OVERVIEW

In this course, we explore the characteristics of international financial markets and examine some international aspects of corporate financial management. In the sections dealing with international financial markets, we address a standard set of questions including:

- What are essential institutional and organizational features of the market place?
- What are the fundamental determinants of prices and price relationships in the market?
- Are market prices set efficiently in relation to a theoretical model, or is there evidence of market inefficiencies or shortcomings in the theoretical models?
- What are the major policy decisions facing private individuals and institutions, as well as public policymakers and regulatory agencies in each market.

In the topics that relate primarily to financial management, our emphasis is on how a financial manager should use his/her knowledge of international financial markets to address questions such as:

- How to measure the firm's exposure to financial and operational risks
- How to manage the firm's exposure to financial and operational risks
- How to evaluate international projects and exploit differences in the cost of capital

ASSIGNMENTS AND GRADING

Students will be required to write mid-term (30% of grade) and final examinations (40% of grade). Several written cases and exercises (25% of grade) will be assigned. The balance of the grade is based on class participation. Historically, the grade distribution in this class has been A's (15-25%), B's (40-60%), with the remainder C's and below.

A set of questions is included at the end of each chapter. Go through these questions by yourself to test your understanding of each chapter.
HOW TO REACH ME

In Person: Stern School of Business, 44 West 4th Street, Room 9-63, New York, NY 10012-1126.

Office Hours: Monday, 4:00 pm - 6:00 pm and Tuesday, 10:00 am - 12:00 Noon and by appointment.

Electronically: Phone: 212-998-0422; FAX: 212-995-4220; E-mail: rlevich@stern.nyu.edu

My Secretary: Ms. Robyn Vanterpool, Phone: 212-998-0702; E-mail: rvanterp@stern.nyu.edu

Course Web Page: Through my personal web page at www.stern.nyu.edu/~rlevich/
Watch this page for course announcements, due dates of assignments, and other information.

TEXT


Chapters from the text are noted in the outline as RML. Other readings are in a packet (P) or on reserve (R).

Students may wish to refer to two alternative textbooks that will be on reserve.


Additional readings of interest will be found in:


LIST OF TOPICS AND ASSIGNMENTS

PART 1: TOPICS IN INTERNATIONAL FINANCIAL MARKETS

Class 1 Introduction to the Study of International Financial Markets and Recent Developments in International Financial Markets

RML, Chapters 1, 2

TOPICS: Understanding prices and price behavior in international financial markets, policy issues facing private individuals, firms, and public policymakers; Overview of international monetary arrangements in theory and in practice, recent developments in exchange rates and interest rates, currency boards, the European Monetary System transforms into the European Monetary Union.

ASSIGNMENT: Chapter 2, Exercises 1, 2, 3, 4.

Class 2/3 Foreign Exchange Markets: Market Structure and Institutions

RML, Chapter 3

TOPICS: Market participants; volume, composition, and growth of trading, foreign exchange products and activities, the relationship between spot and forward contracts, synthetic contracts (the replicating portfolio idea), trends toward automated trading, controls over trading.

ASSIGNMENT: Chapter 3, Exercises 1, 2, 6, 7, 10, 11.

Class 4 International Parity Conditions: Purchasing Power Parity

RML, Chapter 4

TOPICS: International parity conditions in a perfect capital market, why parity conditions are useful, absolute and relative PPP, empirical evidence on PPP, policy decisions and PPP.

ASSIGNMENT: Chapter 4, Exercises 3, 5, 6, 7.

Class 5 International Parity Conditions: Interest Rate Parity and the Fisher Parities

RML, Chapter 5

TOPICS: Interest rate parity and covered interest arbitrage, the impact of transaction costs, taxes and uncertainty on parity; uncovered interest rate parity or the Fisher International Effect, financial strategies based on deviations from parity, forward rate unbiased condition.

ASSIGNMENT: Chapter 5, Exercises 1, 3, 4, 5, 6.

CASE #1: “International Cash Portfolios”
Class 6/7  Determination of Spot Exchange Rates: Theory and Evidence

RML, Chapter 6

Topics: Exchanges rates and macroeconomic news announcements, asset models of the spot exchange rate, the monetary model, the sticky-price monetary model, the portfolio balance model; Empirical evidence on exchange rate models, empirical evidence on the role of news.

***** NOTE: Monday Feb 15 is an NYU Holiday *****

Class 8  Foreign Exchange Market Efficiency

RML, Chapter 7

Topics: Theory of exchange market efficiency, interpreting efficient market studies, empirical evidence on spot market efficiency, technical trading models, empirical evidence on forward market efficiency.

Assignment: Chapter 7, Exercises 1, 2.

Class 9/10  Foreign Exchange Rate Forecasting

RML, Chapter 8


Case #2: “Ford Motor Credit”

Class 11  Eurocurrency Markets

RML, Chapter 9

Topics: Origins of the market, market dimensions and location, pricing Eurocurrency deposits and loans, risks of Eurocurrency deposits, interest rate risk in Eurocurrency loans, competitive responses to offshore markets, approaches to regulating offshore markets.

