Chapter 02
International Financial Markets: Structure and Innovation

Multiple Choice Questions

1. MNCs participate in foreign exchange markets since they:
A. seek to limit their exposure to the economic cycles in their home countries.
B. cannot borrow domestically and must seek foreign investments.
C. cannot find suitable domestic investment opportunities for excess funds.
D. they have transactions with foreign buyers and sellers and invest and borrow internationally.

2. In ________________, parties agree to rates at which currencies will be exchanged immediately.
A. spot markets
B. forward markets
C. equity markets
D. currency markets

3. Mutual funds are involved in foreign exchange markets because:
A. they need to convert funds into other currencies so that they can buy investments denominated in those other currencies.
B. foreign currencies are used by mutual funds to hedge or protect their other investments against losses.
C. mutual fund regulations require that mutual funds diversify their investments by owning a variety of currencies.
D. they are the largest interbanks and seek to speculate in buying and selling foreign currencies.

4. ____________________ seek to exploit discrepancies in currency values in different markets by buying currencies at one value in one market and then selling them quickly at a higher value in another market.
A. Interbanks
B. MNCs
C. Governments
D. Hedge funds

5. Governments are involved in the foreign currency markets for two primary reasons:
A. because foreign currency can be used as a store of value and to manipulate the value of their own currency.
B. to protect against inflation and to control domestic interest rates.
C. so that they can take advantage of discrepancies in currency values in different markets and to protect the value of their currency.
D. to monitor the value of their currency and to control their balance of trade.

6. Foreign exchange transactions can be classified into three categories:
A. spot transactions, forward transactions, and forward exchange swap agreements.
B. foreign currency transactions, domestic currency transactions, and regional currency transactions.
C. hedge transactions, exchange transactions and investment transactions.
D. Interbank transactions, MNC transactions, and miscellaneous transactions.

7. Foreign exchange transactions are easy and inexpensive and even large transactions can be made without affecting market prices because:
A. of the government regulations that apply to foreign exchange markets.
B. speculators keep the foreign exchange markets very active.
C. the foreign exchange markets are so large.
D. the foreign exchange markets are so old and well-established.

8. Most foreign exchange transactions involve the sale or purchase of:
A. Euros (EUR).
B. British pounds (GBP).
C. Japanese yen (YPY).
D. U. S. dollars (USD).

9. The vehicle or intermediate currency in which most international exchange transactions are conducted is the:
A. USD.
B. EUR.
C. JYP.
D. GBP.

10. Most foreign exchange transactions are conducted:
A. through established stock markets such as NASDAQ.
B. over electronic networks like those maintained by Reuters or Bloomberg.
C. as a result of face-to-face negotiations.
D. in established exchange markets in the Middle East.

11. Foreign exchange markets work most efficiently when:
A. they are closely regulated so that speculation is limited.
B. MNCs have difficulty borrowing money domestically.
C. there are market makers who are willing to buy or sell currencies and, therefore, provide liquidity in the market.
D. when the volume of international transactions is high and the demand for foreign currency is increasing.

12. In foreign exchange markets, _________________ is the price that market makers are willing to buy and _____________________ is the price at which market makers are willing to sell a foreign currency.
A. ask; bid
B. bid; ask
C. offer; acceptance
D. acceptance; offer

13. A market maker who is long in EUR will ___________________ if the value of EUR increase.
A. not be affected
B. lose
C. profit or lose depending on the value of other currencies
D. profit

14. In foreign exchange markets, _________________ do not assume responsibilities for making a market in a foreign currency and buy and sell a foreign currency only when they think it will be profitable for them.
A. market makers
B. dealers
C. brokers
D. regulators

15. ________________ in foreign exchange markets do not carry inventories of foreign currencies, but, instead, match buyers and sellers of foreign currencies and earn commissions when they arrange a transaction.
A. Brokers
B. Dealers
C. Market makers
D. Investors

16. The most commonly used settlement system for foreign currency transactions is operated by:
A. the National Association of Securities Dealers Automated Quotations (NASDAQ).
B. the New York Stock Exchange (NYSE).
C. the Society for Worldwide Interbank Financial Communications (SWIFT).
D. the British government.

