

Session 1: Preliminaries

International finance jargon

The balance of payments account

1. How is it possible that the balance of payments account contains an item called 'statistical discrepancy' (Restposten)? In other words, how can something be known that is actually unknown?
2. Was there a Swiss current account surplus or deficit in 2000? Which items of the current account contributed most to it?
3. Suppose a Swiss Toyota dealer imports 20 cars worth 50'000 CHF each and the Japanese manufacturer buys a Swiss bond with the 1 million CHF proceeds. What happens to the Swiss balance of trade? The current account? The balance of payments?
4. Suppose an American buys a share of German stock, paying by writing a check on an account with a Swiss bank. Explain how this transaction generates two entries – a credit and a debit – in the American balance of payments accounts, and describe how each entry would be classified. What happens to the Swiss balance of payments account?
5. A strong Swiss franc (CHF) is a mixed blessing. It _____ the price of imports, thus _____ inflation, and it makes trips to foreign countries _____ for Swiss tourists. But it makes our exports _____. Fill in the blanks.

The FOREX market and financial instruments

6. Partial analysis of the FOREX market: Discuss the ceteris-paribus effects of a) an increase of domestic income, b) an increase of the domestic interest rate, c) a rise of domestic inflation, and d) an increase of the exchange rate e . (Hint: Distinguish between effects that shift the curves and effects that cause shifts along the curves!)
7. Why is a cut of the Swiss National Bank's trend-setting interest rate, i.e. the three-month Libor, followed by a rise of the nominal exchange rate e ?

8. What are the advantages and disadvantages of options relative to forward contracts?
Of swaps relative to forward contracts?
9. Let the current spot USD/DEM rate be 0.6; and the 3 month and 6 month forward rates be 0.7 and 0.65 respectively. The market expects
- The dollar to appreciate initially and then depreciate but still be stronger than now
 - The mark to appreciate initially and then depreciate but still be stronger than now
 - The dollar to depreciate continually
 - The mark to depreciate continually
10. Suppose that the USD/DEM forward rate for currency to be delivered on May 1 is 0.5, and your personal prediction is that it will be 0.6. What position are you going to take in the forward market (e.g., which currency will you sell forward?). If the actual spot rate on May 1 turns out to be 0.55 will your decision prove profitable or not? Suppose that the contract involved USD10'000. How much is your profit (loss)?
11. Let the six month USD/GBP future (forward) rate be 2.00 and the current spot rate be 1.9. You can invest in either a six month put option (on pounds) with a strike price of 2.10 at the cost of USD 0.001 per GBP; and/or in a future contract that obliges you to sell GBP for USD. Let the cost of the forward contract be \$0.001 per GBP. Which investment would you select if you expect the USD/GBP rate of 6 months later to be 1.8.
- The option
 - The future contract
 - Both
 - Neither

12. Let the current USD/DEM spot rate be 0.6, the forward rate be 0.7 and consider the cost of two call options: one with a strike price of 0.65 (option A) and another with a strike price of 0.75 (option B). Based on the information supplied one may conclude that
- A will be more expensive
 - B will be more expensive
 - We cannot tell
 - The cost will be about the same
13. Suppose that you own a forward contract for 100,000 pounds which obliges you to sell pounds for dollars at the price of 2.00 dollars per pound; and that your friend owns a put option on another 100,000 pounds with a strike price of 2.00 dollars per pound. The maturity date is the same for both contracts. The put option has a price of \$3,000. Which of the following cannot occur.
- You both make money but your friend ends up making less than you do.
 - You both lose money but your friend ends up losing more.
 - You make money while your friend loses money.
 - You lose money while your friend makes money.
 - You both lose money but your friend ends up losing less.
14. As in question 10. Situation ‘You make money while your friend loses money’ above can occur if the spot rate on the day of the maturity of the contracts is
- 1.99
 - 2.02
 - 2.05
 - None of the previous