Assignment: Chapter 9, Exercises 2, 3, 4, 5.
Class 12  Eurobond Markets

RML, Chapter 10

TOPICS: Origins of the market, market dimensions and currency composition, regulatory and institutional features, primary market practices, the gray market, onshore-offshore arbitrage, pricing determinants of Eurobonds, competitive responses - the Rule 144a market.

Class 13  International Bond Portfolios

RML, Chapter 14

TOPICS: Dimensions of national bond markets, calculating the hedged and unhedged returns on international bonds, the "free-lunch" notion in international bond funds, active versus passive currency risk management, empirical evidence on international bonds, Brady bonds, global asset allocation.

ASSIGNMENT: Chapter 14, Exercise 1
CASE #3: "Gizmo Global Bond Management"

Class 14  Mid-term Examination

***** Spring Vacation, March 15-20 *****

Class 15  Currency and Interest Rate Futures

RML, Chapter 11

TOPICS: Institutional differences between futures and forwards, the marking-to-market convention, payoff profiles of futures contracts, futures and hedging, the term structure of forward prices, currency risk premium in forwards, success and failure of new futures contracts, do futures markets effect cash market volatility?

ASSIGNMENT: Chapter 11, Exercises 1, 2, 3, 4.
Class 16/17  Currency and Interest Rate Options

RML, Chapter 12

TOPICS: Option terminology, contract specifications, payoff profiles of options, options and hedging, pricing spot currency options, the discrete time binomial option pricing approach (another replicating portfolio), the continuous time lognormal approach, empirical evidence on option pricing models, estimating volatility, historical versus implied volatility, managing the risks in option positions.

ASSIGNMENT: Chapter 12, Exercises 4, 6, 7, 8, 9.
CASE #4: “Gifts from FX Students”

Class 18/19  Currency and Interest Rate Swaps

RML, Chapter 13

TOPICS: Origins of the swap market, measuring the size of the market, gross versus net measures of the market, basic cash flow requirements of currency and interest rate swaps, the swap as a collection of forward contracts (another replicating portfolio), risks of swaps, Measuring the risks of swaps, amortization and diffusion effects, price quoting conventions in swaps, pricing interest rate and currency swaps, sources of gains to the users of swaps, risk exposure and capital requirements for swaps dealers and counterparties, netting agreements, BIS capital requirements.

ASSIGNMENT: Chapter 13, Exercises 1, 2, 10.

PART 2: TOPICS IN INTERNATIONAL CORPORATION FINANCE

Class 20/21  Measuring Exposure to International Financial Risks

RML, Chapter 16, pages 566-86

TOPICS: Macroeconomic risks and the value of the firm, direct and indirect economic exposures, accounting measures of exposure (translation and transaction exposure), economic measures of exposure (regression and scenario analysis), empirical evidence.

ASSIGNMENT: Chapter 16, Exercise 3

Class 22/23  Managing Exposures to International Financial Risks

RML, Chapter 16, pages 586-603; Chapter 17, pages 607-15.

TOPICS: Why should the firm hedge? Financial strategies toward risk management, selecting a suitable hedging instrument, picking the right hedge ratio, the Value at Risk (VAR) approach, BIS regulations and the use of in-house VAR measures.
Class 24 Managing Exposure Using Operational Strategies

Readings:


Paul Krugman, "Pricing to Market When the Exchange Rate Changes," Chapter 3 in Arndt and Richardson (eds.) Real and Financial Linkages Among Open Economies, 1987. (R)


ACS, Chapter 11.

TOPICS: Sourcing and pricing decisions under exchange rate uncertainty, pricing-to-market, exchange rate pass-through, selecting the invoice currency, performance measurement under exchange rate uncertainty

CASE #5: "Jaguar, plc"

Class 25 International Equity Portfolios

RML, Chapter 15

TOPICS: International portfolio diversification, size and institutional features of global equity markets, international investment vehicles (ADRs, closed-end funds, CBs, WEBS), risk and return in international equity markets, factors leading to over- and under-weighting of home country shares, barriers to international investment, harmonization of issuing and listing standards.

Class 26 Topics in Direct Foreign Investment and International Mergers and Acquisitions

Readings:


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ACS, Chapter 17 (including Appendix 17A)

**TOPICS:** Modes of international entry: exports, licensing, joint-ventures, direct investment; Theories of the multinational corporation, country and industry patterns; International mergers and acquisitions.

**Class 27/28  Cost of Capital and International Project Evaluation**

**Readings:**

Richard Levich, "Multinational Firms, Project Evaluation and the Cost of Capital," working manuscript, March 1995. (P)


* Donald Lessard, "Evaluating International Projects: An Adjusted Present Value Approach," Chap. 34 in DRL, first edition (R)


Alan Shapiro, "International Capital Budgeting," Chapter 12 in S&C. (R)


ACS, Chapters 18-19.

**TOPICS:** Cost of capital for the international firm, Effect of segmented versus integrated international capital markets, Project selection under international uncertainty, Capital budgeting in an international context.

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Final Examination
May 10, Monday at 7:35 pm for MW 7:00 pm class
May  4, Tuesday at 5:25 pm for TTh 5:30 pm class

B40.3388 - Spring 1999
Schedule of Classes

**B40.3388 (Section 30)**

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27 meetings 28 meetings

Final Exam: Monday, May 10 at 7:35 pm Final Exam: Tuesday, May 4 at 5:25 pm