17. Fedwire is a settlement system for foreign currency exchange transactions in the United States operated by the:
A. U.S. Treasury Department.
B. Federal Reserve Banks in the United States.
C. New York Stock Exchange.
D. National Association of Securities Dealers Automated Quotations (NASDAQ).

18. The way that Fedwire works is that:
A. the required reserves of banks held in the Federal Reserve System are debited and credited each day to reflect those banks' foreign exchange transactions.
B. at the end of each day, Fedwire sends a bill or a payment to each bank that represents that bank's net foreign exchange activity for that day.
C. Fedwire is simply an electronic messaging system that allows banks to communicate with each other concerning foreign exchange transactions.
D. Fedwire facilitates government approval of all foreign exchange transactions conducted by U.S. entities.

19. The Clearing House Interbank Payment System (CHIPS) is operated by major banks in New York and facilitates foreign exchange transactions by:
A. requiring participating banks to maintain deposits in certain New York banks which process foreign exchange transactions through the deposit accounts maintained in the New York banks.
B. coordinating with and clearing foreign exchange transactions through SWIFT.
C. acting as market makers, dealers and brokers in foreign exchange transactions.
D. aggregating the transactions of banks and processing the net amount of transactions of individual banks through the Fedwire system.

20. A direct quote given in the United States as "USD 0.0109053 per JPY" means:
A. 1 JPY is worth .0109053 USD.
B. 1 USD is worth .0109053 JPY.
C. the value of JPY relative to USD is increasing.
D. the value of USD relative to JPY is increasing.

21. An indirect quote expresses the value of the domestic currency in terms of the:
A. the average exchange rate between two currencies over the last week.
B. domestic currency.
C. foreign currency.
D. a market basket of foreign currencies.

22. Converting an indirect quote to a direct quote require:
A. taking the inverse (1/quote) of the indirect quote.
B. contacting a broker in foreign exchange transactions.
C. taking into consideration the trend (positive or negative) of the value of the two currencies.
D. changing the ratios of the two currencies.

23. Every currency quote contains two components:
A. the price and the time during which that price is valid.
B. the price and the maximum value that will be available at that price.
C. the currency pair and the time during which the quoted price will be valid.
D. the currency pair and the numerical quote.

24. In a currency quote, the first three letters identify the ___________________ and the last three letters identify the ______________________.
A. domestic currency; term currency
B. base currency; term currency
C. foreign currency; base currency
D. domestic currency; foreign currency

25. The currency quote "JPYUSD = 0.0109053" means:
A. 0.0109053 USD can be used to buy 1 JPY.
B. 0.0109053 JPY can be used to buy 1 USD.
C. 0.0109053 JPY can be used to buy 1 of any currency traded in the foreign exchange market where the quote is given.
D. 0.0109053 USD can be used to buy 1 of any currency traded in the foreign exchange market where the quote is given.

26. The bid-ask spread is computed using the following formula:
A. (Ask price - Bid price)/Bid price.
B. (Bid price - Ask price)/Bid price.
C. (Bid price - Ask price)/Ask price.
D. (Ask price - Bid price)/Ask price.

27. Foreign currency quotes typically use ______________ decimal places, and for major currencies, the bid and ask quotes __________________.
A. four; will differ for all four decimal places
B. four; only the fourth decimal place will differ
C. two; only the second decimal place will differ
D. two; all decimal places will differ

28. If a currency quote is given in EUR to USD and USD to JPY, and those quotes can be used to determine EUR to JPY, the quotes are known as:
A. parallel rates.
B. complex rates.
C. cumulative rates.
D. cross rates.

29. The volume of transactions in foreign exchange markets is _________________ due in part to _____________________________
A. increasing gradually; reduced risks in the foreign exchange markets.
B. holding steady; new regulations that make the transactions more difficult.
C. decreasing; the development of new financing instruments that do not depend on foreign exchange.
D. increasing rapidly; the participation of non-bank institutions in the foreign exchange markets.

