INTERNATIONAL FINANCE
FINC 470 - Spring 2020
Draft Syllabus

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International Finance

This course provides an introduction to the *workings of foreign exchange markets*, the impact of monetary policy on exchange rates, the *nature of foreign exchange risk, hedging strategies* for currency risk, determination of the *cost of capital for foreign investments*, and the *valuation of foreign projects*. Throughout the course, we also discuss major events in the global political and business environment, as they interact with developments in the international financial markets. Prominent current issues include *global trade conflicts*, the *coronavirus epidemic*, and the *continuing impact of Brexit*. Such topics will typically be discussed prior to regular lectures to highlight implications of the course material.

The first part of the course introduces the different components of the overall FX Interbank market and explores valuation and hedging of risk-free foreign currency cash flows. The second part discusses the determination of exchange rates, monetary policy, and the international links between exchange rates, inflation rates, internal and external national debt, and interest rates. The third part examines various concepts of exchange risk and explores hedging with forward contracts and foreign currency options. The fourth part considers longer term operational exposures and discusses the need to manage foreign exchange risk in a continually operating international business. Furthermore valuation of foreign investment projects is analyzed. Throughout, a number of cases are examined.

The only formal prerequisite is Finance 430. However, familiarity with corporate finance and capital markets material, as taught in the courses Finance 441 and Finance 950, respectively, is useful. Knowledge of elementary principles of Macroeconomics and Derivatives are helpful throughout, although necessary concepts will be developed from first principles.


**Other Readings:** Supplementary notes, problems and readings will be posted on the course website.

**Course Requirements:** Grading will be based on Class Participation (10%), Group Problem Sets and Case Write-ups (20%), a Midterm Exam (25%), and a Final Exam (45%).

I expect you to do the readings in advance of the class for which they are assigned. The format of the class is lectures and extensive discussion. To facilitate this practice, you should bring your name plate to every class session.
Course Schedule

Week 1: Introduction: Course Overview; FX Spot Market
The Foreign Exchange Spot Market, Overview of Institutional Features
Introduction to Institutions of the Foreign Exchange Interbank Market
Foreign Exchange Spot Transactions; Bid-Ask Quotes; FX Appreciation
ER (2015/2018 edition), Ch.1, pp. 4-26; ER, Ch.5, pp. 111-129.

Week 2: International Money Markets, Hedging Transaction Risk
International Money Markets, Hedging Transaction Risk
Foreign Exchange Forward Transactions; Eurocurrency Market; LIBOR;
Hedging FX Transaction Exposure; Interest Rate Parity Theorem;
ER (2018 Ed.), Ch. 5-6, pp. 129-146; ER, Ch. 8, pp. 200-203; ER, Ch. 11, pp. 272-279.
Hand-In Solutions to Problem Set #1.

Week 3: Interest Rate Parity, FX Hedging, Currency Futures, Carry Trade
Check Interest Parity with Bid-Ask Spread; Extensions to Interest Rate Parity;
Synthetic FX Forward; Hedging Multiple Currencies over Multiple Maturities;
Default Risk; FC Futures Contracts; Uncovered Interest Rate Arbitrage;
Forward Expectations Parity; FX Carry Trade;
Hand-In Solutions to Problem Set #2.

Week 4: Monetary Policy, Inflation, Interest Rates, Central Bank Policy
Monetary Policy; Short Run Inflation/Unemployment Trade-off
Fisher Effect; Money Supply, Inflation and Interest Rates Linkages
Real and Nominal Interest Rates; Central Bank Balance Sheet
Mishkin, Ch. 17; Fed. Res. Bank of San Francisco, U.S. Monetary Policy
Hand-In Solutions to Problem Set #3.

Week 5: Short-Term FX Determination and FX Intervention
FX Flow Market Model; Monetary Policy and Foreign Exchange Rates;
Fed Balance Sheet; Balance of Payments,
ER (2018 Ed.) Ch. 2, pp. 27-48 and 56-61; ER, Ch. 3, pp. 62-71; ER, Ch.6, pp. 158-172;
Hand-In Solutions to Problem Set #4
Week 6: Parity Conditions, Capital Flows, Currency & Debt Crises
National Income Accounting; Linking Internal and External Deficits; Capital Flows; International Investment Position; Currency Crises; Sovereign Debt Crises
Purchasing Power Parity; International Parity Conditions; Real Exchange Rates;
ER (2018 Ed.), Ch. 2, pp. 49-60; ER, Ch. 3, pp. 72-81; ER, Ch. 6, pp. 149-172

Hand-In Solutions to Problem Set #5

Midterm Exam

Week 7: FX Derivatives and Hedging of Transaction Exposure
Measuring FX Volatility; Hedging FX Quantity Risk; Foreign Currency Options

Review of Midterm Solution

Week 8: Types of FX Exposure, Hedging Applications;
Dozier Case; Pricing and Applications; Illustrations: Zenith and Lufthansa.
Foreign Currency Options Hedge Examples
Case: Dozier Inc.
Hand-In Solutions to Problem Set #6

Week 9: International Capital Budgeting and Valuation;
International Capital Budgeting and Valuation;
Introduction to FC Cost-of-Capital; Valuation of Foreign Projects; FX Operating Exposure; Accounting for Political Risk;
ER (2018 Ed.), Ch. 17-18, pp. 431-476,
Salomon Smith Barney: Practical Approach to International Valuation
Hand-In Solutions to Problem Set #7.

Week 10: Valuation Review; Operating Exposure Hedging; Course Review
International Valuation Case; Hedging FX Operating Exposure;
Types of FX Exposures; FX Hedging Philosophy; Hedging Summary
Case: Acquiring Nusantara Communications Inc.
Hand-In Solutions to Problem Set #8

Final Exam – TBD.