

NEW YORK UNIVERSITY  
Stern School of Business - Graduate Division

B40.3388 – Langone Section  
International Financial Management

Richard Levich  
Summer 2007

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COURSE OUTLINE AND READING LIST

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OVERVIEW

In this course, we explore the characteristics of international financial markets and examine some international aspects of corporate financial management. In the sections that deal with international financial markets (e.g. foreign exchange, Eurocurrencies, Eurobonds, futures, options, swaps, etc.), 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?
- How do macroeconomic conditions and regulatory policy choices impact market prices and investor and corporate financial decisions?

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

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ASSIGNMENTS AND GRADING

Students will be required to complete two in-class exams (70% of grade). Two written cases (20% 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 9-90, New York, NY 10012-1126.
- Office Hours: Tuesday, 4:00 - 5:30 pm and Wednesday, 4:00 - 5:30 pm and by appointment.
- Electronically: Phone: 212-998-0422; FAX: 212-995-4233;  
E-mail: rlevich@stern.nyu.edu [Please use only for personal messages. Use **Blackboard** for general questions and comments.]
- My Secretary: Mr. David Bosch, KMC Room 9-171, Phone: 212-998-0347;  
E-mail: dbosch@stern.nyu.edu
- Course Web Page: <http://sternclasses.nyu.edu/>  
Watch this page for course announcements, due dates of assignments, chat room discussions, and other information. Please use the Blackboard "Discussion Boards" for making comments and raising questions of general interest.
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## TEXT

Richard M. Levich, *International Financial Markets: Prices and Policies*, second edition, (New York: Irwin/McGraw-Hill), 2001. (RML)

Chapters from the text are noted in the outline as *RML*. Other readings will be distributed in class (C) or available on our Blackboard site via links.

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## PREREQUISITES

The MBA core courses B01.2303 (Global Business Environment) and B01.2311 (Foundations of Finance) are essential prerequisites for this course.

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## STERN HONOR CODE

Students are expected to abide by the Stern MBA Honor Code in all aspects of this course.

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## BRIEF SCHEDULE OF TOPICS AND CLASSES **(SUBJECT TO CHANGE)**

1.	June 27	Introduction (Chap. 1); Foreign Exchange Markets: Market Structure and Institutions (Chap. 3)
2.	July 2	International Parity Conditions: Purchasing Power Parity (Chap. 4) Covered and Uncovered Interest Parity (Chap. 5)
3.	July 9	Determinants of Spot Exchange Rates: Theory + Evidence (Chap. 6)
4.	July 11	Foreign Exchange Market Efficiency (Chap. 7) and Ford Motor Credit Case (discussion)
5.	July 16	Exchange Rate Forecasting (Chap. 8) Eurocurrency Markets (Chap. 9)
6.	July 18	Eurobond Markets (Chap. 10) International Bond Portfolios (Chap. 14)
7.	July 23	Mid-Term Examination ( <i>Chapters 3, 4, 5, 6, 7, 8</i> ); International Bond Portfolios and Currency Overlay (Chap. 14)
8.	July 25	Mid-Term returned; Currency and Interest Rate Futures (Chap. 11)
9.	July 30	Currency and Interest Rate Options (Chap. 12)
10.	August 1	Currency and Interest Rate Swaps (Chap. 13)
11.	August 6	Measuring and Managing Exposure to International Financial Risks (Chap. 16)
12.	August 8	Final Examination ( <i>Chapters 9, 10, 11, 12, 13, 14 and 16</i> )

## LIST OF TOPICS AND ASSIGNMENTS

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

RML, Chapters 1, 2

*TOPICS:* Understanding major themes affecting 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.

*Note: Chapter 1 is an introduction to the text and Chapter 2 reviews themes covered in your core course "Global Business Environment." Accordingly, you may skim these chapters. They will not be covered specifically in class.*

### Class 1b Foreign Exchange Markets: Market Structure and Institutions

RML, Chapter 3

*TOPICS:* Market participants; volume, composition, growth and profitability 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, and 11.

### Class 2a 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, concept of mean reversion, managerial and forecasting decisions and PPP.

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

### Class 2b International Parity Conditions: Interest Rate Parity and the Fisher Parities

RML, Chapter 5

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

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

*CASE: Ford Motor Credit Company*

Class 3      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 macroeconomic news and exchange rate movements.

Class 4      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, 3 and 5.

Class 5a      Foreign Exchange Rate Forecasting

RML, Chapter 8

*TOPICS:* Forecasting under pegged rates versus floating rates, short-run versus long-run forecasts, forecast performance evaluation -- accurate versus useful forecasts; short-run forecast: trends versus random walks, long-run forecasts: is there mean reversion? composite forecasts.

*ASSIGNMENT:* Chapter 8, Exercises 3 and 4.

Class 5b      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, and approaches to regulating offshore markets; the Japan Premium.

*ASSIGNMENT:* Chapter 9, Exercises 2, 3, 4, and 5.

Class 6a 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 6b 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 bonds, global asset allocation.

*ASSIGNMENT:* Chapter 14, Exercise 1

Class 7 MID-TERM EXAM

Class 8 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 affect cash market volatility?

*ASSIGNMENT:* Chapter 11, Exercises 1, 2, 3, and 4.

Class 9 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, and 9.

*CASE: Gifts from FX Students*

Class 10      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.

Class 11a      Measuring Exposure to International Financial Risks

RML, Chapter 16, pages 600-21

*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, the Value at Risk (VAR) approach.

*ASSIGNMENT:* Chapter 16, Exercise 3

Class 11b      Managing Exposures to International Financial Risks

RML, Chapter 16, pages 621-39.

*TOPICS:* Why should the firm hedge? Financial strategies toward risk management, characteristics of currency exposure and suitable hedging instruments, picking the right hedge ratio, successful vs. flawed hedging strategies, investor response to corporate use of derivatives and hedging.

*CASE:* Jaguar, plc.

Class 12      FINAL EXAM