RISK FREE RATES

Start of session 4

Currency Risk Free Rates

1. You have a choice of valuing a Brazilian company in nominal Brazilian Reais ($R) or US $. The risk free rate in Brazilian Reais is 7.5% and the risk free rate in US $ is 2.5%. In which currency will you derive a higher value for the company?
   - In US $, since the risk free rate is lower, which will push down your discount rate
   - In $R, because you will gain from exchange rate movements in your direction
   - Neither. You should get the same value.
2. What if you were choosing between valuing your company in $R or in real (no inflation) terms?
   - In real terms, since the risk free rate is lower, which will push down your discount rate
   - In $R, because you will gain from exchange rate movements in your direction
   - Neither. You should get the same value.

Low Risk free Rates: The Fed's Role

1. The US treasury bond rate, often used as the risk free rate in US dollars, has been abnormally low for the last 10 years, relative to the previous decade. This is because the Federal Reserve has kept it low, with its quantitative easing.
   - True
   - False
2. The FOMC is meeting today to set rates. What they do will determine whether interest rates will rise or fall in the coming weeks.
   - True
   - False

Negative Interest Rates

1. In the last couple of years, there have been at least three currencies where the long term government bond rate in that currency has dipped into negative territory. If this happens, you cannot do traditional valuation.
   - True
   - False
2. The solution in this case is to replace the negative interest with a normalized rate.
   - True
   - False