

UNIVERSITY OF TEXAS AT EL PASO
DEPARTMENT OF ECONOMICS AND FINANCE
FINANCE 4325, INTERNATIONAL FINANCE (CRN 22975), SECTION 001
12:00 - 1:20 PM TUESDAY AND THURSDAY, BUSN 318
SPRING 2015 SYLLABUS



INSTRUCTOR AND RELATED INFORMATION

Oscar Varela, *Ph.D., CFA*
Charles R. and Dorothy S.
Carter Chair in Business
Administration, and
Professor of Finance
University of Texas at El Paso
Emeritus Professor of Finance
University of New Orleans

Office: BUSN 235
Direct Office Phone: 915-747-7771
Department Phone: 915-747-5245
Student Office Hours:
10:20-11:20am Tuesday and Thursday
1:20-2:20p Tuesday and Thursday
and by appointment
Email: ovarela3@utep.edu

MATERIALS

Varela, Oscar, *Lecture Notes and Problems, International Finance*, posted on the course's UTEP Blackboard site

Perusal of business publications, such as the *Wall Street Journal*, *Financial Times of London*, *Barron's*, the *Economist*, and *Business Week*, especially regarding their international financial data

CATALOG DESCRIPTION/PREREQUISITE: FIN 4325: International Finance (3-0)
This course examines the financial operations of the firm from an international point of view. Topics include the history of international finance, foreign exchange markets, exchange rate determination, foreign exchange exposures (risks) for the multinational firm and techniques to hedge such exposures, international bond, equity and currency markets, trade documentation, and international capital budgeting. Economic, transaction, and accounting exposures and methods to mitigate these with foreign currency options, futures, forwards, and swaps are examined, as are the international business activities of countries (the balance of payments). Prerequisites: ECON 3320 or FIN 3310, each with a grade of "C" or better.

OBJECTIVE: The course examines the managerial implications pertaining to the financial operations of the firm and of investments in the international arena. The standard topics in international finance, such as the history of international finance, foreign exchange markets, exchange rate determination, foreign exchange risk (exposure), hedging techniques for that risk (using forwards, futures, options and swaps), international corporate valuation and capital budgeting, and sources of funds and the cost of capital in the international bond, stock, and money markets, are examined from a managerial point of view. The student should be able to answer questions and solve problems concerning international financial management in the course topic areas, and understand its core contents at the undergraduate level. Students will demonstrate an understanding of the techniques and practices of international finance in all these areas, with the added value of this course derived from the instructor's objective of transferring this knowledge of the international finance literature efficiently and completely, and in as enjoyable a manner as feasible.

OUTCOMES AND MEASUREMENT:

- Outcome 1. Students will demonstrate knowledge of the international financial markets and investing therein.
- Outcome 2. Students will integrate knowledge of the foreign exchange market with exchange rate determination.
- Outcome 3. Students will demonstrate knowledge of contemporary history and current affairs in international finance.
- Outcome 4. Students will examine the international business and financial activities of countries (the balance of payments) and apply to import-export financing.
- Outcome 5. Students will demonstrate knowledge of international capital budgeting and the exposure of foreign investments.
- Outcome 6. Students will integrate understanding foreign exchange risk with hedging using forwards, futures and options on foreign exchange.

Outcomes measurements: Student achievement in course objectives will be assessed based on performance on exams and through in class participation/ attendance.

STUDENT ACCOMODATIONS: If you have or suspect a disability and need accommodations you should contact the Center for Accommodations and Support Services (CASS) at 747-5148 or at cass@utep.edu or go to Room 106 Union East Building.

REQUIREMENTS: Attendance is a requirement and is assumed and expected. Students missing more than 3 classes should seriously reflect on their commitment to this course, as missing classes is highly and directly correlated with poor performance. Students may be asked to produce evidence of their note taking and problem working efforts when seeking the instructor's advice on improving their performance, as key ingredients in improving performance are good note taking (which requires class attendance) and good problem working efforts.

Course grade to be determined by the weighted performance in the following categories, with the final course grade based on the 10 point scale, i.e. 90 percent is an A, 80 percent is a B, etc.

