



**MINISTRY OF EDUCATION AND SCIENCE OF UKRAINE
NATIONAL TECHNICAL UNIVERSITY
"KHARKIV POLYTECHNICAL INSTITUTE"**

**METHODOLOGICAL INSTRUCTIONS
for practical classes on the course
«International credit-settlement and foreign exchange transactions»
for students of specialties
073 «Management»,
072 «Finance, Banking and Insurance»**

Kharkiv 2021

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Compilers: S.V. Klepikova
O.S. Druhova
S. A. Mehovich

Reviewer J.L. Tataryntseva

Department of International Business and Finance

INTRODUCTION

The experience of the world community leading countries gives strong evidence that economic growth and the provision of effective conditions for stable economic development, improvement of social protection, and welfare of the population are possible only if the banking sector of a market economy is effectively developed.

The banking system of Ukraine is one of the domestic leaders of market reforms. With the proclamation of independence in August 1991, Ukraine could form its own banking and monetary system independently. The legal framework for the banking system functioning was the Law of Ukraine “On Banks and Banking Activities” adopted in March of the same year. It embedded the fundamental principles on which the new two-tier banking system of Ukraine was to be built. The banking system was created to expand the infrastructure of the market economy, improve services for entrepreneurs and the population, and bring banking institutions closer to their clients.

Today’s world economy is highly integrated. As a result, cooperation between business parties from different countries is becoming more widespread. One of the major points in implementing foreign economic agreements (contracts) is mutual settlements between the parties – residents of different countries, which due to their specifics are called international settlements.

Moreover, such settlements may relate not only to trade but also to credit, investment or other foreign economic relations. Settlement participants can be institutions, organizations, enterprises and individuals that are payers or recipients of funds.

Topic 1. THE ENVIRONMENT OF INTERNATIONAL MONETARY AND FINANCIAL AND CREDIT RELATIONS

Key terms: *currency systems, formation of the global currency system, the concept of currency, types of currency, exchange rates, types of currency quotations, devaluation and revaluation of currency, types of currency convertibility, currency intervention, exchange restrictions, diversification of foreign exchange reserve.*

A currency is monetary notes, credit funds and means of payment that are used in international settlements. The national currency is the monetary notes, credit funds and means of payment of a particular country that are used in international settlements. A currency system is a state-legal form of currency relations organization. The primary purpose of the currency system is to ensure the international exchange of goods and services; functioning in order to exchange sufficient relevant currency in the presence of a flexible and efficient exchange mechanism.

There are national, global and regional currency systems.

Types of exchange rates:

1. According to quoting methods: direct, indirect
2. According to quoting terms: spot exchange rate, forward exchange rate, cross-exchange rate
3. According to the mechanism of regulation: floating, fixed, hybrid
4. According to the parties of the agreement: buying rate, selling rate

Devaluation is a decrease in the exchange rate of the national currency against foreign currencies or international units of account (SDRs, ECU).

Revaluation is an increase in the exchange rate of the national currency against the international currency or international unit of account.

Convertibility is the ability of a certain country's currency to be freely exchanged for the currencies of other countries and international means of payment at the current exchange rate. There is full and partial, internal and external currency convertibility, as well as blocked (non-convertible) currency.

Currency intervention is the intervention of the central bank in the foreign exchange market transactions to influence the exchange rate of the national currency.

Exchange restrictions are restrictions imposed by the state on transactions with currency, gold and other currency values.

Diversification of foreign exchange reserves is the policy of states, banks, monopolies aimed at regulating the structure of foreign exchange reserves by including different currencies in their composition in order to ensure international settlements, conduct currency intervention and protect foreign exchange losses.

Independent work of students

The main issues of the practical class.

1. Prerequisites and stages of formation of the Ukrainian currency system
2. Exchange rate regime in Ukraine
3. Current characteristics of the international financial environment

The main issues for self-studying.

1. Evolution of the global currency system.
2. Stages of formation of the European currency system.
3. External debt of Ukraine

Topics for reports.

