

Course outline

International finance and globalization



- What is the structure of a financial system?
- How does this structure differ across countries worldwide?
- Why do financial intermediaries exist?
- What are the main risks faced by banks?
- How can different investment opportunities be evaluated?
- How to construct a well-diversified portfolio?

Essential reading for the course:

1. Buckle, M. and E. Beccalli *Principles of banking and finance* (UOL studyguide)
2. Mishkin, F. and S. Eakins *Financial Markets and Institutions*. (Addison Wesley)
3. Allen, F. and D. Gale *Comparing Financial Systems*. (MIT Press)
4. Brealey, R.A. and S.C. Myers *Principles of Corporate Finance*. (McGraw-Hill/Irwin)



Materials for the course:

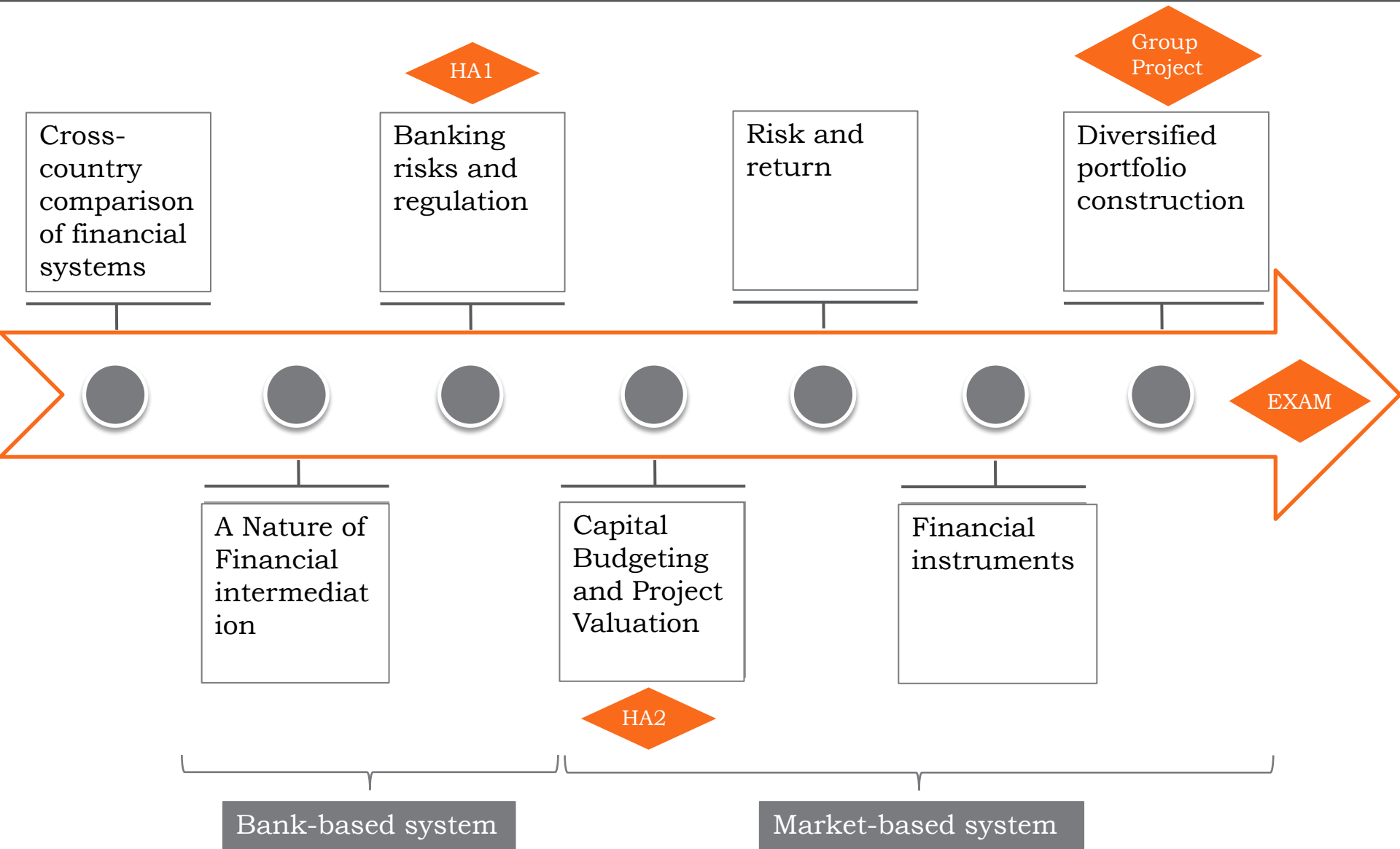
VK group: <https://vk.com/internationalfinanceir>



Final course grade will consist from:

- Class-work during lectures and classes – 15%
- Home assignments – 15%
- Group project – 40%
- Final written exam – 30%





Lecture 1.
Cross-country comparison of financial systems

International finance and globalization

Functions of financial systems

What is a financial system?