EXAM	AVERAGE WEIGHT**	DATE	TIME
Exam I	22.5 percent	Tue, Feb 10, 2015	12:00-1:20pm
Exam II	22.5 percent	Thu, March 19, 2015	12:00-1:20pm
EXAM III	22.5 percent	Thu, April 16, 2015	12:00-1:20pm
Final Exam	22.5 percent	Tue, May 12, 2015	1:00-3:45pm
Attendance	10 percent		

** While on average the weight per exam is 22.5 percent, the lowest exam grade will be weighed 12.5% and the highest exam grade will be weighed 32.5% in the calculation of the final course average. The remaining exams will weigh 22.5% each.

CLASS ATTENDANCE: Class attendance weighs for 10 percent of the final course grade. A zero will be allocated to one-fifth of this attendance weight when a student misses a lecture class for the second time in this course on days (and at the time) when the roll is (randomly) called. Cumulatively, a zero will be allocated to all 10% of this attendance weight when a student misses six lecture classes in this course on days (and at the time) when the roll is (randomly) called. Lecture classes are classes on days when an exam is not given – because there is a separate policy for missing exams. Exceptions to this full penalty for missing classes are possible on a case by case basis, but they will be limited to cases where the reason for missing class is completely beyond the student's control or the student has an official university exemption for missing a class. Simply speaking, any student missing six or more classes on days (and at the time) when the roll is (randomly) called in this course will receive 0% credit on 10% of the final course grade, compared to those students equivalent in all other respects but with perfect attendance on days when the roll is (randomly) called.

EXAMS: Situational problem, mini-cases, essay and definitional type questions, and multiple-choice and true-false questions, will appear in the examinations. The final exam will be comprehensive, whereas all other exams will include on a non-cumulative basis only the material shown in the course outline.

MISSED EXAMS: Credit for a missed exam may be made-up ONLY IF:

(1) the reason for missing the exam is beyond the student's control, e.g. such as a medical excuse, jury duty, death in the family or automobile accident, or

(2) prior consent is obtained from the instructor for missing the exam based on a non-frivolous excuse, e.g. such as a job interview or out-of-town job related travel.

In either case, **the student must submit a written and signed statement concerning the reasons for missing the exam, with appropriate documentation, and petition for a makeup.**

A missed exam will carry a zero grade if these conditions are not met.

Otherwise, the first missed exam will be made-up in the comprehensive final exam, and will cause the final exam to weigh 45 percent rather than 22.5 percent in the final course grade. [If the final exam grade is the lowest (highest) exam grade and the final exam also makes up credit for a missed exam, then only the missed exam component of the final exam grade will be weighed 12.5 (32.5) percent as a lowest (highest) exam grade, whereas the final exam component will weigh 22.5 percent.] A student that misses more than one exam, presuming that the conditions for an approved make-up are met, will need to take an actual make-up of the missed exam at a time convenient to both the student and instructor.

Any student missing the Final Exam, presuming that the conditions for an approved make-up are satisfied, will need to take an actual make-up of the Final Exam at a time convenient to both the student and instructor. Students missing the Final Exam under approved conditions will receive (unless precluded by university rules) a grade of "I" (incomplete) for the course (unless the make-up can be conveniently scheduled before the university deadline for submission of grades). Students receiving a grade of "I" for missing the Final Exam will be responsible for making up the Final Exam at a time convenient to both the student and instructor. A make-up of the Final Exam because of an Incomplete grade is subject to university rules.

ACADEMIC HONESTY: Academic honesty is paramount to the existence of academic integrity in a course. During the taking of exams, no student in this course is to receive or give assistance to any other student in this course, nor should assistance through the use of unauthorized materials be used by anyone. In fulfilling other course requirements, work submitted by any student, or any assigned group of students in the

case of group projects, must be the original work of that student or group, with appropriate credit given when other sources are used.

