

MACQUARIE UNIVERSITY

Division of Economic and Financial Studies



UNIT OUTLINE
2005

ECON 867
INTERNATIONAL FINANCIAL MANAGEMENT
(Semester 1 Evening stream)

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

Unit convenor:

Dr Kim Hawtrey (khawtrey@efs.mq.edu.au)

ECON 867

International Financial Management

Welcome from Kim Hawtrey

Hi, and thanks for choosing to join us in this unit. I hope you will find it stimulating, and also really useful for your career.

I am very enthusiastic about this class. This semester my pledge to you is to do my very best to:

- *communicate clearly what is expected so that you feel comfortable*
→ *example ... no calculations in the test or exam*
- *create a good learning atmosphere so that you feel free to explore ideas*
→ *example ... a tasty coffee and muffin break in week 2*
- *use a variety of teaching techniques that help you learn*
→ *example ... the 'class online vote' in week 3*
- *give constructive feedback so you know how you are travelling*
→ *example ... I will make written comments on your test and essay*

In summary, I am genuinely interested in assisting your progress, and I wish you all the best in ECON867 for 2005.

Kim Hawtrey

1. ABOUT THIS UNIT

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.

Students in this unit should read this unit outline carefully at the start of semester. It contains important information about the unit. If anything is unclear, please consult with the teaching staff in the unit.

2. TEACHING STAFF

Staff for the course (Evening stream Semester 1):

Dr Kim Hawtrey weeks 1-7

(C5C room 392, tel 98508504, khawtrey@efs.mq.edu.au)

Professor Jocelyn Horne weeks 8-12

(C5C room 371, tel 98507287, JHORNE@efs.mq.edu.au)

Enquiries about the subject matter of particular lectures can be directed to the lecturer concerned. General course enquiries about administration and assessment can be made to Dr Hawtrey. It is best to use email in the first instance.

3. CLASSES

Classes comprise a three-hour block (with hourly 10-minute breaks), held on Thursdays (6-9pm) in W5AT1.

The timetable for classes can be found on the University website at <http://www.timetables.mq.edu.au>.

4. UNIT WEB PAGE

The web page for this unit can be found at:

<http://www.econ.mq.edu.au/courses/econ867> (click the 'evening' stream).

5. LEARNING OUTCOMES

Upon successful completion of this unit you will:

- understand how foreign exchange markets work
- gain insight into decisions facing managers in a multinational firm
- know how to measure and manage international risk
- be able to evaluate global borrowing and investments
- judge the direction of foreign currencies

In addition to these discipline-related learning objectives, the unit will develop the following generic skills:

- critical analysis skills
- communication skills

6. LEARNING TOPICS

Week 1: Introduction to international financial management

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

Week 2: International 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 3: International options

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

Week 4: International futures

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

Week 5: 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 6: 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 7: 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 8: 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 9: Purchasing power parity (PPP)

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 10: Interest rate parity (IRP)

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.

Week 11: 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 12: 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 13: EXAMINATION (6-8pm, Thursday 9 June, W5A T1)

7. ADDITIONAL READING (OPTIONAL)

There is no mandatory 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 optional.

A basic reference book (optional) is:

Moosa, I., *International Finance: an analytical approach*,
2nd edition, Sydney: McGraw-Hill 2003

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*

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

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

8. TEACHING AND LEARNING STRATEGY

Summary: The unit is taught using the approach known as 'involved learning'. This seeks to provide a range of learning experiences including interactive lecture input, plus online participation, plus a class test, plus a research essay, plus practice exercises, leading to the final examination:

- while there are no formal tutorials in this course, each lecture session will incorporate applications and practical exercises to aid understanding of concepts

- in week 5 a class test will help you practice multiple choice and short answer skills

- in week 8 an in-class essay will help develop your research and writing skills

- in week 9, a set of practice exercises is supplied (with solutions) to help you prepare for the exam. You should work on these during weeks 9-12. They are not for handing in.

In Week 13 the Final Examination will test your success in the unit.

Lectures: You are expected to participate in all lectures. Lecture notes can be downloaded prior to class each week from the WebCT ECON867 homepage: www.econ.mq.edu.au/courses/econ867 . Alternatively, the notes are also available in hard copy from ERIC (C5C 244).

