PRACTICE QUESTIONS

CURRENCY DERIVATIVES A BEGINNER'S MODULE

1. There are many ____________ in the financial and business environment today.

[2 Marks]

a) **risks**
b) mergers and acquisitions
c) legal issues
d) consolidations

Correct Answer: **risks**

2. Exchange rate fluctuations are a risk to **[2 Marks]**

a) Issuers
b) Merchant Bankers
c) Those with an obligation to pay in a foreign currency
d) None of the above

Correct Answer: **Those with an obligation to pay in a foreign currency**

3. Exchange rate risks can be mitigated by using **[2 Marks]**

a) Index Futures
b) Currency derivatives
c) Stock Futures
d) Interest Rate derivatives

Correct Answer: **Currency derivatives**

4. Financial Institutions assist businesses in managing their financial risks by creating various instruments. **[1 Mark]**

a) hedging
b) speculative
c) exotic
d) financial

Correct Answer: **hedging**

5. Businesses use derivatives primarily for **[1 Mark]**

a) hedging
b) forecasting
c) estimation
d) understanding stock price behaviour

Correct Answer: hedging

6. use currency derivatives to hedge against exchange rate risks. **[1 Mark]**

a) Exporters
b) Importers
c) Banks
d) All of the above

Correct Answer: All of the above

7. USD-GBP futures is a contract on the ___________________ **[3 Marks]**

a) US Dollar and Indian Rupees
b) US Dollar and Japanese Yen
c) US Dollar and Euro
d) US Dollar and British Pound

Correct Answer: US Dollar and British Pound

8. A currency pair has a _________ and a _____ ____________ **[2 Marks]**

a) base currency, price currency
b) base currency, terms currency
c) price currency, base currency
d) price currency, terms currency

Correct Answer: base currency, terms currency

9. A USD-INR rate of R. 82.2525 implies that Rs.82.2525 must be paid to obtain US Dollar (s) **[2 Marks]**

a) one
b) two
c) three
d) four

Correct Answer: one

10. A change of USD-INR rate from Rs. 82.50 to Rs. 81.50 implies that the buyer of USD will have to pay INR now to buy USD. **[1 Mark]**

a) less
b) more

Correct Answer: **less**

11. In order to maintain the government participates in the open currency market.

[1 Mark]

a) a floating exchange rate
b) a fixed exchange rate

Correct Answer: **a fixed exchange rate**

12. Tick size refers to the ___ at which traders can enter bids and offers. **[1 Mark]**

a) base price differential
b) actual price differential
c) maximum price differential
d) minimum price differential

Correct Answer: **minimum price differential**

13. A market participant may enter into a spot transaction and exchange the currency

[3 Marks]

a) after 1 month
b) after 2 months
c) at any future date
d) at current time

Correct Answer: **at current time**

14. Futures contracts can be traded on a_____________platform. **[2 Marks]**

a) FII
b) banking
c) stock exchange
d) OTC

Correct Answer: **stock exchange**

15. Futures contracts do not have any expiry date. **[2 Marks]**

a) False
b) True

Correct Answer: **False**

16. One year interest rates in US and India are say 7% and 10% respectively and the spot rate of USD in India is Rs. 82 One year forward exchange rate should be Rs. - ______________________________ **[1 Mark]**

a) 85.23
b) 84.50
c) 87.45
d) 87.86
Correct Answer: **84.50**

17. One year interest rates in US and India are say 7% and 11% respectively and the spot rate of USD in India is Rs. 83. One year forward exchange rate should be Rs. ______________ **[1 Mark]**

a) 86.39
b) 89.90
c) 90.65
d) 90.55
Correct Answer: **86.39**

18. OTC contracts are **[1 Mark]**

a) illegal
b) standardized contracts
c) non-standardized contracts
d) more expensive than futures contracts
Correct Answer: **non-standardized contracts**

19. Purchasing a futures contract means the buyer must hold on to the contract till expiry and cannot close out the contract with an offsetting transaction prior to expiry.

[1 Mark]

a) False
b) True
Correct Answer: **False**

20. An oil-importing firm - ABC Co. is expected to make future payments of USD 100000 after 3 months (in USD) for payment against oil imports. Suppose the current 3-month futures rate is Rs.83 . ABC Co. can go ____________in the futures contract to hedge itself. **[2 Marks]**

a) Short
b) Long
Correct Answer: **Long**

21. An exporter - ABC Co. is expected to receive an amount of USD 100000 after 3 months (in USD). Suppose the current 3-month futures rate is Rs. 85 . ABC Co. can go_____________in the futures contract to hedge itself. **[2 Marks]**

a) Short
b) Long
Correct Answer: Short

22. An oil-importing firm - ABC Co. is expected to make future payments of USD 100000 after 3 months (in USD) for payment against oil imports. Suppose the current 3-month futures rate is Rs. 83. ABC Co. goes short in the futures contract to hedge itself. Its hedging strategy will protect itself against adverse exchange rate movements.

[3 Marks]

a) False
b) True
Correct Answer: False

23. An oil-importing firm - ABC Co. - is expected to make future payments of USD 100000 after 3 months (in USD) for payment against oil imports. Suppose the current 3-month futures rate is Rs. 87. ABC Co. goes long in the futures contract to hedge itself. Its hedging strategy will protect itself against adverse exchange rate movements.

[3 Marks]

a) False
b) True
Correct Answer: True

24. By hedging, the losses made in the underlying market is offset by the profits made in the futures market. **[3 Marks]**

a) False
b) True
Correct Answer: True

25. A speculator buys 107 USD-INR contracts@ Rs. 83.00 per contract and sells them @ Rs. 84.00 per contract. Assuming 1 contract = 1000 USD, the total profit made by the speculator is Rs. **[2 Marks]**

a) 107000
b) 109000
c) 1070
d) 10700
Correct Answer: 107000