Section 1.3.1 of UTEPs *Handbook of Operating Procedures* provides the basis for the academic administration of charges of scholastic dishonesty. The *Handbook* states: "Any student who commits an act of scholastic dishonesty is subject to discipline. Scholastic dishonesty includes, but is not limited to cheating, plagiarism, collusion, the submission for credit of any work or materials that are attributable in whole or in part to another person, taking an examination for another person, any act designed to give unfair advantage to a student or the attempt to commit such acts. Disciplinary proceedings may be initiated against any student for any of the following acts or omissions:

1.3.1.1 "cheating" includes:

- a.** copying from the test paper of another student, engaging in written, oral, or any other means of communication with another student during a test, or giving aid to or seeking aid from another student during a test;
- b.** possession and/or use during a test of materials which are not authorized by the person giving the test, such as class notes, books, or specifically designed "crib notes";
- c.** using, obtaining, or attempting to obtain by any means the whole or any part of non-administered test, test key, homework solution, or computer program, or using a test that has been administered in prior classes or semesters, but which will be used again either in whole or in part without permission of the instructor; or accessing a test bank without instructor permission;
- d.** substituting for another person, or permitting another person to substitute for one's self, to take a test; and
- e.** falsifying research data, laboratory reports, and/or other records or academic work offered for credit;

1.3.1.2 "plagiarism" means the appropriation, buying, receiving as a gift, or obtaining by any means another's work and the unacknowledged submission or incorporation of it in one's own academic work offered for credit, or using work in a paper or assignment for which the student had received credit in another course without direct permission of all involved instructors.

1.3.1.3 "collusion" means the unauthorized collaboration with another person in preparing academic assignments offered for credit or collaboration with another person to commit a violation of any provision of the rules on scholastic dishonesty."

FIN 4325 COURSE OUTLINE¹
Attendance is assumed and expected
and absences are penalized

29 Sessions / 15 Weeks

I. Week I. Session 1 Tue Jan 20

The Course of the Course

II. Week I. Session 2 Thu Jan 22

LECTURE 1 International Markets and Investing

I. Introduction

II. The Generic Paradigm of Financial Markets

III. International Money Markets: Euro and Asian Currency Markets

IV. International Bonds: Foreign Bonds and Eurobonds

V. International Stocks

A. Risk and Return

B. Shares in Foreign Markets, Foreign Shares in Domestic Markets and Depository Receipts

C. Exchange Traded Funds and Mutual Funds

VI. Foreign Investments and Portfolio Diversification

VII. Summary

Questions and problems, all

Varela, Oscar, 2002, "The Efficiency of Net Asset Values for Asian-Country Mutual Funds in the US," *Journal of Business Finance and Accounting* 29, 761-786.

Varela, Oscar and Sang H. Lee, 1993, "International Listings, the Security Market Line and Capital Market Integration: The Case of U.S. Listing on the London Stock Exchange," *Journal of Business Finance and Accounting* 20, 843-863.

III. Week 2. Session 3 Tue Jan 27

LECTURE 1 Continued

¹ The instructor reserves the right to revise the course outline, and slow down or speed up as the class pace dictates. Particularly emphasized will be the sections in the course outline that are in boldface.

IV. Week 2. Session 4 Thu Jan 29

LECTURE 2 The Foreign Exchange Market

I. Prologue

II. Foreign Exchange Market I (New York's *Wall Street Journal*)

III. Foreign Exchange Market II (London's *Financial Times*)

IV. Bid/Offer Quotes

A. Bid/Offer Outright Quotes

B. Bid/Offer Outright Quotes' Interpretations

C. Cross Rates from Bid/Offer Outright Quotes

V. Appreciation and Depreciation

VI. Forward Premium and Forward Discount

VII. Speculation in Foreign Exchange

A. Spot Market Speculation

B. Forward Market Speculation

VIII. Black Markets in Foreign Exchange

IX. Summary

Questions and problems, all

Lajaunie, John, Atsuyuki Naka and Oscar Varela, 1995, "Integration of the Foreign Exchange Market Across Tokyo, London and New York Using Cointegration Analysis," *Journal of International Financial Markets, Institutions and Money* 5, 37-50.

V. Week 3. Session 5 Tue Feb 3

LECTURE 2 Continued

Sundar, Cuddalore, and Oscar Varela, 1998, "The Behavior of Black Market and Official Exchange Rates in Latin America: A Cointegration Analysis," *The Journal of Economics* XXIV, 149-170.

