

**FINAL EXAMINATION****BACHELOR OF BUSINESS ADMINISTRATION (HONOURS)****COURSE : INTERNATIONAL FINANCE****COURSE CODE : FIN4253****DURATION : 3 HOURS****INSTRUCTIONS TO CANDIDATES:**

1. This question paper consists of **TWO (2)** parts : PART A (3 questions)
: PART B (3 questions)
2. Answer **ALL** questions from PART A and PART B.
3. Please check to make sure that this examination pack consists of:
 - i. The Question Paper
 - ii. An Answer Booklet
4. Do not bring any material into the examination hall. The use of a calculator is allowed.
5. Please write your answer using permanent ink.

MYKAD/ PASSPORT NO : _____

ID. NO. : _____

LECTURER : _____

SECTION : _____

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE TOLD TO DO SO

This question paper consists of 6 printed pages including the front page.

PART A

QUESTION 1

- A. Explain how exchange rates affect the cost of imports and exports. Use the concepts of appreciation and depreciation to illustrate the impact on trade. (5 marks)

- B. A Malaysian aerospace technology company is planning to upgrade its drone-navigation system for an upcoming government project. To complete the upgrade, the company needs to import advanced navigation sensors and is evaluating two potential international suppliers. The first supplier is from South Korea, offering the sensors at a fixed price of ₩310,000,000, with the current exchange rate standing at RM0.0035 per won. The second supplier is based in the United Kingdom, quoting a price of £180,000 at today's exchange rate of RM5.60 per pound.

Currency analysts have forecast that over the next six months, the South Korean won will appreciate by 3% and the British pound by 4% against the ringgit.

Required:

Find the ringgit cost today and after appreciates for each country.

(5 marks)

(Total: 10 marks)

QUESTION 2

- A. Distinguish between liquid assets and illiquid assets. (5 marks)

- B. In 2024, the following countries experience different inflation rates: United States (US): 4%, United Kingdom (UK): 7%, Japan: 1% and Canada: 5%.

United States is the domestic country, and the initial exchange rates at the start of 2024 are 1 British Pound (GBP) = 1.20 USD, 1 Japanese Yen (JPY) = 0.0070 USD and 1 Canadian Dollar (CAD) = 0.75 USD

Required:

Estimate the exchange rate end of year and percentage changes for USD/GBP and USD/JPY according to relative Purchasing Power Parity (PPP).

(5 marks)

(Total: 10 marks)

QUESTION 3

- A. Discuss **TWO (2)** factors that shift the aggregate demand (DD curve) to the right.
(5 marks)
- B. Explain how a currency devaluation affects aggregate demand and the central bank's balance sheet in a fixed exchange rate system.
(5 marks)

(Total: 10 marks)

(TOTAL: 30 MARKS)

PART B

QUESTION 1

Between 2023 and 2025, the United States and Mexico experienced noticeable differences in inflation and monetary policy. In 2023, the USD/MXN exchange rate stood at 18 pesos per U.S. dollar. By 2024, inflation in the U.S. increased modestly to 3%, while Mexico experienced significantly higher inflation of 8%. This inflation gap was largely attributed to Mexico's decision to expand its money supply to finance public expenditure programs. According to the monetary approach to exchange rates, this rise in Mexico's money supply contributed to higher domestic prices, lowering the real value of the peso and putting downward pressure on its exchange rate.

At the same time, transportation costs for agricultural goods between the U.S. and Mexico rose due to new inspection procedures at border checkpoints. As a result, the prices of vegetables exported from Mexico increased, creating deviations from Purchasing Power Parity (PPP) in the short run. Although PPP suggests that exchange rates should move in line with relative changes in price levels, real-world frictions such as trade barriers, transport costs, and the existence of non-tradable services meant that PPP adjustments did not occur immediately. Analysts still expected the exchange rate to move toward its long-run PPP level but acknowledged that short-run distortions were likely to persist.