30. When lending or borrowing occurs in a currency that is not the domestic currency of the country where the transaction takes place, the transaction is said to have taken place in the:
A. eurocurrency market.
B. foreign market.
C. domestic market.
D. foreign exchange market.

31. Foreign currency transactions that are in the USD are called:
A. foreign currency transactions.
B. foreign exchange transactions.
C. Eurocurrency transactions.
D. Eurodollar transactions.

32. Banks that are involved in borrowing and lending transactions in currencies other than their domestic currencies are called:
A. Eurobanks.
B. foreign banks.
C. market makers.
D. foreign exchange dealers.

33. The leading indicator for the Eurocurrency markets is the London Inter Bank Offered Rate (LIBOR), which:
A. is the prime rate that is then charged in the European Community.
B. is the average rate charged on loans by the central banks in all European nations.
C. reflects the rate at which Eurobanks are willing to loan money to other institutions.
D. indicate the liquidity that is currently found in the foreign exchange market.

34. The London Inter Bank Offered Rate (LIBOR):
A. is the interest rate set by the central bank in Great Britain.
B. reflects a set of interest rates based on a variety of currencies and maturities at which Eurobanks are willing to lend to each other.
C. the interest rate set by the European Investment Bank.
D. reflects an average of the prime interests rates prevailing in a variety of developed nations.

35. Eurocurrency markets developed in the 1950's primarily because:
A. the US limited foreign investments that could be made by US-based corporations.
B. banks in Europe joined together to compete with US banks for foreign deposits.
C. the US encouraged MNCs to invest in foreign assets.
D. regulations in the US limited interest rates that US banks could pay on deposits.

36. The principal feature of Euro markets is:
A. lack of regulation.
B. high interest rates that are available.
C. lower risks than are present in other markets.
D. lower rates on borrowed funds.

37. Most transactions in Eurocurrency markets are:
A. transactions involving governmental entities.
B. secured transactions between sovereign wealth funds and MNCs.
C. secured transactions between Interbanks and MNCs.
D. unsecured transactions between private parties.

38. The two key financial instruments used in the Eurocurrency markets are:
A. foreign exchange swap agreements and Euro commercial paper.
B. Euro commercial paper and Euro certificate of deposit.
C. Euro certificate of deposit and Euro negotiable instruments.
D. Euro negotiable instruments and foreign exchange swap agreements.

39. ___________________________ are agreements to pay a specific sum of money at a specified interest rate in a specified period of time, often six months.
A. Euro certificates of deposit
B. Euro promissory notes
C. Euro commercial paper
D. Euro loan agreements

40. ___________________________ are markets where medium term and long term international debt instruments are issued and traded.
A. International debt markets
B. Global exchange markets
C. MNC debt markets
D. Foreign debt markets

41. Floating rate notes are financial instruments with interest rates linked to _____________ that are traded on the _________________________.
A. US Treasury bill rates; foreign exchange markets
B. LIBOR; Eurocredit market
C. LIBOR; foreign debt markets
D. US Treasury bill rates; Eurocurrency markets

42. Eurobonds are bonds that are:
A. the same as foreign bonds.
B. issued in European countries.
C. issued in a country but are denominated in a currency other than the currency of the country where they are issued.
D. issued in a European currency.

43. Two characteristics that distinguish Eurobonds from bonds typically issued in the United States are:
A. interest on Eurobonds is paid annually and Eurobonds are bearer bonds.
B. interest on Eurobonds is paid when the principal of the bonds are paid and Eurobonds are bearer bonds.
C. interest on Eurobonds is paid in Euros and Eurobonds are payable in demand.
D. interest on Eurobonds is paid in Euros and Eurobonds are bearer bonds.

44. ____________________ are Eurobonds that are issued simultaneously in multiple regions or countries.
A. Global bonds
B. Foreign bonds
C. Eurocurrencies
D. Samurai bonds

45. Collateralized debt obligations are:
A. essentially the same thing as Eurobonds.
B. bonds issued by MNCs payable in the domestic currency of the MNC.
C. equity instruments issued by MNCs that are convertible into Eurobonds.
D. backed by risky assets and are sold in classes having different levels of risk.

