International Financial Environment

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SCHOOL OF BUSINESS ADMINISTRATION IN KARVINA

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Boeing 787 Dreamliner

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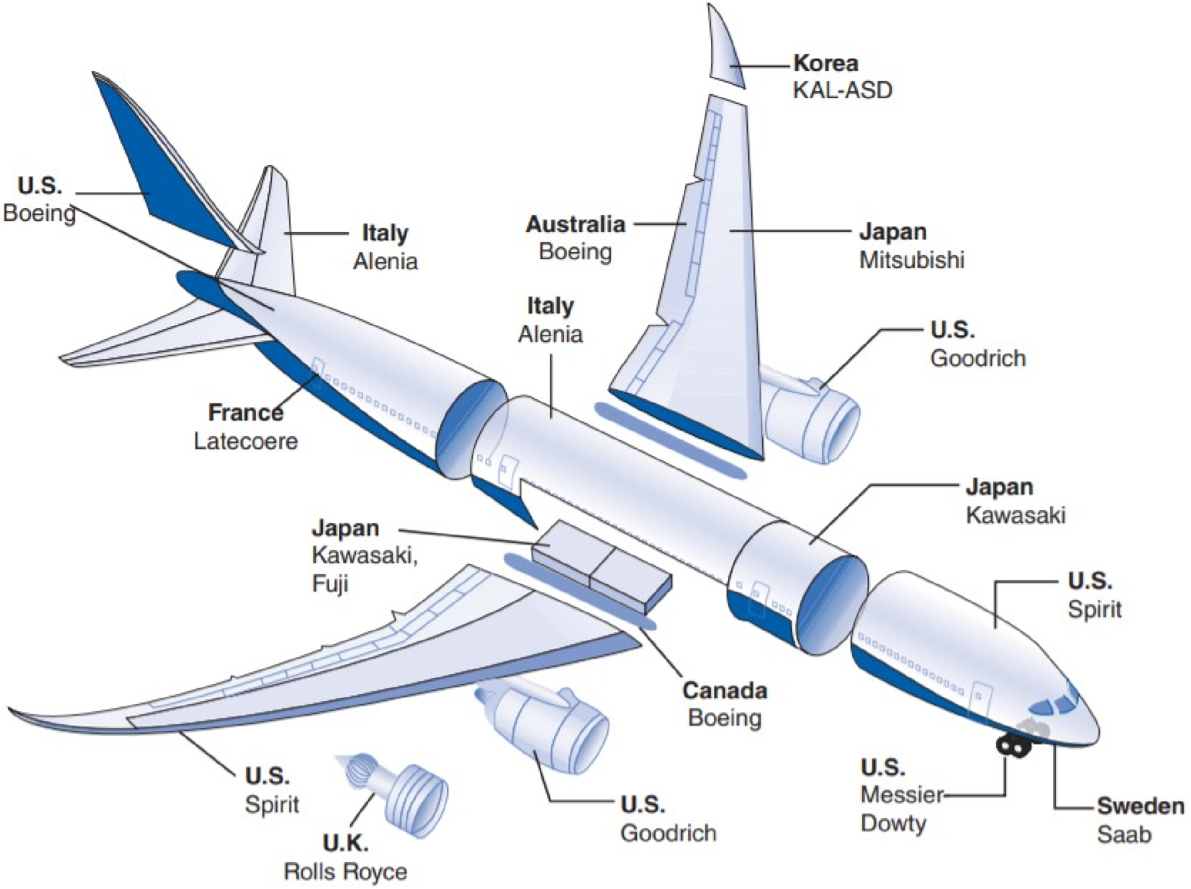

Questions and Applications

???What is the financial system???

