

Finance
Course Number: 33:390:375
Course Title: International Financial Management

COURSE DESCRIPTION

This course provides an overview of the foreign exchange market, investing in financial and real assets across national borders, and managing the extra dimension of risk that results from investing in or borrowing foreign currencies. I will strive in every class to provide some current context to what we are studying.

We begin the course with a look at macro financial issues, beginning with a brief history of the current global “financial architecture.” For decades following World War II the US dollar served as the foundation for the global financial system. Then on January 1, 1999 the euro made its debut. A significant amount of world trade is now denominated in euros, and so, the euro increased in global importance at the expense of other reserve currencies.

We will study how different countries manage the external values of their currencies based on the IMF’s classification methodology. Some governments tie their currencies to a major currency, such as the USD, the yen, or the euro. Other countries let their currencies float. There are significant macroeconomic implications to the choice of currency regime. Flexible currencies can provide the “safety valve” as countries adjust to economic shocks or the excesses of fiscal and monetary policies. Fixed exchange rates can create asset or inflation bubbles that eventually burst.

We then study the basics of foreign exchange rate determination, including the concepts of purchasing power parity, covered interest arbitrage, and interest rate parity. What are the relationships between interest rates, inflation, and exchange rates? And what does comparing the price of a Big Mac across countries tell us? Are higher interest rates consistent with a stronger or a weaker currency? The answer is more complicated than you might think. (The short answer is “yes.”)

Usually we think that if a currency weakens, exports will increase and imports will decrease. Trade deficits narrow and surpluses widen. Seems simple enough, but this is not always the case. In fact, there are two factors that complicate how exports and imports respond to change in currency value. Research reveals that in many countries imports initially increase, and a trade deficit widens when a currency weakens. The inflation differential between two countries also influences how imports and exports respond to changing currency values.

Next, we will study how multinational companies deal with foreign currency risk. There are risks when a contract has been signed, but not completed. There are risks associated with the loss of competitiveness. And there are many risks for companies that choose to build or buy factories in foreign countries. We will study the tools companies use to hedge their currency exposure.

Firms can acquire inputs and sell what they produce in their home markets business, and they can also become multinational businesses. We will study why firms become multinational, and what the risks are

for firms that venture beyond their home borders.

We will study how firms acquire capital from foreign markets. A company can issue debt or stock in foreign markets. They can also borrow from a foreign bank. How is each of these transactions accomplished? We will look at some recent examples of these deals. One major source of international credit is a eurocurrency loan. We will work through the process that creates eurocurrencies. We will also cover the basics of interest rate and currency swaps.

You have studied NPV analysis in Financial Management or Corporate Finance. In this final section of the course, we will link the parity rules studied earlier to the real, as opposed to financial, investment decisions global firms make. Whether NPV analysis produces a positive or a negative result can depend on whether Purchasing Power Parity and the International Fisher Effect hold.

COURSE MATERIALS

The textbook is *Global Money Markets and Institutions*, which is a customized text based on *International Financial Management* by Eun and Resnick, 8th edition, McGraw-Hill publisher.

Also, please register with the CFA Institute for their daily news summary called “CFA Institute Financial NewsBrief.” The NewsBrief provides a daily summary of financial news, some of which we will discuss in class. The link is: https://www2.smartbrief.com/subscribertools/archive.jsp?brief=cfa&sid=e7bb096a-7588-45de-9a2a-68f68cc86423&utm_source=brief.

LEARNING GOALS AND OBJECTIVES

I.) For All Finance & Economics Department Classes:

- a. Successful students will demonstrate an understanding of corporate finance and solve corporate finance problems related to the time value of money, basic capital budgeting, and the financing decision of the firm.
- b. Successful students will demonstrate their ability to analyze investments in financial instruments and apply the basics of portfolio theory.
- c. Successful students will demonstrate their knowledge of and the ability to analyze the characteristics of global financial markets and institutions.

For International Financial Management:

- a.) Learn the various ways governments manage exchange rates, including the gold standard, and the consequences of those choices for national economic policies.
- b.) Master balance of payments accounting, especially how national economic policies and markets for goods, services, real assets, and financial assets adjust to international imbalances.
- c.) Learn how the currency forwards market works and the significance of forward market equilibrium conditions.
- d.) Understand the key relationships between inflation, nominal interest rates, real interest rates, and exchange rates. Master the concept of real exchange rates and its role as an indicator of a potential currency crisis.