Essay Questions

46. What role do interbanks play in the foreign exchange markets?

47. What is the "bid-ask spread" and how does it affect the costs that MNCs incur in the foreign exchange market?

48. Why does London play such a prominent role in the foreign exchange market?

49. Why is there a difference between LIBOR rates and U.S. Treasury rates?

50. What is a foreign bond and what relevance does it have to international finance?

Chapter 02 International Financial Markets: Structure and Innovation Answer Key

Multiple Choice Questions

1. MNCs participate in foreign exchange markets since they:
A. seek to limit their exposure to the economic cycles in their home countries.
B. cannot borrow domestically and must seek foreign investments.
C. cannot find suitable domestic investment opportunities for excess funds.
D. they have transactions with foreign buyers and sellers and invest and borrow internationally.

Difficulty Level: Easy
Section: Introduction

2. In _________________, parties agree to rates at which currencies will be exchanged immediately.
A. spot markets
B. forward markets
C. equity markets
D. currency markets

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets

3. Mutual funds are involved in foreign exchange markets because:
A. they need to convert funds into other currencies so that they can buy investments denominated in those other currencies.
B. foreign currencies are used by mutual funds to hedge or protect their other investments against losses.
C. mutual fund regulations require that mutual funds diversify their investments by owning a variety of currencies.
D. they are the largest interbanks and seek to speculate in buying and selling foreign currencies.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Other Participants in Foreign Exchange Markets; Other Financial Institutions

4. ____________________ seek to exploit discrepancies in currency values in different markets by buying currencies at one value in one market and then selling them quickly at a higher value in another market.
A. Interbanks
B. MNCs
C. Governments
D. Hedge funds

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Other Participants in Foreign Exchange Markets; Other Financial Institutions

5. Governments are involved in the foreign currency markets for two primary reasons:
A. because foreign currency can be used as a store of value and to manipulate the value of their own currency.
B. to protect against inflation and to control domestic interest rates.
C. so that they can take advantage of discrepancies in currency values in different markets and to protect the value of their currency.
D. to monitor the value of their currency and to control their balance of trade.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Other Participants in Foreign Exchange Markets; Governments

6. Foreign exchange transactions can be classified into three categories:
A. spot transactions, forward transactions, and forward exchange swap agreements.
B. foreign currency transactions, domestic currency transactions, and regional currency transactions.
C. hedge transactions, exchange transactions and investment transactions.
D. Interbank transactions, MNC transactions, and miscellaneous transactions.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Market Characteristics: Size and Currencies; Market Size

7. Foreign exchange transactions are easy and inexpensive and even large transactions can be made without affecting market prices because:
A. of the government regulations that apply to foreign exchange markets.
B. speculators keep the foreign exchange markets very active.
C. the foreign exchange markets are so large.
D. the foreign exchange markets are so old and well-established.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Market Characteristics: Size and Currencies; Market Size

8. Most foreign exchange transactions involve the sale or purchase of:
A. Euros (EUR).
B. British pounds (GBP).
C. Japanese yen (YPY).
D. U. S. dollars (USD).

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Market Characteristics: Size and Currencies; Currencies Traded

9. The vehicle or intermediate currency in which most international exchange transactions are conducted is the:
A. USD.
B. EUR.
C. JYP.
D. GBP.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Market Characteristics: Size and Currencies; Currencies Traded

10. Most foreign exchange transactions are conducted:
A. through established stock markets such as NASDAQ.
B. over electronic networks like those maintained by Reuters or Bloomberg.
C. as a result of face-to-face negotiations.
D. in established exchange markets in the Middle East.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Market; Market Structure

11. Foreign exchange markets work most efficiently when:
A. they are closely regulated so that speculation is limited.
B. MNCs have difficulty borrowing money domestically.
C. there are market makers who are willing to buy or sell currencies and, therefore, provide liquidity in the market.
D. when the volume of international transactions is high and the demand for foreign currency is increasing.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Market; Market Structure; Marker Makers

