International Finance
Prof. A. K. Misra
Department of Management
Indian Institute of Technology, Kharagpur

Lecture - 39
Test – 3

In session number 39, we will have a test; that is evaluation number 3. Here you will have, as I mentioned earlier that in the evaluation we have 20 objective questions and 5 short questions. We will discuss the objective question and also the short question in a smooth manner. Here we will be discussing first objective question; first I will ask you the objective question in a piece of paper, you write down your answer. After the end of the 20 questions, we will discuss all the 20 objective questions that I will mention you, what is the actual answer and also I will discuss with you how the answer arrived. In the subjective question, only I will provide you what is called key answer to the questions.

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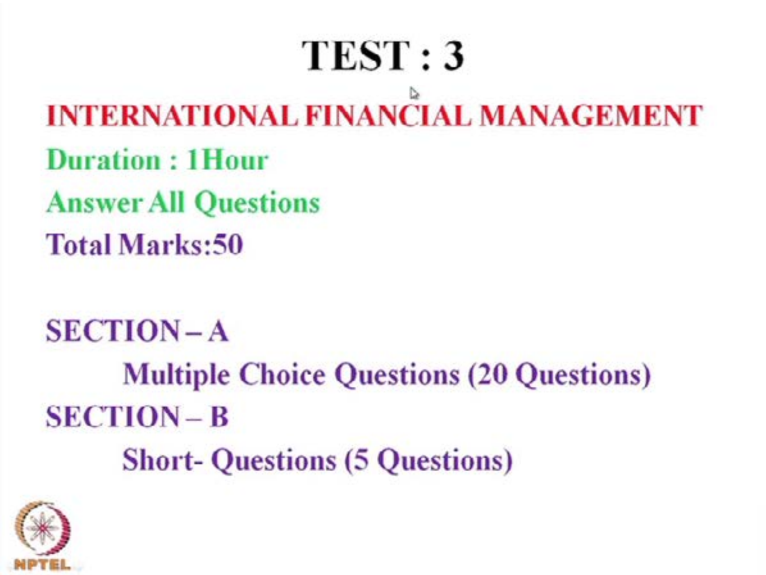

Let us move to the question in test 3. Here I mention that we have a two parts; Part- A multiple choice question, Part-B is short question. Each multiple choice question is one mark. There are 20 questions are there twenty marks will be there and in short question Section-B, 5 questions are there; each question carry six mark, we have thirty marks. So, first multiple choice question we will discuss, then you will go back to again to the short questions.

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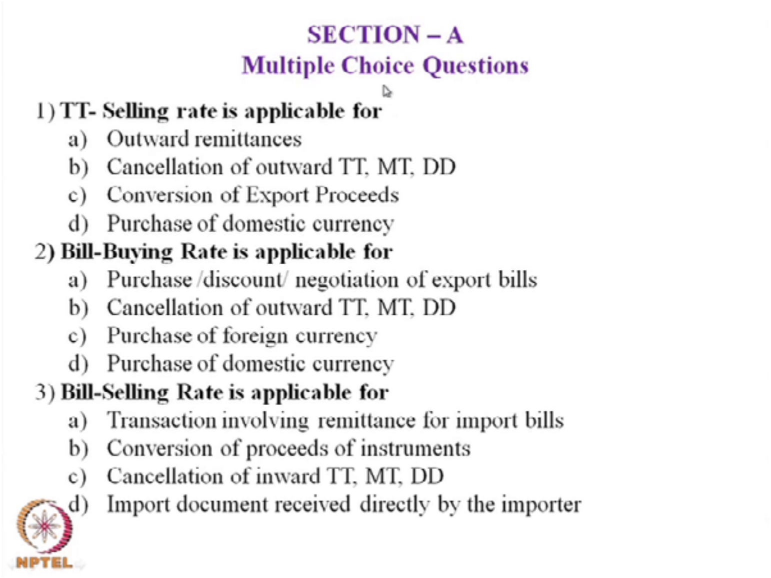

So in the first question, you keep a piece of paper with you and try to mark the actual answer if it is a, b or c or d. So, I will go through the questions; I will after that I will let you all know the actual a, b, c what are the content. Then you mark a, b, c whichever the right. After the end of the 20 question, we will discuss the answer of the 20 questions. So, let us start.

Question number 1: TT selling rate is applicable for, the choices are for you; a) outward remittances; b) cancellation of outward TT, MT, and DD; c) conversion of export proceeds; d) purchase of domestic currency. You mark the answer; keep it with you. Question number 2: Bill-buying rate is applicable for, the choices are for you; a) purchase discount/ negotiation of export bills; b) cancellation of outward TT, MT, DD; c) purchase of foreign currency; d) purchase of domestic currency. Mark the answer; keep it with you.

Question number 3: Bills-selling rate is applicable for, the choices are for you; a) transaction involving remittance for import bills; b) conversion of proceeds of instruments; c) cancellation of inward TT, DD, MT; d) import document received directly by the importer. Mark the answer; keep it with you.

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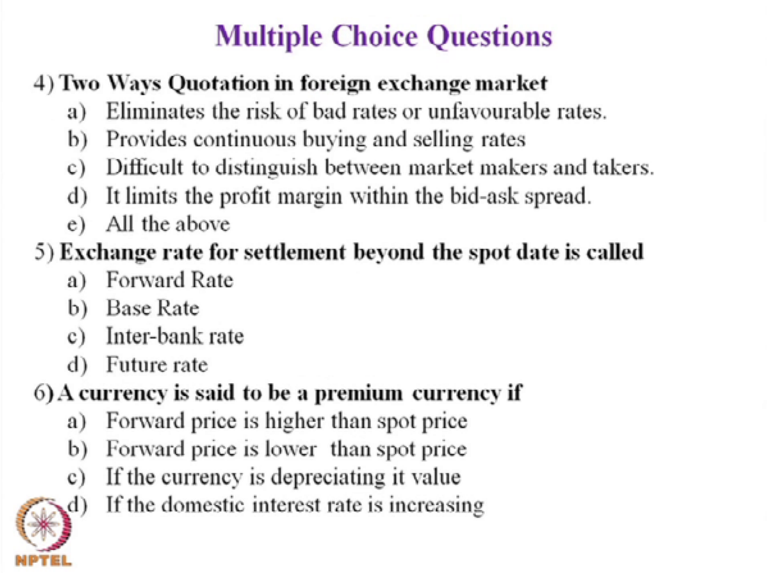

Question number 4 is for you: Two way quotation in foreign exchange market. The answers are a) eliminate the risk of bad rates or unfavourable rates; b) provides continuous buying and selling rates; c) difficult to distinguish between market makers and market takers; d) it eliminates the profit margin within the bid-ask spread; e) all the above. Mark the answer; keep it with you.