- e.) Master how multinational firms use forwards, interest rate swaps, currency swaps, forward rate agreements, and other risk-sharing tools to hedge currency risk.
 - f.) Understand how multinationals use global stock and bond markets to acquire capital. Learn the basics of euro-currency loans, euro-medium term notes, and American Depository Receipts.
 - g.) Learn the basics of international capital budgeting, including the linkage between inflation differentials and the investment choices global firms make.
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PREREQUISITES

The prerequisite for Global Money Markets and Institutions is: 390:300 or 390:310.

ACADEMIC INTEGRITY

I do NOT tolerate cheating. Students are responsible for understanding the RU Academic Integrity Policy (<http://academicintegrity.rutgers.edu/>)

I will strongly enforce this Policy and pursue *all* violations. On all examinations and assignments, students must sign the RU Honor Pledge, which states, “On my honor, I have neither received nor given any unauthorized assistance on this examination or assignment.” I will screen all written assignments through *SafeAssign* or *Turnitin*, plagiarism detection services that compare the work against a large database of past work. Don’t let cheating destroy your hard-earned opportunity to learn. See business.rutgers.edu/ai for more details.

ATTENDANCE AND PREPARATION POLICY

University policy is that attendance is required. I do not take attendance. If you know you will be absent for a university approved activity, such as you are a member of a sports team, or you are ill, have a family emergency, or an interview, please send a message.

COURSE REQUIREMENTS

The course will have two mid-term exams and a research project. Each mid-term exam will have 20 multiple choice questions.

The project should be at least 12-15 double-spaced pages, including graphs and tables, but not including a title page and works cited. Remember, this is 30% of your semester grade. Turn in a paper you are proud of. Be sure there are appropriate internal citations and that the paper is well edited.

There will be about eight homework assignments and a couple critical thinking exercises that we will discuss in class. All the problem assignments and critical thinking exercises will count toward your final semester grade.

All homework assignments, and critical thinking exercises will be submitted via Canvas.

Some Possible Project Topics:

- a.) Choose several global companies and compare how they hedge currency risk.
 - b.) Which countries are the most competitive in the global economy? Which are the least competitive? How do countries at the bottom move up to the middle ranking?
 - c.) What are the key indicators of a currency/sovereign debt/banking crisis? Which countries are most vulnerable to a crisis?
 - d.) What are the economic growth prospects for Africa?
 - e.) Will the new regulations affecting large global banks (Basel III) prevent another global financial crisis, or will they just drain banks of profits?
 - f.) Discuss the logic behind currency carry trades, and analyze a couple current opportunities.
 - g.) Define the attributes of an Optimum Currency Area and determine if the Eurozone is one.
 - h.) Define and discuss the policies that fall under “dollarization.” Discuss some examples of countries that have dollarized. Has it been beneficial? Provide some examples of how specific companies have been affected. What are the mechanics of dollarization? Discuss the “de-dollarization” that is occurring in Peru.
 - i.) Compare capital structures of companies in the same global industry across countries. Pick a couple industries and several companies from each industry.
 - j.) Discuss microfinance and how it might be used to diminish poverty in the developing world. Emphasize actual transactions and policies that have been implemented.
 - k.) The “shadow” banking system: its significance for global finance and the challenges faced by regulators.
 - l.) Analyze the effect central bank easing during the Great Recession had on global equity markets. What does the unwinding of central bank balance sheets imply about equity markets for the coming year? Document the actual increases in central bank liquidity and the shrinking of balance sheets which is now underway in many countries.
 - m.) Analyze the effect of trade on real economic growth in both developed and emerging countries. Who are the winners and losers as trade volumes increase and decrease?
 - n.) Can crypto currencies be a socially useful financial tool, especially in developing countries that have little commercial banking infrastructure? What positive role can governments/central banks play as regulators of cryptos?
 - o.) Demographics and investing.
 - p.) A topic of your choice, which I must approve.
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CLASSROOM CONDUCT

No computers, tablets, cell phones, or devices of any kind can be used in class.

Occasional lateness is understandable. Busses are late, cars breakdown, and traffic is unpredictable. But, chronic tardiness, frequently being 15-20 minutes late, is disruptive and disrespectful to me and the class. Don't make a habit of being late.

EXAM DATES AND POLICIES

The exam dates are approximate and are listed in the Course Schedule section.

If you have a disability that influences testing procedures, please provide me an official letter from the Office of Disability Services at the start of the semester.

You cannot use a phone to make calculations during an exam. You must use a non-programmable calculator. No formula sheets will be allowed for the exams.

Problem Set Assignments: No problem set assignments will be accepted after ().

Critical Thinking Exercises: These must be submitted by the due date stated on the assignment. Late submissions will not be accepted.

