MACQUARIE UNIVERSITY

Division of Economic and Financial Studies

UNIT OUTLINE

2003

(Semester 2 Daytime stream)

ECON 867
INTERNATIONAL FINANCIAL MANAGEMENT

Unit homepage: **www.econ.mq.edu.au/courses/econ867**

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ECON 867
International Financial Management

1.   COURSE OVERVIEW

World financial markets and global investment flows form an influential part of today's economic landscape.

The aim in this course is to talk the language of international finance, identify the key issues, and equip students with core skills for a career in international financial management.

Whilst the course uses the latest techniques and includes a number of case studies, the approach is non-technical.

2.   TEACHING PROGRAM

Staff for the course (Daytime stream Semester 2):

   Dr Kim Hawtrey   Lecturing weeks 1-13
   (C5C Room 392. Telephone 98508504. Email khawtrey@efs.mq.edu.au)

Enquiries about the subject matter of lectures can be directed to the lecturer in the first instance by email, or by phone or in person. Dr Hawtrey can answer general enquiries about course administration and assessment.

Classes comprise a three-hour block (with hourly 10-minute breaks), held as follows:

   Thursdays 10am - 1pm   W5AT2

There are no formal tutorials in this course; each lecture session will incorporate applications and practical exercises to aid understanding of concepts.

3.   COURSEWORK AND ASSESSMENT

Assessment for ECON867 is based on an assignment and final exam, weighted as shown below:

Assignment	30%
Examination	70%

The Assignment (30%) is to be submitted by **8pm sharp Monday 13 October 2003**, and should be lodged in the ECON867 box in ERIC (C5C244).

The assignment TOPIC can be found on page 6 of this unit outline.

Your assignment must be submitted using the official cover sheet (see page 7) with plagiarism declaration signed (page 8). Keep a dated, witnessed copy of your assignment in case of misadventure. Length: 2000 words

Late assignments may or may not be received, at the discretion of the Lecturer-in-charge, and will be subject to a lateness penalty.

After staff processing, marked assignments will be returned to students in Week 13 of semester (they can be collected at ERIC).

The <u>Examination</u> (70%) will be two hours in duration and will consist of a mix of multiple choice and long-answer questions.

The exam will be based on the lecture notes: this is where students should focus their attention. Textbooks and additional readings are optional and will not be required knowledge for the exam.
The examination will aim to test concepts and understanding of principles, rather than detailed application of methods. <u>No mathematical calculations or detailed worked case studies will be required in the exam</u>.

4. <u>ADDITIONAL READING (OPTIONAL)</u>

There is no single text for the course. Students should focus on the material presented in lectures. The exam will be based on lecture notes, not on textbooks or other readings.

If some students wish to read beyond the lecture notes in selected areas to improve their understanding, then the readings below are provided. These are <u>optional</u>.

A basic reference book (optional) is:

Moosa, I., *International Finance: an analytical approach*,

1st edition, Sydney: McGraw-Hill 1998

Copies of this book are available in the Co-Op bookshop.

Other useful reference texts for the course include:

Moffet, M., A. Stonehill & D. Eiteman, *Fundamentals of Multinational Finance,* 2003

Click, R, & J. Coval, *Theory and Practice of International Financial Management,* 2002

Eun, C.S. & B.G. Resnick, *International Financial Management,* 2001

Juttner, J. *International Finance and Global Investments,* 1998

Levich, R.M., *International Financial Markets: Prices and Policies*, 1998

5.   LECTURE TOPICS

Week 1: Introduction: foreign currency markets
Provides an overview of the broad features and functions of foreign exchange (FX) markets, especially in the Australian context. How foreign currencies trading operates. Explanation of spot, forward and expected future exchange rates.

Week 2: International parity: IRP and PPP
Relates spot and forward exchange rates to international interest rate differentials, a relationship known as 'interest rate parity'. Discussion of covered and uncovered interest parity. Develops the concept of the real, effective exchange rate and the concept of 'purchasing power parity' (PPP). The role of arbitrage in maintaining interest parity relationships.

Week 3: Modelling the exchange rate
Deals with the economics of exchange rate determination in the broader macroeconomic context. Factors affecting the equilibrium exchange rate. Approaches to modelling the historical path of the exchange rate.

Week 4: Currency swaps
Looks at the economics of international swaps, both interest and currency swaps. The role of swaps in risk-management. Accounting for swaps. Swap spreads. Commodity swaps.

Week 5: Currency futures
Managing foreign currency risk through the use of FX futures. Hedging with currency futures. How to use futures for speculation. Hedging limits.

Week 6: Currency options
Exchange rate risk may be hedged through the FX options market. Discussion of types of options, option pricing and strategies.

Week 7: Measuring currency risk
Considers risk premia in foreign exchange rates. Methods for measuring the volatility of a single currency. The Value-at-Risk (VAR) methodology for measuring trading book risk. Other relevant risks such as sovereign risk, country risk.

