**INTERNATIONAL FINANCE ASSIGNMENT**

Name

Institutional Affiliation

Course number

Instructor name

Due date

**Question One:** **Describe the following in International financial system**

**(a) International Bonds Market**

The international bonds market is the marketplace for government, transnational corporate and global organisation bonds. It is an essential part of the international financial structure and gives businesses a way to raise funds. On this market, traders can buy and sell bonds, and bond values are impacted by a variety of variables, including interest rates, the state of the economy, and credit ratings. The market also gives investors the chance to diversify their portfolios and allows governments and businesses to raise money at a lower rate than they would with bank loans (Eterovic & Eterovic, 2023, p. 84).

**(b) International Equity Market**

The international equity market is a marketplace where shares of publically traded corporations are bought and sold beyond borders. This market enables investors to diversify their holdings across several industries and geographies by purchasing shares in corporations with headquarters in various nations. Global political upheaval, corporate performance, and economic conditions all have a significant impact on the worldwide equities market. The market gives businesses a way to generate finance through the sale of shares and gives investors a chance to make money by owning shares of businesses that are based in several nations (Gilligan & Wright, 2020, p. 19).

**(c) International Banking**

International banking is the offering of financial services by financial institutions with operations in several nations (Eterovic & Eterovic, 2023, p. 84). Lending, currency exchange, trade finance, and other financial services are some examples of these services. By giving firms, administrations, and citizens’ access to funding and other services, multinational banks significantly contribute to the facilitation of global trade and investment. Additionally, they aid in the transfer of savings from surplus nations to those with deficits, promoting the development and growth of the world economy.

**(d) International Financial Agencies**

International financial agencies are organisations that were founded to foster global financial stability and economic growth. These groups may include global financial regulators like the Financial Stability Board in addition to multilateral development banks including the World Bank and the Asian Development Bank. To support nations and businesses in achieving long-term prosperity and growth, these organizations offer funds, technical support, and policy recommendations. Additionally, they serve as a forum for international cooperation and conversation on financial concerns as well as aid in the coordination of global economic policy.

**(e) Changing Roles of IMF and the World Bank**

Over the years, the roles played by the World Bank and the International Monetary Fund (IMF) have undergone significant changes. The IMF was initially established to promote global monetary coherence and provide assistance to countries experiencing balance of payments problems (Pleas, 2020, p. 21). Its duties today include keeping tabs on the status of the global economy, providing member countries with policy suggestions and technical assistance, and promoting global financial stability. The World Bank was established after World War II to provide financial assistance for industrialization and the recovery of economies. However, it now contributes more financially and technically to social growth, ecological sustainability, and poverty reduction. The conditionality, governance, and openness of both organizations' practices have drawn criticism in different contexts.

**Question Two:**

**(a) Challenges of International Trade**

International trade faces several challenges that can impede its growth and development. One significant challenge is protectionism, which refers to policies that restrict imports through tariffs, quotas, and other barriers. Protectionism can harm consumers and producers by increasing the cost of goods and services and limiting access to markets (Krueger, 2020, p. 45).

Another challenge is currency exchange rate fluctuations, which can affect the competitiveness of countries and corporations in international trade. Volatility in exchange rates can also create uncertainty for investors and businesses, which can lead to reduced investment and trade.

Other challenges include non-tariff barriers, such as technical standards and regulations, which can create additional costs for businesses and limit market access. Intellectual property rights protection and enforcement can also pose challenges for companies operating in different countries.

International trade can also face obstacles related to infrastructure and logistics, especially in less developed countries where communication and transportation facilities may be weak. This might make crossing international borders more expensive and time-consuming.

Lastly, political unrest, hostilities, and corruption can significantly hinder trade across nations by raising the stakes for investors and eroding market trust.

In general, overcoming these obstacles is crucial for advancing inclusive, sustainable, and global commerce that benefits all parties.

**(b) Classical Theories of International Trade**

Classical theories of international trade are based on the idea that trade is mutually beneficial and can increase wealth and welfare for all countries involved. The three main classical theories of international trade are the theory of absolute advantage, the theory of comparative advantage, and the factor endowment theory.

According to Adam Smith's concept of absolute advantage, nations should specialize in manufacturing items in which they have a clear edge or a lower cost of manufacturing, and exchange these products with other nations. This approach places a strong emphasis on the advantages of specialization and workforce division (Cooper, 2018, p. 21).

According to David Ricardo's theory of comparative advantage, nations should focus on generating items for which they have a comparative edge or a lower opportunity cost, and exports those items with other nations. This idea highlights the advantages of trade even when one nation has a clear edge in all areas of commerce.

The factor endowment theory, which was created by Eli Heckscher and Bertil Ohlin, contends that nations ought to export commodities made with their plentiful variables of production and import things made with their limited means of production. This idea emphasizes how a nation's resource endowments play a significant role in influencing trade practises (Cooper, 2018, p. 21).

Overall, these classical theories of international trade provide a foundation for understanding the benefits of trade and specialization, and the importance of comparative advantage and factor endowments in determining trade patterns.

**(c) Importance of International Trade Treaties**

International trade treaties are essential for promoting global economic development, increasing market access, and eliminating trade barriers. These agreements help define international commercial norms and regulations and provide a framework for resolving trade disagreements.

International trade accords also give nations a way to communicate and coordinate on matters pertaining to trade and investment. This could contribute to a more transparent and consistent trade policy and boost market trust.

Moreover, by lowering trade barriers and fostering economic development, trade agreements can provide doors for developing nations to integrate into the world economy. Trade pacts can cut consumer expenses and boost industry efficiency by expanding markets and boosting competition. In general, international trade agreements are crucial for fostering inclusive and sustainable economic development.