I will give you credit in Canvas when you submit a completed problem set or a critical thinking exercise. It is always possible that I make a mistake and fail to give you proper credit for the assignments you turn in. Any disputes about credit for these assignments must be communicated to me in an email by (). Otherwise, the Canvas total stands as your submitted work for the semester.

GRADING POLICY

The weights for the course requirements are:

Exam 1: 32.5%.

Exam 2: 32.5%.

Project: 30.0%

Homework & Critical Thinking Exercises: 5.0%.

The grading scale:

A: 91 – 100.

B+: 86 – 90.

B: 81 – 85.

C+: 75 – 80.

C: 70 – 74.

D: 60 – 69.

This is the formal grading scale, but grades are scaled once final semester averages have been determined.

COURSE SCHEDULE

Week 1:

Course introduction.

Week 2:

Chapter 2: The International Monetary System.

- a.) Bretton Woods and the reasons behind its breakdown.
- b.) IMF exchange rate regime taxonomy and examples of each regime.
- c.) History of Eurozone and “Optimal Currency Areas.”

You are responsible for the sections titled “The European Monetary System” and “The Euro and the European Monetary Union.”

Week 3:

Chapter 3: The Balance of Payments.

- a.) Components of BOP accounts.
- b.) Government policies that narrow Current Account imbalances.
- c.) Emphasis on dynamic adjustment qualities of BOP framework.
- d.) Defending overvalued and undervalued currency in a fixed rate regime.
- e.) Does the US consume too much or does the ROW save too much? Arguments on both sides.

You are responsible for the section on the “J-Curve.”

Your project topic is due. Write your name and the project title, not the letter, on a page. I do not want an email.

Week 4:

Chapter 5: The Market for Foreign Exchange.

- a.) Direct and indirect quotes.
- b.) Forward markets.
 - i.) Bid/ask spreads.
 - ii.) Forward points.
 - iii.) Forward discount & premium, including link to interest rate differentials.

Detailed slides for Chapter 5 are posted on Canvas.

Week 5:

Chapter 6: International Parity Relationships and Forecasting Foreign Exchange Rates.

- a.) Interest Rate Parity and Covered Interest Arbitrage.
- b.) Uncovered Interest Rate Parity and carry trades.
- c.) Purchasing Power Parity, including absolute and relative PPP.
- d.) Real exchange rates, deviations from PPP, and link to BOP crises.
- e.) Carry Trades.
- f.) Comparing PPP and the IFE (International Fisher Effect).

Detailed slides for Chapter 6 are posted on Canvas.

No class

Week 6:

Chapter 6: Continues.

Chapter 6: Conclusion.

Week 7:

Exam 1: Chapters 2, 3, 5, & 6.

Chapter 8: Management of Transaction Exposure.

- a.) Types of exposure to currency fluctuations.
- b.) Reasons to hedge currency exposures and reasons not to hedge.
- c.) Forward and money market hedges.

Week 8:

Chapter 8: Conclusion.

Chapter 9: Management of Economic Exposure.

- a.) Significance of market structure and elasticity.
- b.) Hedging operating risk.
 - i.) Matching strategies.
 - ii.) Flexible sourcing, market diversification, and link to PPP.
 - iii.) Product differentiation.

Week 9:

Chapter 9: Conclusion.

Chapter 11: International Banking and Money Market.

- a.) LIBOR.
- b.) International capital market borrowing: foreign vs euro transactions.
- c.) Eurocurrencies, eurocurrency creation, euro commercial paper, and eurocredits.
- d.) BIS data on foreign commercial paper borrowing by currency.
- e.) Forward Rate Agreements (FRAs).

Week 10:

Chapter 11: Conclusion.

Chapter 12: International Bond Market.

- a.) Foreign bonds versus euro bonds.
- b.) Global bonds, euro MTNs, and dual currency bonds.
- c.) BIS data on international bond market borrowing by currency and type of debt offering.

Week 11:

Chapter 13: International Equity Market.

- a.) Benefits of cross listing.
- b.) ADRs.
 - i.) How they are created.
 - ii.) Total rate of return decomposed into local market and currency returns.
- c.) Discussion of empirical findings on benefits of cross listing.

Week 12:

Chapter 14: Interest Rate and Currency Swaps.

- a.) Logic and mechanics of vanilla interest rate swaps.
 - i.) Everyone wins. Is there a free lunch?
- b.) Logic and mechanics of generic currency swap.
 - i.) Why would a borrower pay a higher interest rate than is available in its home market?

You are responsible for the section titled “Risks of Interest Rate and Currency Swaps.”

