Outline for
Wharton - Merrill Lynch Investment Banking Institute

Outline for International Finance Sessions August 2006:

Instructor: Professor Gordon M. Bodnar
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Sessions 1&2: Exchange Rate Basics and International Money Markets – Tuesday August 8, 1:30-4:45pm
Summary: Covers basic nomenclature and structure of the foreign exchange market. Examines the concept of purchasing power parity, real exchange rates and inflation-adjusted exchange rates for determining equilibrium rates and forecasting. Discusses the international money (euro-) markets and its instruments and derives and the international parity conditions that form the equilibrium linkages between the money and exchange markets.

Readings:
- All About the Foreign Exchange Market in the United States, NYFRB, 1998 (58 pgs)
- Triennial Survey of Foreign Exchange and Derivatives Market Activity, BIS, 2004 (7 pgs + charts)

Assignment: Problem set #1 – nomenclature, bid-ask spreads, real exchange rates plots, parity calculations. (3 - 4 hours)
Due: Thursday August 10 before dinner

Session 3: Exchange Rate Exposures – Wednesday August 9, 1:15 – 2:45pm
Summary: Defines and analyzes the forms of exchange rate exposure facing firms, both from accounting and economic perspectives. Examines the different forms of operating exposure from exchange rates for both domestic and multinational firms. Demonstrates several methods for measuring the size of an exposure in order to address the issue of hedging.

Readings:
- Classnote: Corporate Exposures to Exchange Rates (17 pgs)
- Exchange rate exposure: a simple model – Bodnar and Marston (14 pgs)

Session 4: Hedging Exchange Rate Exposure – Wednesday August 9, 3:00 – 4:30pm
Summary: Discusses the basic financial instruments and operational methods used for hedging the different forms of FX exposure. Works in detail through an example of a foreign currency transaction exposure, focusing on forward contracts, money markets and option hedging techniques to reduce volatility of cash flow or limit the loss. Considers operational methods to reduce or hedge FX exposure and examines the role of options and more complex financial instruments, such as range forwards and participating forwards, to reducing impact of exchange rate changes on enterprise value. Discusses evidence on actual practice of US firms to managing FX risk.

Readings:
- Classnote: Techniques for Managing Economic Exposure (14 pgs)

Assignment: Jaguar plc 1984 case (21 pgs) – exchange rate forecasting, exposure measurement, and hedging. (2 - 3 hours) – Due August 11, 1:15pm - to be discussed in class
Session 5: Discussion of Jaguar plc 1984 case – Friday August 11, 1:15 – 2:30pm
Summary: Discusses issues of understanding the nature of international markets in order to form equilibrium based exchange rate forecasts. Focuses on the measurement and conceptual understanding of Jaguar’s exposure to its new owners. Considers hedging strategies to reduce exposure and impact of these approaches under various exchange rate scenarios.

Session 6: Taxation of International Income, Repatriation Policy and Transfer Pricing – Friday August 11, 2:45 – 4:30pm (note: I am transferring 15 minutes to this session)
Summary: Covers the basics of taxes facing international activities. Discusses both territorial and worldwide principles and covers the structure of a foreign tax credit system using the US system as an example. Issues of legal structure, ownership levels, split rate countries, pooling, and limits of FTC are also covered. Briefly looks at issues related to defining regional taxable income for global firms. The major forms of repatriations and their impact on the tax situation are examined and the issue of transfer pricing is addressed along with examples of the common methods for determining prices and the rise in Advance Pricing Agreements.

Readings:
- Taxation of International Operations - Chapter 17 (33 pgs)

Assignment: Problem set #2 – exchange rate hedging, option combinations, international taxes (2 - 3 hours)

Due: When Paul says so……