Set of institutions, which allow the exchange of funds between lenders-savers and borrowers-spenders

Functions of financial systems

- channel households' savings to the corporate sector that has pool of investment opportunities
- provide intertemporal consumption smoothing
- allow risk sharing for firms and households
- provide diversification & insurance



Types of financial systems

Bank-based

Types of financial systems

Market-based

Financial intermediaries (FI)

Banks, mutual funds, pension funds, insurance companies

FIs buy and sell financial contracts (loans, deposits, insurance).
These contracts are not marketable.



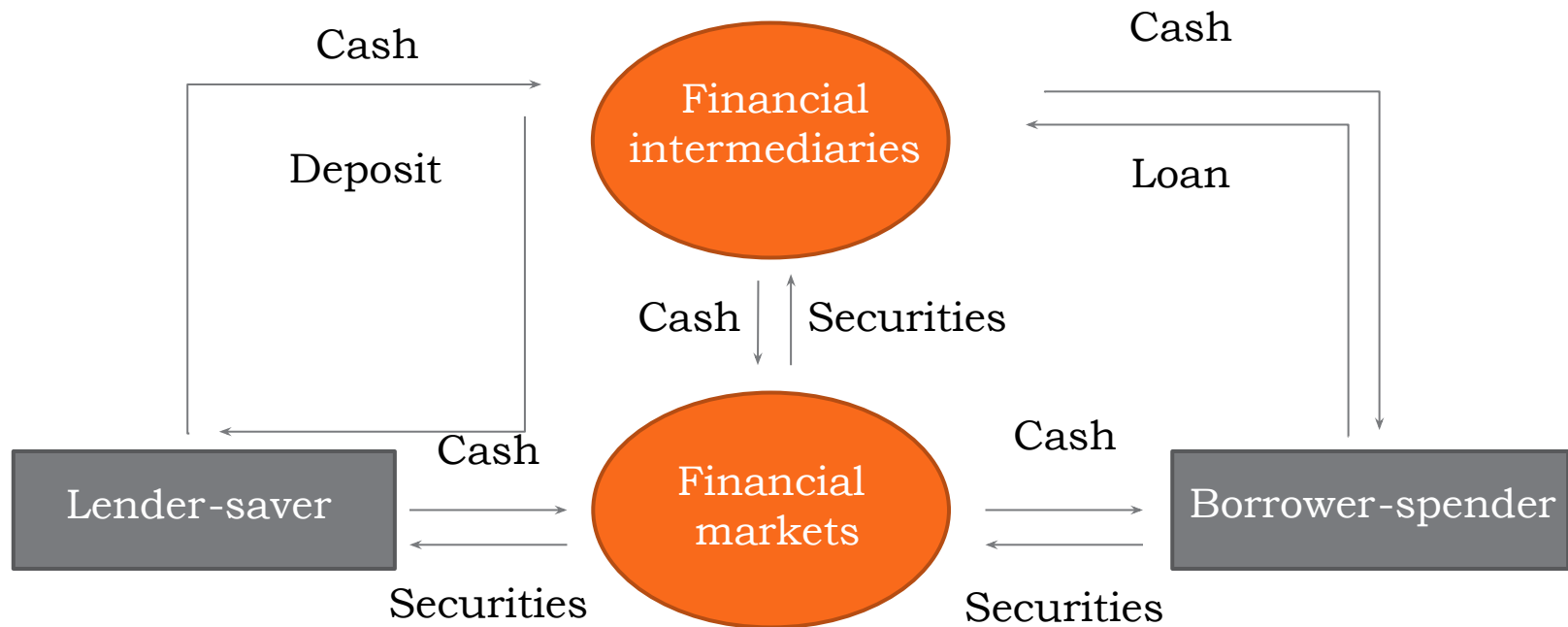
Financial markets

Bond and Stock Markets