Sundar, Cuddalore, Oscar Varela and Atsuyuki Naka, 1997, "Black Market and Official Exchange Rates, Cointegration and Purchasing Power Parity in Developing Asian Countries," *Global Finance Journal* 8, 221-238.

VI. Week 3. Session 6 Thu Feb 5

REVIEW International Financial Markets, Investing and Foreign Exchange Market

VII. Week 4. Session 7 Tue Feb 10 – EXAM 1

VIII. Week 4. Session 8 Thu Feb 12

LECTURE 3 Contemporary History and Current Affairs
in International Finance

I. Impact of Flexible Exchange Rates in Contemporary History

- A. Foreign Exchange Risk**
- B. Emergence of Derivatives Markets**

II. History Before Flexible Exchange Rates

- A. Classical Gold Standard**
- B. Classical Gold Standard Ends and Modified Gold Standard Begins**
- C. Gold Exchange Standard: Bretton Woods 1944-1976**
- D. Problems with Bretton Woods**

III. The Jamaican Agreement, Flexible Exchange Rates and Recent Events

- A. The Jamaican Agreement and Efforts to Manage the Exchange Rate**
- B. The European Union, the Euro, NAFTA and Other Trade Agreements**
- C. Financial Crisis and Other Less Flexible Exchange Rate Systems**

IV. Summary

Questions and problems, all

IX. Week 5. Session 9 Tue Feb 17

Return and Review Exam 1

X. Week 5. Session 10 Thu Feb 19

LECTURE 3 Continued

XI. Week 6. Session 11 Tue Feb 24

LECTURE 4 Foreign Exchange Forwards

I. Introduction

II. Market Interest Rates (*Financial Times*, 11/05/2002)

III. Covered Interest Rate Parity

- A. What is Interest Rate Parity?**
- B. What Happens if Interest Rate Parity Does Not Hold**
- C. Interest Rate Parity for the Euro and USD**
 - No Covered Interest Arbitrage Opportunities for the Euro and USD
- D. Lack of Interest Rate Parity for the Euro and USD**
 - Covered Interest Arbitrage Opportunities for the Euro and USD

IV. Equilibrium Conditions for Interest Rate Parity

V. When is Covered Arbitrage Feasible?

VI. Synthetic Bid and Offer Forward Quotes

- A. Synthetic Forward Bid Rate**

- B. Synthetic Forward Offer Rate
- VII. Uncovered Interest Rate Parity
- VIII. Forward Speculation Against a Change in Interest Rate Spreads
- IX. Financial Value of a Forward Contract
- X. Deviation from Interest Rate Parity
 - A. 1978-1980 Japan
 - B. 1970-1974 Germany
- XI. The Unbiased Forward Rate and Interest Parity with Cointegration
- XII. Summary**
- Questions and problems, 1,2,3,5**

XII. Week 6. Session 12 Thu Feb 26

LECTURE 4 Continued

XIII. Week 7. Session 13 Tue Mar 3

LECTURE 5 Exchange Rate Determination

I. Introduction

- A. Law of One Price in a One Currency World
- B. Law of One Price in a Multi-Currency World

II. Classical Purchasing Power Parity

- A. Absolute Purchasing Power Parity
- B. Relative Purchasing Power Parity

III. Currency Appreciation/Depreciation and Relative PPP

IV. The Real Exchange Rate

V. Efficient (versus Relative) Version of Purchasing Power Parity

VI. Monetary Approach to the Theory of Exchange Rate Determination

- A. Monetary Approach with Absolute Purchasing Power Parity
- B. Monetary Approach with Relative Purchasing Power Parity
- C. Monetary Approach with the Quantity Theory of Money
- D. The Level of Support for the Monetary Approach

VII. International Fisher Effect or Uncovered Interest Rate Parity

VIII. Portfolio Balance Approach to the Exchange Rate

IX. Foreign Exchange Forecasts and Interest Rate Parity

X. Summary

Questions and problems, 1,2,3,4,5,6,8,9,10

LECTURE 5 Exchange Rate Determination - Sect I to IV, VI.A, VI.D, VII, IX, X

XIV. Week 7. Session 14 Thu Mar 5 (Spring break Mar 9-13)

LECTURE 5 Continued

Fullerton, Tom and Andre Varella Mollick, 2013, "Border Region Panel Evidence on PPP Deviations," *Applied Economics* 45, 2175-2182.