Question number 5 for you is: Exchange rate for settlement beyond the spot date is called, the choices are for you, a) forward rate; b) base rate; c) inter-bank rate; d) future rate. Mark the answer; keep it with you. Question number 6 for you is: A currency is said to be a premium currency if, the choices are for you is, a) forward price is higher than the spot price; b) forward price is lower than the spot price; c) if the currency is depreciating its value; d) if the domestic interest rate is increasing. Mark the answer; keep it with you.

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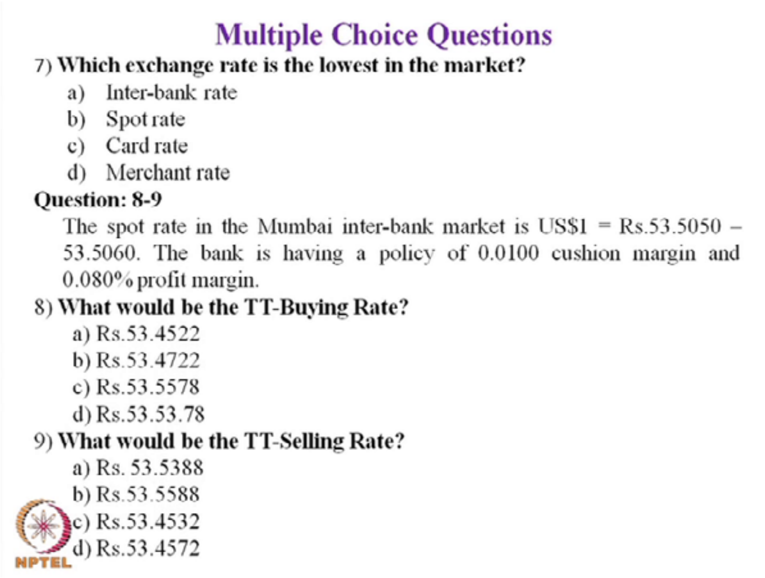

Question number 7; the question number 7 is for you, which exchange rate is the lowest in the market? The choices are for you, a) inter-bank rate; b) spot rate; c) card rate; d) merchant rate. Mark the answer; keep it for you. Question number 8 and 9, there is a small write up is there; after that I will ask the question number 8 and 9. The write up is, the spot rate in the Mumbai inter-bank market is 1 US dollar equal to 53.5050-53.5060. The bank is having a policy of 0.0100 cushion margin and 0.080 percentage profit margins.

With this background, the question number 8 is: What would be the TT-buying rate? The choices are for you, a) Rupees. 53. 4522; b) Rupees 53.4722; c) Rupees 53.5578; d) Rupees 53.5378. Mark the answer; keep it with you. Question number 9; question number 9 for you is: What would be the TT-selling rate? The choices are for you, a) 53.5388; b) 53.5588; c) 53.4532; d) 53.4572. Mark the answer; keep it with you. Question number 8 and 9, with the write up you try to find, try to answer the question number 8 and 9.

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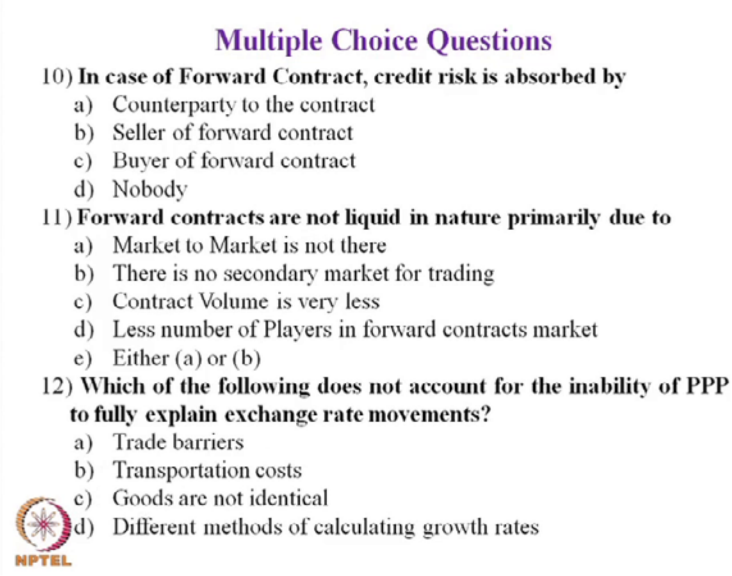

Let us move to question number 10. Question number 10 for you is: In case of forward contract, credit risk is absorbed by; the choices for you are a) counterparty to the contract; b) sellers of forward contract; c) buyers of forward contract; d) nobody. Mark the answer; keep it with you. Question number 11; the question number 11 for you is: Forward contracts are not liquid in nature primarily due to, the choices for you are, a) mark to market is not there; b) there is no secondary market for trading; c) contract volume is very less; d) less number of players in forward contract market; e) either a or b. Mark the answer; keep it with you.

Question number 12; question number 12 is for you, which one of the following does not account for the inability of purchasing power parity to fully explain exchange rate movement? The question number 12 for you is, which one of the following does not account for the inability of purchasing power parity to fully explain exchange rate movements? The answers are for you, a) trade barrier; b) transportation cost; c) goods are not identical; d) different method of calculating growth rate. Mark the answer; keep it with you.

