(*University of Choice*)

MASINDE MULIRO UNIVERSITY OF SCIENCE AND TECHNOLOGY (MMUST)

MAIN/BUNGOMA/WEBUYE CAMPUS

UNIVERSITY EXAMINATIONS

2023/2024 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER EXAMINATIONS

FOR THE DEGREE
OF
BACHELOR OF COMMERCE

COURSE CODE: BCF 430

COURSE TITLE: INTERNATIONAL FINANCE

DATE: Tuesday 16th April 2024 **TIME: 11.30-1.30pm**

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)

Kenya's Africa trade surplus hits new high of Sh121 billion

Kenya's exports to Africa exceeded imports by Sh121 billion in nine months through September, hitting record-high levels that signal increased deals on the continent for traders amid President William Ruto's aggressive diplomatic offensive. Official data shows traders sold goods worth Sh324.79 billion to African countries in the review period, a 20.86 percent jump over Sh268.73 billion in a similar period the year before.

The jump in earnings from exports on the continent came at a time expenditure on imports fell a modest 2.85 percent year-on-year to Sh203.79 billion, the first drop since the Covid-19 shutdowns three years earlier. This resulted in surplus for Kenya's merchandise trade in Africa more than doubling after rocketing 105.21 percent to Sh121.01 billion from Sh58.97 billion in a similar period in the prior year, the highest on record based on publicly-available data published by the Kenya National Bureau of Statistics (KNBS).

Analysis of the KNBS data shows the growth in export earnings was largely driven by higher demand for cement clinkers, lubricants, wheat flour, food preparations and re-exports of kerosene-type jet fuel from Kenya. The increased purchase for goods from Kenya was largely made by traders from Uganda, DR Congo, Tanzania, Somalia and South Sudan, according to the data.

This came at a time Dr Ruto championed the removal of trade barriers amongst African countries to ease movement of goods, services and labour through integration of regional trading blocs. The integration is aimed at creating the world's largest single market of about 1.4 billion people with an estimated economic output of more than $3 trillion (about Sh474 billion under prevailing conversion rates) under the ambitious African Continental Free Trade Agreement (AfCFTA).

"The main hurdle to realizing an integrated market under AfCFTA is the weak business environment in many African countries largely due to high interest rates, high tax rates and bureaucratic red tape," Ken Gichinga, chief economist at Mentoria Economics, said in a past interview. "Cultural and language barriers also make it tough to appreciate the market opportunities." Africa's under-developed transport networks have also been blamed for raising cost of goods and services as much as 40 percent, rendering intra-African trade uncompetitive compared with trade with developed continents such as Europe.

The climb in earnings from exports also came at a time the Kenyan shilling weakened against regional currencies by double digits. For example, the Kenyan currency shed about 15.80 percent against the Ugandan currency in nine months through September 2023, about 10.59 percent of value against the Tanzanian currency and 20.04 percent against the US dollar, according to data published by the Central Bank of Kenya. Uganda remained the country's largest destination for Kenyan goods, accounting for more than a third (35.33 percent) of exports to Africa. Goods worth Sh98.77 billion were trucked into the land-locked country, Kenya's largest trading partner, in the nine-month period compared with Sh72.98 billion a year earlier. The jump in exports to Uganda was largely driven by demand for cement clinkers, according to KNBS.

Exports to Tanzania grew 17.91 percent in the review period to Sh49.47 billion, largely lifted by re-exports of kerosene-type jet fuel. The data further shows that exports to DRC grew by half (51.24 percent) to Sh18.81 billion on increased orders for "wheat flour, food preparations and preparations of organic-surface active agents". Exports to Somalia grew at the same pace (51.50 percent) to Sh16.78 billion, while earnings from goods to South Sudan swelled 27.55 percent to Sh23 billion, largely driven by sale of lubricants and food preparations to the country ravaged by persistent civil war.