Practice exercises will be made available, to help you apply your learning and to prepare for the examination. The practice set contains forty multiple choice

questions, with solutions provided. These can be downloaded from the unit homepage from week 9 (after the mid semester test; the practice set will not be available before the mid semester test). The practice exercises take the place of tutorials: you should steadily work through them section-by-section over the period of weeks 9-12. They are not to be handed in for grading; rather, the practice exercises are for personal student use as a learning aid. Assessment: Assessment for ECON867 is based on a class test, assignment and final exam, weighted as shown below:

Class test	10%
Assignment	20%
Examination	70%

The **Class test** (10%) will be held in **week 5 (Thursday 31 March)**, in class at 6.00 pm. It will comprise 10 multiple choice questions and a one-page written-answer question (time allowed will be 45 minutes). It will cover the material from weeks 1-4 of the course.

The **Assignment** (20%) is an essay that is **written in class** in **week 8 (Thursday 5 May)**. Time allowed will be one (1) hour.

To do the "in-class essay" you need to prepare. You are given the topic in advance (see below) and are expected to prepare thoroughly by reading some or most of the set readings and planning your essay outline beforehand. No notes can be brought into the classroom.

The assignment TOPIC can be found on page 10 of this unit outline.

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

The **Examination** (70%) will be two hours in duration and will consist of a mix of multiple choice and long-answer questions. It will be held in week 13, during normal class time (**6.00 pm Thursday 9 June 2005**).

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. No calculations or detailed worked case studies will be required in the exam.

The examination period is shown above. The only exception to not sitting the exam at the designated time is because of documented illness or unavoidable disruption. In these circumstances you may wish to consider applying for Special Consideration. Information about the procedure is available at <http://www.reg.mq.edu.au//Forms.APSCon.pdf>.

IMPORTANT: students must pass the final exam to pass ECON867.

9. PLAGIARISM

The University defines plagiarism in its rules: "Plagiarism involves using the work of another person and presenting it as one's own". Plagiarism is a serious breach of the University's rules and carries significant penalties. You must read the University's practices and policies on plagiarism. These can be found in the *Handbook of Undergraduate Studies* or on the web at: <http://www.student.mq.edu.au/plagiarism/>.

10. UNIVERSITY POLICY ON GRADING

Academic senate has a set of guidelines on the distribution of grades across the range from Fail to High Distinction. Your final result will include one of these grades plus a standardised numerical grade (SNG).

On occasion your raw mark for the Unit (ie the total of your marks for each assessment item) may not be the same as the SNG that you receive. Under the Senate guidelines, results may be scaled to ensure that there is comparability across the University, and across different enrolment years. The process of scaling does not change the order of marks among students.

For more information on the policy see: <http://www.mq.edu.au/senate/MOUonly/Issues/Guidelines2003.doc>.

11. STUDENT SUPPORT SERVICES

Macquarie University provides a range of Academic Student Support Services. Details of these can be accessed at <http://www.student.mq.edu.au>.

12. UNIT CALENDAR

Week	Date of lecture	Topic	Lecturer
1	3 March	Introduction	KH
2	10 March	Swaps	KH
3	17 March	Options	KH
4	24 March	Futures	KH
5#	31 March	Measuring currency risk	KH
6	7 April	Managing currency exposure	KH
7	14 April	International investing	KH
<i>(mid semester break)</i>			
8*	5 May	International funding	JH
9^	12 May	PPP	JH
10^	19 May	IRP	JH
11^	26 May	Modelling the E rate	JH
12^	2 June	Forecasting the E rate	JH
13	9 June	EXAM	KH

Class test: 6.00 pm 31 March

* Assignment to be written in class on Thursday 5 May

^ Practice exercises to be completed during weeks 9-12

13. **ASSIGNMENT TOPIC: "THE REAL EXCHANGE RATE"**

DATE: In class, 6.00 pm 5 May

NATURE OF ASSIGNMENT: In-class Essay

Essay Question:

Discuss the issues raised by the measurement of the real exchange rate, and discuss the influences that determine the real exchange rate, including evidence from studies of at least two different currencies.

References (all available in ERIC)

Reserve Bank of Australia, '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 N. 2001-04*, Reserve Bank of Australia, Sydney

Gylfason, T., 'The real exchange rate always floats', *Australian Economic Papers*, 41(4), December 2002, p369

Duval, R., 'What do we know about long run equilibrium exchange rates? PPP versus macroeconomic approaches', *Australian Economic Papers*, 41(4), December 2002, p 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, p404

Maeso-Fernandez, F. et al, 'Determinants of the Euro real effective exchange rate: a BEER/PEER approach', *Australian Economic Papers*, 41(4), December 2002, p437

Fisher, C and K. Sauernheimer, 'A history of the D-mark's real external value', *Australian Economic Papers*, 41(4), December 2002, p499

MacDonald, R., ;Modelling the long-run real effective exchange rate of the New Zealand dollar', *Australian Economic Papers*, 41(4), December 2002, p519