year, and that one-year, credit risk-free loans in the United States are yielding only 10 percent. Credit risk-free one-year loans are yielding 16 percent in the United Kingdom.

70. If the exchange rate remains constant at \$1.60 to  $\pounds 1$  throughout the year, sterling revenue from U.K. loans will be
- $\pounds 6.25$  million.
  - $\pounds 7.875$  million.
  - $\pounds 7.25$  million.
  - $\pounds 6.625$  million.
  - $\pounds 11.26$  million.



71. If the spot foreign exchange rate remains constant at \$1.60/£1 throughout the year, the return from the U.K. investment will be
- A. 15%.
  - B. 12%.
  - C. 16%.
  - D. 13%.
  - E. 7%.
72. The weighted return on the bank's portfolio of investments would be
- A. 15%.
  - B. 12%.
  - C. 16%.
  - D. 13%.
  - E. 7%.
73. If the exchange rate had fallen from \$1.60/£1 at the beginning of the year to \$1.50/£1 at the end of the year when the FI needed to repatriate the principal and interest on the loan. What would be the dollar loan revenues at the end of the year?
- A. \$6.25 million.
  - B. \$11.6 million.
  - C. \$7.25 million.
  - D. \$6.625 million.
  - E. \$10.875 million.
74. If the exchange rate had fallen from \$1.60/£1 at the beginning of the year to \$1.50/£1 at the end of the year when the FI needed to repatriate the principal and interest on the loan. What would the dollar loan revenues at the end of the year be as a return on the original dollar investment?
- A. 13%.
  - B. 12.55%.
  - C. 16%.
  - D. 8.75%.
  - E. 7.25%.
75. If the exchange rate had fallen from \$1.60/£1 at the beginning of the year to \$1.50/£1 at the end of the year, the weighted return on the FI's asset portfolio would be
- A. 13.29%.
  - B. 12.56%.
  - C. 16%.
  - D. 8.75%.
  - E. 9.38%.
76. If the exchange rate had fallen from \$1.60/£1 at the beginning of the year to \$1.50/£1 at the end of the year, the net interest margin for the FI on its balance sheet investments is
- A. 3.29%.
  - B. -3.29%.
  - C. 4%.
  - D. 8.75%.
  - E. 0.38%.

Your U.S. bank issues a one-year U.S. CD at 5 percent annual interest to finance a C\$1.274 million (Canadian dollar) investment in two-year, fixed rate Canadian bonds selling at par and paying 7 percent annually. You expect to liquidate your position in one year. Currently, spot exchange rates are US\$0.7849 per Canadian dollar.

t = 0	t = 1			
	4	5	6	7
	No changes	US\$0.765/C\$	C rate=7.5 percent	US\$0.765/C\$
US CD:				
US\$1 million	US\$1.05 m	US\$1.05 m	US\$1.05 m	US\$1.05 m
Canadian Bonds:				
			C Bond P: C\$1.268 million	
C\$1.274 m	C\$1.363 m	C\$1.363 m	Coupon: C\$0.089m	C\$1.357 m
	US\$1.07 m	US\$1.043 m	US\$1.065 m	US\$1.038 m
Profit	US\$0.02 m	US\$(0.007) m	US\$0.015 m	US\$(0.012) m