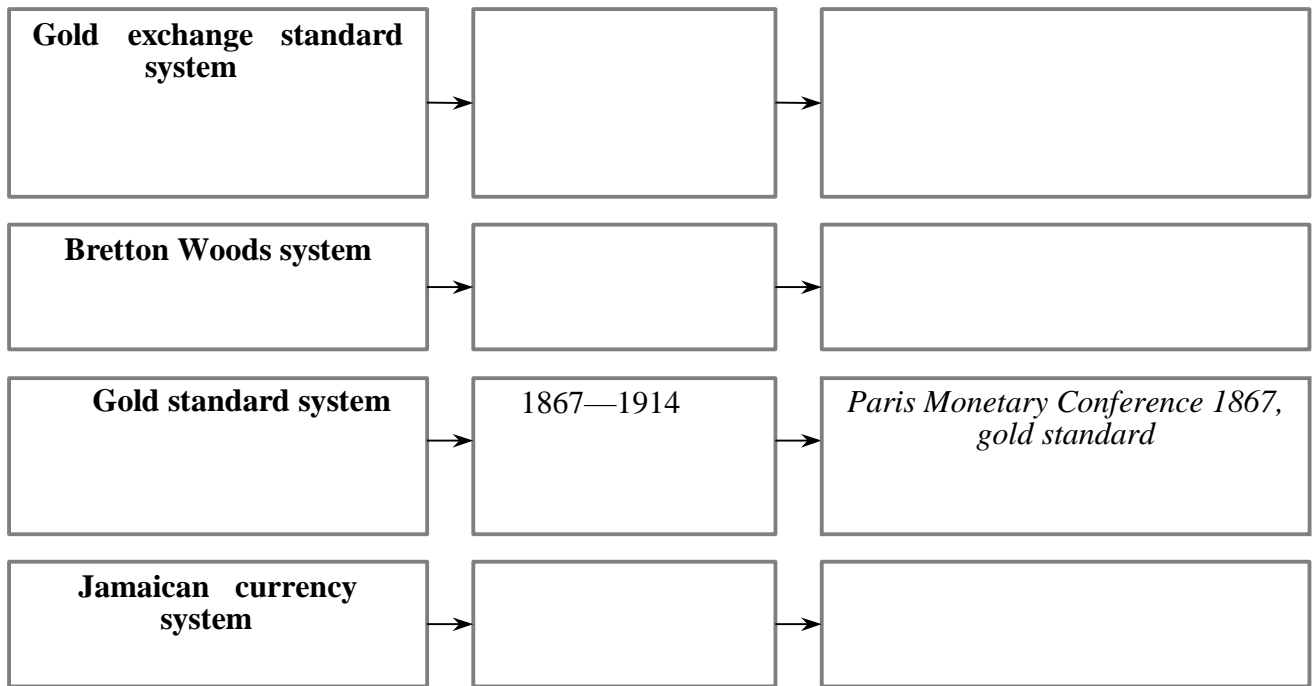
1. Development of the Ukrainian currency system.
2. Evolution of currency systems.
3. Decree of the Cabinet of Ministers «On the system of currency regulation and currency control».

Self-practice exercises

Exercise 1. Name the elements of currency systems you know and complete the table.

The major elements of the national and global currency systems	
National currency system	Global currency system
1.	1.
2.	2.
3.	3.

Exercise 2. Describe the named currency systems according to the diagram.



Exercise 3. Name the fundamental elements of the gold standard system.

Exercise 4. Name the fundamental elements of the gold exchange standardsystem.

Exercise 5. Name the main elements of the Bretton Woods global currency system.

Exercise 6. Name the main elements of the Jamaican global currency system.

Exercise 7. Describe the European Currency System.

Period of operation	
Background	
Aim	
Authorities of exchange controls	
Exchange rate regime	
Main elements	

Exercise 8. Describe the forms of convertibility by types and parties of foreign economic transactions and the location of the party. Give examples of countries that support these forms.

	Description	Country
<i>According to the types and parties of foreign economic transactions</i>		
Freely convertible currency		
Partially convertible currency		
Non-convertible currency		
<i>According to the location of the party</i>		
External convertibility		
Internal convertibility		

Exercise 9. Name the stages of formation of the Ukrainian currency system. Complete the table.

Stages (dates)	Laws and regulations

Practical exercises

1. The American corporation "Fresh Gross" supplies soy-bean flakes for feed production to the British company «HealthyChicken». Since January 1, the pound sterling exchange rate has fallen from \$ 2.8 to \$ 2.4 per pound.

Define the damage incurred by American exporters because of depreciation of the pound sterling if the amount of unperformed contracts to partners is 35 million pounds.

2. Suppose that the US dollar quoted in Montreal against the Canadian dollar at the exchange rate of \$ 1. US = \$ 1.19 Canada.

Define the quotations of the Canadian dollar in San Francisco while maintaining the same exchange rate in these foreign exchange markets.

3. Suppose that the dollar exchange rate in Tokyo was 132 yen, and in Mexico City – 3,045 pesos. Calculate the exchange rate of the Mexican peso against the yen in Tokyo and the exchange rate of the Japanese yen against the American peso in Mexico City.

4. Calculate the ratio between the hryvnia (UAN) and the Swiss franc (CHF) if the buying rate is

$$1\text{USD} = 20,520 \text{ (UAN)}$$

$$1\text{USD} = 0,964 \text{ (CHF)}$$

the selling rate is

$$1\text{USD} = 20,578 \text{ (UAN)}$$

$$1\text{USD} = 0,978 \text{ (CHF)}$$

Topic 2. COUNTRY BALANCE OF PAYMENTS

Key terms: *balance of claims and liabilities, balance of international indebtedness, balance of payments, balance of payments items, balance measurement, factors that affect the balance of payments, balance-of-payments policy.*

There are several types of international settlement balances:

- the balance of claims and liabilities (balance sheet is used to identify net creditor and net debtor countries. It characterizes the ratio of all debts of this country from foreign partners at a certain date and liabilities of this country, regardless of the terms of payments);

- the balance of international indebtedness (shows only the ratio between foreign assets and foreign exchange reserves of the country on the one hand and liabilities to foreign investors on the other);

- the balance of payments (shows the ratio of foreign payments and revenue receipts from abroad over time (year, quarter, month).