Definition of Financial System

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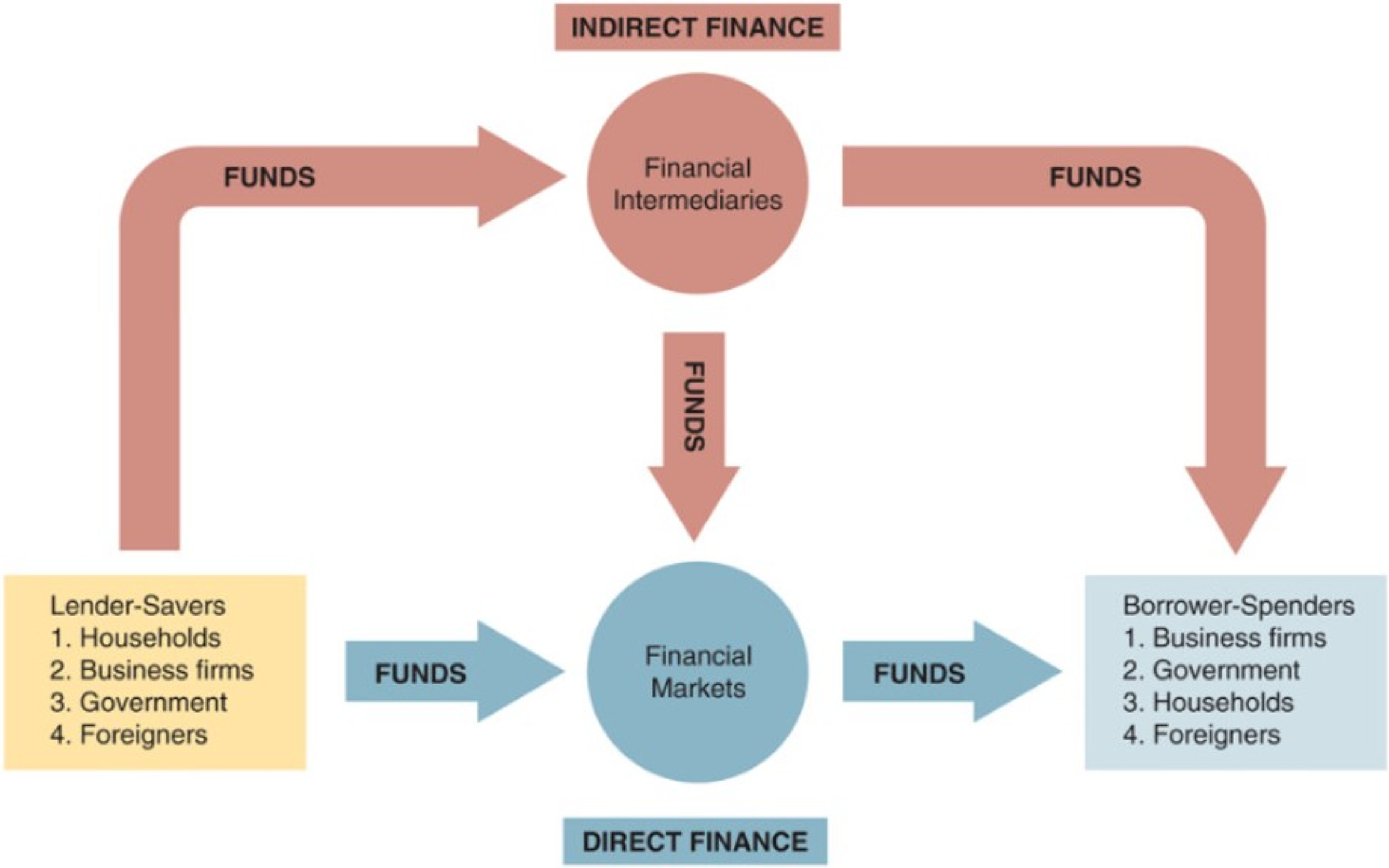
- Financial system is system that allows transfer money between savers and borrowers

- Functions
  - to channel funds from lenders to borrowers
  - to create a payment and clearing mechanism


INDIRECT FINANCE
FUNDS
Financial Intermediaries
FUNDS
FUNDS
Lender-Savers
1. Households
2. Business firms
3. Government
4. Foreigners
FUNDS
Financial Markets
FUNDS
Borrower-Spenders
1. Business firms
2. Government
3. Households
4. Foreigners
DIRECT FINANCE

Types of Financial System

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- M-System
  - based on capital markets
  - USA, Great Britain

- B-System
  - based on financial intermediaries (banks)
  - Czech Republic, Germany, Austria

Questions and Applications

???What about financial system in your country???

