

DEPARTMENT OF ACCOUNTING AND FINANCE

AcF305: International Financial and Risk Management **Michaelmas Term 2023-24**

1 Module Objectives

The objectives of this module are to:

- Describe the structure of the international monetary system;
- Analyse the relationships between interest rates, inflation rates and exchange rates;
- Explain the main determinants of exchange rate movements and risk;
- Deepen course participants understanding of derivatives by applying basic concepts to foreign exchange futures, options and other related instruments for risk management;
- Explain the use of foreign exchange derivatives in the context of corporation risk management;
- Provide guidelines for corporate financial decision making in an international context.

2 Learning Outcomes

By the end of the module, students should:

- Be able to give reasoned analyses of developments in international financial markets;
- Be familiar with the valuation of foreign exchange futures, options and other related financial instruments;
- Understand the objectives of exchange-rate risk management,
- Be familiar with the fundamentals of financing, investing, and risk management in international financial markets.

3 Reading and e-learning resources

The core textbook for this module is:

Sercu, Piet (2009), *International Finance: Theory into Practice*, 1st edition, Princeton University Press, Cambridge, NJ, ISBN-10: 069113667X, ISBN-13: 978-0691136677.

Students are expected to have read the chapters outlined in Section 6 of this document before attending lectures and tutorials. The purpose of the lectures and tutorials is to elaborate on a subset of the (more relevant) topics in the textbook. Even so, all material specified in the chapters in Section 6 is exam relevant, with exceptions noted. Furthermore, additional readings are listed in Section 6.

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4 Module Administration

The module is taught by Dr Mykola Babiak (lectures and workshops). The contact details are as follows:

- Office: Charles Carter, Office C04
- E-mail: m.babiak@lancaster.ac.uk
- Office hours: Mondays 10:00-11:00, 13:00-14:00

The module is taught in person. There are two 1-hour lectures in each week of the Michaelmas term. In addition, there is one 1-hour tutorial from weeks 2 to 10. Tutorial attendance is compulsory, and students are expected to prepare the exercises in advance, as they may be asked to participate in the classroom discussion. It is the students' responsibility to ensure that they register attendance in compulsory sessions. The total study time for this module is expected to be at least 150 hours.

5 Module Assessment

The module is assessed as follows:

- Coursework: 25%
- Exam: 75%

The coursework is a group work. Students should determine the composition of the group, and the size of the group must be of 5-6 students. Groups with less than 5 students or more than 6 students are not allowed. The group composition must be sent by email to Mykola Babiak before the end of week 4. Note that this should be done using the Excel file (a template for this is uploaded on Moodle), which should include the student ID, surname, forename, and Lancaster email address. Students who do not belong to any group will be allocated to groups by the Department.

The coursework consists of solving numerical questions using Excel and writing a report. All group members will be awarded with the same mark; therefore, it is important that group members are well organised when working on the assignment. It is strongly advised that group members meet as early as possible to facilitate the organisation of the group. Students are expected to consult the group work guidelines issued by Lancaster University Management School (available on the module Moodle site) before contacting module directors about any potential problems with teammates.

The coursework assignment must be submitted via Moodle by 15 December (Friday of week 10), noon. Further details will be communicated via module Moodle site in due course.

Note: Department reserves the right to adjust coursework marks after coursework has been returned to students to ensure that the coursework marks have an appropriate distribution.

Any visiting student who intends to leave Lancaster before the summer examination must inform the module director(s) immediately so that alternative assessment may be arranged. Please note that there is no opportunity for re-assessment for visiting students failing to achieve the necessary pass mark for their home University.

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6 Lecture Outline

NOTE: copyright for articles, including those linked via 'My Resource List', resides with the authors. These articles should be used as part of the module only.

Legend for Reading: [E] - Essential.

Week 1: International Finance: Institutional Background
(Money; Balance of Payments; Exchange Rate Regimes)

Reading:

- Sercu (2009), Chapter 2. [E]
- Wolf, M. (2010), "Could the world go back to the gold standard?", Financial Times Blog, 1 Nov 2010.
- The Economist (2011), "Currency interventions: Francs for nothing", The Economist, 10 Sep 2011.

Week 2: Spot Markets for Foreign Currency

(Exchange Rates; Markets for FX; the Law of One Price; Purchasing Power Parity; Cryptocurrencies)

Reading:

- Sercu (2009), Chapter 3. [E]
- The Economist (2013), "The Big Mac index: Value meal", The Economist, 13 July 2013.
- Rogoff, K. (1996), "The Purchasing Power Parity Puzzle", Journal of Economic Literature 34(2), 647-668.

Week 3: Understanding Forward Exchange Rates for Currency

(Forward Contracts; Relation between FX and Money Markets; Covered Interest Parity; Market Value of an Outstanding Forward Contract)

Reading:

- Sercu (2009), Chapter 4. [E]
- Froot, K.A. and Thaler, R.H. (1990), "Anomalies: Foreign Exchange", Journal of Economic Perspectives 4(3), 179-192.
- Green, P. (1992), "Is Currency Trading Profitable? Exploiting Deviations from Uncovered Interest Parity", Financial Analysts Journal 48(4), 82-86.

Week 4: Using Forward Contracts for International Financial and Risk Management

(Forwards in Real-World Markets; Using Forwards in Risk Management: Hedging, speculation and the Impact of Market Imperfections; Carry trade)

Reading:

- Sercu (2009), Chapter 5. [E]
- The Economist (2009), "Corporate hedging gets harder: The perils of prudence", The Economist, 18 June 2009.
- Kojien R., Moskowitz T., Pedersen L., Vrugt E. (2017), "Carry", Journal of Financial Economics, 127(2), 2018, p.197-225.

Week 5: Currency Futures and Swaps

(From Forwards to Futures; Using Futures in Risk Management: Hedging; Swap Contracts)

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Reading:

- Sercu (2009), Chapters 6 & 7. [E]
- Kritzman, M. (1991), "What Practitioners Need to Know...About Regressions", Financial Analysts Journal 47(3), 12-15.

Week 6: Currency Options, another instrument for international risk management
(Currency Risk and Options; Jargon and Institutional Features; Arbitrage Relations; Hedging)

Reading:

- Sercu (2009), Chapter 8. [E]
- Kritzman, M. (1992), "What Practitioners Need to Know...About Currencies", Financial Analysts Journal 48(2), 27-30.

Week 7: Rationales for Corporate Hedging and Measuring Risk Exposure
(Relevance of Hedging; Risk & Exposure; Hedging Contractual, Operating and Accounting Exposures)

Reading:

- Sercu (2009), Chapters 12 & 13. [E]

Week 8: Cost of International Capital and Risk Management – the International CAPM

Reading:

- Sercu (2009), Chapter 19. [E]
- Stulz, R.M. (1999), "Globalization, Corporate Finance, and the Cost of Capital", Journal of Applied Corporate Finance 12(3), 8-25.

Week 9: The Fed and international Capital Budgeting

(Central bank activities; The Fed and FOMC meetings; failure of the CAPM and InCAPM; international capital budgeting)

Reading:

- Sercu (2009), Chapter 21. [E]
- Brusa F., Wilson M., and Savor P. (2017) "One Central Bank to Rule Them All".

Week 10: Course Summary and Exam Info

Reading: none

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Mykola Babiak

September 2023