K. J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES & RESEARCH
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PGDM-Exec 2016-17; Batch 6; Tri V

International Finance

(End-Trimester Examination)

Max marks 50 — 27th December 2017
Duration: 3 Hrs

Note: Attempt any five Questions. All questions carry equal marks. Restrict each of your answers to around 40 lines.

1. Answer **any four** questions from Section A
2. Case studies in Section B are **compulsory**

Section A

1. Explain the new risks faced by MNC's compared to that of a domestic firm with suitable examples. What do you mean by imperfect markets?
2. What impact would the following events have on India's balance of payments if
   A) China devalues its currency
   B) Indian government provides subsidy to Indian textiles exporters
   C) Thai Bhat (currency)appreciates with respect to all major currencies
   D) India encourages capital inflows for investments in government securities and equity markets.
3. Write short notes on
   i. Gold Standard and automatic adjustment
   ii. European Monetary system
   iii. Bretton Woods System
   iv. Government intervention in currency markets
4. Differentiate between the following terms:
   i. Dollarization and Currency Board arrangement
   ii. Pegged and Crawling peg Exchange Rate System
   iii. Fixed and Floating exchange rate system
5. Explain the following terms:
   i. NEER and REER
   ii. Exchange rate and effective exchange rate
   iii. Nominal and real exchange rate

6. Differentiate between the following terms with suitable examples:
    i. Spot and forward rate
    ii. Direct and indirect rate
    iii. Interbank and merchant rate
    iv. Bid and ask rate

Section B

7. Case Study-1 – Euro crisis and Poland's Economy (Case copy provided)

Discussion questions

a) How was Poland able to avoid the worst effects of the economic crisis that gripped most of Europe during 2008-09?
b) What lessons can be derived from the Polish experience during 2008-09?
c) Even though Poland has been committed to liberalizing its economy since the collapse of communism in 1989, significant vestiges of the old system still remain. Why do you think it has taken Poland so long to transform its economic, political and legal system?

Case Study 2 – South Korean Currency crisis (Case copy provided)

Discussion Questions

a) What role did the Korean government play in creating the 1997 crisis?
b) What role did the Korean enterprise play in creating the 1997 crisis?
c) Why was the Korean central bank unable to stop the decline in the value of the Won?(its currency)
d) In late 1997, the IMF stepped in with a rescue package that included $55 billion in emergency loans to support the currency. These loans had the effect of stabilizing the Won, and over the next few years South Korea enjoyed strong currency. If the IMF had not stepped in, what have occurred?

Section B - Q- 7.

International Finance Case studies

a) Euro crisis - Poland Economy

The financial crisis of 2008-09 had impacted Euro adversely. Poland was the notable exception. Economic growth during 2009 was 1.5% while all other European economies contracted. Between 2010 and 2012 Poland registered average growth rate of 3.4% per annum. How did Poland achieve this?

After four decades of Communist rule, in the year 1989, democratic government was elected and embraced upon market-based economic policies. It had opened up its markets for international trade and foreign investment and privatized many state-owned businesses. It had joined European Union in the year 2004 and had access to European markets for exports. Poland's exports accounted for about 40% of GDP and recorded highest growth. Real GDP doubled over this period, compared to a 70% increase in neighbouring Slovakia and 45% in the Czech Republic.

Poland's government used conservative fiscal policies and did not expand public debt that led to increase in investor confidence. There was no large outflow of funds during the 2008-09 economic turmoil. This stands in stark contrast to what happened in the Baltic States, where investors pulled money out of those economies driving their currencies down and raising cost of government debt and precipitated a full-blown economic crisis that required the IMF and EU to step in with financial assistance.

A tight monetary policy in early 2000s in Poland helped to curb inflation. Joining EU helped Poland to expand its exports of automobile components to Germany.

Still country was suffering from migrant workers problems and increase in unemployment to around 12% by 2012. Tax system was complex and ease of doing business rank was at 62 out of 183 countries. Even after 20 years of reforms, transition from socialist to market based economy was not completely successful as still many state-owned enterprises remain to be privatized.

Polish government had been trying to simplify tax system, reduce tax rates and Entrepreneurship Law was passed in March 2009 which reduced controls that companies had to comply with. Privatized state – owned enterprises were at 2.5% of GDP in the year 2010.

b) South Korea Currency Crisis

South Korean economy had "economic miracle" for 30 years and became the world's 11th largest economy. By the end of year 1997, the currency plunged by 67% against US dollar. IMF had to step in with a rescue package of &55 billion. The reason for this sudden fall of events had its roots in the investments made by the industrial conglomerates or *Chaebol*, during 1990s. The populist measures by the President of South Korea investing in export oriented industries and new factories led to investment led boom. These investments were made by heavily borrowing almost four times of their equity.

The volume of investments soared with quality declining. Other factors led to the fall were: unrealistic projections about the demand conditions and excess capacity build in semiconductor industry based on global shortage which was of temporary nature, prices falling due to excess supply by as much as 90%. These conditions led default on debt repayments and bankruptcy. Matters got complicated as borrowings were in US dollar. Exchange rate was stable ($1=850 won) and there was a interest rate difference made attractive borrowing strategy. But the risk was that if exchange rate on won depreciates the size of the debt burden that South Korean companies would have to service would increase when measured in local currency. Currency depreciation increased borrowing cost and led to depress corporate earnings and bankruptcies.

Foreign investors started speculating about the ability of Korean companies to pay debt service and pulled out investments from stock and debt markets. Currency exchange rate fallen from around 840 to 900 won = $1. Central bank stepped in to control exchange rate and to keep at W1000 = $1 by using reserves and step up investor confidence. This action did not yield results and rating downgrades caused stock market to fall by 5.5%.

S&P's credit rating downgrade led to sell off Korean Won. Increase in interest rates, intervention by the central bank led to further fall in reserves and price of won plunged to W1500 = $1. This had resulted in further losses to the extent of $15 billion to Korean firms.

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