Compare the financial system in your home country with one typical B-based system and one typical M-based system.

Statistics

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- domestic credit provided by financial sector (% of GDP)
  http://data.worldbank.org/indicator/FS.AST.DOMS.GD.ZS

- market capitalization of listed companies (% of GDP)
  http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS

Definition of the International Monetary System

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- Complex system of international arrangements, rules, institutions, policies in regard to exchange rates, international payments and international capital flows

- Institutional framework within which
  - International payments are made
  - Movements of capital are accommodated
  - Exchange rates are determined

- International monetary system has evolved over time as international trade/business/finance have changed, technology has improved and political systems have changed

Questions and Applications

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When government of Greece experienced problems in meeting its debt obligation in 2010, some investors became concerned that the crisis would spread to other European countries. Explain why integrated European financial markets might allow a debt crisis in one European country to spread to other countries in Europe.

???

Questions and Applications

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???What is the money, why money came into existence???

Definition of the Money

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OBCHODNĚ PODNIKATELSKÁ FAKULTA V KARVINÉ

- Money is any good that is widely accepted for the purposes of the exchange and in the repayments of debts

- Functions
  - medium of exchange
    - money is used to intermediate the exchange of goods and services
    - it solves the problem of the double coincidence of wants
  - unit of account
    - money measures the market value of goods, services, and other transactions
    - it decreases number of prices (in barter: 4 types of goods = 6 prices, 100 types of goods = 495 prices)
  - store of value
    - money is a way to keep some of our wealth in a readily spendable form for future needs

Questions and Applications

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???Can we consider Bitcoin or other cryptocurrencies as money???

Evolution of the International Monetary System

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- Bimetallism (before 1850s – 1870)
- Classic Gold Standard (1870s – 1914)
- Interwar period (1918 – 1939)
- Bretton Woods system (1945 – 1972)
- System of floating exchange rates (1972 – present)

Present International Monetary System

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- Variety of exchange rate regimes
  - Selection depends on a country's preferences and specifics
- Three most important currencies (USD, EUR, JPY)
  - Discussions on the role of GBP and CNY
- Evidences on monetary integration with the Eurozone as the most advanced example
- Financial crises as a phenomena of current system
  - Crises in Latin America
  - Crises in South-East Asia
  - Global financial crisis
- Discussions on controls and regulation of international capital flows