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Multiple Choice Questions

13) **A higher domestic money supply causes the domestic currency to**

a) depreciate more in the short run than in the long run.
b) depreciate more in the long run than in the short run.
c) appreciate more in the short run than in the long run.
d) appreciate more in the long run than in the short run

14) **Under inconvertible paper currency standard the internal purchasing power of domestic currency is influenced by**

a) Domestic Inflation,
b) Domestic taxes
c) Products Quality
d) Interest rate
e) Both (a) and (b)

15) **The three different types of forex transactions are**

a) Spot, forward, swaps
b) Spot, Cash, OTC
c) Spot, forwards, Futures
d) Spot, futures & options

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Let us move to question number 13. Question number 13; question number thirteen is for you: A higher domestic money supply causes the domestic currency to, the answers are for you, a) depreciate more in the short run than in the long run; answer b) depreciate more in the long run than in the short run; answer c) depreciate more in the short run than in the long run; answer d) depreciate more in the long run than in the short run. Mark the answer; keep it with you.

Question number 14; question number 14 for you is: Under inconvertible paper currency standard, the internal purchasing power of domestic currency is influenced by, choices for you are, a) domestic inflation; b) domestic taxes; c) product quality; d) interest rate; e) both a and b. Mark the answer; keep it with you. Question number 15; the question number 15 is for you: The three different type of forex transactions are, the choices for you are, a) spot, forward, swaps; b) spot, cash, OTC; c) spot, forward, futures; d) spot, future and options; Mark the answer; keep it with you.

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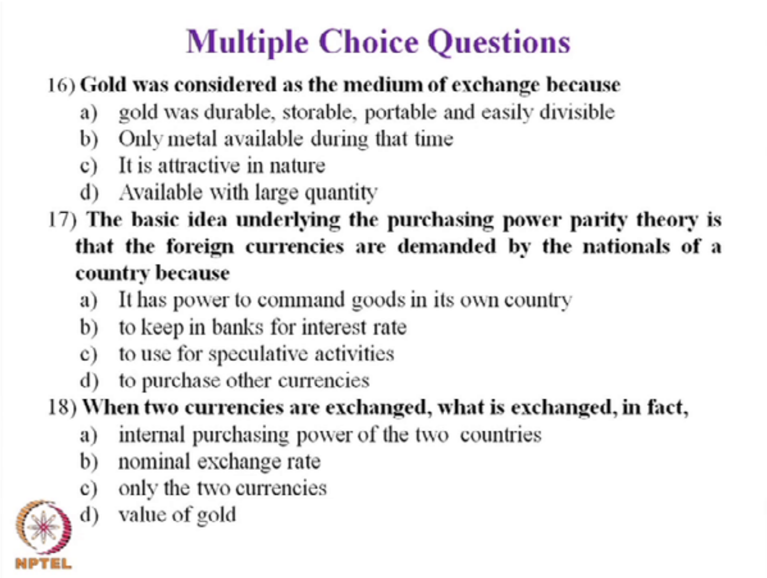

Let us move to question number 16. The question number 16 for you is: Gold was considered as the medium of exchange because the choices for you are, a) gold was durable, storable, portable and easily divisible; answer b for you is, only metal available during that time; the choice c for you is, it is attractive in nature; the choice d for you is, available with large quantity. Mark the answer; keep it with you.

Question number 17; the question number 17 for you is: The basic idea underlying the purchasing power parity theory is that the foreign currencies are demanded by the national of a country because the choices for you are, a) it has more power to command goods in its own country; b) to keep in banks for interest rate; c) to use for speculative activity; d) to purchase other currency. Mark the answer; keep it with you.

Question number 18; the question number 18 for you is: When two currencies are exchanged, what is exchanged, in fact, the choices for you are; a) internal purchasing power of the two countries; b) nominal exchange rate; c) only the two currencies; d) value of gold. Mark the answer; keep it with you.

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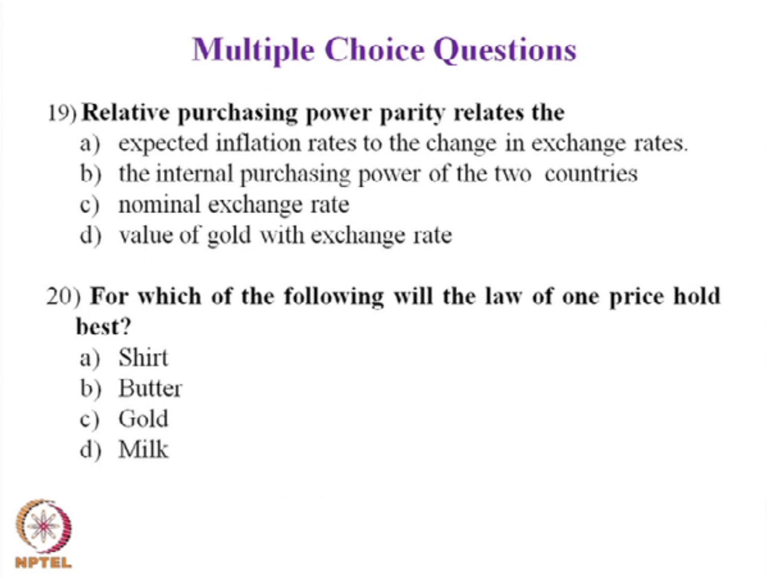

Let us move to question number 19. The question number 19 for you is; Relative purchasing power parity relates the, choices for you are, a) expected inflation rate to the change in exchange rates; b) the internal purchasing power of the two countries; c) nominal exchange rate; d) value of gold with exchange rate. Mark the answer; keep it with you.

Question number 20; question number 20 is for you: For which of the following will the law of one price hold best? Question number 20 for you is: For which of the following will be the law of one price hold best? The choices are for you, a) short; b) butter; c) gold; d) milk. Mark the answer; keep it with you. All 20 questions we have discussed and I hope you have marked all the right answers.

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SECTION – A
Multiple Choice Questions

1) **TT- Selling rate is applicable for**
   a) Outward remittances
   b) Cancellation of outward TT, MT, DD
   c) Conversion of Export Proceeds
   d) Purchase of domestic currency
2) **Bill-Buying Rate is applicable for**
   a) Purchase /discount/ negotiation of export bills
   b) Cancellation of outward TT, MT, DD
   c) Purchase of foreign currency
   d) Purchase of domestic currency
3) **Bill-Selling Rate is applicable for**
   a) Transaction involving remittance for import bills
   b) Conversion of proceeds of instruments
   c) Cancellation of inward TT, MT, DD
   d) Import document received directly by the importer

Let us go to the answers of each of the 20 questions. The question number a, the answer here: TT-selling rate is applicable for? The question here, TT-selling rate is applicable for outward remittances. When you need foreign exchange, you go to the bank, ask for TT-selling rate. So, TT-selling rate is outward remittances. You want to send dollar from India to Canada; you go to the bank, ask for TT-selling rate. So, you sell a TT. So, answer to question number 1: TT-selling rate is applicable to a; answer is a, outward remittances.

