International Finance  
Finance 319  
Winter 2001

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Course Website: http://www.citi.umich.edu/u/galka/319  
Office Hours: Monday 10:00a.m. - 12:00p.m.  
Thursday 1:00p.m. - 3:00p.m. (or by appointment).

Schedule

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<th>Section</th>
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<tr>
<td>001</td>
<td>M W</td>
<td>8:30am - 10:00am</td>
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Midterm: Take home  
Final: TBA

Course Objectives

This course provides the analytical framework for understanding of the international financial system. An overview of international financial institutions will be provided. We will study the determinants of cross-border capital flows and explore different exchange rate regimes. We will analyze the reasons for financial crises and the mechanisms that are employed to overcome them.

Further, we will focus on the opportunities of international financial markets for risk-management and asset allocation objectives. We will examine analytical tools for portfolio management and hedging in an international context. The course will benefit students interested in a practical understanding of international financial arrangements, and seek careers in financial industry, or with corporate finance departments.

Grading and Requirements

This course will have three homework assignments, one case study a take-home midterm and a final exam. The written assignments and the midterm are due at the beginning of the class in which they are discussed. Students are encouraged to work together and turn in the written assignments, which are optimal: the
homework grade could be substituted by the class participation grade. Write-ups could reflect the work of up to 4 students.

Good questions are purposely written to be ambiguous. While there are no right answers, there are good and bad arguments. If you are uncomfortable with ambiguity you should reconsider taking this course, or prepare to deal with the subject where ambiguity is an essential feature.

**Attendance:** The subject of international finance is conceptually demanding and hardly could be mastered through an independent self-study. Thus, attendance of lectures is crucial to absorb the material. Attendance and promptness will be rewarded accordingly.

Midterm exam: (Take home) 30%
Final exam: (Take home) 30%
Homework / Class participation: 40%,

where the grade for the homework is calculated as an average of the home assignments (i.e. 20% of the total grade) and the case study (i.e. 20% of the total grade) grades. Students will have an option to re-weight the final at 60 % of the total grade (dropping off the midterm grade).

A handwritten ‘cheat sheet’ will be permitted on the Final exam. Also students could purchase extra exam time: its cost is 1 point reduction of their exam score per extra minute (the total score for each exam is 100, with up to 10 additional bonus points). No make-ups will be allowed, except with a formal excuse from the Academic Services Office.

Grade Appeals: Grade appeals are in writing only, and have to be submitted within 5 days after the date when the written work is returned.

**Prerequisites:** Fin 310 and CSIB 319 (can be taken concurrently)

**Readings:** The primary readings will come from an excellent textbook *International Financial Markets* by Richard Levich (McGraw-Hill) (further Levich), SECOND EDITION (2001). Lecture notes and relevant excerpts from various publications will supplement the textbook. Many readings will be posted as pdf files. Thus, students will need Adobe Acrobat Reader (see [www.adobe.com/prodindex/acrobat/readstep.html](http://www.adobe.com/prodindex/acrobat/readstep.html)). In order to disseminate the class materials efficiently, it is advisable to check the web site in advance (i.e. within 24 hrs) of each class. Most course materials will be distributed in class and posted on course web site, and linked to my home page at the URL [http://www.citi.umich.edu/~galka/319](http://www.citi.umich.edu/~galka/319)

**Introduction**
Course Overview. Subject and structure of the course

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1 That is, 40% of a student’s grade will be determined by either the student’s homework or class participation grade – whichever is higher.


**International Financial System**

The functions of money, Government and banks’ role, Current Account, Balance of Payments Rules of the game: Gold standard, Bretton woods, Fixed and Floating exchange rate regimes, Recent developments

**Levich**: Chapters 1 & 2. (R)


**Foreign Exchange Market Structure**

Spot and Forward Contracts, Arbitrage, types of risk, Modern institutions, Controls

**Levich**: Chapter 3. (R)

**International Parity Conditions**

Purchasing Power Parity and Interest Rate Parity

*Transaction costs, Limits of arbitrage, Purchasing power parity (PPP), Real exchange rate parity, Fisher effect*

**Levich**, Chapters 4 and 5, (R)


First Homework Assignment
Exchange rates

*Analysis of supplies and demand for currency, Government policies*

**Levich**, Chapter 6, p. 176, (R)

Second Homework Assignment

**Efficiency**

*Foreign exchange market efficiency: theoretical considerations and real world constraints*

**Levich**, Chapter 7, (R)

“Foreign exchange banks charge into online battle,” 2000, Financial times, August 15.

**Currency Crises**

Inconsistent Optimal Policies, Commitment Constraint, Contagion


*Market pre- post crises markets’ behavior, government policies and their limitations.*


**Recent Developments. Regulation**

Recent developments of the international financial institutions and instruments, Sources and Costs of Information, Market Structure, Market Power, Regulation

**Levich**, Chapter 17, (R)

**Millman**, “Nuclear Finance,” pp.195-225. (S)


Take-home Midterm is distributed in class

**Financial Information: Past, Present, Future**

**Sources of information, where does its bias come from?**


Trillion Dollar Bet (2000), A documentary by Nova

Case Study is distributed (LTCM)

**Exchange rate forecasting**

*Levich*, Chapter 8. (S)

**Offshore Financial Markets**


*Levich*: Chapters 9 and 10. (R)

**International Financial Crisis**

**Derivative Securities**

Currency and Interest Rate Futures, Options and Swaps. The reasons for financial innovation. The terminology, risk assessment: theory and practice.

*Levich*: Chapters 11, 12 and 13. (R)

**Third Homework Assignment**

International Asset Portfolios. Bond & Equity Portfolios
Levich: Chapters 14, 15 & 16, (R)

Financial Institutions and Hi-Tech


Conclusions and Summary

References