Balance of Current Account in Selected Countries

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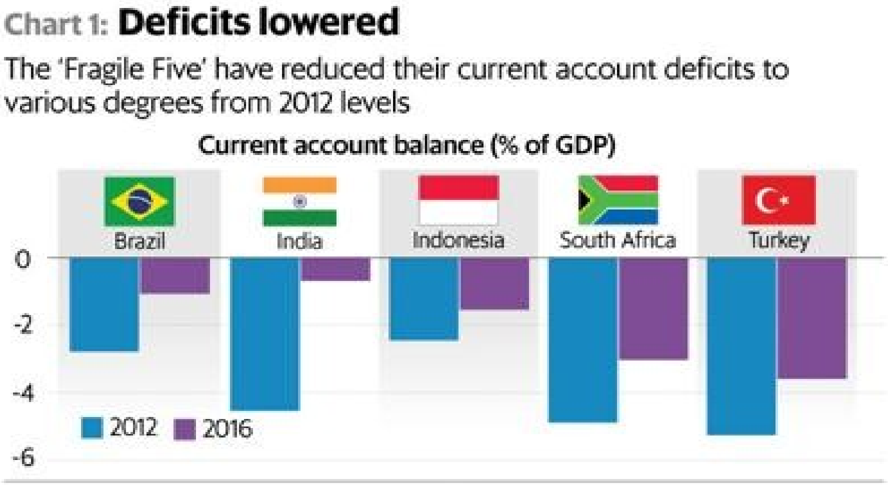
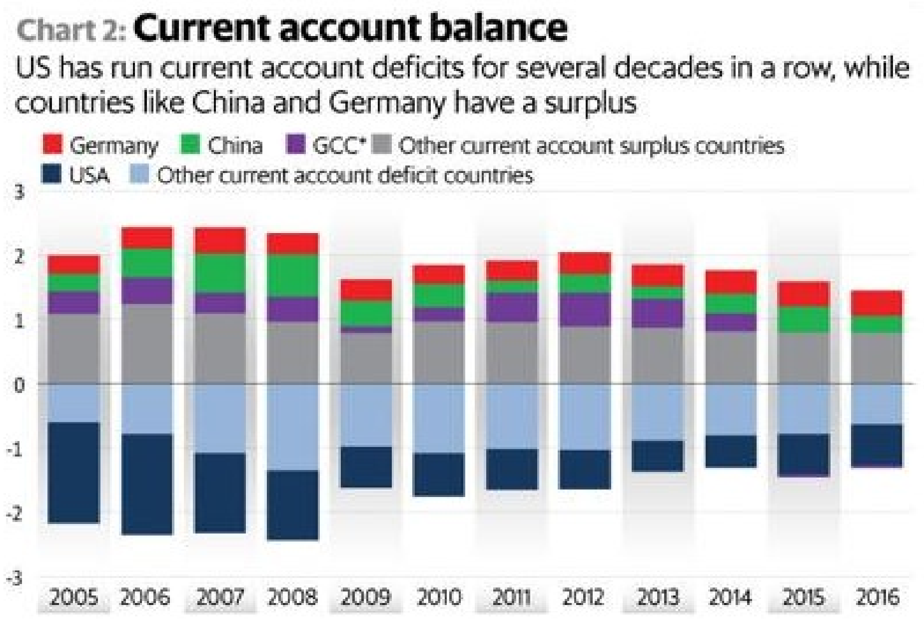
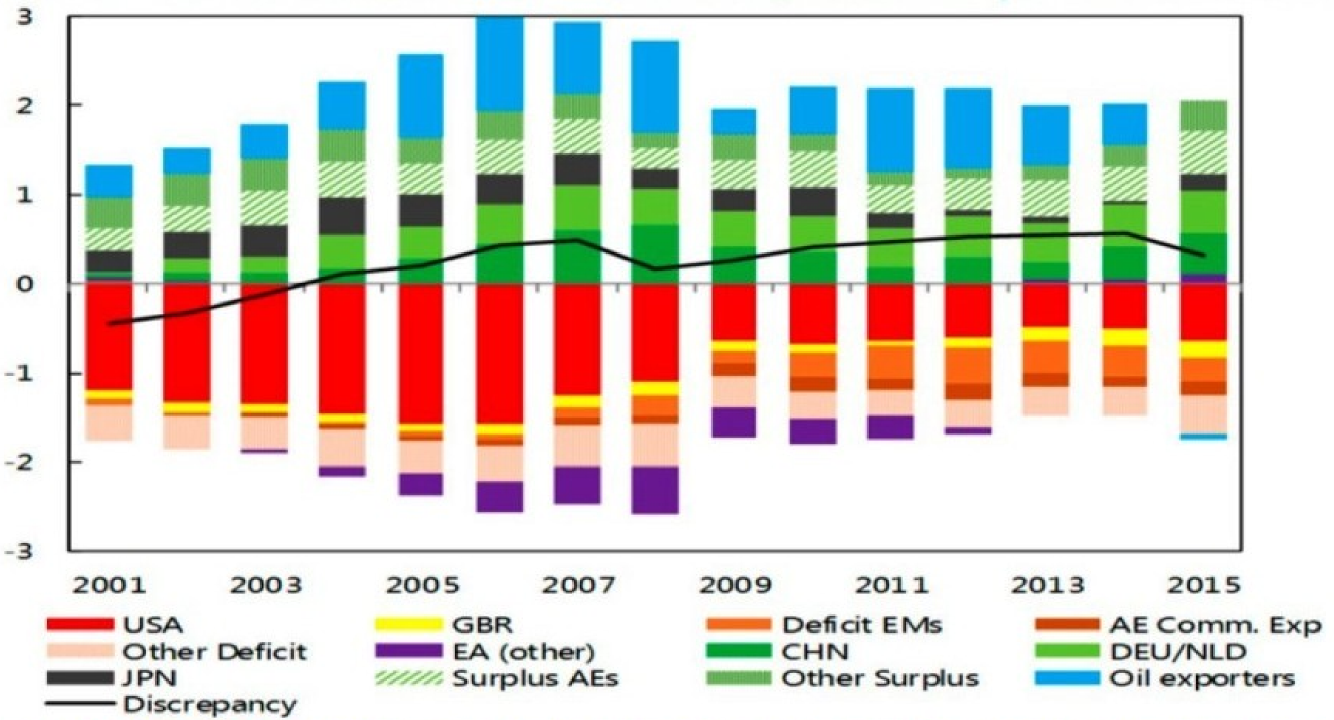