**(d) The contribution of Africa continent to International trade**

The contribution of the African continent to international trade has been relatively low compared to other regions of the world. According to the World Bank, Africa accounts for only about 3% of global trade. However, there are some positive developments in recent years, such as the African Continental Free Trade Area (AfCFTA) agreement signed in 2018, which aims to create a single market for goods and services across the continent and increase intra-African trade (Olabisi D, 2021, p. 67).

Additionally, Several African countries have experienced growth in certain industries such as agriculture, minerals, and manufacturing, which have contributed to increased trade. Nigeria, the largest economy in Africa, has a significant oil industry and a growing agricultural sector. South Africa, one of the most developed economies in Africa, has a well-developed mining sector and a strong manufacturing industry. Kenya a leader in technology innovation in Africa has a growing service sector, including financial services and telecommunications.

However, these countries and others face challenges such as infrastructure deficits, political instability, and trade barriers, which hinder the full potential of African countries in international trade. To fully benefit from international trade, Africa needs to address these challenges and promote inclusive and sustainable economic growth.

**Question Three**

**(a) Three foreign exchange risks**

Foreign exchange risk refers to the risk that a company or investor may incur losses due to fluctuations in exchange rates. Here are three types of foreign exchange risks:

1. Transaction risk: This risk arises from the effect of exchange rate fluctuations on transactions, such as buying or selling goods or services, and the resulting payment obligations.
2. Translation risk: This risk arises when a company has assets or liabilities denominated in a foreign currency, and exchange rate fluctuations can impact the value of these assets or liabilities when they are translated into the company's domestic currency.
3. Economic risk: This risk results from the effects of exchange rate variations on a business's cash flows, which can affect the profitability and attractiveness of the business. These cash flows include revenues and costs related to overseas transactions.

**(b) Instruments for Hedging Against Foreign Exchange Risks in International Finance Giving Their Advantages and Disadvantages.**

There are several instruments that companies and investors can use to hedge against foreign exchange risks in international finance, each with its own advantages and disadvantages. Here are three common instruments:

1. Forward contracts: A forward contract is a pact to buy or sell a particular currency at a defined rate and date in the future. This instrument's benefit is that it offers exchange rate certainty, enabling businesses to confidently plan their upcoming transactions. The drawback is that it is rigid and might not be appropriate for all forms of transactions.
2. Options contracts: Options contract grants its owner the right, but not the duty, to purchase or sell a certain currency at a future date and rate. This instrument's flexibility and ability to let businesses benefit from advantageous exchange rate changes are its advantages. The drawback is that it could cost more than other equipment and might need special knowledge to use efficiently (Vicky & Patrick, 2019, p. 49).
3. Currency swaps: A currency swap is an agreement between two parties to exchange currencies at a predetermined rate and date, with the intention of reversing the transaction at a later date. The advantage of this instrument is that it can be customized to suit specific needs, and can provide more flexibility than other instruments. However, the disadvantage is that it can be more complex and may require specialized knowledge to use effectively (Vicky & Patrick, 2019, p. 49).

In general, the instrument selected will depend on the particular requirements and conditions of the business or investor, in addition to their level of experience in global finance.

**(c) Types of Currency Quotations in International Finance**

There are two types of currency quotations used in international finance:

1. Direct quotation: A direct quotation is a currency exchange rate in which the domestic currency is the base currency and the foreign currency is the quote currency. For example, if the exchange rate between USD and Kenyan Shillings is 110, the direct quotation would be USD/KES 110, meaning that 1 US dollar can buy 110 Kenyan Shillings.
2. Indirect quotation: An indirect quotation is a currency exchange rate in which the foreign currency is the base currency and the domestic currency is the quote currency. For example, if the exchange rate between USD and Kenyan Shillings is 110, the indirect quotation would be KES/USD 0.009, meaning that 1 Kenyan Shilling can buy 0.009 US dollars.

The choice of quotation depends on the convention used in a particular market or country.

**Question Four:** **Describe the significance of the following in international finance management.**

**(a) Purchasing Power Parity (PPP)**

Purchasing Power Parity (PPP), offers a framework for analysing the relative worth of currencies, is important in international financial management. According to PPP, exchange rates should be adjusted to equalize the costs of comparable goods and services across nations. Businesses and investors should understand this idea since it enables them to assess whether a currency has been over or undervalued and decide on currency exchanges wisely (Officer, 2022, p. 49).

**(b) Interest Rate Parity Theory (IRP)**

The Interest Rate Parity Theory (IRP) is important because it explains how interest rates and exchange rates relate to one another. According to IRP, the disparity in the interest rates of the two nations should be equal to the anticipated change in exchange rates over the same time period. Because it enables firms and investors to anticipate future exchange rate swings and manage their currency risks, this theory is crucial.

**(c) International Fisher’s Effect**

International Fisher's Effect is significant in international finance management as it explains the relationship between nominal interest rates, inflation rates, and exchange rates. The theory suggests that the difference in nominal interest rates between two countries should equal the expected difference in their inflation rates, which in turn affects the expected change in exchange rates. This concept is important for businesses and investors as it allows them to forecast future exchange rate movements based on inflation differentials (Gong, 2018, p. 32).

**(d) Fixed and floating exchange rate systems**

The decision between fixed and floating exchange rate systems has a considerable impact on how well governments can control their monetary policies and how stable exchange rates are. A floating exchange rate system offers more freedom but may be volatile, whereas a fixed exchange rate system offers stability but restricts a country's capacity to modify its currency in response to shifting economic conditions. Because it influences the costs and hazards involved in international trade and investment, the choice of exchange rate system can have a big impact on firms and investors.

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