The Management University of Africa

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DIPLOMA UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DIPLOMA IN INTERNATIONAL RELATIONS AND DIPLOMACY

DIR 107: INTERNATIONAL FINANCE

DATE: 29TH MARCH 2022

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. DO NOT write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **FOUR** questions.
6. Question **ONE** carries **30 MARKS** and the rest carry **10 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

THE IMF AND THE NEW FINANCIAL ARCHITECTURE

If the current global monetary system is characterized by instabilities, what is the role of institutions in resolving financial crises associated with such instabilities? It is well known that the International Monetary Fund (IMF) is responsible for assisting member countries in the resolution of their crises. Most observers agree that the Asian crisis was a crucial test for the IMF for two reasons. First, the IMF has been criticized for not having anticipated and prevented the crisis. In the years prior to the crisis, it was common for economists to praise the phenomenal economic growth of the Asian tigers with their export-oriented strategies. Stable currencies and the abundant flow of foreign capital almost assured continued growth. As capital flows began to slow down, the currencies became over-valued, the stock markets did not start to decline, and neither the IMF nor other groups were able to foresee the magnitude of the forthcoming crisis. Certainly there were warning signs of overheating economies, stock market and real estate bubbles, excessive short-term borrowing from foreign banks to finance long-term domestic investments, and other indicators, but the IMF did not translate these early warnings into appropriate policies to prevent the Asian crisis. Second, the IMF has been criticized for the way it handled the Asian crisis. The main elements of the response were tight fiscal and monetary policies, backed by "bailout funds" mobilized by the IMF. Such policies were aimed at achieving goals such as limiting the magnitude of currency depreciation, rebuilding foreign currency reserves, preventing an outright default on foreign obligations, and restoring economic confidence. Beyond these macroeconomic policies, the IMF also responded to the Asian crisis by enforcing capital adequacy standards that led to bank closures in certain countries. For example, 58 out of 91 finance companies in Thailand were suspended, and 56 were eventually liquidated. In Indonesia, 16 commercial banks were physically closed, while in Korea, 14 out of 30 merchant banks were suspended. These steps were taken to limit losses that had been accumulated by these institutions and to restore confidence in the banking system. Furthermore, additional initiatives were introduced to restructure and reform the banking sector, to curb monopolies and promote free competitive market structures, to restore price stability, and to avoid recession. The IMF approach has been both defended and criticized extensively. Those who defend it claim that the Asian economies have recovered rather rapidly. They also defend the IMF against complaints that it did not anticipate the crisis by arguing that economists have difficulty predicting turning points in any economy. They also note that the governments of some of the countries involved appear to have withheld information from the IMF. The IMF was unaware, for example, of costly attempts to defend exchange rates and by the time the IMF was asked for assistance, these economies had reached a critical stage of vulnerability. The degree of currency risk hedging was also hidden from the IMF. Such strategies to offset risk, including volatile derivatives and other instruments, are very difficult to monitor because they are off-balance-sheet transactions. Prior to the crisis, there was little hedging of currency risk by Asian financial institutions. Thus the Asian financial institutions were unprotected from currency risk. The collapse of these unhedged institutions during the crisis worsened the financial contagion. Also, the IMF's recommendation to tighten fiscal policy was based on fears that economies were "overheated". As such fears became unwarranted; the IMF abandoned those recommendations in favor of a looser fiscal stance. Those who criticize the policies offer different arguments. Some claim that the IMF prematurely rushed to extend funds to crisis countries and that such action worsened the situation by sending a signal that the IMF would always come to the rescue. Critics argue further that the IMF released funds with few guarantees that countries would comply with suggested reforms, and its enforcement of such agreements was weak. Others complain that rather than maintaining its traditional role of lending, the IMF became involved in mandating structural reforms for borrowing countries. In addition to criticizing the IMF for prescribing ineffective and perhaps inappropriate reforms, some in the international community have questioned the IMF's monetary policy recommendations to Asian economies.

Required:

a) In reference to the case study, discuss five (5) role of IMF **(10 Marks)**

b) Explain the main characteristics of the modern world financial market

(8 Marks)

c) Define financial crisis

(2 Marks)

d) Discuss the major types of financial crisis

(10 Marks)

QUESTION TWO

Using examples, briefly explain five importance/ roles of international finance

(10 Marks)

QUESTION THREE

a) Discuss the four major factors driving financial globalization

(4 Marks)

b) Differentiate between current account and current capital account

(6 Marks)

QUESTION FOUR

a) Discuss the implications of Interest rate parity

(5 Marks)

b) Write short notes on
   i. Euro notes
   ii. Eurocurrency
   iii. Eurobond

(5 Marks)

QUESTION FIVE

a) Explain the advantages of American depository receipts

(6 Marks)

b) Giving examples explain the Currency risk mitigation strategies

(4 Marks)

QUESTION SIX

a) Analyze three types of long-term financing

(6 Marks)

b) Illustrate ways of mitigating political risk

(4 marks)