

● **Course objective:** To learn the theory and practice of international finance and its application to business and economic policy. Primarily a lecture course, students will present solutions to several Harvard Business School Cases on cross border valuation and investment, as well as on global mergers and acquisitions.

● **Description:** *International Finance* provides a working knowledge of international financial issues, theories, concepts and practice. The first part of the course examines the mechanics of the foreign exchange market, reviewing spot, forwards, futures and options. The second part of the course constructs the four building blocks of international finance: interest rate parity (covered and uncovered interest rate arbitrage), purchasing power parity, the international Fisher (expectations) effect, and asset market equilibrium (money market and exchange market equilibrium). The role of the money supply in exchange rate and price level determination according to interest rate parity is stressed. The case for common currencies is reviewed. In the third part of the course, currency risk management is explored in detail. We then analyze Ponzi schemes and other fraudulent financial practices. We conclude with a review of financial leverage, moral hazard and the financial crisis of 2008-2009.

● **Instructor:** Michael Connolly michael.connolly@duke.edu.

● **Textbook:** Michael Connolly, *International Financial Management* 2nd edition, Peking University Press, 2012. ISBN: 978-7-301-20606-5: available at the

● **Outline of topics:**

1. Features of international finance

Currencies 1

Accounting rules 2

Stakeholders 3

Legal framework 3

Institutional framework 4

Language 5

Taxation 6

Regulatory framework 7

Political risk 10

Intellectual property rights 11

2. History of money, finance and seigniorage

Prerequisites of good money 15

Money and exchange rates 16

History of monies 17

Foreign exchange history 23

Banks and banking 25

The Federal Reserve System 26

The international monetary institutions 27

History of the stock exchanges 29

3. The foreign exchange market

- A floating exchange rate system 42*
- A fixed exchange rate system 45*
- The Euro—"irrevocably fixed" exchange rates 53*
- The Chinese yuan 57*
- The SWIFT international clearing system 60*
- Theories of the long-run movement of exchange rates 61*
- Purchasing power parity 61*
- The monetary approach to the exchange rate 66*
- The IMF's real effective exchange rate 70*
- Foreign currency futures versus forward contracts 71*
- Forwards and futures in commodities 74*
- Arbitrage determination of the spot and future rates 78*
- Exchange rate forecasting 87*
- Random investing 89*

4. Hedging foreign exchange risk

- Hedging defined 113*
- Credit ratings 116*
- Default risk premium 121*
- Hedging foreign exchange transactions exposure 123*
- Related techniques for hedging foreign exchange risk 133*
- Hedging operating exposure 135*
- Foreign currency swaps 140*
- Back-to-back (parallel) loans 141*
- Accounting exposure 142*
- Financial Accounting Standards Board—FASB 52 142*
- Hedge accounting 143*
- Trade finance 144*
- Hedging interest rate exposure 145*
- Reference rates 146*
- Forecasting forward interest rates 147*
- The yield curve 147*
- A strip of the yield curve 148*
- Appendix: Risk and Insurance 155*

5. Money and Financial Management

Capital structure 167

Cross-listing on foreign stock exchanges 170

International liquidity and market integration 171

Transfer pricing 171

International taxation 175

Working capital management 178

International mergers and acquisitions 180 Offshore banking 187

An international business plan - the Azteca Café 194

Optimal investment analysis 196

6. International financial scams and swindles

Pyramids: an international perspective 221

Corporate governance failures 231

The Sarbanes-Oxley Act of 2002 237

Lessons learned 256

7. Financial leverage, moral hazard and counterparty risk

The financial crisis of 2007-2009

Financial leverage 262

Securitization 265

Leveraged households 267

The role of the government: Fannie Mae and Freddie Mac 268

Rising and falling home equity 269

Strategic default 274

Counter-party risk 280

Leveraged financial institutions 281

The bankruptcy of Lehman Brothers 283

The macro-economic impact of the financial crisis 288

The Volcker Rule 292

The Dodd-Frank Regulatory Bill 295

8. Appendix: The time value of money 300

9. Solutions to problems 316

About the instructor

● Education

Ph.D., Economics, University of Chicago

Doctoral thesis advisor: Robert A. Mundell 1999 Nobel Prize Laureate

B.A., Economics, *Phi Beta Kappa*, UC Berkeley

● Current positions and honors

Professor of Economics, University of Miami

Professor of Finance, Hunan University, Changsha, PRC

Honorary Doctorate, Universidad Norbert Wiener, Lima, Perú.

Author of over 50 articles, three books authored and four edited.

Editor in Chief, *Journal of Economic Policy Reform* (1998-2011)

● Recent publications

International Business Finance, Taylor & Francis, plc London 2007 and Peking University Press (in Chinese), 2007

International Financial Management 2nd edition, Beijing © Peking University Press, in English and Chinese, June 2012.

● Fulbright Teaching Awards:

Instituto Tecnológico Autónomo de México, 1985 (in Spanish).

Instituto de Economía de Montevideo, Uruguay, 1991 (in Spanish).

Instituto de Economía de Lisboa, Portugal, 1996

● Other teaching:

Duke University, Duke in New York (2008-2013)

Université de Cocody, Abidjan, Ivory Coast (in French) (2003-13)

Université de Yaoundé, Cameroon (in French) (2003-05) ,

University of Uppsala, Sweden (1974),

Université de Paris Dauphine (in French) (1981-1991)

Université de Genève, Switzerland (1972-73)

The Johns Hopkins Bologna Center, Italy. (1962-63)

Harvard (1968-1972) and *Columbia Universities* (1994-1996)

● Business experience:

Consultant to the *World Bank* on trade, finance, and lending missions: Uzbekistan, 1993-1996, Mongolia, 1992-1995, Ghana, 1992, Kenya, 1992, Paraguay, 1991, Sénégal, 1991, Perú, 1991-1992, Uruguay, 1989-91, Cameroon, 1986-89, Ecuador, 1987-88, Argentina, 1985-86, 1989.

Sovereign bond consultant, *UBS Warburg* (now *UBS Wealth Management*): 2001-2002.