XV. Week 8. Session 15 Tue Mar 17

REVIEW History, Forwards and Determination

XVI. Week 8. Session 16 Thu Mar 19 - EXAM 2

XVII. Week 9. Session 17 Tue Mar 24

LECTURE 6 The International Business and Financial Activities of Countries

I. Introduction to the Balance of Payments

A. Credits and Debits, Surpluses and Deficits, and Balances

B. Components of the Balance of Payments

II. The Balance of Payments: The U.S., Japan and China

A. Trade Deficits and Surpluses

1. Debt Financing and the Balances of Trade and Payments

B. Balance on Goods and Services

C. Balance on Goods, Services and Income

D. Balance on the Current Account

E. Balance on the Capital and Financial Accounts

III. Positive Analysis of Imbalances in the Balance of Payments

A. Normative versus Positive Analysis

B. Opportunity Costs of Surpluses and Deficits

IV. Normative Views on the Balance of Payments

A. U.S. Sales of its Assets to Foreigners?

B. U.S. Vulnerability to Foreign Ownership of its Assets?

C. Protective Measures?

D. Values of Currencies?

V. The Balance of Payment Positions of Other Countries

VI. Monetary Approach to the Balance of Payments

A. Overall Balance

B. Monetary Equilibrium and Changes in International Reserves

C. Changes in International Reserves and the Balance of Payments

D. Balance in the Balance of Payments, International Reserves and Monetary Equilibrium

VII. Efforts to Promote Trade

VIII. Summary

Selected Balance of Payments Statistics for 2006

Questions and problems, all

XVIII. Week 9. Session 18 Thu Mar 26 (no class Tue Mar 31 – Cesar Chavez day)

Return and Review Exam 2

XIX. Week 10. Session 19 Thu April 2

LECTURE 6 Continued

XX. Week 10. Session 20 Tue April 7

LECTURE 7 International Capital Projects

I. Introduction

II. General Capital Budgeting for Domestic Projects

A. Traditional Approach for Determining the Project's Cash Flow

B. Project Financing and the Weighted Average Cost of Capital

C. Acceptance and Rejection Criteria: NPV and IRR

III. International Capital Budgeting

A. Initial Pro Forma Balance Sheet for International (Foreign) Project

1. Argentina (Foreign) Perspective

2. Chile (Domestic) Perspective

IV. Special Issues for International Capital Budgeting: Franchise and License Fees, Export Profits, Tax Credits, Subsidies and Forecasts of Varying Exchange Rates

A. Franchise or License Fees, Export Profits and Tax Credits

B. Subsidies and Varying Exchange Rates

C. Interest Charges

V. Summary

Questions and problems, all

Abdou, Khaled and Oscar Varela, "When US Venture Capital Ventures Abroad", *Accounting and Finance*, Vol. 54, No. 1 (2014), pp. 1-23.

XXI. Week 11. Session 21 Thu April 9

LECTURE 8 Credit and Delivery Exposure

I. Introduction

II. Arms-Length Exporting and Importing and Credit and Delivery Risks

A. Credit Exposure - Will Exporter Receive Payment When Due

B. Delivery Exposure - Will Importer Have Goods Shipped When Due

C. The Settlement of Credit and Delivery Exposures – The Draft

D. An Illustration of the System at Work

E. Advantages and Disadvantages of this System and Related Issues

F. Other Documents

III. Other Methods of Arms-Length Exporting And Importing Trade

IV. Government Efforts to Promote Exports: The U. S. Export-Import Bank, Foreign Credit Insurance Association, Private Export Funding Corporation and Overseas Private Investment Corporation

V. Summary

Questions and problems, all

XXII. Week 11. Session 22 Tue April 14

REVIEW Business and Financial Activities of Countries, International Capital Projects, and Credit and Delivery Exposure