Question number 2: Bills-buying rate is applicable for, when the exporters buy the bill, the bills-buying rate is applicable. The question number 2, answer is a; purchase/discount/ negotiation of export bill. The exporter exports the bill. They buy bills-buying rate to convert the export earning into Indian rupee or any other domestic currency. The bills-buying rate is applicable for; question number 2 is answer is a, purchase/discount/negotiation of export bill.

Then question number 3: The bill-selling rates applicable for; the bill-selling rate is applicable for. Here question number 3: Bill-selling rate is applicable for, you can see the answer of three; the answer of three is also a. The answer of question number 3 also transaction. Question number 3; answer also a, transaction involving remittance of such import bill. Bill-selling rate is applicable to import bills. Bill-selling rate is applicable to imports bill. So question number 3, the answer is a.

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Multiple Choice Questions

4) **Two Ways Quotation in foreign exchange market**
   a) Eliminates the risk of bad rates or unfavourable rates.
   b) Provides continuous buying and selling rates
   c) Difficult to distinguish between market makers and takers.
   d) It limits the profit margin within the bid-ask spread.
   e) All the above

5) **Exchange rate for settlement beyond the spot date is called**
   a) Forward Rate
   b) Base Rate
   c) Inter-bank rate
   d) Future rate

6) **A currency is said to be a premium currency if**
   a) Forward price is higher than spot price
   b) Forward price is lower than spot price
   c) If the currency is depreciating it value
   d) If the domestic interest rate is increasing

Let us move to question number 4. Question number 4 is: Two way quotation in foreign exchange market. Two way quotations, the buyer quotation, seller quotation, the bid-ask spread in two way quotation. Two way quotation in the foreign exchange market is, the answer is e) all the above. It eliminate the bad rate, it provide continuous buying and selling rate. It is difficult to distinguish who is the market maker, who is the market taker, it limit the profit margin. So, the two way quotation in foreign exchange market; the question number 4, the answer is e) all the above. The question number 4, the answer is e) all the above.

Question number 5: Exchange rate for settlement beyond the spot date is called? Exchange rate for settlement beyond the spot date is called? The question number 5, the answer is forward rate. Beyond the spot date; that is beyond two days, any buyer or sale of foreign currency you know that, it can be possible only in forward rate. Spot date is zero to two days. Beyond the two days, any purchase or sale of foreign currency take place at forward rate. The question number 5, the answer is a) forward rate.

Let us move to question number 6. Question number 6 is: A currency is said to be premium currency. A currency is said to be premium currency, when the value increases. Rupee value today is 45, then tomorrow if you purchase if it is 43, it is a premium currency. It is 45 to 46; it is depreciating. Depreciation is the discount currency to rupee; a currency is said to be premium currency if value appreciate. So, forward price will be higher than the spot price. The forward price should be higher than the spot price, then the currency will be appreciated or premium currency. So, question number 6, the answer is a. The question number 6, the answer is a.

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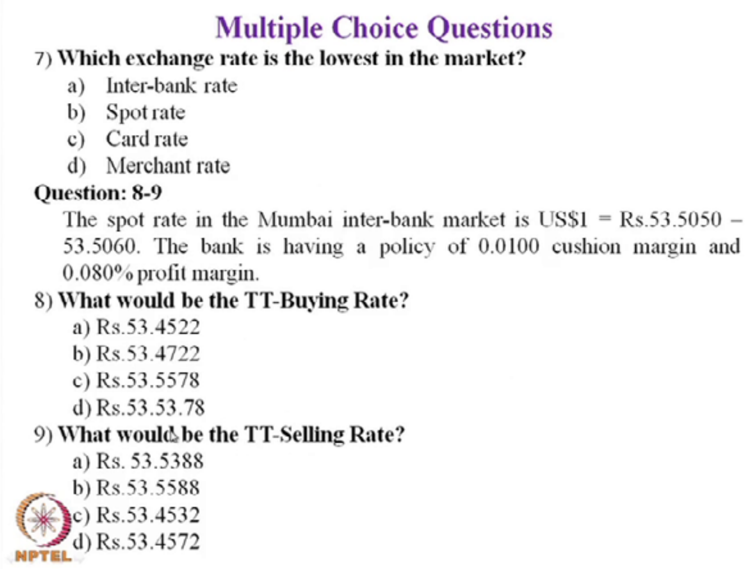

Let us move to question number 7. The question number 7 is, which exchange rate is the lowest in the market? Which exchange rate is the lowest in the market? The question number 7 here is; it is the merchant rate. The exporter/importer rate, they are high volume transaction rate. Since they are high volume transaction export/imports are high volume transaction, because of that they command the market and get the lowest possible rate. The merchant rate is the lowest possible rate in the market. So, the question number 7, which exchange rate is the lowest in the market? It is the merchant rate. So, 7 number question the answer is d) merchant rate.

The question number 8 and 9 there is a write up for you. You go through the write up; answer the question. So here we are asking you, what would be the TT-buying rate? TT buying rate; who buy TT? Those who have foreign currency, they sell the foreign currency and purchase the Indian rupee.

