

EXAM FM QUESTION OF THE WEEK

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Week of April 7/08

The current exchange rate between Hong Kong dollars and Canadian dollars is
 $\$1\text{HK} = \0.13 Canadian . The annual effective rate of interest in Canada is 4.00% for a one-year zero-coupon bond and in Hong Kong it is 2.50% .

Under the assumption of no arbitrage opportunities, find the one-year forward delivery price, for a forward contract to purchase \$1 Hong Kong dollar in Canadian funds.

The solution can be found below.

Week of April 7/08 - Solution

The asset is \$1 Hong Kong, and it pays a dividend rate of 2.50%. The prepaid forward price of \$1 Hong Kong in Canadian funds is $\frac{.13}{1.025}$, and the forward price for delivery in one year is $\frac{.13}{1.025} \times 1.04 = .131902$ Canadian dollars.