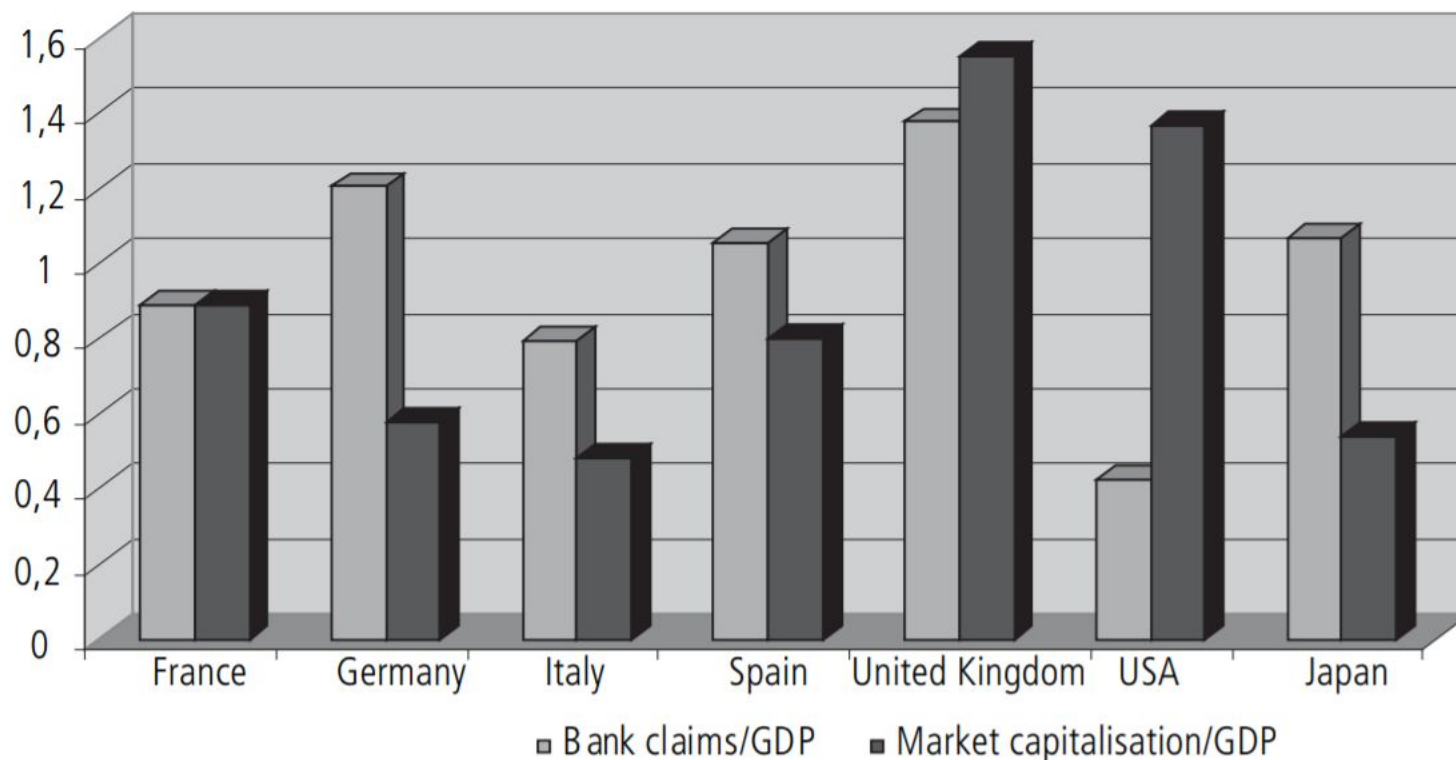
Governments and corporations raise funds by issuing financial instruments (Securities):

- Debt instruments (Bonds)
- Equity instruments (Shares or Stocks)
- Derivatives



Indirect finance: Bank-based financial systemDirect finance: Market-based financial system

International comparison of banks and markets, 2009



Bank-based countries: Germany, Japan, Italy
Market-based countries: USA, UK, Australia

Sources: OECD Statistics (for GDP data); World Federation of Exchanges (for stock exchange data); European Banks Federation; Bank of England; Federal Reserve Bank of USA; Bank of Japan.

Why are there differences in the relative importance of financial markets and intermediaries in different countries?