Current Account Imbalances (% of World GDP)



Note: Surplus AEs: Korea, Hong Kong SAR, Singapore, Sweden, Switzerland, Taiwan POC; AE Commodity Exporters: Australia, Canada, New Zealand; Deficit EMs: Brazil, India, Indonesia, Mexico, South Africa, Turkey; Oil exporters: WEO definition plus Norway

Source: IMF, 2016 External Sector Report, July 2016.

Top 20 Countries According to Foreign Exchange Reserves

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Rank	Country or region	Foreign exchange reserves (millions of US$)	Figures as of
1	China[a]	3,115,500	January 2020[1]
2	Japan	1,371,337	October 2019[2]
–	*Europe (ECB - Eurosystem)*	921,279	September 2019[2][3]
3	Switzerland	846,620	October 2019[2]
4	Russia	562,300	31 January 2020[4]
5	Saudi Arabia	500,148	November 2019[5]
6	Taiwan[6]	479,131	January 2020[7]
7	India	473,001	7 February 2020[8][b]
8	Hong Kong	434,200	November 2019[9]
9	South Korea	408,800	December 2019[10]
10	Brazil	356,884	December 2019[11]
11	Singapore	276,795	October 2019[12]
12	Thailand	227,500	December 2019 [13]
13	Germany	221,217	December 2019[14]
14	United Kingdom	200,906	Jan 2020[15]
15	Mexico	182,915	September 2019[16]
16	France	169,005	October 2019[17]
17	Italy	164,992	June 2019[18]
18	Czech Republic	149,713	December 2019[19]
19	Iran[c]	132,600	31 December 2017[20]
20	Indonesia	131,700	October 2019[21]

Key International Financial Institutions

- International financial institutions are integral part of the international monetary system as they built up the institutional framework
- Several institutions with global or remarkably international influence
  - International Monetary Fund
  - World Bank and World Bank Group
  - Central banks of major economic centers (Federal Reserve System, European Central Bank, Bank of Japan, Bank of England)
  - Regional development banks
  - Bank for International Settlements
  - European Investment Bank
- Listed institutions differ in size as well as objective

Economic and monetary union (EMU)

