INTERNATIONAL FINANCE

FINC 470 - Spring 2019

Draft Syllabus

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Major current events in the global political and business environment are intrinsically linked to international financial markets. Two prominent issues involve Brexit and the U.S.-China trade conflict. Such topics will be discussed during class prior to the regular lectures to provide illustrations of concepts and implications of the course material. Overall, the class first provides an introduction to the workings of the foreign exchange markets, the impact of monetary policy on exchange rates, the nature of foreign exchange risk, hedging strategies for currency risk, and assessment of the cost of capital for foreign projects. The first part introduces the different elements 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 and interest rates. Moreover, the balance of payments is reviewed and its impact on exchange rates and country risk is considered. The third part examines various concepts of exchange risk and analyzes 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 connection of the class material to current events as reported in newspapers and journals is also emphasized.

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 it is helpful if you bring your name plates.
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: Hand-In Solutions to Problem Set #4

5. Short-Term FX Determination, FX Intervention, Balance of Payments
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;
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
Returning Graded Midterm Exams

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.