Reasons for differences	Bank-based countries (Germany, Japan)	Market-based countries (USA, UK)
Households behavior	Risk averse: Hold money mainly in cash and bonds with low risk	Risk lover: Hold money mainly in risky equity (shares)
Firms behavior	Raise funds mainly from banks	Raise funds mainly from banks, but some funds are also raised from markets by issuing securities
Reaction on financial crises and bubbles	Apply heavy regulations and restrictions on stock market	All restrictions on stock market are temporary
Integration of banking and commerce	High: banks have more info about firms	Low: banks have less info about firms
Integration of banking and non-banking services	High: banks provide investment, underwriting, insurance, trust properties	Low: banks provide only traditional deposit-loan services

Russia

Banking structure

Central bank=Regulator: Central Bank of Russia

Insurance: Deposit Insurance Agency of Russia (up to 1,4 mln RUB per depositor per bank)

Largest banks: Sberbank, VTB, Gazprombank, Russian Agricultural Bank, Alfa Bank, Credit Bank of Moscow

Financial markets structure

Regulator: Central Bank of Russia

Government bonds: OFZ
Interest rate in RUB: 7,25%

Exchange: Moscow Exchange

Main stock indexes:
MOEX Russia Index – in RUB
RTS Index (RTSI)- in USD

Historical timeline

1998
Default

2007-2009
Global financial
crisis

2014-2015
Exchange rate
crisis

United States of America

Banking structure

Central bank=Regulator: Federal Reserve system (FED)

Insurance: Federal Deposit Insurance Corporation (FDIC) (up to \$250,000 per depositor per bank)

Largest banks: JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, Morgan Stanley

Financial markets structure

Regulator: The United States Securities and Exchange Commission (SEC)

Government bonds: US Treasuries

Interest rate in USD: 2%

Exchanges:

1. NYSE (New York Stock Exchange)
2. NASDAQ

Main stock indexes:

S&P 500 –top 500 usa companies

Dow Jones Industrial Average (DJIA)- industrial companies

NASDAQ – technological companies

Historical timeline

1929

The Great Crash
(Black Thursday)

1930

Great
Depression

1933-1999

Glass-Steagall
Act

1997

The internet
bubble

2007

The Great
Recession

United Kingdom

Banking structure

Central bank=Regulator: Bank of England (BoE)

Insurance: Financial Services Compensation Scheme
(up to GBP 85,000 per depositor per bank)

Largest banks (universal): HSBC, Lloyds, Royal Bank of Scotland, and, Barclays

Financial markets structure

Regulator: Financial Conduct Authority (FCA)

Government bonds: Gilts
Interest rate in GBP: 0,75%

Exchange: London Stock Exchange (LSE)

Main stock indexes:
Financial Times Stock Exchange (FTSE)

Historical timeline

1711
South Sea
Company Bubble

1720
Bubble Act

1824
Repeal of Bubble
Act

1986
The “Big Bang”

2007-2009
Global financial
crisis

Germany

Banking structure

Central bank: Deutsche Bundesbank

Bank regulatory: Federal Financial Supervisory Authority (BaFin)

Insurance: BdB (for private banks), VÖB (for public sector banks), BVR (for co-operative banks), DSGV (Savings banks) (unlimited up to 30% of a liable capital of a bank)

Largest banks (universal): Deutsche Bank, Dresdner, Commerzbank

Financial markets structure

Regulator: Federal Financial Supervisory Authority (BaFin)

Government bonds: Bund

Interest rate in EUR: 0%

Exchange: Deutsche Börse

Main stock indexes:
HDAX, DAX

Japan

Banking structure

Central bank: Bank of Japan

Insurance: Deposit Insurance Corporation of Japan

Largest banks: Mitsubishi UFJ Financial Group, The Nomura Trust & Banking Co.

Financial markets structure

Regulator: Securities and Exchange Surveillance Commission

Government bonds: JGBs

Interest rate in Yen: -0,1%

Exchange: Japan Exchange Group (Tokyo Stock Exchange + Osaka Securities Exchange)

Main stock indexes:

Nikkei 225- industrial companies,
Topix (TPX)

The current trend is towards **market-based systems (disintermediation)**

- government intervention has become discredited
- economic theory emphasises the effectiveness of financial markets in allocating resources

However, market imperfections, such as **transaction costs and asymmetric information**, represent important limitations of financial markets and are the main reasons why bank-based systems still exist.



Thank you!

Essential reading for Lecture 1:

1. Buckle, M. and E. Beccalli Principles of banking and finance (UOL studyguide) **pp. 16-18, 40-62**
2. Mishkin, F. and S. Eakins *Financial Markets and Institutions*. (Addison Wesley) **Chapter 1,2,18**

P.S. Very funny YouTube channel about history:

South Sea Bubble example:

https://www.youtube.com/playlist?list=PLhyKYa0YJ_5CwbTgovbJJhy1LyAaDqStr