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- Final stage of long-lasting process of economic integration in Europe
- EMU has been a long standing objective since late 1960s
- Euro area with single currency and monetary policy emerged in 1999
- Economic and monetary union involves
  - Policy harmonization to remove obstacles to factor mobility
  - A more marked and wider range of common policies, especially in relation to macroeconomic policy
  - Irrevocably fixed exchange rates or, as in the case of the EU, a single currency
  - A common monetary policy – that is, one interest rate and exchange rate policy determined by a single Central Bank
  - Some pooling of foreign exchange reserves
  - Possible inter-state transfers to offset economic distortions arising from EMU

European Union and Euro Area (Eurozone)

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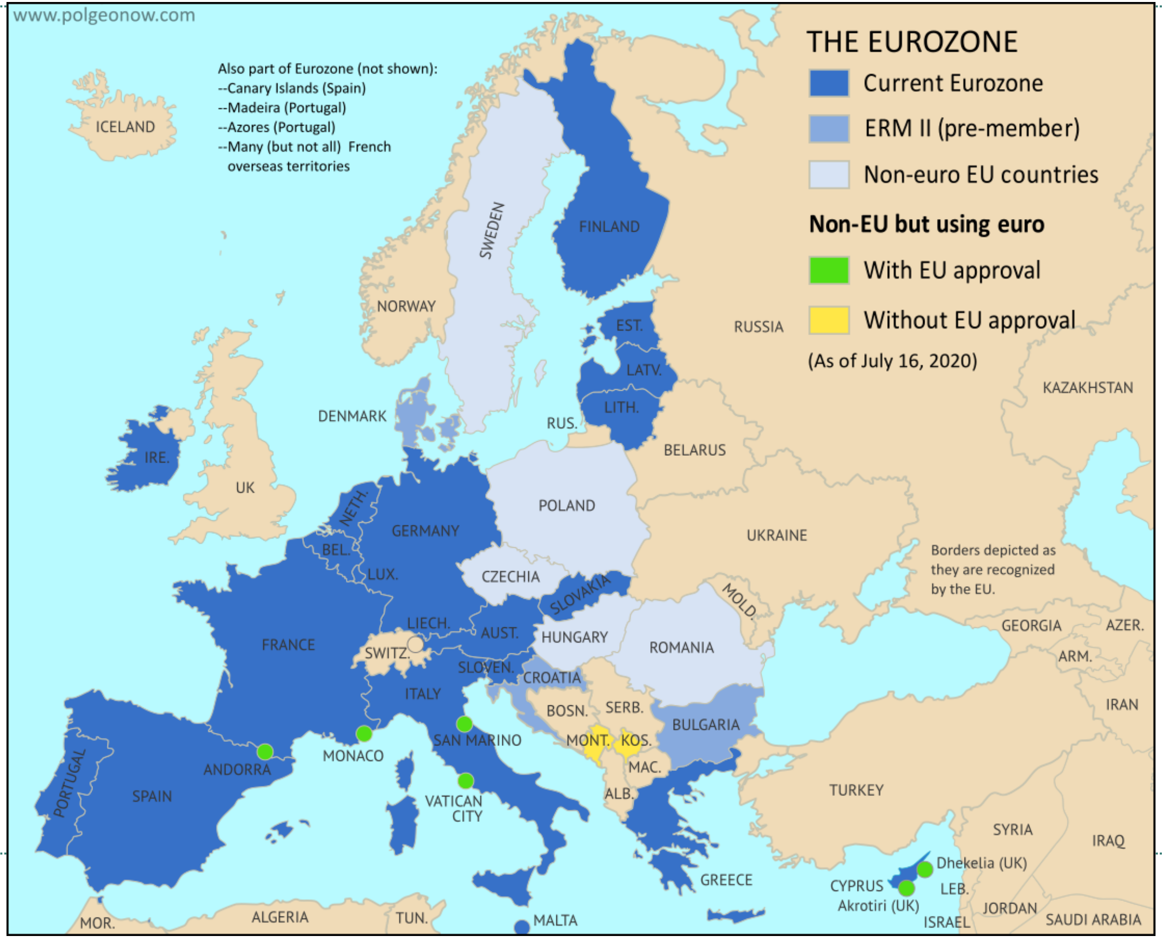

Why Some EU Members do not Have the Euro?

