

Module 1

The Role of Global Capital Markets

The Foreign Exchange Market (No company is an island...)

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Going global

Most companies are exposed to changes in exchange rates

- Exports of goods
- Imports of inputs
- Overseas operations/assets
- Overseas liabilities
- ...
- Overseas competition.



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Where's the market?

An **Over-The-Counter (OTC)** wholesale dealer market where a small number of **accredited dealers** provide real-time currency prices.

1. Companies contact brokers.
2. Brokers provide orders to buy/sell currencies to dealers.
3. Dealers quote prices at which they will buy/sell.

FX market organizes trading in currencies but does not provide financing – e.g. a loan in foreign currency!

Is there no primary market?

The exchange rate

It's a relative price – the value of a currency is expressed in terms of another currency.

$$USD/CNY = 6.2$$

Domestic/trade/base currency = USD

Foreign/terms currency = Chinese Yuan (CNY)

USD/CNY indicates 6.2 Chinese Yuan buys 1 USD.

Alternatively:

CNY/USD indicates 0.1613 USD buys 1 Chinese Yuan.



Changes in the exchange rate

Appreciation

If USD/CNY increases, the base currency (USD) increases in value, i.e. one USD buys more CNY.

Depreciation

If USD/CNY decreases, the trade currency (USD) decreases in value, i.e. one USD buys less CNY.

Fixed, managed or floating

Some countries fix/peg the value of their currency to another currency.

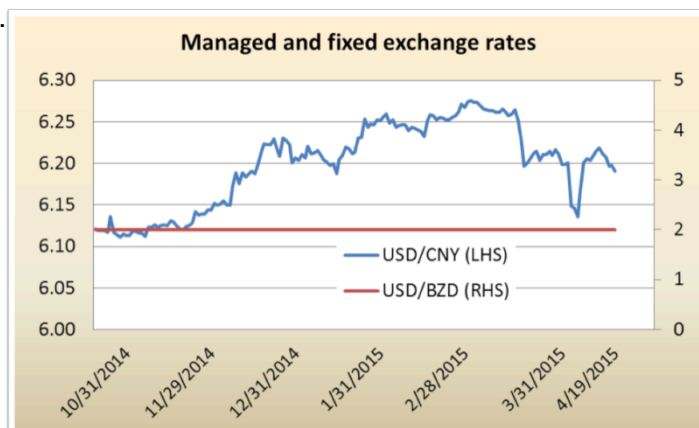
- *Belize Dollar against the USD*
2 BZD = 1 USD

Others control/manage the movements against another currency.

- *Chinese Yuan against the USD*

Most let the market determine the value = floating exchange rates.

What about the EURO?





FX centers

New York, Frankfurt, Tokyo, London, Sydney – are the traditional FX markets.

Straddling the world's time zones for 24/7 price discovery in the world's leading trading currencies (*USD, EURO, CNY, JPY, GBP*).

New centers emerge:
Beijing, Mumbai, Seoul, Sao Paulo.

FX trading is OTC, but online platforms link regional markets.



Source list

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