Week 13:

Exam 2: Chapters 8, 9, 11, 12, 13, & 14.

Thanksgiving holiday

Week 14:

Chapter 17: International Capital Structure and the Cost of Capital.

- a.) The International CAPM.

- b.) Why does the cost of capital differ between countries?
- c.) The effect of cross listing on the cost of capital: empirical studies.

You are responsible for the section titled “Cross-Border Listings of Stocks.”

Week 15:

Special Topics: OCAs & Portfolio Optimization.

SUPPORT SERVICES

If you need accommodation for a *disability*, obtain a Letter of Accommodation from the Office of Disability Services. The Office of Disability Services at Rutgers, The State University of New Jersey, provides student-centered and student-inclusive programming in compliance with the Americans with Disabilities Act of 1990, the Americans with Disabilities Act Amendments of 2008, Section 504 of the Rehabilitation Act of 1973, Section 508 of the Rehabilitation Act of 1998, and the New Jersey Law Against Discrimination. More information can be found at ods.rutgers.edu.

[Rutgers University-New Brunswick ODS phone (848)445-6800 or email dsoffice@echo.rutgers.edu]

[Rutgers University-Newark ODS phone (973)353-5375 or email ods@newark.rutgers.edu]

If you are *pregnant*, the Office of Title IX and ADA Compliance is available to assist with any concerns or potential accommodations related to pregnancy.

[Rutgers University-New Brunswick Title IX Coordinator phone (848)932-8200 or email jackie.moran@rutgers.edu]

[Rutgers University-Newark Office of Title IX and ADA Compliance phone (973)353-1906 or email TitleIX@newark.rutgers.edu]

If you seek *religious accommodations*, the Office of the Dean of Students is available to verify absences for religious observance, as needed.

[Rutgers University-New Brunswick Dean of Students phone (848)932-2300 or email deanofstudents@echo.rutgers.edu]

[Rutgers University-Newark Dean of Students phone (973)353-5063 or email DeanofStudents@newark.rutgers.edu]

If you have experienced any form of *gender or sex-based discrimination or harassment*, including sexual assault, sexual harassment, relationship violence, or stalking, the Office for Violence Prevention

and Victim Assistance provides help and support. More information can be found at <http://vpva.rutgers.edu/>.

[Rutgers University-New Brunswick incident report link: <http://studentconduct.rutgers.edu/concern/>. You may contact the Office for Violence Prevention and Victim Assistance at (848)932-1181]

[Rutgers University-Newark incident report link: https://cm.maxient.com/reportingform.php?RutgersUniv&layout_id=7 . You may also contact the Office of Title IX and ADA Compliance at (973)353-1906 or email at TitleIX@newark.rutgers.edu. If you wish to speak with a staff member who is confidential and does **not** have a reporting responsibility, you may contact the Office for Violence Prevention and Victim Assistance at (973)353-1918 or email run.vpva@rutgers.edu]

If students who have experienced a temporary condition or injury that is adversely affecting their ability to fully participate, you should submit a request via <https://temporaryconditions.rutgers.edu>.

If you are a military **veteran** or are on active military duty, you can obtain support through the Office of Veteran and Military Programs and Services. <http://veterans.rutgers.edu/>

If you are in need of **mental health** services, please use our readily available services.

[Rutgers University-Newark Counseling Center: <http://counseling.newark.rutgers.edu/>]

[Rutgers Counseling and Psychological Services–New Brunswick: <http://rhscaps.rutgers.edu/>]

If you are in need of **physical health** services, please use our readily available services.

[Rutgers Health Services – Newark: <http://health.newark.rutgers.edu/>]

[Rutgers Health Services – New Brunswick: <http://health.rutgers.edu/>]

If you are in need of **legal** services, please use our readily available services: <http://rusls.rutgers.edu/>

Students experiencing difficulty in courses due to **English as a second language (ESL)** should contact the Program in American Language Studies for supports.

[Rutgers–Newark: PALS@newark.rutgers.edu]

[Rutgers–New Brunswick: eslpals@english.rutgers.edu]

If you are in need of additional *academic assistance*, please use our readily available services.

[Rutgers University-Newark Learning Center: <http://www.ncas.rutgers.edu/rlc>]

[Rutgers University-Newark Writing Center: <http://www.ncas.rutgers.edu/writingcenter>]

[Rutgers University-New Brunswick Learning Center: <https://rlc.rutgers.edu/>]

[Optional items that many faculty include:

- Students must sign, date, and return a statement declaring that they understand the RU Academic Integrity Policy.

- Students must sign, date, and return a statement declaring that they understand this syllabus.]