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- United Kingdom (GBP)
  - Before Brexit: „opt-out" clause and five economic tests by Gordon Brown
  - Brexit left United Kingdom outside the EU
- Denmark (DKK)
  - „Opt-out" clause
  - Adoption of Euro refused by referendum
- Sweden (SEK)
  - Referendum + political decision to not fulfill one criterion
- BG, CZ, HR, HU, PL, RO
  - Convergence criteria must be fulfilled first
  - Political will to accept the euro must exist

Three Stages for the EMU Implementation

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- Stage One (July 1, 1990 – December 31, 1993)
  - Exchange controls were abolished, capital movements liberalized
  - Set up of formal convergence
- Stage Two (January 1, 1994 – December 31, 1998)
  - Name of the new currency decided
  - Practical framework for the euro adoption defined
  - European Central Bank established
- Stage Three (January 1, 1999 – continuing)
  - 11 countries joined Euro Area (Greece two years later)
  - Single monetary policy came into effect
  - Euro coins and notes introduced in early 2002

Convergence is Key in the EMU

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- Nominal convergence
  - Five convergence criteria (Maastricht criteria) for countries joining the Euro Area
- Real convergence
  - Economic cycle, structure of economy
  - Real exchange rates, productivity, labor costs
  - International trade, international investments
- Institutional convergence
  - Legal institutions and legal acts
  - Shareholders‘ and creditors‘ rights, investor protection
  - Market regulations
  - State capacity on enforcing contracts and tax collection

Maastricht Convergence Criteria

What is measured	Price stability	Sound public finances	Sustainable public finances	Durability of convergence	Exchange rate stability
How it is measured	Consumer price inflation rate	Government deficit as % of GDP	Government debt as % of GDP	Long-term interest rate	Deviation from a central rate
Convergence criteria	Not more than 1.5 percentage points above the rate of the three best performing Member States	Reference value: not more than 3%	Reference value: not more than 60%	Not more than 2 percentage points above the rate of the three best performing Member States in terms of price stability	Participation in ERM II for at least 2 years without severe tensions

Costs and Benefits of EMU

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- Benefits
  - elimination of intra-EU transaction costs lower interest rates
  - uniform interest rates
  - removal of exchange rate uncertainty in intra-EMU trade
  - removes the option of competitive devaluations between EU states
  - financial integration
  - economic cushioning from domestic political instability
  - creates a new international currency to represent the EU's combined economic weight
- Costs
  - short term deflation
  - loss of the exchange rate as a tool of national economic policy
  - loss of power to set interest rates and control the supply of money
  - potential problems related to a lack of 'real' convergence and potential policy conflicts
  - the inappropriateness of one monetary policy for so many states

European Central Bank (ECB)

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- ECB is the central bank with responsibility for conducting monetary policy for the euro area
- European System of Central Banks (ESCB) comprises the ECB and the national central banks of all EU Member States whether they have adopted the euro or not
- Eurosystem comprises the ECB and the the national central banks of those countries that have adopted the euro
  - The Eurosystem and the ESCB will co-exist as long as there are EU Member States outside the euro area
- Euro area consists of the EU countries that have adopted the euro

Objective and instruments of the ECB monetary policy

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- The primary objective is to maintain price stability in the euro area
- Price stability defined as a year-on-year increase in the Harmonized Index of Consumer Prices (HICP) for the euro area of below 2%
- Operational framework consists of the following instruments
  - Open market operations
    - Main refinancing operations
    - Longer-term refinancing operations
    - Fine-tuning operations
    - Structural operations
  - Standing facilities
    - Marginal lending facility
    - Deposit facility
  - Minimum reserve requirements to credit institutions

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