77. Your position is exposed to
  - A. interest rate risk only.
  - B. credit risk only.
  - C. exchange rate risk only.
  - D. interest rate and exchange rate risk only.
  - E. interest rate risk, exchange rate risk, and credit risk.
78. If you wanted to hedge your bank's risk exposure, what hedge position would you take?
  - AA short interest rate hedge to protect against interest rate declines and a short currency hedge to protect . against increases in the value of the Canadian dollar with respect to the U.S. dollar.
  - BA short interest rate hedge to protect against interest rate increases and a short currency hedge to protect . against declines in the value of the Canadian dollar with respect to the U.S. dollar.
  - CA long interest rate hedge to protect against interest rate increases and a long currency hedge to protect . against declines in the value of the Canadian dollar with respect to the U.S. dollar.
  - DA long interest rate hedge to protect against interest rate declines and a long currency hedge to protect . against increases in the value of the Canadian dollar with respect to the U.S. dollar.
  - EA long interest rate hedge to protect against interest rate declines and a short currency hedge to protect . against increases in the value of the Canadian dollar with respect to the U.S. dollar.
79. If in one year there is no change to either interest rates or exchange rates, what is the end-of-year profit or loss for the bank? (Hint: Annual interest is paid on both the Canadian bonds and the CD on the date of liquidation in exactly one year.)
  - A. Profit of US\$20,000.
  - B. Loss of C\$224,000.
  - C. Profit of US\$50,000.
  - D. Profit of C\$63,700.
  - E. Profit of US\$313,000.
80. What is the end-of-year profit or loss to the bank if in one year the exchange rate falls to US\$0.765 per Canadian dollar? (Assume that there is no change in interest rates.)
  - A. Loss of US\$75,000.
  - B. Profit of C\$274,000.
  - C. Loss of US\$7,000.
  - D. Profit of C\$9,000.
  - E. Loss of US\$5,000.
81. What is the end-of-year profit or loss to the bank if in one year Canadian bond rates increase to 7.5 percent? (Assume no change in either current U.S. interest rates or current exchange rates.)
  - A. Loss of US\$5,000.
  - B. Profit of US\$15,000.
  - C. Loss of C\$119,000.
  - D. Profit of C\$50,000.
  - E. Loss of C\$50,000.

82. What is the end of year profit or loss on the bank's cash position if in one year both Canadian bond rates increase to 7.5 percent and the exchange rate falls to US\$0.765 per Canadian dollar? (Assume no change in U.S. interest rates.)
- A. Loss of US\$12,000.
  - B. Loss of US\$75,000.
  - C. Profit of C\$9,000.
  - D. Profit of US\$50,000.
  - E. Loss of C\$119,800.

The one-year CD rates for financial institutions with AA ratings are 5 percent in the U.S. and 8 percent in France. An AA-rated U.S. financial institution can borrow by issuing CDs or lend by purchasing CDs at these rates in either market. The current spot rate is \$0.20/Euro.

83. If the bank receives a quote of \$0.1975/€ for one-year forward rates for the Euro (to buy and to sell), what is the arbitrage profit for the bank if it uses either \$1,000,000 as the notional amount?
- A. \$5,000.
  - B. \$16,500.
  - C. \$19,350.
  - D. \$22,000.
  - E. \$25,675.
84. What should be the one-year forward rate in order to prevent any arbitrage?
- A. \$0.1944/€.
  - B. \$0.1975/€.
  - C. \$0.2000/€.
  - D. \$0.2025/€.
  - E. \$0.2031/€.
85. What should be the spot rate in order for no arbitrage to take place, assuming the one-year forward rate is \$0.1975/€?
- A. \$0.1944/€.
  - B. \$0.1975/€.
  - C. \$0.2000/€.
  - D. \$0.2025/€.
  - E. \$0.2031/€.

Suppose that the current spot exchange rate of U.S. dollars for Russian rubles is .15. The price of Russian-produced goods increases by 8 percent, and the U.S. price index increases by 3 percent.

86. According to PPP, the 8 percent rise in the price of Russian goods relative to the 3 percent rise in the price of U.S. goods results in a(n)
- A. depreciation of the Russian ruble by 5 percent.
  - B. depreciation of the Russian ruble by 6 percent.
  - C. appreciation of the Russian ruble by 5 percent.
  - D. appreciation of the Russian ruble by 6 percent.
  - E. depreciation of the Russian ruble by 7 percent.
87. According to PPP, the new exchange rate of Russian rubles to U.S. dollars is
- A. 0.15.
  - B. 0.1425.
  - C. 0.141.
  - D. 0.1605.
  - E. 0.159.

An FI has purchased (borrowed) a one-year \$10 million Eurodollar deposit at an annual interest rate of 6 percent. It has invested these proceeds in one-year Euro (€) bonds at an annual rate of 6.5 percent after converting them at the current spot rate of €1.75/\$. Both interest and principal are paid at the end of the year.

