Mohamed Khaider University, Biskra

Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: International Finance

Branch: International Trade
Level: Third year Bachelor

Lecture 08: International Financial Markets

Learning Outcomes

The specific objectives of this lecture are to describe the background and corporate use of the following international financial markets:

- International money market

- International credit market

- International bond markets

- International stock markets

Financial managers of MNCs must understand the available international financial markets (Foreign exchange market. International credit market. International money market. International bond markets. International stock markets) so they can be used to facilitate the firm's international business transactions.

1- International Money Market:

A- Definition

Each country has a money market whereby surplus units (individuals or institutions with available short-term funds) can transfer funds to deficit units (institutions or individuals in need of funds). Financial institutions such as commercial banks accept short-term deposits from surplus units and redirect the funds toward deficit units. The international money market developed to accommodate the needs of MNCs. vestment would be greater than the interest rate quoted for the foreign investment. Financial institutions such as commercial banks serve this market by accepting deposits and providing loans in various currencies. These intermediaries typically also serve as dealers in the foreign exchange market.

B- Money Market Interest Rates among Currencies

The money market interest rate on short-term deposits or short-term loans in a particular currency in international money markets is dependent on the supply of short-term funds provided by surplus units and the demand for short-term funds by deficit units in that currency. A currency's money market is highly influenced by its respective London Interbank Offer Rate (LIBOR), which is the interest rate most often charged for short-term loans between banks in international money markets. The term LIBOR is commonly used even though many international interbank transactions do not pass through London.

When a currency's LIBOR rises, money market rates denominated in that currency tend to rise as well, just as U.S. money market rates tend to move with the federal funds rate (the interest rate charged on loans between U.S. banks).

C- European Money Markets

To conduct international trade with European countries, corporations in the United States deposited U.S. dollars in European banks. The banks accepted the deposits because they could then lend the dollars to corporate customers based in Europe. These dollar deposits in banks in Europe (and on other continents) are known as Eurodollars (not to be confused with the euro, which is the currency of many European countries today). The growing importance of the Organization of the Petroleum Exporting Countries (OPEC) also contributed to the growth in Eurodollar deposits. Because OPEC generally requires payment for oil in dollars, the OPEC countries began to deposit a portion of their oil revenues in European banks. These dollar-denominated deposits are sometimes referred to as petrodollars.

D- Risk of International Money Market Securities

When MNCs and government agencies issue debt securities with a short-term maturity (one year or less) in the international money market, these instruments are referred to as international money market securities. MNCs typically pay a slightly higher rate than their local government when borrowing in international money markets because of a small risk premium to reflect credit (default) risk. International money market securities are also exposed to exchange rate risk when the currency denominating the securities differs from the investor's home currency.

2- International credit market

Multinational corporations and domestic firms sometimes obtain medium-term funds via term loans from local financial institutions or by issuing notes (medium-term debt obligations) in their local markets. However, MNCs also have access to medium-term funds through banks located in foreign markets. Loans of one year or longer that are extended by banks to MNCs or government agencies in Europe are commonly called Eurocredits or Eurocredit loans, which are transacted in the Eurocredit market. These loans can be denominated in dollars or in one of many other currencies, and their typical maturity is five years.

3- International bond markets

A- Definition

The international bond market facilitates the flow of funds between borrowers who need long-term funds and investors who are willing to supply long-term funds. Multinational corporations can obtain long-term debt by issuing bonds in their local markets, and they can also access long-term funds in foreign markets. An international bond issued by a borrower foreign to the country where the bond is placed is known as a foreign bond. For example, a U.S. corporation may issue a bond denominated in Japanese yen that is sold to investors in Japan. In some cases, a firm may issue a variety of bonds in various countries.

B-Eurobond Market

Eurobonds are bonds that are sold in countries other than the country whose currency is used to denominate the bonds. Eurobonds are denominated in a number of currencies. The U.S. dollar is used most often, accounting for 70 to 75 percent of Eurobonds.

4- International stock markets

Some MNCs issue stock outside their home country, many investors purchase stocks outside their home country. MNCs may issue stock in foreign markets for various reasons. MNCs may more readily attract funds from foreign investors by issuing stock in international markets. They have their stock listed on an exchange in any country where they issue shares, because investors in a foreign country are only willing to purchase stock if they can later easily sell their holdings locally in the secondary market. The stock is denominated in the currency of the country where it is placed. An MNC's stock offering may be more easily digested when it is issued in several markets. The stocks of some U.S.-based MNCs are widely traded on numerous stock exchanges around the world, which gives non-U.S. investors easy access to those stocks and also gives the MNCs global name recognition. Many MNCs issue stock in a country where they will generate enough future cash flows to cover dividend payments.

5- How Financial Markets Serve MNCs

The first function is foreign trade with business clients. Exports generate foreign cash inflows while imports require cash outflows. A second function is direct foreign investment, or the acquisition of foreign real assets. This function requires cash outflows but generates future inflows either through remitted earnings back to the MNC or through the sale of these foreign assets. A third function is short-term investment or financing in foreign securities in the international money market, and the fourth function is longer term financing in the international bond or stock markets. An MNC may use international money or bond markets to obtain funds at a lower cost than they can be obtained locally.

Reference:

Jeff Madura. International Financial Management, 13th Edition. Cengage Learning . Canada. 2016