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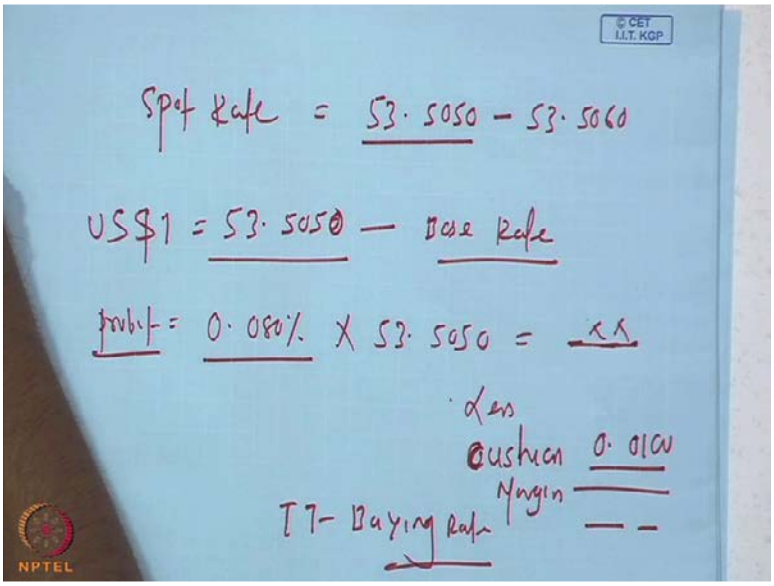

So, TT-buying rate; TT-buying rate means here spot rate. The spot rate you can see the write up here. The spot rate is 53.5050, 53.5060. So, TT buying rate applicable to, you buy a TT means you have foreign currency; you want to convert the foreign currency into domestic currency. When you have foreign currency, you will sell the foreign currency; the banker will give you less rate. You can see that banker will give you 53.5050 per US dollar. Per for US dollar 1, the 53.5050 is the bankers will give you; this is the base rate.

And since you have the bank having a policy of 0.01 cushion. So, they will cushion rate in there and bank also charge 0.80 percent profit margin. So, you have to minus the profit margin; profit margin bank will charge, profit margin they will surrender less rupee to you. Profit margin is 0.080 percentage, so 0.080 and profit will be; with the base rate, profit margin will be 0.080 percentage into base rate 53.5050; this is the applicable rate. On this, less; this is the applicable rate. This is applicable rate, less cushion rate.

The cushion rate is if you see, the cushion margin is 0.010; the cushion margin is less. Less cushion margin. From here, minus the cushion margin 0.0100; so, here minus this rate, this rate will come. This is the final rate that is called TT-buying rate and the answer is for you. The question number 8; you can see the question number 8, the answer is for you. Question number 8, answer is a. Question number 8, the answer is a. The question number 8, answer will be a for you.

So the question number 8, this answer will be TT-buying rate will be 53.4522. The answer will come 53.4522; the answer will be 53.4522. So, question number 8, the answer is a. Similarly the question number 9; if you see the question number 9, question number nine is: What would be the TT-selling rate? When you sell a TT, when you required foreign currency; so when you required foreign currency, bank will charge you more money; more INR.

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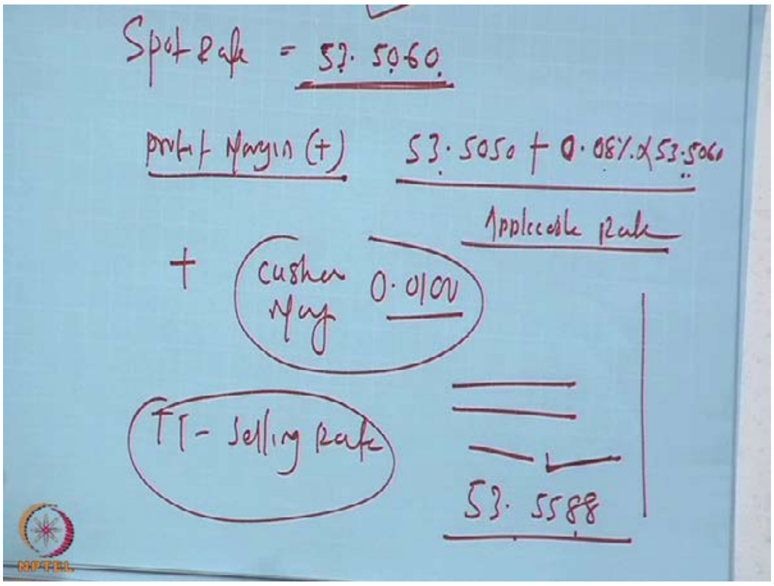

So, the applicable spot rate is base rate or applicable spot rate is it will be 53.5060. To pay more Indian rupee, to purchase 1 dollar, you are selling a TT, you are buying foreign currency. Here the cushion margin, here you have to add what is called the profit margin. Profit margin you have to add here; profit margin will be positive. So, profit margin 53.5050 plus profit margin is 0.08 percentage into again 53.5060. This will be the applicable rate and here also you add cushion margin; cushion margin is 0.010.

So on this applicable rate, you add cushion margin. Then final rate will be the TT-selling rate. Final rate will be the TT-selling rate. The answer for the question number 9 is b. Answer for the question number nine is b. We can see the answer for the question number 9; that is 53.5588. Your answer will be 53.5588; this is the answer for you. So, here you have to find the TT-selling rate and TT selling-rate how to find? You are your buying foreign currency, you surrender more rupee.

The base rate is 53.5060. Here you have to add the profit margin of 0.08 percentage, 0.08 percentage add. So, you will get the applicable rate. On applicable rate, you add the cushion margin 0.0100; that is 0.01 and after that you will get the TT-selling rate. Answer will be to question number 9 is 53.5588; this is the answer for you.

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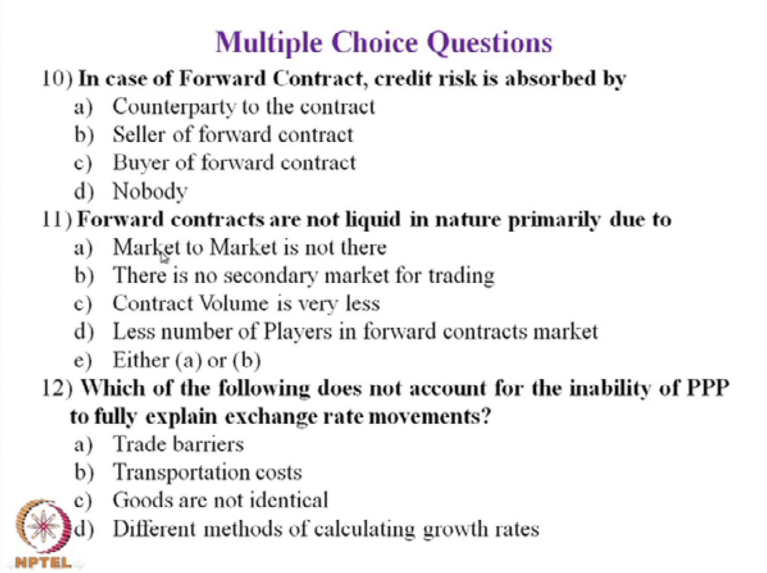

The question number 10; let us move to question number 10. Question number 10: In case of forward contract, credit risk is absorbed by whom? Forward market is unorganised market. So, nobody bear the credit risk. The bank may sell the forward contract if the exchange rate is highly volatile, it goes against them; significantly, they will not abide by the forward contract. So, nobody bear the forward contract credit risk. So, question number 10, the answer is d. Question number 10, the answer is d) nobody bears the credit risk in forward contract market.