Week 8: Managing currency exposure
Defining a firm's currency exposure. Accounting conventions for capturing the firm's exposure. 'Natural' versus 'synthetic' ways of managing foreign currency exposure: discussion of hedging approaches involving physical markets.

Week 9: Forecasting the exchange rate
Discusses techniques for predicting the future path of the exchange rate. The relative merits of econometric models versus other approaches to forecasting currency movements.

Week 10: International funding
Looks at arguments for and against raising finance globally, both short and long term. Various types of international financial instrument and their advantages. Defining the 'international cost of capital'.

Week 11: International investing
Deals with decisions relating to making foreign investment, both 'portfolio' and 'direct'. Benefits of global portfolio diversification. International CAPM model. Alternative theories to explain foreign investment.

Week 12: International taxation
The impact of taxation, including the impact of differential capital income and witholding tax regimes, on offshore financing and investing decisions.

Week 13: International banking
The Eurocurrency market. Cross-border banking activities. International monetary system and alternative exchange rate regimes.

COURSE CALENDAR

Week	Date of lecture	Topic
1	31 July	FX markets
2	7 Aug	International parity
3	14 Aug	Modelling the exchange rate
4	21 Aug	FX Swaps
5	28 Aug	FX Futures
6	4 Sept	FX Options
7	11 Sept	Measuring currency risk
8	18 Sept	Managing currency exposure
9	25 Sept	Forecasting exchange rates
	(mid semester break)	
10*	16 Oct	International funding
11	23 Oct	International investing
12	30 Oct	International taxation
13	6 Nov	International banking

* Assignment due by 8pm Monday 13 October

6.   **ASSIGNMENT TOPIC**

DUE DATE: 8pm 13 October2003 (to be deposited in ERIC ECON867 box)

NATURE OF ASSIGNMENT: Essay (2000 words)

Essay Question:
Discuss the measurement and determination of the real exchange rate, including evidence from studies of at least two different currencies.

References
Article, Measuring the real exchange rate, Reserve Bank of Australia *Bulletin*, November 2001, page 70

Ellis, L., Measuring the real exchange rate: pitfalls and practicalities, *Research Discussion paper No. 2001-04,* Reserve Bank of Australia, Sydney

Gylfason, T., The real exchange rate always floats, *Australian Economic Papers,* 41(4), December 2002, page 369

Duval, R., What do we know about long-run equilibrium real exchange rates? PPP vs macroeconomic approaches, *Australian Economic Papers,* 41(4), December 2002, page 382

Detken, C. et al, Determinants of the effective real exchange rate of the synthetic euro: alternative methodological approaches, *Australian Economic Papers,* 41(4), December 2002, page 404

Maeso-Fernandez, F. et al, Determinants of the Euro real effective exchange rate: a BEER/PEER approach, *Australian Economic Papers,* 41(4), December 2002, page 437

Fischer, C. & K. Sauernheimer, A history of the D-mark's real external value, *Australian Economic Papers,* 41(4), December 2002, page 480

Federici, D. & G. Gandolfo, Endogenous growth in an open economy and the real exchange rate, *Australian Economic Papers,* 41(4), December 2002, page 499

MacDonald, R., Modelling the long-run real effective exchange rate of the New Zealand dollar, *Australian Economic Papers,* 41(4), December 2002, page 519

STUDENT SURNAME: ....

7.   ASSIGNMENT COVER SHEET

(To be attached to the front of your assignment)

DUE DATE: 8pm 13 Oct 2003 (to be deposited in ECON867 box in ERIC)
LENGTH: 2000 words

FULL NAME: ....

STUDENT No: ....

ASSESSMENT:	Good	Fair	Poor
Presentation			
Length			
Analysis			
Expression			
Layout			

Marks deducted:	**Lateness**	....
	Poor presentation	....
	No acknowledgments	....
	Length	....
	Poor grammar	....
	No data attached	....
	No estimates attached	....

FINAL MARK (out of 30)   ....

Marker's comment:

7

PLAGIARISM DECLARATION

Plagiarism involves using the work of another person and presenting it as one's own. Any of the following acts constitutes plagiarism unless the source of each piece of borrowed material is clearly acknowledged:

(a) copying out part(s) of any document or audiovisual material, including computer or web based material

(b) using or extracting another person's concepts, computations, experimental results or conclusions

(c) summarising another person's work

(d) submitting substantially the same wording, results or material as another student.

Encouraging or assisting another person to commit plagiarism is also an improper form of academic conduct and may attract the same penalties as plagiarism.

STATEMENT TO BE SIGNED BY STUDENT:

1. I have read the description of plagiarism above

2. In my assignment I have carefully acknowledged the source of any material which is not my own work

3. I am aware that plagiarism can attract severe academic penalties

....
     (NAME)   **(STUDENT I.D.)**   **(signature)**

THIS PAGE MUST BE COMPLETED AND ATTACHED TO THE ESSAY.