University Center Abdelhafid Boussouf-Mila

Faculty of Economics, Commercial &

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Lecture four: International finance

Addressed To master one Students-Semester 1

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International finance refers to the study of monetary interactions between two or more countries, focusing on how financial markets, institutions, and policies affect the global economy. It encompasses a wide range of topics, such as exchange rates, international trade, foreign direct investment (FDI), capital flows, and the role of international financial institutions like the IMF and World Bank.

1. Exchange Rates

Exchange rates are the prices at which one currency can be exchanged for another. They are a critical component of international finance, influencing trade and investment between countries.

Fixed vs. Floating Exchange Rates:

Fixed Exchange Rates: The value of a currency is pegged to another currency (e.g., the US dollar) or a basket of currencies. The government or central bank maintains this value by intervening in the foreign exchange market.

Floating Exchange Rates: The value of a currency is determined by supply and demand in the foreign exchange market. Most major currencies, like the US dollar, euro, and yen, follow a floating exchange rate regime.

Currency Depreciation and Appreciation:

Depreciation refers to a decrease in the value of a currency relative to others.

Appreciation refers to an increase in the value of a currency.

Exchange Rate Mechanisms: The way exchange rates are determined affects trade balance, inflation, and economic stability.

2. International Trade and Investment

Global trade and investment are central to international finance, facilitating the exchange of goods, services, and capital across borders.

Balance of Payments (BOP): The BOP is a record of all economic transactions between a country and the rest of the world. It includes the current account (exports, imports, income from abroad) and the capital account (investments, loans).

Trade Theories:

Comparative Advantage: Countries should specialize in producing goods and services that they can produce more efficiently, then trade with other countries to maximize overall welfare.

Absolute Advantage: A country can produce a good more efficiently than another country, leading to trade benefits.

Foreign Direct Investment (FDI): Investments made by a country in businesses or assets in another country. FDI plays a key role in global economic integration.

3. International Financial Markets

International financial markets include global capital markets, foreign exchange markets, and commodity markets. These markets allow for the flow of funds across borders, offering investment opportunities and enabling countries to raise capital.

Global Capital Markets:

Countries can raise capital by issuing bonds or stocks to international investors.

Eurobonds are an example of bonds issued outside the jurisdiction of the country whose currency is used for the bond.

Foreign Exchange Markets:

Currencies are traded in the foreign exchange (Forex) market. This market is highly liquid, with a daily turnover of over $6 trillion.

Commodity Markets:

Commodities like oil, gold, and agricultural products are traded globally. Prices of these commodities influence exchange rates and economic stability.

4. Role of International Financial Institutions

International financial institutions (IFIs) play a key role in global economic stability and development.

International Monetary Fund (IMF):

The IMF monitors global financial stability and provides financial assistance to countries facing balance of payments crises.

It also offers policy advice to help countries stabilize their economies.

World Bank:

The World Bank provides loans and grants to developing countries to support projects that improve infrastructure, education, and health, aiming to reduce poverty and promote development.

World Trade Organization (WTO):

The WTO is an international organization that promotes free trade by regulating trade agreements and resolving trade disputes between countries.

5. Capital Flows and Financial Crises

Capital flows refer to the movement of money for investment or borrowing between countries. These flows can be short-term (e.g., speculative investment) or long-term (e.g., FDI, foreign loans).

Financial Crises:

Currency Crises: When a country's currency experiences a sharp devaluation due to a loss of investor confidence.

Banking Crises: Occur when financial institutions face insolvency, often leading to government intervention.

Sovereign Debt Crises: When a country cannot meet its debt obligations, leading to defaults or restructurings.

Examples of international financial crises include:

Asian Financial Crisis (1997): A series of currency devaluations and financial collapses in East Asia, sparked by speculative investment and excessive borrowing.

Global Financial Crisis (2008): A collapse of financial institutions due to risky lending practices, especially in the mortgage market, affecting economies worldwide.

6. Risks in International Finance

There are various risks associated with international finance that investors and governments must consider:

Exchange Rate Risk: The potential for currency values to fluctuate, affecting the returns on investments or international business operations.

Political Risk: Changes in political leadership, government policies, or instability that could affect business operations.

Economic Risk: Changes in macroeconomic conditions, such as inflation, recession, or trade policy shifts.

7. Financial Instruments in International Finance

Foreign Exchange Contracts: Contracts that allow businesses or investors to hedge against the risk of exchange rate fluctuations.

Swaps: Financial contracts in which two parties exchange financial instruments, such as currencies or interest rates, to hedge against risks.

Derivatives: Financial contracts whose value depends on the price of an underlying asset, such as foreign exchange or commodities.

Terminology

- Exchange Rate - سعر الصرف
- Currency Depreciation - انخفاض قيمة العملة
- Currency Appreciation - زيادة قيمة العملة
- Foreign Direct Investment (FDI) - الاستثمار الأجنبي المباشر
- Balance of Payments (BOP) - ميزان المدفوعات
- Capital Account - الحساب الرأسمالي
- Current Account - الحساب الجاري
- Comparative Advantage - الميزة النسبية
- Absolute Advantage - الميزة المطلقة
- Eurobonds - السندات الأوروبية
- Foreign Exchange Market (Forex) - سوق الصرف الأجنبي

- Global Capital Markets - الأسواق المالية العالمية
- International Monetary Fund (IMF) - صندوق النقد الدولي
- World Bank - البنك الدولي
- World Trade Organization (WTO) - منظمة التجارة العالمية
- Sovereign Debt Crisis - أزمة الديون السيادية
- Banking Crisis - أزمة مصرفية
- Currency Crisis - أزمة العملة
- Hedging - التحوط
- Derivatives - المشتقات المالية