May 2015

Bachelor of Business Administration (BBA) Examination

VI Semester

International Finance

Time 3 Hours] [Max. Marks 80

Note : Attempt any four questions (out of seven questions) from Section A. Each question of Section A carries 15 marks. Section B is compulsory and carries 20 marks.

Section A

1. "The Theory of Comparative Cost Advantage is an improvement over the Theory of Absolute Cost Advantage." Explain.
2. What are the different facilities through which the member countries get Balance of Payments support from IMF ?
3. What do you understand by Purchasing Power Parity (PPP) ? Explain with examples.
4. Balance of Payment always balances. Discuss. Explain the concept of Disequilibrium in Balance of Payment and. Methods of Correcting Disequilibrium.
5. Discuss the objectives of Raising of Resources from International Markets. Describe the different instruments through which the companies can raise funds from International Markets.
6. What is Exchange Rate ? Discuss the arguments for and against Fixed and Flexible Exchange Rates. Discuss the objectives of Exchange Control.
7. Write short notes on any two of the following :

   (a) GDR (b) IMF

   (c) ADR (d) Participants in Foreign Exchange Markets.

Section A

8. After reading the case, answer the questions given at the end of the case :

RBI INTERVENTION AND THE INR/USD EXCHANGE RATE

RBI's Intervention in the foreign exchange market started well in 1990s in the wake of the adoption of the managed floating exchange rate regime. Although the purpose in general has been to check undesirable volatility in the exchange rate, RBI states the objectives as follows :

1. To influence the trend movements in the exchange rates because they perceive long term equilibrium values to be different from actual values.
2. To maintain export competitiveness.
3. To manage volatility in order to axe risk in financial market transactions.

4. To protect the currency from speculative attack.

The intervention has now turned more signiffiarit in view of large inflows on account of foreign investment - both FDI and FII. The quantum of FDI has suddenly soared up front US $7.722 billion from FY 2005-06 to US $19.531 billion luring FY 2006-07. The investment by FII was too large. The net investment was as big as US $3.225 billion during FY 2006-07, although the gross investment was much bigger. During the first four months of FY 2007-08, FDI and FIIs' net investment were respectively of the order of US $6.609 bllion and US $11.774 billion.

It was natural for INR to appreciate in the sequel of huge supply of US dollar in the foreign exchange market. INR, which was once at a low of 46.88 per US dollar during April 2006, appreciated to 41.19 during April 2007 and further to 39.77 during September 2007. Indian imports turned cheaper following appreciation. But the exports turned costlier in the international market with the result that the export value was badly affected. The textile sector, informational technology sector and a few others were a case in point, although some of the other exports were not hit so badly. Thus making exports competitive is on the top of the present-day agenda and for which RBI has stepped in for large market intervention.

If one looks at the RBI intervention, it is clear that in the whole of the financial year, 2006-07, RBI bought US dollar and never sold them in the foreign exchange market. The same trend continued in the following six months. The rationale Behind it Was to maintain the demand for dollars and help them not to fall. But now the question is whether the intervention has been effective.

The short-run efficacy of intervention depends on a host of factors including market positioning, timing of intervention and quantum of intervention vis-a-vis market turnover. But, in this context, a very big problem on the count of FIIs' investment cannot be overlooked. It is that during the later months of FY 2006-07 and the first half of FY 2007-08, the gross inflow of FIIs' investment was on average around ten times the net figures If RBI bases its intervention of buying US dollar from the market on the net investment basis, it would be definitely a wrong judgement to contain any appreciation in the value of rupee. On the contrary, if the basis is the gross investment, large intervantion is unwarranted. The figures in the table below show that the buying of US dollar as percentage of FIIs' net and gross investments has been oscillating in a wide range. Thus we can say that the intervention should have been still more fine-tuned;

Again, RBI's buying US dollar in relation of the turnover in the foreign exchange market, as the figures in the table below show, has been fluctuating. It shows the lack of fine-tuning between the two variables. And so, we cannot expect too much from the intervention, although the impact of intervention is visible at times. For example, When the intervention as percentage of turnover in the foreign exchange market was the highest at 2.66 per cent, the rupee appreciation was one of the lowest at 0.25 per cent.

RBI Intervention, FIIs' Investment and turnover in the Foreign Exchange Market

Period	RBIs buying of US $ in million	Buying of US $ as % of turnover in FOREX market	Buying of US $ as % of FIIs' gross investment	Buying of US $ as % of FIIs' net investment	INR/USD exchange rate	% Change in exchange rate
Nov' 06	3198	0.71	44	192	44.74	--
Dec' 06	1818	0.41	21	-241	44.28	1.03
Jan' 07	2830	0.61	26	-758	44.16	0.27
Feb' 07	11862	2.66	97	807	44.27	-0.25
Mar' 07	2307	0.40	19	283	43.47	1.18
Apr' 07	2055	0.33	19	146	41.19	5.24
May' 07	4426	0.81	33	303	40.57	1.51
June' 07	3192	0.48	23	181	40.70	-0.32
Jul '07	11428	1.61	56	271	40.44	0.64
Aug '07	1815	0.25	12	-104	40.90	-1.14
Sep '07	11867	1.48	64	218	39.77	2.76

Based on RBI figures and the study of Financial Express dated 2-12-2007.

1. How does inflow of foreign investment influence the exchange rate of INR / USD ?
2. Do you find any relation between RBI intervention and the INR / USD exchange rate ?
3. Why has RBI gone for only buying USD and not for selling it ?
4. Do you find that the quantum of RBI's intervention has some sort of relation with the FIIs' investment or with the turnover in foreign exchange market ?