12. In foreign exchange markets, ________________ is the price that market makers are willing to buy and ____________________ is the price at which market makers are willing to sell a foreign currency.
A. ask; bid
B. bid; ask
C. offer; acceptance
D. acceptance; offer

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Market; Market Structure; Marker Makers

13. A market maker who is long in EUR will __________________ if the value of EUR increase.
A. not be affected
B. lose
C. profit or lose depending on the value of other currencies
D. profit

Difficulty Level: Difficult
Section: Section 2.1, Foreign Exchange Market; Market Structure; Marker Makers

14. In foreign exchange markets, _________________ do not assume responsibilities for making a market in a foreign currency and buy and sell a foreign currency only when they think it will be profitable for them.
A. market makers
B. dealers
C. brokers
D. regulators

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Market; Market Structure; Dealers and Brokers

15. ________________ in foreign exchange markets do not carry inventories of foreign currencies, but, instead, match buyers and sellers of foreign currencies and earn commissions when they arrange a transaction.
A. Brokers
B. Dealers
C. Market makers
D. Investors

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Market; Market Structure; Dealers and Brokers

16. The most commonly used settlement system for foreign currency transactions is operated by:
A. the National Association of Securities Dealers Automated Quotations (NASDAQ).
B. the New York Stock Exchange (NYSE).
C. the Society for Worldwide Interbank Financial Communications (SWIFT).
D. the British government.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Market; Market Structure Settlement

17. Fedwire is a settlement system for foreign currency exchange transactions in the United States operated by the:
A. U.S. Treasury Department.
B. Federal Reserve Banks in the United States.
C. New York Stock Exchange.
D. National Association of Securities Dealers Automated Quotations (NASDAQ).

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Market; Market Structure; Settlement

18. The way that Fedwire works is that:
A. the required reserves of banks held in the Federal Reserve System are debited and credited each day to reflect those banks' foreign exchange transactions.
B. at the end of each day, Fedwire sends a bill or a payment to each bank that represents that bank's net foreign exchange activity for that day.
C. Fedwire is simply an electronic messaging system that allows banks to communicate with each other concerning foreign exchange transactions.
D. Fedwire facilitates government approval of all foreign exchange transactions conducted by U.S. entities.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Market; Market Structure; Settlement

19. The Clearing House Interbank Payment System (CHIPS) is operated by major banks in New York and facilitates foreign exchange transactions by:
A. requiring participating banks to maintain deposits in certain New York banks which process foreign exchange transactions through the deposit accounts maintained in the New York banks.
B. coordinating with and clearing foreign exchange transactions through SWIFT.
C. acting as market makers, dealers and brokers in foreign exchange transactions.
D. aggregating the transactions of banks and processing the net amount of transactions of individual banks through the Fedwire system.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Market; Market Structure; Settlement

20. A direct quote given in the United States as "USD 0.0109053 per JPY" means:
A. 1 JPY is worth .0109053 USD.
B. 1 USD is worth .0109053 JPY.
C. the value of JPY relative to USD is increasing.
D. the value of USD relative to JPY is increasing.

Difficulty Level: Difficult
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

21. An indirect quote expresses the value of the domestic currency in terms of the:
A. the average exchange rate between two currencies over the last week.
B. domestic currency.
C. foreign currency.
D. a market basket of foreign currencies.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

22. Converting an indirect quote to a direct quote require:
A. taking the inverse (1/quote) of the indirect quote.
B. contacting a broker in foreign exchange transactions.
C. taking into consideration the trend (positive or negative) of the value of the two currencies.
D. changing the ratios of the two currencies.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

23. Every currency quote contains two components:
A. the price and the time during which that price is valid.
B. the price and the maximum value that will be available at that price.
C. the currency pair and the time during which the quoted price will be valid.
D. the currency pair and the numerical quote.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

24. In a currency quote, the first three letters identify the ___________________ and the last three letters identify the ______________________.
A. domestic currency; term currency
B. base currency; term currency
C. foreign currency; base currency
D. domestic currency; foreign currency

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

25. The currency quote "JPYUSD = 0.0109053" means:
A. 0.0109053 USD can be used to buy 1 JPY.
B. 0.0109053 JPY can be used to buy 1 USD.
C. 0.0109053 JPY can be used to buy 1 of any currency traded in the foreign exchange market where the quote is given.
D. 0.0109053 USD can be used to buy 1 of any currency traded in the foreign exchange market where the quote is given.

