Course outline

International finance and globalization

Course target

- 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?

Literature and materials

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)

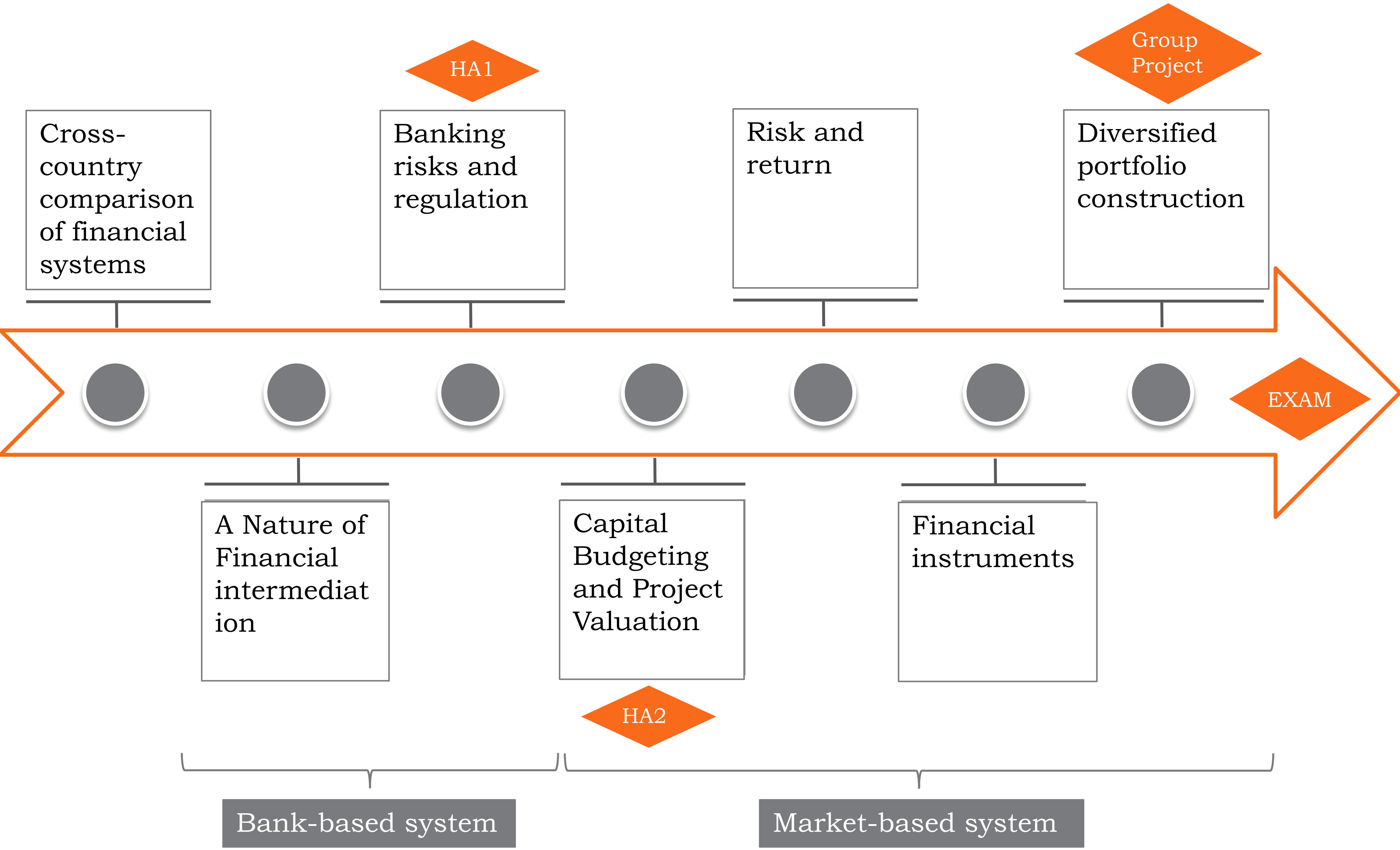
Materials for the course:

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%

Course timeline



Lecture 1.
Cross-country comparison of financial systems

International finance and globalization

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

Financial intermediaries (FI)