Dr Ruto has been aggressively rallying his counterparts on the continent to adopt payment system which facilitates settlement of intra-African trade deals in national currencies as a first step towards reducing reliance on the US dollar in intra-Africa trade. "Technology is going to play a big role, making sure that our businesspeople are not unnecessarily encumbered by looking at that currency and this currency to be able to trade. We will try and see whether we can take that out of the equation so that they can concentrate on enhancing trade between our countries," the President said on November 7 last year. Kenya is the leading candidate to host the Pan-African Payment and settlement system (Papss) whose adoption will be determined by a vote during African Union's Assembly of Heads of State and Government set to be held next month.

BUSINESS DAILY, MONDAY JANUARY 08 2024

Required:

A. Define trade surplus. Explain how different it is from current account balance. (4 Marks)
B. A country with a large trade surplus must run large capital account deficits. Explain this statement based on the facts presented in the above case. (8 Marks)
C. 'The climb in earnings from exports also came at a time the Kenyan shilling weakened against regional currencies by double digits'. Explain the pros and cons of a weak Shilling. How can the government remedy this? (12 marks)
D. 'This came at a time Dr Ruto championed the removal of trade barriers amongst African countries to ease movement of goods, services and labour through integration of regional trading blocs'. Define economic integration. Discuss how this can be achieved with sufficient support from the case. (6 Marks)

QUESTION TWO: 20 MARKS

A. Define multinational restructuring. Explain ways through which multinational corporations can engage in multinational restructuring. (8 Marks)
B. Upay Ltd (a UK company) is deciding whether to borrow Swiss Francs for one year. The quoted interest rate for Swiss Francs is 9% and the quoted rate of the pound is 14%. Upay Ltd develops a probability distribution for the Swiss Francs possible percentage change in value over the life of the loan:

Possible rate of change in Swiss Franc	Probability of Occurrence
-6%	5%
-4%	10%
-1%	15%
+1%	20%
+4%	20%
+6%	15%
+8%	10%
+10%	5%
	100%

Required:

Determine the effective financing rate for Upay. Advice the company whether to finance its operations using the Swiss Francs or the pound. (12 Marks)

QUESTION THREE: 20 MARKS

A. Define netting. You have been provided with the following inter-subsidiary payments matrix.

Payments owed by subsidiary Located in:	US dollar value in thousands owed to subsidiary located in: Canada	France	Japan	Switzerland	US
Canada	-	30	80	10	30
France	50	-	20	50	40
Japan	90	20	-	10	20
Switzerland	10	40	10	-	40
US	10	50	10	10	-

Required:

Prepare the netting schedule showing the net amounts each subsidiary should receive. (12 marks)

B. Discuss any four alternative transfer pricing methods used by multinational corporations. (8 Marks)

QUESTION FOUR: 20 MARKS

A. Explain briefly any three theories which drive firm's desire to expand their businesses internationally. (3 Marks)

B. Distinguish between locational, triangular and covered interest arbitrage. (3 Marks)
Suppose you are provided with the following information:

i. The quoted exchange rates for the US dollar and the British Pound viz a viz the Kenya shilling and the cross exchange rate between the pound and the dollar as follows:

$1 = Ksh. 154 £1 = Ksh 192 £1 = $ 1.30

Required:

Determine the actual cross exchange rates between the dollar and the pound and explain how you would conduct a triangular arbitrage if you had Ksh. 1,000,000 to invest. (4 Marks)

ii. Ushirika Bank and Usaidizi Bank serve the forex market by buying and selling currencies. The exchange rate quoted at Ushirika bank for $1 = Ksh. 155 while the exchange rate quoted at Usaidizi Bank is $1 = Ksh. 155.5. There is no bid/ask spread. Suppose you have Ksh. 500,000 and you wanted to take advantage of the differences in the quotations. Explain how you would go about it. (4 Marks)

iii. You are a guru in forex trading. A curious investor has approached to provide advice on how he can use covered interest arbitrage to earn some superior returns. He has provided you with the following information:

- He has Ksh. 50,000,000 for 90 days to invest preferably in South Africa.
- The current spot rate of the South African Rand (ZAR) is Ksh.8
- The 90-day forward rate of the ZAR is Ksh. 9
- The 90-day interest rate in Kenya is 4%
- The 90-day interest rate in South Africa is 6%

Required:

Explain to him how he can conduct the arbitrage and what his payoff would be if he invested in South Africa as opposed to Kenya. (6 Marks)