Difficulty Level: Difficult
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Quotations

26. The bid-ask spread is computed using the following formula:
A. (Ask price - Bid price)/Bid price.
B. (Bid price - Ask price)/Bid price.
C. (Bid price - Ask price)/Ask price.
D. (Ask price - Bid price)/Ask price.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Bid-Ask Spread and Transaction Costs

27. Foreign currency quotes typically use _____________ decimal places, and for major currencies, the bid and ask quotes _________________.
A. four; will differ for all four decimal places
B. four; only the fourth decimal place will differ
C. two; only the second decimal place will differ
D. two; all decimal places will differ

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Bid-Ask Spread and Transaction Costs

28. If a currency quote is given in EUR to USD and USD to JPY, and those quotes can be used to determine EUR to JPY, the quotes are known as:
A. parallel rates.
B. complex rates.
C. cumulative rates.
D. cross rates.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Currency Cross Rates

29. The volume of transactions in foreign exchange markets is ________________ due in part to ___________________________
A. increasing gradually; reduced risks in the foreign exchange markets.
B. holding steady; new regulations that make the transactions more difficult.
C. decreasing; the development of new financing instruments that do not depend on foreign exchange.
D. increasing rapidly; the participation of non-bank institutions in the foreign exchange markets.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Market Trends

30. When lending or borrowing occurs in a currency that is not the domestic currency of the country where the transaction takes place, the transaction is said to have taken place in the:
A. eurocurrency market.
B. foreign market.
C. domestic market.
D. foreign exchange market.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets

31. Foreign currency transactions that are in the USD are called:
A. foreign currency transactions.
B. foreign exchange transactions.
C. Eurocurrency transactions.
D. Eurodollar transactions.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurodollars and LIBOR

32. Banks that are involved in borrowing and lending transactions in currencies other than their domestic currencies are called:
A. Eurobanks.
B. foreign banks.
C. market makers.
D. foreign exchange dealers.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurodollars and LIBOR

33. The leading indicator for the Eurocurrency markets is the London Inter Bank Offered Rate (LIBOR), which:
A. is the prime rate that is then charged in the European Community.
B. is the average rate charged on loans by the central banks in all European nations.
C. reflects the rate at which Eurobanks are willing to loan money to other institutions.
D. indicate the liquidity that is currently found in the foreign exchange market.

Difficulty Level: Intermediate
Section: Section 2.2, International Money Markets; Eurodollars and LIBOR

34. The London Inter Bank Offered Rate (LIBOR):
A. is the interest rate set by the central bank in Great Britain.
B. reflects a set of interest rates based on a variety of currencies and maturities at which Eurobanks are willing to lend to each other.
C. the interest rate set by the European Investment Bank.
D. reflects an average of the prime interests rates prevailing in a variety of developed nations.

Difficulty Level: Medium
Section: Section 2.2, International Money Markets; Eurodollars and LIBOR

35. Eurocurrency markets developed in the 1950's primarily because:
A. the US limited foreign investments that could be made by US-based corporations.
B. banks in Europe joined together to compete with US banks for foreign deposits.
C. the US encouraged MNCs to invest in foreign assets.
D. regulations in the US limited interest rates that US banks could pay on deposits.