Question number 11; question number 11 is: Forward contracts are not liquid in nature primarily due to? Forward contract are not liquid in nature primarily due to, mark to market is not there. There is no secondary market for trading, these two; so here, either a or b. So question number 11, the forward contract not liquid because either mark to market is not there or there is no secondary market for trading. So, the question number 11, the answer is e) either a or b. Question 11 because either a, the forward mark to market is not there. Similarly forward market, there is no secondary market. So, any of the one; a or b will be the answer for the question number 11. Question number eleven, the answer is e) either a or b.

Question number 12; question number 12 is, which one of the following does not account for inability of purchasing power parity to fully explain exchange rate movement? Which one of the following does not account for purchasing power parity to explain the exchange rate movement? Does not account for trade barrier; account trade barrier decide the purchasing power parity transportation cost; decide the purchasing power parity, goods are not identical; that also decide the purchasing power and different methods of calculating growth rate. Here the twelve number question answer is d. Twelve number question, answer is d. All these things are first, second, third; they account for the inability of purchasing power to explain purchasing power parity. Question number 12, the answer is d.

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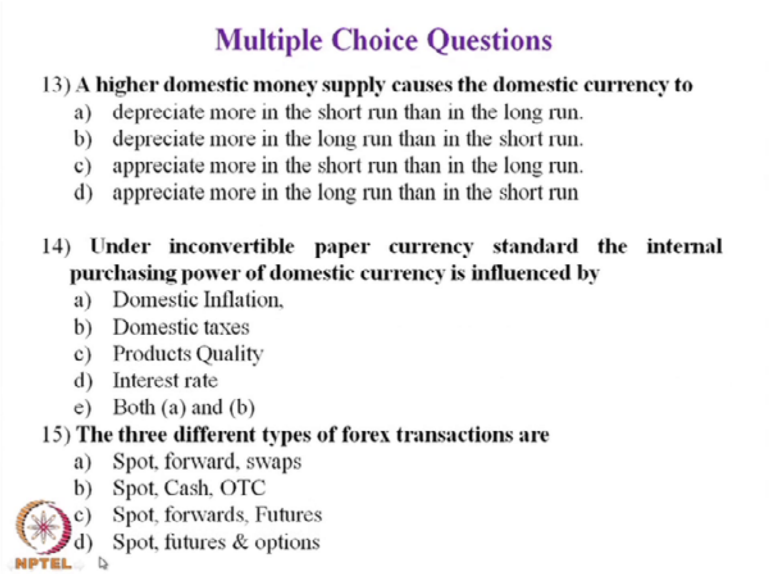

Question number 13: Higher domestic money supply causes the domestic currency to; when the currency supply, domestic money supply increases; though what will happen to the domestic currency? A short run, the rupee will depreciate. Suppose more amount of rupee will circulate in the Indian economy, the short run rupee value will depreciate than in the long run. Because in the long run government of India again controls the rupee value.

So in the short run, higher domestic money supply causes the domestic currency in the short run to depreciate than in the long run. Long run it will now erase the depreciation; short run it will be highly depreciated. So, more money supplies in the economy; the rupee or the domestic currency depreciate more in short run than in long run.

So, here thirteen number question the answer is a) depreciate more in the short run than in the long run. The long run there will be correction; the correction in more, export will be more cheaper and there will be more export and more export may arrest the depreciation; more flow inflow of dollar will be there in the economy. So, long run depreciation may be arrested, but short run depreciation will be more. The question number 13, the answer is a.

Question number 14; question number 14 is: Under inconvertible paper currency standard, the purchasing power parity of domestic currency influenced by? The purchasing power parity of the domestic currency is influenced by? Domestic inflation, domestic taxes, product quality, interest rate, or both a and b. It will be because under inconvertible paper currency standard, internal purchasing power is influenced by inflation, internal purchasing power influenced by taxes.

If more inflation is there, purchasing power will be less; more taxes will be there, purchasing power also less. So, here a and b will be the answer. So, question number 14, the answer is a and b. Here the question number 14, the answer is e) both a and b. The question number 14, the answer is e) both a and b; that is domestic inflation and taxes influence the purchasing power under inconvertible paper currency standard.

Question number 15; question number 15 is: The three different type of forex transaction. Forex transaction generally we have spot transaction, forward transaction, and futures transaction. So for question number 15, we have answer is c. The question number 15, the answer is c) the spot, forward, and future. These are the three different transactions available in the foreign currency market. The question number 15, the answer is c. The question number 15, the answer is c.

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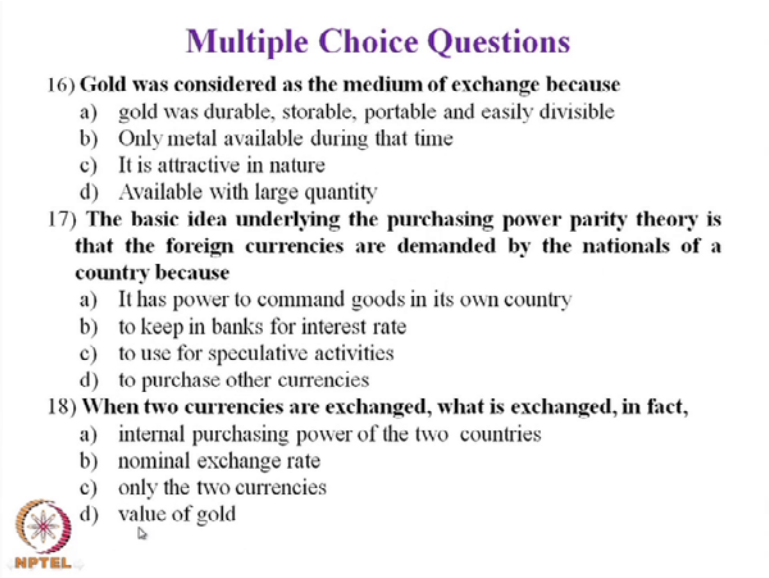

The question number 16; question number 16: Gold was considered as a medium of exchange because the answer is here a. Question number 16: Gold was considered as the medium of exchange because the answer is a) gold was durable, storable, portable, and easily divisible. So, gold was durable, the price is stable, storable; you can store it because it is portable. You can store, easily divisible to small minute unit you can do; you can divide it and have an own purchasing power. So, the gold was considered as the foreign currency in foreign exchange medium, because the gold was durable, portable, storable, and easily divisible. So, question number 16, the answer is a. The question number 16, answer is a.