Required:

- a. Using relative Purchasing Power Parity (PPP), calculate the expected USD/MXN exchange rate and percentage change in inflation rate. Indicate either the U.S. dollar expected to appreciate or depreciate.
(5 marks)
- b. If Mexico increases its money supply by 12% while real output grows by only 2%, determine the approximate change in price level using the monetary approach.
(3 marks)
- c. Analyse how Mexico's expansion of money supply contributed to the depreciation of the peso in the long run.
(6 marks)
- d. Identify **TWO (2)** reasons why PPP did not hold in the short run between the U.S. and Mexico.
(6 marks)

(Total: 20 marks)

QUESTION 2

During the height of the COVID-19 pandemic, Malaysia faced one of its most severe short-run economic contractions. As the Movement Control Order (MCO) was implemented, household consumption fell sharply due to reduced mobility, job losses, and rising uncertainty. Businesses postponed investment decisions, and export demand weakened as global supply chains were disrupted. These shocks reduced aggregate demand (AD), pushing the economy below its potential output. The Malaysian ringgit (MYR) depreciated in early 2020 as investors moved toward safer assets such as the US dollar. This depreciation made Malaysian goods cheaper internationally, providing some support to the current account.

To counter the collapse in demand, the government introduced large fiscal packages such as PRIHATIN and PEMERKASA+, which included wage subsidies, cash assistance, and increased public sector spending. These measures boosted consumption and investment, shifting the DD curve to the right. At the same time, Bank Negara Malaysia (BNM) reduced the Overnight Policy Rate multiple times, lowering domestic interest rates. Lower interest rates prompted a short-run depreciation of the ringgit, shifting the AA curve upward as capital inflows fell. Together, fiscal and monetary expansions moved the economy toward a new short-run equilibrium where the goods market and asset markets were again aligned. By late 2021, as restrictions eased and income recovered, demand for money rose, contributing to a gradual appreciation of the ringgit, reflecting the monetary dynamics described by the AA schedule.

Required:

- a. Using the DD schedule framework, identify how Malaysia's fiscal stimulus packages during 2020 helped shift the DD curve to the right.
(7 marks)
- b. Analyse the impact of Bank Negara Malaysia's monetary policy on the AA curve and how depreciation of the ringgit contributes to an increase in aggregate demand.
(6 marks)
- c. Classify how the interaction between fiscal and monetary policy helped Malaysia restore short-run equilibrium output. Refer to the intersection of the DD and AA curves.
(7 marks)

(Total: 20 marks)

QUESTION 3

Hong Kong operates one of the world's most enduring fixed exchange rate systems. Since 1983, the Hong Kong Monetary Authority (HKMA) has pegged the Hong Kong dollar (HKD) to the US dollar at around HKD 7.8 per USD under the Linked Exchange Rate System (LERS). This fixed exchange rate is maintained through active foreign exchange intervention, where HKMA buys or sells US dollars to stabilize the currency. Unlike floating currencies, the HKD must remain within a predetermined band, so HKMA constantly monitors market conditions and adjusts its balance sheet to maintain credibility.

During periods of financial stress such as the 1997 Asian Financial Crisis and the 2019–2020 political and economic uncertainties speculative pressure caused large capital movements. When the HKD came under depreciation pressure, HKMA sold foreign reserves and bought HKD to prevent the exchange rate from weakening. This intervention reduced Hong Kong's money supply, increased interest rates, and helped restore stability. Conversely, during periods of capital inflows such as during the US Federal Reserve's low-interest-rate cycle in 2020–2021 HKMA bought US dollars and sold HKD to prevent appreciation. This expanded the domestic money supply and lowered interest rates, maintaining the peg while supporting liquidity in the banking system.

Because Hong Kong maintains a fixed exchange rate, monetary policy independence is extremely limited. The HKMA cannot freely adjust interest rates for domestic economic conditions, as it must follow US interest rate movements to preserve the peg. As a result, fiscal policy has become Hong Kong's main short-run stabilization tool. For example, during the pandemic, Hong Kong's government implemented large fiscal stimulus packages to support demand, knowing that monetary policy could not be used. These dynamics demonstrate the macroeconomic implications of fixed exchange rates, balance sheet adjustments, foreign reserve management, and the constraints on monetary policy under the LERS framework.

Required:

- a. Using the fixed exchange rate framework, evaluate how the Hong Kong Monetary Authority (HKMA) intervenes in the foreign exchange market to maintain the USD–HKD peg. Illustrate the effects on its balance sheet and the domestic money supply.
(10 marks)
- b. Identify why Hong Kong has limited monetary policy independence under the Linked Exchange Rate System and how does this relate to the AA curve and interest parity condition.
(10 marks)
- c. Evaluate the effectiveness of fiscal policy in Hong Kong under a fixed exchange rate system. Use examples from the pandemic period to support your analysis.
(10 marks)

(Total: 30 marks)

(TOTAL: 70 MARKS)

(TOTAL: 100 MARKS)