Difficulty Level: Intermediate
Section: Section 2.2, International Money Markets; Eurocurrency Markets: Origins and Instruments

36. The principal feature of Euro markets is:
A. lack of regulation.
B. high interest rates that are available.
C. lower risks than are present in other markets.
D. lower rates on borrowed funds.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurocurrency Markets: Origins and Instruments

37. Most transactions in Eurocurrency markets are:
A. transactions involving governmental entities.
B. secured transactions between sovereign wealth funds and MNCs.
C. secured transactions between Interbanks and MNCs.
D. unsecured transactions between private parties.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurocurrency Markets: Origins and Instruments

38. The two key financial instruments used in the Eurocurrency markets are:
A. foreign exchange swap agreements and Euro commercial paper.
B. Euro commercial paper and Euro certificate of deposit.
C. Euro certificate of deposit and Euro negotiable instruments.
D. Euro negotiable instruments and foreign exchange swap agreements.

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurocurrency Markets: Origins and Instruments

39. __________________________ are agreements to pay a specific sum of money at a specified interest rate in a specified period of time, often six months.
A. Euro certificates of deposit
B. Euro promissory notes
C. Euro commercial paper
D. Euro loan agreements

Difficulty Level: Easy
Section: Section 2.2, International Money Markets; Eurocurrency Markets: Origins and Instruments

40. __________________________ are markets where medium term and long term international debt instruments are issued and traded.
A. International debt markets
B. Global exchange markets
C. MNC debt markets
D. Foreign debt markets

Difficulty Level: Easy
Section: Section 2.3, International Debt Markets

41. Floating rate notes are financial instruments with interest rates linked to ______________ that are traded on the ___________________________.
A. US Treasury bill rates; foreign exchange markets
B. LIBOR; Eurocredit market
C. LIBOR; foreign debt markets
D. US Treasury bill rates; Eurocurrency markets

Difficulty Level: Intermediate
Section: Section 2.3, International Debt Markets; Eurocredits

42. Eurobonds are bonds that are:
A. the same as foreign bonds.
B. issued in European countries.
C. issued in a country but are denominated in a currency other than the currency of the country where they are issued.
D. issued in a European currency.

Difficulty Level: Easy
Section: Section 2.3, International Debt Markets; Eurobonds: Origins

43. Two characteristics that distinguish Eurobonds from bonds typically issued in the United States are:
A. interest on Eurobonds is paid annually and Eurobonds are bearer bonds.
B. interest on Eurobonds is paid when the principal of the bonds are paid and Eurobonds are bearer bonds.
C. interest on Eurobonds is paid in Euros and Eurobonds are payable in demand.
D. interest on Eurobonds is paid in Euros and Eurobonds are bearer bonds.

Difficulty Level: Intermediate
Section: Section 2.3, International Debt Markets; Features of Eurobonds and Their Markets

44. ____________________ are Eurobonds that are issued simultaneously in multiple regions or countries.
A. Global bonds
B. Foreign bonds
C. Eurocurrencies
D. Samurai bonds

Difficulty Level: Easy
Section: Section 2.3, International Debt Markets; Preference for Eurobonds

45. Collateralized debt obligations are:
A. essentially the same thing as Eurobonds.
B. bonds issued by MNCs payable in the domestic currency of the MNC.
C. equity instruments issued by MNCs that are convertible into Eurobonds.
D. backed by risky assets and are sold in classes having different levels of risk.

Difficulty Level: Intermediate
Section: Section 2.3, International Debt Markets; Complexity

Essay Questions

46. What role do interbanks play in the foreign exchange markets?

Interbanks are simply banks that buy and sell currencies in the foreign exchange markets, both to meet the needs of their customers who conduct business in multiple currencies and who must acquire or sell those currencies, but interbanks also act as intermediaries in the foreign exchange markets. Since interbanks regularly buy both buy and sell currencies in the foreign exchange markets, their participation not only as dealers in foreign exchange but also as market makers in foreign exchange provide a level of liquidity (easy of buying and selling most currencies) to the foreign exchange markets that allows those markets to operate efficiently and dependably.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Other Participants in Foreign Exchange Markets