The question number 17: The basic idea underlying the purchasing power parity theory is that foreign currencies are demanded by the national of a country because; the foreign currencies are demanded by the national of a country because? The answer is here; answer is here a. Answer is here a) it has power to command goods in own country. It has a power to command goods in own country. The 17 number question, the basic idea of purchasing power parity theory is that foreign currency are demanded by national of a country because it is foreign currency have a power to command the goods and services in own country. Question number 17, the answer is a. The question number 17, the answer is a.

Question number 18: When two currencies are exchanged, what is the exchange, in fact; when two currencies are exchanged, we exchange the internal purchasing power of the two countries. So, question number 18, the answer is a) when two currencies are exchanged, we exchange the internal purchasing power of the two country. So question number 18, the answer is a. The question number 18, the answer is a.

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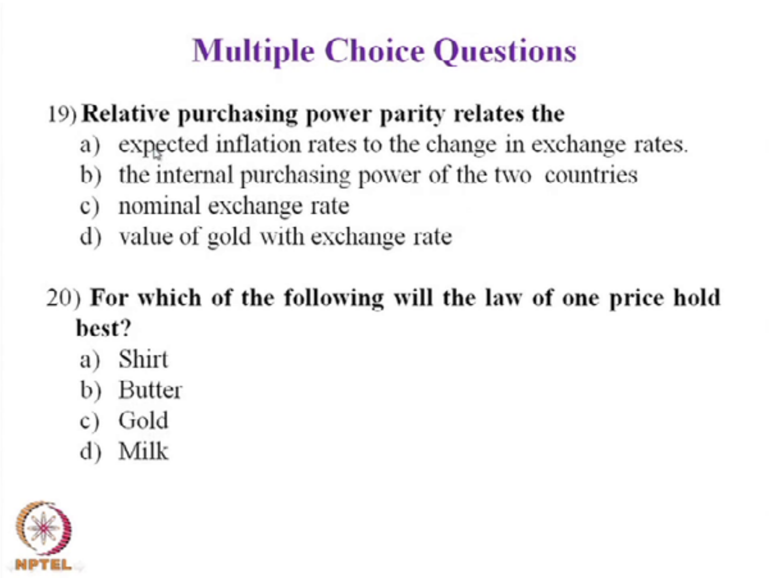

Question number 19; question number 19 is: Relative purchasing power parity relates; relative purchasing power parity relates to inflation. Relative purchasing power parity relates to the expected inflation. So, relative purchasing power parity relates to expected inflation rate to the change in exchange rate. So, question number 19, the answer is a. The question number 19, the answer is a) expected inflation rates to the change in exchange rate. Relative purchasing power relates the expected inflation rate to the change in exchange rate.

Question number 20; the question number 20 is: For which of the following will the law of one price hold the best? Law of one price means the value of the particular commodity or the item will be same across the different countries. The law of one price generally hold best for gold. The gold law of one price generally hold best for gold. The law of one price generally hold best for gold. The law of one price held good for or best for old only. So here question number 20, the answer is c. The question number 20, the answer is c.

With this, we have discussed the 20 questions along with their answers. I hope you have compared your answer with my answer and try to find how many correct answers you have done. So, let us move to the subjective question. I will ask you 5 subjective question and you have to answer it. I will provide you the key answer for each question; the key answer for each questions.

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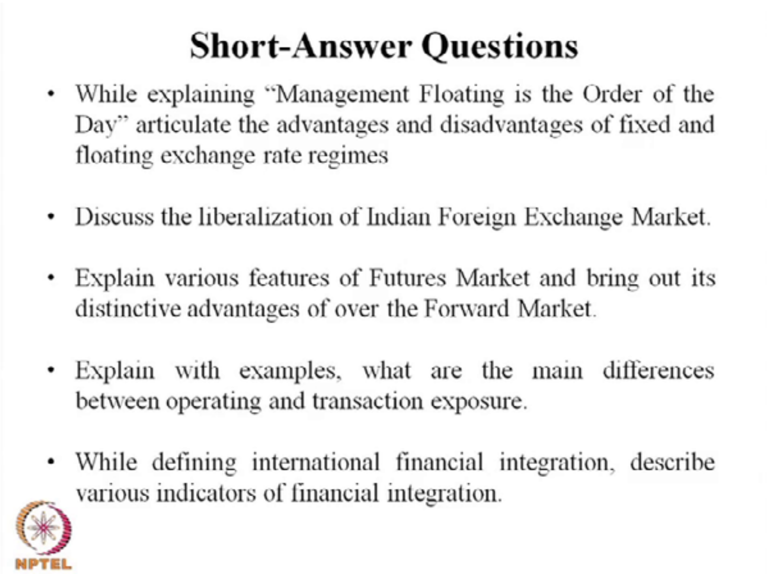

So, subjective questions are there. The subjective questions are you can see the question; you have to write each question 100 to two 200 words. And I will provide the broad heads of answer for each question and you have to expand the answer and write it 100 to 200 words. Each question carries six marks.

So, question number 1: While explaining "managed floating is the order of the day"; while explaining managed floating is the order of the day. Articulate the advantages and disadvantages of fixed and floating exchange rate regimes. This question already we have discussed one session; one session we discussed the various exchange rate standard. There we have discussed about managed floating exchange rate, their advantage and disadvantage; if you remember, you can answer the question very easily.

