

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCED DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: TREASURY MANAGEMENT 2 (IOBM – AD309)**

**Date: Tuesday, 13th November 2018**

**Time Allocated: 3 hours (13:30 – 16:30 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section

**QUESTION 1**

1. Refer to the following excerpt from the foreign exchange trading platform Thompson Reuters on a given trading day:

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **Forward Points** | |
| **Currency Quote** | **Spot Rate** | **1 month** | **3 months** |
| GBP/USD | 1.4523/64 | 95/84 | 103/97 |
| EUR/USD | 1.2054/63 | 63/73 | 60/68 |
| USD/JPY | 117.19/24 | 36/42 | 38/35 |

1. State which base currencies are trading at a forward premium or discount for the given tenors. *(2 marks)*
2. Compute the table of 1 month and 3 months forward exchange rates.

*(9 marks)*

1. Identify and explain the factor that determines whether a currency trades at a premium/discount. *(4 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. What is meant by locational arbitrage? *(2 marks)*
2. As treasurer at a large mining company, you are long JPY1.339 billion on your currency position. A dealer from Bit-first Investment Bank (BFIB) is quoting USD/JPY at 107.20/107.25 and EUR/USD at 1.2535/1.2540 while at the same time a cross trader at Fast-Serv Bank (FSB) is quoting EUR/JPY at 133.80/133.90. Demonstrate how you would go about a triangular arbitrage to benefit from inconsistent quotes showing your profit in JPY. *(7 marks)*
3. Highlight **three** uses of an interest rate swap as a risk management tool.*(6 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. Describe **two** advantages to an investor of a zero coupon bond over coupon paying bonds. *(4 marks)*
2. Why would a large corporate client opt for the issuance of commercial paper as a source of short-term finance to bank credit? *(3 marks)*
3. Define a discount security and provide **two** examples of money market instruments issued at a discount. *(4 marks)*
4. An asset manager invests US$100,000,000 Face Value in a 91 day certificate of deposit at the rate of 4.45%. If she wishes to sell the paper 42 days later, what will be the yield if she is offered a price of 100,543,246.36? *(4 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. Explain **two** distinguishing characteristics between Futures and Forward contracts. *(4 marks)*
2. Provide and explain **two** uses of Foreign Exchange Swaps. *(4 marks)*
3. If six months swap points for the ZAR/INR are quoted at 42/48, what does that tell us about the ZAR/INR forward exchange rate quote and the level of interest rates in South Africa and India? *(3 marks)*
4. A Germany investor wishes to conduct an 80-day swap transaction with a US investor. Deposit rates in the US are observed at 4.25% – 4.75% whilst in Germany they have been noted at 3.30% – 3.65%. If the EUR/USD spot exchange rate on the day they wish to trade is quoted as 1.2465, calculate the swap points on the trade. *(4 marks)*

**(Total 20 marks)**

**SECTION B (40 MARKS)**

Answer ANY **TWO** questions from this section

**QUESTION 5**

1. Give a brief explanation of the clean floating exchange rate system and highlight **two** of its advantages and **two** disadvantages. *(6 marks)*
2. During the period 1980s to 1990s the United States Dollar (USD) weakened against the Japanese Yen (JPY) but was strong against the Euro (EUR). Discuss the competitive exposures of US companies against;
3. Japanese companies *(7 marks)*
4. European companies *(7 marks)* **(Total 20 marks)**

**QUESTION 6**

1. A United States of America (US) based company is considering a new project and management is discussing whether the new project should be located either in the US or Australia. Consider the following data;

|  |  |  |
| --- | --- | --- |
|  | **If located in the US** | **If located in Australia** |
| Expected Return | 25.0% | 23.0% |
| Standard deviation of the expected return | 7% | 8% |
| Correlation of the expected return with returns from existing US business | 85% | 25% |

Assuming the new project will contribute 35% of funds for the corporation’s total portfolio and the return from the existing project portfolio is 18% with standard deviation of 9.0%.

**Required**

Compare the expected total portfolio return the corporation would obtain by having the new project in the US against Australia. *(5 marks)*

1. Your brother is working on an assignment of interest rate management, he has asked for your guidance on the reasons why corporation manage interest rates. Prepare some guiding notes to help him. *(5 marks)*
2. State and briefly discuss **two** term structure of interest rate theories that explain the shape of the yield curve. *(10 marks)*  **(Total 20 marks)**

**QUESTION 7**

1. Discuss how the Portfolio Balance Theory explains changes in the levels of exchange rate in the economy. (*8 marks)*
2. The Financial Market in Malawi is shallow and underdeveloped. Discuss.

*(12 marks)* **(Total 20 marks)**

**QUESTION 8**

1. Explain the concept of Interest Rate Parity. *(5 marks)*
2. If 365 day interest rates in the United Kingdom are observed at 2.75% whilst in the United States they are at 3.25% for the same tenor and the GBP/USD spot exchange rate is 1.3262. Calculate the 365 day forward rate for the GBP/USD. *(5 marks)*
3. Highlight the distinction between currency risk and currency exposure. *(5 marks)*
4. The Treasurer of a large sugar manufacturer headquartered in Brazil with many subsidiaries in Europe has recently complained of the volume of transactions that his office handles. Recommend to him ‘**netting**’ as a cash flow management technique to resolve his situation. *5 marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**