XXIII. Week 12. Session 23 Thu April 16 - EXAM 3

XXIV. Week 12. Session 24 Tue April 21

LECTURE 9 Economic Exposure

I. Introduction

II. Economic Exposure When Currencies Depreciate

A. A European Firm's Economic Exposure from its Investment in a Mexican Firm

B. Static Analysis – No Change in MXN Cash Flows after MXN Depreciates

C. Dynamic Analysis Scenario I for Currency Depreciation

D. Dynamic Analysis Scenario II for Currency Depreciation

III. Economic Exposure When Currencies Appreciate

A. A European Firm's Economic Exposure from its Investment in a Chinese Firm

B. Static Analysis – No Change in CNY Cash Flows after CNY Appreciates

C. Dynamic Analysis Scenario I for Currency Appreciation

D. Dynamic Analysis Scenario II for Currency Appreciation

IV. Hedging Economic Exposure Through Diversification

V. Other Variations in the Analysis of Economic Exposure

VI. Summary

Questions and problems, all

XXV. Week 13. Session 25 Thu April 23

Return and Review Exam 3

XXVI. Week 13. Session 26 Tue April 28

LECTURE 9 Continued

Wei, Zuobao, Oscar Varela, Juliet D'Souza and Kabir Hassan, 2003, "The Financial and Operating Performance of China's Newly Privatized Firms." *Financial Management* 32, 107-126.

Wei, Zuobao and Oscar Varela, 2003, "State Equity Ownership and Firm Market Performance: Evidence from China's Newly Privatized Firms." *Global Finance Journal* 14, 65-82.

Wei, Zuobao, Oscar Varela and M. Kabir Hassan, 2002, "Ownership and Performance in Chinese Manufacturing Industry." *Journal of Multinational Financial Management* 12, 61-78.

XXVII. Week 14. Session 27 Thu April 30

LECTURE 10 Foreign Exchange Futures

I. Introduction

II. Foreign Currency Futures Quotations

III. General Concepts for Hedging With Currency Futures

IV. Foreign Currency Futures Speculation

V. Futures Cost of Carry and Interest Rate Parity

VI. Futures Prices, Forward Prices and Interest Rates

VII. Hedging With Futures: Optimal Hedge Ratio

VIII. Combined Delta-Cross Hedge Ratio

IX. Delta Hedge

X. Cross Hedge

XI. Delta-Cross Hedge Ratio Regression Approach

XII. Perfectly Matching Hedge Ratio

XIII. Summary

Questions and problems, 1,2,3,4

XXVIII. Week 14. Session 28 Tue May 5

LECTURE 11 Foreign Exchange Options

I. Introduction

II. Foreign Exchange Option Quotations

III. Holding Calls on Currencies: Features, Speculation, Hedging

IV. Holding Puts on Currencies: Features, Speculation, Hedging

V. Other Examples for Hedging With Currency Options

VI. Writing Calls and Puts On Foreign Currencies

VII. Foreign Currency Call Option Pricing Theory

VIII. Put-Call Parity, and Foreign Currency Put Option Pricing Theory

IX. Valuing Calls and Puts Using Forward Exchange Rates

X. Summary

Questions and problems, 1,2,3,4

XXIX. Week 15. Session 29 Thu May 7

COURSE SUMMARY

Final Exam, Tuesday May 12, 2015, from 1:00pm to 3:45pm

Holdout lectures on Accounting Exposure, Payment Exposure or Currency Swaps with this material selectively covered if time permits.

International Finance - 22975 - FIN 4325 - 001

Associated Term: Spring 2015

Registration Dates: Oct 06, 2014 to May 07, 2015

Levels: Undergraduate

Attributes: Busn Bachelor's Course (AACSB)

Public Access to Course Information: [Oscar Varela](#) (P)

Course Fee(s): None.


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Main Campus Campus

Lecture (LECT) Schedule Type

3.000 Credits

[View Catalog Entry](#)

Scheduled Meeting Times						
Type	Time	Days	Where	Date Range	Schedule Type	Instructors
Class	12:00 pm - 1:20 pm	TR	College of Business Admin 318	Jan 20, 2015 - May 07, 2015	Lecture (LECT)	Oscar Varela (P) 
ADA Accessible						