Kellogg School of Management
4205 Andersen Hall
Northwestern University
Spring Quarter 2008
Section 61

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Office Hours: Tuesday 11am-1pm

Finance 470
International Finance

This class provides an introduction to the workings of the foreign exchange markets, the impact of economic policy on exchange rates, the nature of foreign exchange risk and important aspects of financial management of the multinational corporation. The first part examines the determination of spot and forward exchange rates, monetary policy, alternative exchange rate systems, and the international links between exchange rates, inflation rates and interest rates. Moreover, the balance of payments is studied and its impact on exchange rates and country risk is explored. The second part of the class examines various concepts of exchange risk and analyzes hedging exchange risk with forward contracts and foreign currency options. To the extent time allows, the need to manage exchange risk in a continually operating international business is debated and/or the issue of how to assess the profitability and cost of capital of foreign investments is analyzed. Also, a number of actual corporate cases are examined. Throughout, the connection to current events as reported in newspapers and journals is emphasized.

The only formal prerequisite for the course is Finance 430. However, familiarity with Finance 441 is useful in the second half of the course. Knowledge of elementary principles of Macroeconomics and Derivative Securities are helpful throughout, although necessary concepts will be developed from first principles.

Textbook: **Eun, C.S. and B.G. Resnick: International Financial Management;**
Fourth Edition; McGraw-Hill/Irwin, 2007.

Other Readings: A packet of articles available from the bookstore. Supplementary notes and readings will be handed out in class.

Course Requirements: Grading will be based on Class Participation (10%), Problem Sets and Case Write-ups (20%), a Midterm Exam (25%), and a Final Exam accounting for 45% of your course grade. 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 discussion. To facilitate this practice it is helpful if you bring your name plates.

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Course Schedule

Week 1 **Introduction and Overview of Course**

1. Short Term Foreign Exchange and International Money Markets

Introduction to the Foreign Exchange Interbank Market;
Foreign Exchange Spot and Forward Transactions;
Eun & Resnick, Chapter 1, pp. 4-24.
Eun & Resnick, Chapter 5, pp. 106-131.

Week 2 **2. Interest Rate Parity and Hedging FX Transaction Exposure**

Interest Rate Parity Theorem; Hedging Foreign Exchange Transaction Exposure;
Valuing FC Cash Flows; FX Carry Trade; Uncovered Interest Rate Parity
Eun & Resnick, Chapter 6, pp. 132-141;
Eun & Resnick, Chapter 8, pp. 192-198;
Eun & Resnick, Chapter 11, pp. 266-276;
Course packet, Carry Trade readings

Week 3 ***Hand-In Solutions to Problem Set #1.***

3. Monetary Policy, Inflation, Interest Rates and Growth

Mechanics of Monetary Policy; Short Run Inflation/Unemployment Trade-off
Fisher Effect; Evidence on Money Supply, Inflation and Interest Rates Linkages
Mankiw, Chapters 29-30; Course Packet
Federal Reserve Bank of San Francisco, U.S. Monetary Policy; Course packet
Eun & Resnick, Chapter 6, pp.147-148;

Week 4 **4. FX Rate Systems, FX Intervention and Balance of Payments**

Alternative FX Rate Regimes; Demand and Supply Diagram for FX Determination;
Central Bank FX Intervention; Balance of Payments and National Income Accounting
Eun & Resnick, Chapter 2, pp. 25-39.
Eun & Resnick, Chapter 3, pp. 59-77.
Economic Report of the President, Excerpts in Course Packet

Week 5 ***Hand-In Solutions to Problem Set #2.***

5. Exchange Rate Determination and International Parity Conditions

Purchasing Power Parity; other International Parity Conditions; Real Exchange Rates;
Future Expected Spot Exchange Rates; Foreign Exchange Risk Premia
Eun & Resnick, Chapter 6, 141-161;
Wall Street Journal: German Bonds Look Good; Course Packet
The Economist: The Paradox of Plenty; Course Packet
The Economist: A Much Devalued Theory, Course Packet

Week 6 **Midterm Exam, Thursday, May 8; In-Class**

Hand-In Solutions to Problem Set #3A.

5. Exchange Rate Determination and International Parity Conditions (Wrap-Up)
Implications for Foreign Investment Analysis;
Some Stylized Macroeconomic Facts; Course packet

6. Growth in Developing Countries, Currency Crises
Choice of FX Regime; Currency Crises; Growth in BRIC countries;
Eun & Resnick, Chapter 2, pp. 39-58.
Goldman Sachs: Dreaming with BRICs: The Path to 2050; Course Packet

Week 7 ***Hand-In Solutions to Problem Set #3B.***

7. FX Volatility and Foreign Currency Derivatives
Characterizing Volatility and Risk in FX Market;
Descriptive on Foreign Currency Futures; Foreign Currency Options
Eun & Resnick, Chapter7, pp. 162-177.
Carlson et al: "Dozier Industries (A)"; Course Packet
Goldman Sachs: The Case for Investing in Spanish Bonds; Course Packet

Week 8 **Make-Up Class for Memorial Day, May 21** (Date to be Confirmed !!)

8. Hedging Applications with Foreign Currency Derivatives
Why Hedge? Examples: Zenith and Lufthansa; Merck and Western Mining Review
FX Operating (Economic) Exposure, Measuring and Managing
Eun & Resnick, Chapter 8, pp. 198-221.

Week 9 **Memorial Day, May 26, No Classes - Make-Up Class (tentative) on May 21**

8. Hedging Applications with Foreign Currency Derivatives (continued)
FX Operating (Economic) Exposure, Measuring and Managing
Eun & Resnick, Chapter 9, pp. 222-243.

Week 10 ***Hand-In Solutions to Problem Set #4.***

9. International Valuation
Brief Review: Domestic Capital Budgeting; Adjusted Present Value (APV)
Corporate Examples
Eun & Resnick, Chapter 18, pp. 449-466.
Harvard Business School: Cross-Border Valuation; Course Packet
SalomonSmithBarney: Practical Approach to International Valuation; Course Packet

Final Exam **Tuesday, June 10, 9:00-11:15am**