

1. On March 1st, Luis entered into a forward contract to sell 20,000 British pounds (£) at an exchange rate of \$1 : £ 0.7 on September 30th. He's a currency speculator in the US. He gambles on the exchange rates of currencies. (Wells could have done this too, but he was at the Yankee game, so he missed the chance.)

Examine the first sentence: On September 30th, what will Luis need to do to fulfill his contract?

If the exchange rate on September 30th is \$1 : £ 0.5, what will it cost Luis in USD to buy the £ 20,000?

Then when he sells them at the forward contract rate above on the 30th, how much in USD will he get back?

So what's his profit or loss?

Assume his broker takes a fee of \$50 on this contract. What is Luis' profit or loss, net of fees?

Different scenario

If the exchange rate on September 30th is \$1 : £ 0.85, what will it cost Luis in USD to buy the £ 20,000?

Then when he sells them at the forward contract rate above on the 30th, how much in USD will he get back?

Assuming the same fee, what is his profit or loss, net of fees?

2. Think about that wedding in Bali. The total expenses for the wedding come to 450 million rupiah, which you will pay on June 10th, 2016. You know that the rupiah is very volatile, so you use a forward contract to lock in an exchange rate of \$1 : Rp 11,000 for that date.

On June 10th the exchange rate for the rupiah is \$1 : Rp 10,000.

a) How much will you pay in USD for the wedding using the forward rate?

b) How much would you have paid in USD using the actual rate on that day?

c) How much did you save or lose on the forward?

3. View the chart to the right. What's happening to the value of the yen compared to the dollar?

Conversely, what's happening to the value of the dollar compared to the yen?

Exchange Rates

Jan 1st: \$1: ¥ 120
Apr 1st: \$1: ¥ 115
Jul 1st: \$1: ¥ 109
Oct 1st: \$1: ¥ 102

Circle the right word: If you were going to try to make money by buying yen and then selling it later, your goal is to buy it when it's strong/weak and sell it when it's strong/weak.

Kaitlyn buys \$10,000 worth of yen on Jan 1st. How much does she get in yen?

She then takes all that yen and changes it back to USD on Jul 1st. How much does she get in USD?

What's her profit on this position?

Kaitlyn buys \$500,000 worth of yen on Jan 1st. How much does she get in yen?

She then takes all that yen and changes it back to USD on Oct 1st. How much does she get in USD?

What's her profit on this position?

4. On January 1st, Alex enters into a forward contract to sell \$100,000 into the Japanese market on Apr 1st at the January 1st exchange rate of 120 yen to 1 dollar.

On Apr 1st, how much does she earn in yen?

On Apr 1st, how much should she have earned if she had used the April exchange rate?

How much was her profit?

5. On January 1st, Millina enters into a forward contract to sell \$100,000 into the Japanese market on July 1st at the January 1st exchange rate of 120 yen to 1 dollar.

On July 1st, how much does she earn in yen?

On July 1st, how much should she have earned if she had used the July exchange rate?

How much was her profit?

6. On April 1st, Natalia enters into a forward contract to sell \$100,000 into the Japanese market on Oct 1st at the April 1st exchange rate of 120 yen to 1 dollar.

On Oct 1st, how much does she earn in yen?

On Oct 1st, how much should she have earned if she had used the Oct exchange rate?

How much was her profit?