SHAN FICH370 / ECCH371: International Money and Finance

The Alliance for Global Education International Business Program,

Summer 2009

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Course objective

This course attempts to familiarize students with basic theories of international money and finance and major policy problems encountered by China when integrating the country into the global financial system. Topics to be discussed include, among others, Chinese exchange rate regimes and policies, and the implications of possible RMB convertibility; Chinese commercial banking system, its characteristics and institutional underpinnings; new investment and financing techniques including currency derivatives, like forwards and options; development of China's capital market, and the role of QFII (qualified foreign institutional investors) and QDII (qualified domestic institutional investors); foreign exchange reserve management; international financial markets, including bond and equity markets; international portfolio diversifications.

Course assessment

- Class Discussion: 10%. An attendance sheet will be given in every class session for students to sign.
- Response papers: 10%. Questions may from time to time be raised during the class and students are encouraged to actively participate in the class discussion.
- Two presentations, 25% each, total 50%. Individual presentations are all related to topics presented in the class. Topics for presentation will be given at least one week prior to the actual presentation.
- Capstone project 30%. Students are encouraged to discuss project topics with me during the course. Grades are given based on the quality of the written report and of the presentation.

Course outline

1. The Chinese commercial banking system

This lecture aims to give students a brief account of China's commercial banking system in general, and its evolving structure and increasing functional sophistication in particular. It addresses the following questions: How did the system evolve? What is the current situation? What are the likely consequences of foreign banks' equity participation in the Chinese banks? And where is the banking system heading to?

More specifically, we will review and explore the following issues:

- Historical evolution and the role of the big four.
- The changing landscape of the Chinese banking system: the state banks; joint stock banks; foreign banks; etc.
- Foreign banks' China operations.
- Foreign banks' equity participation in Chinese banks: consequences and effects

Class discussion: Foreign investment in Chinese banks: implications and consequences
The lecture will take three class hours.

Readings:

- Bekier, Matthias, R. Huang, and G. P. Wilson, "How to fix China's banking system", *McKinsey Quarterly*, 2005, No. 1.
- Binder, S., J. Luc Ngal and Yi Yang, "The Opportunity in Asset Management in China" The McKinsey Quarterly, Oct. 2007.
- Podpiera, R., "Progress in China's Banking Sector Reform: has bank behavior changed? IMB WP/06/71, 2006.
- The McKinsey Quarterly, "New frontiers in treasury management at banks", November, 2007.
- Chaudhuri, Snehasish, "Banking Reform in China, progress and constraints", IBS Research Centre, Kolkata, 2007.
- Alfaro, Laura and Rafael Di Tella, "To Float or not to Float (A) and (D)", Harvard Business School, 2006.
- KPMG, "Retail Banking in China: New frontier", KPMG and Reuters, 2007.

2. RMB exchange rate and exchange rate policies in China

The Chinese currency, RMB, is under increasing pressure for revaluation. This lecture provides an overview of China's exchange rate polices and the setting of RMB exchange rate. It discusses the evolution of RMB exchange rate regime and attempts to provide some rationales for the discrepancies between stated exchange arrangement and actual policy behavior. It also addresses the main problems of the current system as well as reform strategies aimed at establishing a more flexible and more independent exchange rate policy framework. The lecture will focus its discussion on the following points:

- The RMB exchange rate determination
- The exchange rate regime of RMB
- The evolution of RMB exchange rate policies
- Problems of the current exchange rate policy
- The reform of RMB exchange rate regime
- The issue of RMB convertibility

Class discussion: Implications of freer RMB exchange rate movements, and possible RMB convertibility.
This lecture will take 6 class hours.

Readings:

- Calvo, G., and C. Reinhart, 2002. "Fear of Floating." *Quarterly Journal of Economics* 117 (2): 379-408.
- Rogoff, K., 1996. "The Purchasing Power Parity Puzzle." *Journal of Economic Literature* 34: 647-668.
- Goldstein, M. & N. Lardy, "China's Exchange Rate Policy Dilemma", unpublished manuscript, Institute for International Economics.
- Lardy, N., "Exchange Rate and Monetary Policy in China", Cato Journal, Vol. 25, No. 1, winter 2005.
- Laurens, B. J. & R. Maino, "China: Strengthening Monetary Policy Implementation", IMF WP/07/14, 2007.
- Eun, Cheol S. and Bruce G. Resnick, *International Financial Management*, Chapters 2, 5 and 6. McGraw Hill, 4th ed. 2007.
- Alfaro, Laura and Rafael Di Tella, "To Float or not to Float (B), (C) and (E)", Harvard Business School, 2006.
- Gruben, W. C. & D. Mcleod "Capital Account liberalization and Inflation", Economics Letters 77 (2002), 221-225.