47. What is the "bid-ask spread" and how does it affect the costs that MNCs incur in the foreign exchange market?

The bid price is what someone who is seeking to buy a specific foreign currency on the foreign exchange market is willing to pay for that currency, and the ask price is what someone who is seeking to sell a specific currency on the foreign exchange market is willing to accept for that currency. The bid-ask spread is the difference between the two prices, and, if a dealer can find an ask price that is less than a bid price, the bid-ask spread represents the profit that the deal can make by buying the currency at the ask price and selling it at the bid price. Liquid currencies (those that are bought and sold easily) have low spreads since they are regularly traded and bid and ask prices are essentially the same, but illiquid currencies (those that are not bought and sold as easily) have higher spreads since there are not as many buyers and sellers of those currencies. When an MNC seeks to buy or sell on the foreign currency market, it typically conducts those transactions through a dealer in foreign currency, and the bid-ask spread for the particular currency that the MNC is seeking to buy or sell will be the dealer's profit on the transaction, paid by the MNC.

Difficulty Level: Intermediate
Section: Section 2.1, Foreign Exchange Markets; Bid-Ask Spread and Transaction Costs

48. Why does London play such a prominent role in the foreign exchange market?

The British pound, though once a very important currency in foreign exchange markets, is no longer as important, but London continues to be an important center for the foreign exchange market. That is partially because of history - for a long time, the British pound was at least one of the most important currencies in the world, and London, as the capital of Great Britain, played an important role in the foreign currency markets. As the importance of the British pound has waned, though, London has continued to occupy an important place in the foreign exchange markets, now because of geography. London is located between the increasingly important financial centers in the Far East and the continuing important financial center in the United States, New York. Financial offices in London are open for afternoon trade in the Far East and for morning trading in New York. While it might seem that advances in technology would mean that transactions in foreign exchange markets would not require person-to-person communications, the fact is that even with advances in technology, people are still needed to complete trades.

Difficulty Level: Easy
Section: Section 2.1, Foreign Exchange Markets; Foreign Exchange Markets: 24-Hour Trading

49. Why is there a difference between LIBOR rates and U.S. Treasury rates?

LIBOR (London Inter Bank Offered Rate) is the interest rate that Eurobanks (banks involved in foreign currency transactions) offer for loans to other Eurobanks. U.S. Treasury rates are the rates which the U.S. government is willing to pay on the obligations that it issues. In most cases, LIBOR rates and U.S. Treasury rates are almost the same, and any difference in the rates is primarily attributable to risk. The U.S. Treasury is generally considered to be a very low risk - the chances that the U.S. Treasury will not honor its obligations is very low. While Eurobanks are substantial institutions with significant assets and, therefore, offer low risk of not honoring their obligations, the risk that a Eurobank will not honor its obligations is somewhat greater than the risk that the U.S. Treasury will not honor its obligations, and that slight difference in risk represents the difference in U.S. Treasury rates and LIBOR rates.

Difficulty Level: Intermediate
Section: Section 2.2, International Money Markets; Eurodollars and LIBOR

50. What is a foreign bond and what relevance does it have to international finance?

Foreign bonds were bonds issued in a particular country, say the United States, denominated in the currency of the United States, the USD, but issued by an entity that was not considered to be a domestic (U.S.) issuer. For instance, if the Bank of China issued a bond in the United States denominated in the USD, the bond would be considered to be a foreign bond. While foreign bonds are still issued as part of international finance, a similar, but in important aspects different instrument, has supplanted the foreign bond to some extent. Eurobonds are issued by a foreign issuer (not considered to be an issuer in the country where the bond is issued) in a country but are issued, not denominated in the currency of the country where they are issued, but are denominated in another currency that is not the currency of the country where they are issued or the currency of the issuer. For instance, if the Bank of China issued a bond in the United States denominated in euros, the bond would be considered to be a Eurobond. Both the foreign bond and the Eurobond represent the flexibility that issuers of bonds have in targeting their markets and in taking advantage of the relative strengths or weaknesses of various currencies.

Difficulty Level: Difficult
Section: Section 2.3, International Debt Markets; Eurobonds: Origins