Banks, mutual funds, pension funds, insurance companies

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

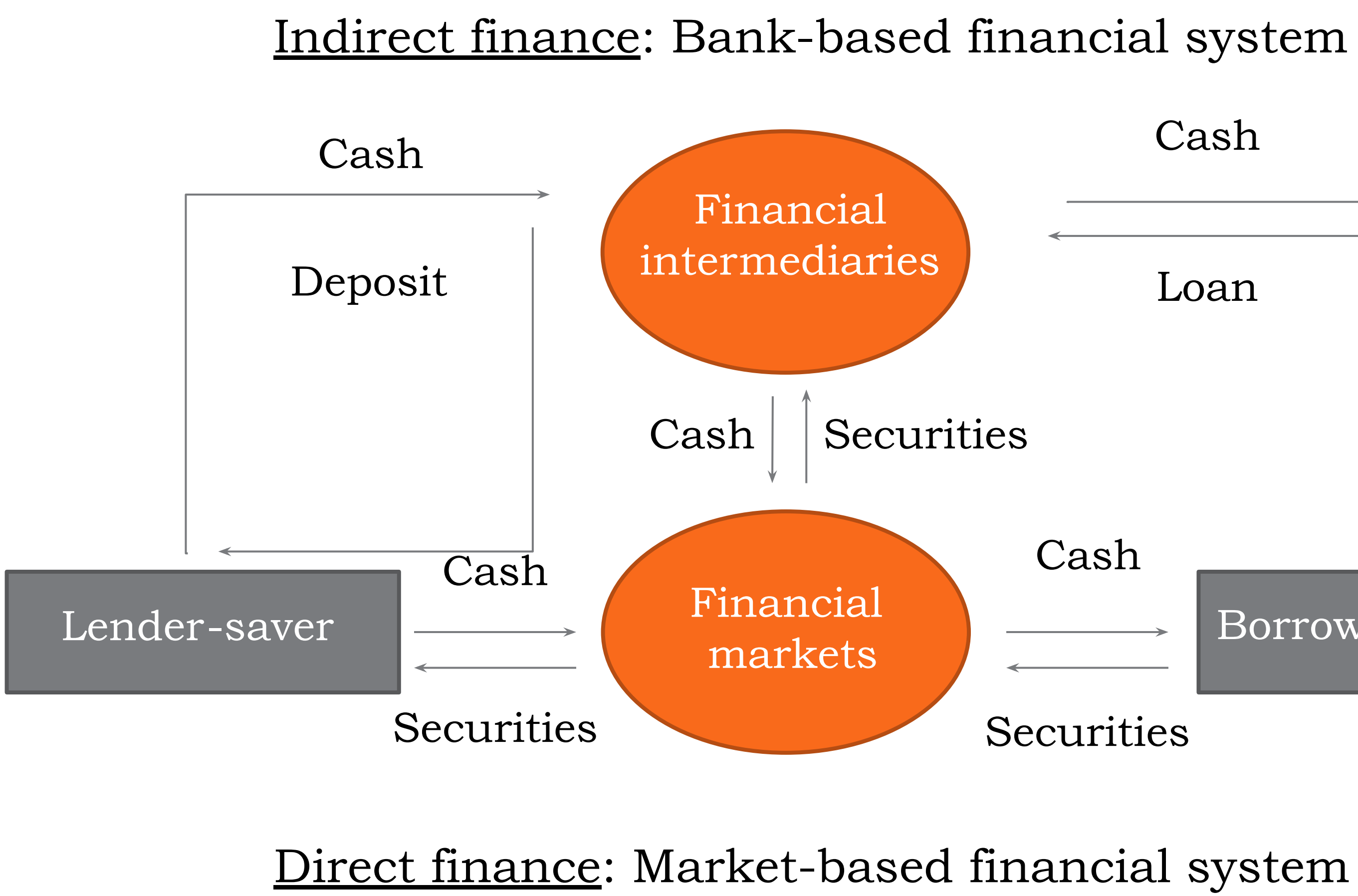
Market-based

Financial markets

Bond and Stock Markets

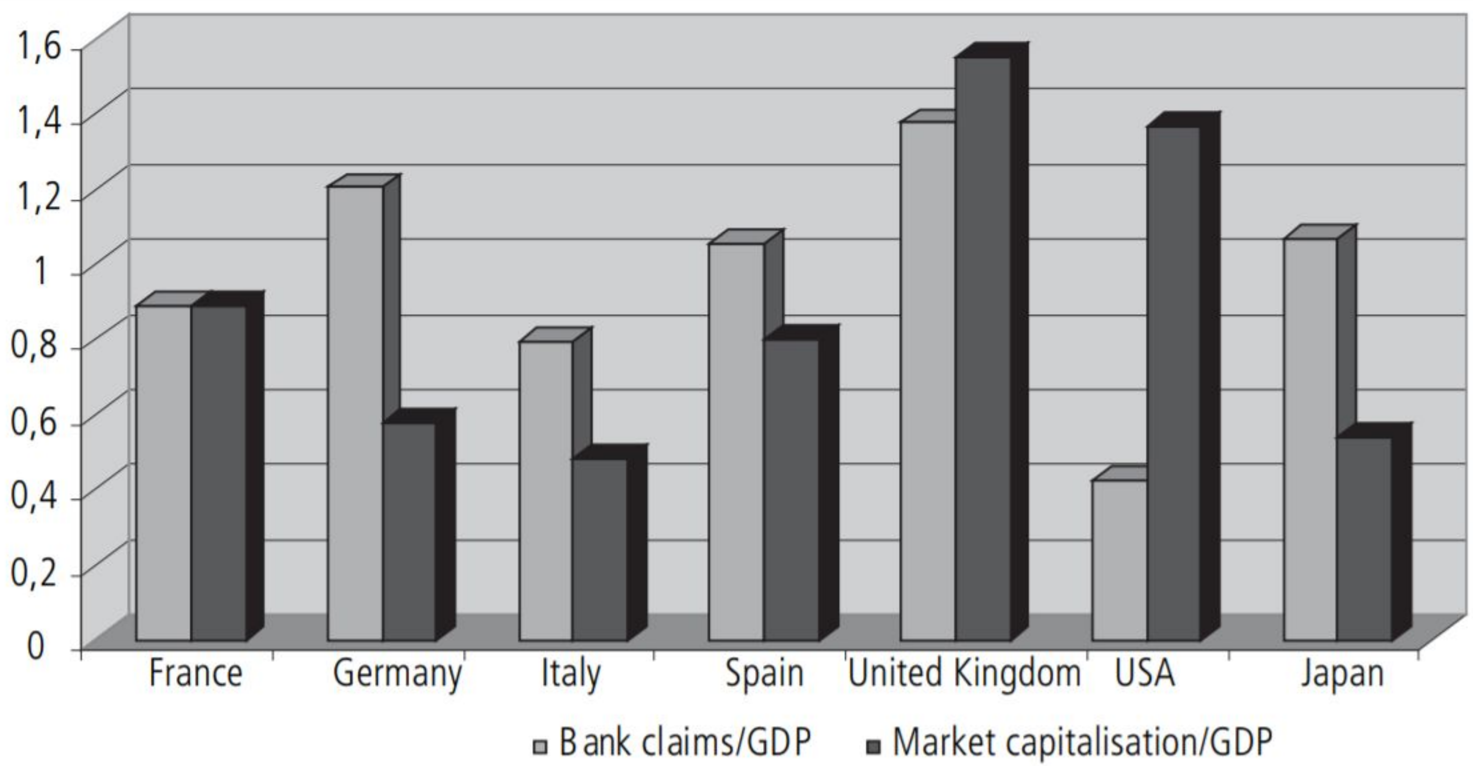
Governments and corporations raise funds by issuing financial instruments (Securities):

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


Indirect finance: Bank-based financial system
Cash
Deposit
Financial intermediaries
Cash
Loan
Cash
Securities
Cash
Lender-saver
Financial markets
Cash
Borrower-spender
Securities
Securities
Direct finance: Market-based financial system

Bank-based VS Market-based systems across countries

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