88. What is the spread earned by the bank at the end of the year if the exchange rate remains at €1.75/\$?
- A. 0.50 percent.
  - B. 1.00 percent.
  - C. 1.5 percent.
  - D. 2.0 percent.
  - E. 2.5 percent.
89. What is the spread earned by the bank if the end-of-year exchange rate is €1.77/\$?
- A. -1.00 percent.
  - B. -0.70 percent.
  - C. -0.25 percent.
  - D. 0.00 percent.
  - E. 0.20 percent.
90. What is the spread earned if the bank can sell one-year forward Euros at €1.755/\$?
- A. -0.70 percent.
  - B. -0.25 percent.
  - C. 0.00 percent.
  - D. 0.20 percent.
  - E. 0.50 percent.
91. At what one-year forward rate will the bank earn a 1 percent spread?
- A. €1.7344/\$.
  - B. €1.7418/\$.
  - C. €1.7478/\$.
  - D. €1.7750/\$.
  - E. €1.7842/\$.
92. **92. Assume that instead of investing in Euro bonds at a fixed rate of 6.5 percent, it invests them in variable rates of LIBOR + 1.5 percent, reset every six months. The current LIBOR rate is 5 percent. What is the spread earned by the bank if LIBOR at the end of six months is 5.5 percent? Assume both interest and principal will be reinvested in six months. Assume the exchange rate remains at €1.75/\$ at the end of the year.**
- A. 0.50 percent.
  - B. 0.68 percent.
  - C. 0.86 percent.
  - D. 0.90 percent.
  - E. 0.95 percent.
93. Assume that instead of investing in Euro bonds at a fixed rate of 6.5 percent, the FI invests them in variable rates of LIBOR + 1.5 percent, reset every six months. The current LIBOR rate is 5 percent. Assume both interest and principal will be reinvested in six months. Assume the exchange rate remains at €1.75/\$ at the end of the year. What should be the LIBOR rates in six months in order for the bank to earn a 1 percent spread?
- A. 5.25 percent.
  - B. 5.48 percent.
  - C. 5.76 percent.
  - D. 5.86 percent.
  - E. 5.94 percent.

94. Assume that instead of investing in Euro bonds at a fixed rate of 6.5 percent, the FI invests them in variable rates of LIBOR + 1.5 percent, reset every six months. The current LIBOR rate is 5 percent. LIBOR at the end of six months is 5.5 percent. Assume both interest and principal will be reinvested in six months. Assume the exchange rate remains at €1.75/\$ at the end of the year. What should be the one-year forward rate in order for the bank to earn a spread of 1 percent?
- A. €1.7344/\$.
  - B. €1.7418/\$.
  - C. €1.7478/\$.
  - D. €1.7750/\$.
  - E. €1.7842/\$.

Yen Bank wishes to invest in Yen loans at a rate of 10 percent. The bank will fund the loans in the domestic CD market at a rate of 6.3 percent. This on-balance-sheet FX risk will be hedged in the spot market at a forward rate of \$0.62/¥. The spot rate on yen is \$0.60/¥.

95. What must be the forward exchange rate to eliminate the preference for the yen loans?
- A. \$0.6416/¥.
  - B. \$0.5798/¥.
  - C. \$0.6118/¥.
  - D. \$0.5991/¥.
  - E. Insufficient information.
96. What must be the spot exchange rate to eliminate the preference for the yen loans?
- A. \$0.6416/¥.
  - B. \$0.5798/¥.
  - C. \$0.6118/¥.
  - D. \$0.5991/¥.
  - E. Insufficient information.

## ch14 Key

1. FALSE
2. TRUE
3. FALSE
4. TRUE
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30. TRUE
31. TRUE
32. TRUE
33. TRUE
34. TRUE
35. B
36. A

37. C  
38. A  
39. D  
40. D  
41. B  
42. A  
43. D  
44. D  
45. E  
46. B  
47. E  
48. A  
49. C  
50. C  
51. A  
52. E  
53. A  
54. A  
55. B  
56. D  
57. C  
58. C  
59. C  
60. B  
61. D  
62. A  
63. C  
64. A  
65. A  
66. A  
67. B  
68. C  
69. C  
70. C  
71. C  
72. D  
73. E  
74. D

- 75. E
- 76. E
- 77. E
- 78. B
- 79. A
- 80. C
- 81. B
- 82. A
- 83. B
- 84. A
- 85. E
- 86. A
- 87. B
- 88. A
- 89. B
- 90. D
- 91. B
- 92. C
- 93. C
- 94. C
- 95. B
- 96. A



# ch14 Summary

<u>Category</u>	<u># of Questions</u>
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