3. The foreign exchange market and currency derivatives

This lecture aims to help students understand the organization of the foreign exchange market and to describe the mechanics of spot currency transactions and, to explain how forward premiums and discounts are calculated. It also introduces some basic currency derivatives, namely, currency futures and options. It presents the difference between currency forward and futures contracts, and between currency futures and options. The lecture identifies how currency futures and options contracts can be used to manage currency risks. We will take six class hours to cover all the materials in this lecture.

Reading:

- Eun, Cheol S. and B. G. Resnick, *International Financial Management*, chapters 5, 6 and 7. McGraw-Hill，4th ed., 2007.

4. Currency risks and their management

This lecture is designed to introduce to students various types of foreign exchange risks that a Chinese company or an international/multinational company may encounter when it operates both in China and globally. We will first define the nature of different types of currency exposure, namely, transaction exposure, operating exposure and accounting exposure. Then we will employ the instruments that were presented in Lecture three by which these exposures may be managed, including: forward contract; and currency options; etc.

Reading:

- Eun, Cheol S. and B. G. Resnick, *International Financial Management*, chapters 8, 9 and 10. McGraw-Hill，4th edition, 2007.

5. International Financial Markets

This lecture looks at different markets for international money, bonds and stocks. International money market provides a basic platform on which international borrowing and lending activities take place. International banks and their operations are the core of international money market. International bond and stock markets are places where international institutions and corporations raise funds. We will discuss the major types of international bonds. We will also discuss various trading methods of international equities, as well as the advantages to firms of cross-listing equity shares in more than one country. We will need three class hours to present the material in this lecture.

Reading:

- Eun, Cheol S. & Bruce G. Resnick, *International Financial Management*, chapters 11, 12 and 13，McGraw Hill 4th edition, 2007.

6. Development of China's Capital Market (I and II)

This lecture, which will be presented in two parts, each takes three class hours, reviews the process of the development of China's capital market. We will describe the unique features of the market structure, the A-share and B-share. We will also take a close look on the roles played by QFII and QDII.

Class discussion: How much can QFII do to help building up an efficient and full-fledged capital market in China?

Reading:

- McKinsey on Finance "A quiet revolution in China's capital markets", No. 24, summer 2007.
- Jianwei Liu & Chunjiao Liu "Value Relevance of Accounting Information in Different Stock Market Segments, The Case of Chinese A_, B_, & H Shares", Journal of International Accounting Research, Vol. 6, No. 2, 2007, pp55-81.
- Moerman, F. Wu, Niping, "China's Quest for Sound Capital Market", International Financial Law Review, 02626969, Sep. 2005, Vol. 24, Issue 9.
- Huang, A. G., Hung-Gay Fung, "Floating the Non-floatables in China's Stock Markets" Emerging Markets Finance & Trade, Vol. 41, No. 5, Sept-Oct 2005, pp 6-26.

7. Foreign exchange reserves management in China

This lecture discusses the management of foreign exchange reserves in China. With sustained surpluses from both current account and capital account, China has accumulated tremendous amount of foreign exchange reserves, most of which are invested in the U.S. treasury bills. To change the current situation, a more appreciated RMB within a more flexible exchange rate regime might be necessary to stop or even to reverse the trend of reserves accumulation, while a more diversified currency and investment structure is critical for a safer and more profitable management of the foreign exchange reserves in China. The lecture will present:

- The accumulation of foreign exchange reserves in China
- The status qua of the foreign exchange reserves management
- The directions for reform and their possible consequences

Class discussion: Should China dump its holding of the U.S. treasury bills?
Topic 7 will take three class hours, including class discussion.

8. International Portfolio Investment

This lecture discusses general advantages of international investing. We will explain how international portfolio investment can allow investors to achieve a better risk-return tradeoff than by investing solely domestically. We then present various ways by which an investor can diversify into foreign securities. We will also identify some barriers to investing overseas. The lecture will take three class hours.

Reading:

- Eun, Cheol S. and B. G. Resnick, *International Financial Management*, chapter 15. McGraw-Hill，4^{th} edition, 2007.