However I am providing the broad answer. So, at present no countries in the world, either fixed or completely floating exchange rate. Completely fixed and completely floating; two extreme exchange rate system at present. Almost all country is having managed floating exchange rate system. They have their exchange rates which are floating; however, they are through their different measures the sell and buy the purchase of currency, they are managing the floating exchange rate, and they are allowing the domestic currency to fluctuate within a certain band.

So, managed floating is the order of the day because extreme two cases, they are completely fixed and completely floating is not available at present. So, countries are declaring that they are allowing the domestic currency to fluctuate, to allowing the domestic currency to be market determinant; however, their own central bank managing the floating which is within the certain band. Then question is here, what are the advantages of and disadvantages of fixed and floating exchange rate.

As I mentioned that fixed exchange rate, the reserve bank of India in case of India or the central bank of other country, they maintain the fixed exchange rate. Then you have to buy and sell continuously foreign exchange to maintain the domestic currency at particular exchange rate. They have to have a reserve system, reserve for foreign currency, to buy and sell the foreign currency so as to maintain the exchange rate at a fixed level. For fixed exchange rate, the domestic inflation needs to be controlled

The fixed exchange rate, the domestic interest rate needs to be controlled; therefore fixed exchange rate, the domestic money supply needs to be controlled. For fixed exchange rate, the central bank need to sacrifice their domestic policy for the external policy of having fixed exchange rate. So, domestic growth rate, domestic expansion needs to be sacrificed to have fixed exchange rate. These are the disadvantage of the fixed exchange rate. What are the advantages? There is no exchange rate fluctuation, there is no risk; everything is stable. So, there is a stable foreign exchange market.

But for the stability of foreign exchange market, you have to sacrifice the growth of the own economy; that is the disadvantage of the fixed exchange rate. The question is what is the advantage of floating exchange rate? The floating exchange rate, the exchange rate is a market determined. Domestic money supply, domestic interest rate, domestic growth expansion need not be sacrificed. There is no requirement of having large foreign currency reserve to maintain the fixed floating exchange rate.

So, there is independence on the part of the central bank to independently have monetary policy, monetary expansion, money supply and having own growth, own interest rate for the economy. But what are the disadvantages of floating exchange rate? The domestic exchange may be highly fluctuate, domestic there will be uncertainty in the market, there will be high fluctuation risk in the market, but that risk is comparable. This is comparable, risk is manageable and this manageable risk provides incentive to the central bank to practice an independent monetary policy. So now you have to discuss, you have to decide which policy is good; floating or fixed? In this way, you can answer your own in the question number one.

Question number 2: Discuss the liberalization of Indian Foreign Exchange Market. Here the foreign exchange market over the period, since 90 to 92 onwards has been liberalised; how the current account convertibility we have accepted, how we have had adopted the report of the Sodhani Committee, the Tarapore Committee, how we have allow the foreign FI inflow in the foreign exchange market, how we have developed the foreign current account convertibility, how we have slow progressively migrated to a significant liberalization of capital account. You have to discuss all these things in the liberalization of foreign exchange market.

Question number 3: Explain various features of futures market and bring out its distinctive advantage over the forward market. As I mentioned earlier in our earlier discussion in different sessions, we have futures market, we have forward market. The forward market is highly unorganised. It is run by the commercial bank; there is no secondary market for the forward market. The rates are different for different players in the market, the rates are not comparables, the forward market is not available beyond three month.

The forward market that credit risk is not addressed by the forward market players. The forward market though it is unorganised and there is no secondary market, there is no mark to mark to market; forward markets also goods for the country. Because small value transaction in forward market is goods; however, forward markets have a own disadvantages are there. But in case of futures market, futures market is run by a exchange traded fund. There is an exchange which provide the futures market. Exchange bears the credit risk. There will be buyers and sellers; they do not know each other.

Then there is a secondary market, continues trading are there in futures market. Futures market is standardized in the form of price, in the form of volume, in the form of size. So, futures market is standardized market and forward market is unstandardized market;

however, futures market the minimum volume, the minimum contract you have to purchase. Futures markets are run by the contract; minimum contract size will be 1000 dollar. In case of India those who have less than that, they cannot enter to futures market.

Futures markets are not available because in between time period, there is a maturity period of future market. Suppose in between time period you want a hedging, then you have to go to the forward market. So, all these things you can discuss in future and forward markets. All these features are discussed in futures market and forward market. The futures market is standardized; forward market is unstandardized. Futures market is available for high volume transaction; forward market is available for small value transaction. Futures market, the price are standardized, the contract rate is standard rate; in forward market, nothing is standardized. Futures market there is no credit risk; forward market credit risk is very high. Futures market credit risk is bear by the exchange; forward market credit risk is bear by nobody. All these things you can discuss in the question number 3.

Question number 4: Explain with example what are the main differences between operating and transaction exposure? As we discussed earlier sessions, operating exposures is nothing but economic exposure and transaction exposures are day-to-day exposure of day-to-day asset, liability, transaction of foreign currency, that fluctuates in the exchange rate, affect the day-to-day transaction; that is transaction exposure and operating exposure over the period, the fluctuation of exchange rate leads to the change in the valuation of the company, change in the valuation of asset liability of the company.

It may increase the import cost, it may decrease the export earnings. All these things, they are part of the operating exposure, economic exposure. Economic and operating exposure long term in nature, but transaction exposure is short term in nature. Economic exposure very difficult to absorb; transaction exposure can be absorbed through the buyers through what is called contract. Contract negotiation in the purchase of financial contract and by a purchase of forward contract, future contract from the market, all these things you can discuss in question number 4.

Question number 5: While defining international financial integration, describe various indicators of financial integration. The financial integration means what? When all segments of financial market are integrated, we have financial integration. International financial integration means the money market, the forex market; the equity market should be integrated. There will be law of one price will prevail in the market and the various indicators of financial market integrations or the arbitrage opportunity in the money market should not be there. Our international trade in the form of foreign currency should be huge; should be more than 35-40 percent.

The International stock market will be, domestic stock market will be influenced by the foreign stock market. Our FI inflow should be continuous in nature. Our foreign exchange liberalization should be significant. All these are the indicators of financial market integration. All these things you have discussed in our earlier classes, you can go through the class and find what are the other indicators available for financial market integration side? With this let me complete the test number 3.