(University of Choice)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY (MMUST)

MAIN/BUNGOMA/WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS

2022/2023 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER EXAMINATIONS

FOR THE DEGREE
OF
BACHELOR OF COMMERCE

COURSE CODE: **BCF 430**

COURSE TITLE: **INTERNATIONAL FINANCE**

DATE: Tuesday 18th April 2023 **TIME:** 12.00-2.00pm

INSTRUCTIONS TO CANDIDATES

Answer **QUESTION ONE** and **ANY OTHER TWO (2)** questions

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

QUESTION ONE: (30 MARKS) COMPULSORY

Forex reserves dip to 10-year low amid debt repayments

"Kenya's foreign exchange reserves dropped to the lowest in seven years, further breaching the critical level of four months' import cover in the wake of huge foreign debt repayments. Reserves currently stand at Sh869 billion ($6.939 billion), equivalent to 3.88 months' import cover, according to the latest Central Bank of Kenya (CBK) data. Kenya's reserves have been depleting partly because of repayments to bilateral and commercial lenders and the CBK's intervention to try and slow down the shilling's depreciation against the US dollar.

The shilling has remained on a steady decline against the dollar, exchanging at Sh125.24 on Monday in contrast to Sh113.63 at the same time last year. The reserves have remained below the four months' import cover since January 26, dropping by Sh66 billion during the two-week period. This emerged in a period when the country was expected to repay foreign debts estimated at Sh63 billion, according to the World Bank tracker of public debt.

The reserves are used by countries to meet their international financial obligations such as paying foreign debts, influencing monetary policy and supporting the importation of critical goods. The size of the official reserves usually projects an air of confidence and calms investors' fears in the event they want to move their money out of a country. "The one lever that the government has the least control of is currency as they can't generate foreign exchange. Reserves don't serve any purpose beyond providing confidence and that has already been lost. So even if the worry is about the reserves, what lever does the CBK have beyond depreciating the currency?" a financial sector analyst posed.

Kenya has over the years relied on external financing to replenish its reserves but now faces the prospect of having to make debt repayments without sufficient inflows, according to another analyst. The government is betting on debt inflows to shore up the reserves, with concessional funding from the World Bank and the International Monetary Fund (IMF) expected to boost the forex cover. Previous disbursements from the multi-lateral lenders have had the effect of lifting the reserves to new highs. Kenya now waits for the disbursement of Sh93.9 billion ($750 million) from the World Bank by June this year and continued flows from IMF's 38-month Sh293.1 billion ($2.34 billion) programme. The country is further betting on re-entry to the international capital markets to rebuild the cover through the issuing of either a Eurobond or a syndicated loan.

Analysts who spoke to the Business Daily say Kenya faces limited options in attracting new forex inflows, with raising yields on domestic government debt instruments one of them. The move deployed by countries such as Zambia has the effect of bloating government debt service costs. While Kenya targets keeping reserves at a minimum of four months of estimated imports, the central bank has previously maintained that its fall should not cause alarm, terming the breach of the limit a 'non-event'. "It's not like a trap that when you get in, you get caught. It's not an accident that something happens when you are below that number. We still believe we have adequate reserves to smooth out any volatility. We are also doing our best endeavours to ensure we get reserves," CBK governor Patrick Njoroge said on November 24, 2022."

(Source: Business Daily, Tuesday February 14th, 2023)

Required:

A. "The one lever that the government has the least control of is currency as they can't generate foreign exchange. Reserves don't serve any purpose beyond providing confidence and that has already been lost. So even if the worry is about the reserves, what lever does the CBK have beyond depreciating the currency?" a financial sector analyst posed. Discuss this statement. (8 Marks)

B. "Kenya has over the years relied on external financing to replenish its reserves but now faces the prospect of having to make debt repayments without sufficient inflows…". Explain other available options that the country can use to replenish its reserves. (8 Marks)

C. Any surplus or deficit in the current account is matched and cancelled out by an equal surplus or deficit in the capital account. In view of the facts presented in the case, explain how this will take place. (8 marks)

D. How would you classify the exchange rate system in place in Kenya? Justify your answer with relevant examples. (6 Marks)

QUESTION TWO (20 MARKS)

A. Governments closely regulate any foreign direct investments that adversely affect locally owned companies. Discuss any five methods in which this is done. (10 Marks)

B. Discuss some of the firm- specific characteristics that can influence a firm's cost of capital. (10 Marks)

QUESTION THREE (20 MARKS)

A. Huduma Bank quotes a bid rate of £0.58 for the US dollar and an ask rate of £0.60. Determine the bid/ask percentage spread. Discuss some of the factors that affect the bid/ask spread. (10 Marks)

B. Discuss some of the possible ways of encouraging international trade with specific examples from a country of your choice. (10 Marks)

QUESTION FOUR (20 MARKS)

A. Distinguish between interest rate parity and international Fisher effect. (2 Marks)

B. You are provided with the following information: -

	USA	Europe
Nominal interest rate	4%	6%
Expected Inflation	2%	5%
Sot rate	-	$1.13
1 year forward rate	-	$1.10

i. Based on the above information, do you think interest rate parity hold? (2 Marks)

ii. According to PPP determine the expected spot rate of the euro in 1year. (4 Marks)

iii. According to the IFE, determine the expected spot rate of the euro in 1 year. Compare and contrast the result with PPP. (6 Marks)

C. Explain any four types of transfer prices that companies use to transfer goods and services. (8 Marks)