A balance of payments is the balance sheet account of international transactions as value terms of the entire complex of world economic relations of the country as the revenues and payments ratio.

Any transaction that results in foreign payments is included in the BoP as a "debit" and is taken into account with a negative "-" sign. Conversely, any transaction that results in revenue receipts from abroad is included in the BoP as a "credit" and is taken into account with a positive "+" sign.

The balance of payments comprises the following components:

- balance of trade, i.e. the ratio between export and import of goods;
- balance of services and non-commercial payments (invisible balance);
- capital and credit balance.

A balance of trade is the ratio of the value of exports to imports. Since a significant part of foreign trade carries out on credit, there are discrepancies between the figures of trade, payments and receipts actually made for the relevant period.

A balance of services and non-commercial payments includes payments and receipts from transportation, insurance, information transfer, cultural and scientific exchanges, various commissions, advertising, organization of exhibitions, fairs, etc.

A capital and credit balance expresses the ratio of export and import of public and private capital, granted and received international credits.

There are factors that affect the balance of payments position: uneven economic and political development of countries, international competition; economy cyclical swings; growth of foreign government expenditures, related to the economy militarization and military expenditure; increasing international financial interdependence; developments in international trade; the impact of monetary and financial factors; inflation; trade and political discrimination against certain countries; extraordinary circumstances: crop failure, natural disasters, catastrophes; etc.

Independent work of students

The main issues of the practical class.

1. Balance of payments and economic situation in Ukraine: dynamics, influencing factors.
2. Impact of the country's balance of payments on the exchange rate of the national currency.
3. Balance-of-payments policy (balancing mechanisms).

The main issues for self-studying.

1. Balance of payments of developing countries.
2. Balance of payments of Russia, USA, Japan, Great Britain, Germany, Australia.
3. State balance-of-payments policy.

Topics for reports:

1. Balance of payments of Ukraine 2000-2005.
2. Balance of payments of Ukraine 2006-2011.

3. Balance of payments of Ukraine 2012-2017.
4. Balance of payments theories.

Self-practice exercises

Exercise 1. Give a current classification of the balance of payments items according to the IMF methodology

A. Current Account

Total: A. Balance of current account

B.

Total: A + B

C.

D. Errors and omissions

Total: A + B + C + D (corresponds to the concept of liquidity in the US)

E. Reserved items

F.

G.

Total:

H. Total change in SDR reserves

Exercise 2. What is the material basis for the balance of payments policy?

1.

2.

3.

4.

Exercise 3. *Indicate the measures that are used to reduce the balance of payments deficit*

1. _____
2. _____
3. _____
4. _____
5. _____

Exercise 4. *What factors affect the balance of payments? Explain.*

<i>Factors</i>	<i>Explanation. Examples.</i>

Practical exercises

1. *Make the balance of payments based on the transactions.*

Suppose that all transactions take place in a fictitious country N, in which the dollar acts as the domestic currency.

1. A European importer buys equipment from a manufacturer based in the country N for \$ 3 million. The payment was made by reducing dollar deposits owned by European banks in country N.

	Item	Total
Credit		
Debit		

2. Importers of country N bought products from Latin American suppliers in the amount of \$ 1.2 million. The payment was made by transferring dollar funds to exporters in Latin America that sold the funds to Latin American banks.

	Item	Total
Credit		
Debit		

3. Tourists from country N travel to Europe and spend 400 thousand dollars on travel expenses, hotel and food. They exchange traveler's cheques in dollars for euros at

various banks in Europe. European banks deposit traveler's cheques to other bank accounts in country N.

	Item	Total
Credit		
Debit		

4. Residents of country N receive interest payments and dividends of \$ 200,000 on their portfolio investments in London, Zurich and Paris. These funds are available through the clearing accounts of European banks in domestic banks of country N.

	Item	Total
Credit		
Debit		

5. A company of the country N buys 60 % of the voting stock in a European company for \$ 800,000. Payment is made as a transfer of dollars to the seller. The seller exchanges dollars for their currency, and European banks accumulate the received dollars on deposits in banks of country N.

	Item	Total
Credit		
Debit		

6. The government of country N provides assistance to Ukraine as an unrequited transfer of agricultural products in the amount of \$ 300,000. Ukraine does not pay any cash, but the unrequited transfer is recorded in the balance of payments of country N.

	Item	Total
Credit		
Debit		

7. The UK Central Bank buys \$ 100,000 of country N from British commercial banks. Payment is made in local currency.

	Item	Total
Credit		
Debit		

8. Banks of country N are involved in a loan provided to Argentina in the amount of 50 thousand dollars. A borrower from Argentina temporarily deposits dollars in the bank of country N.

	Item	Total
Credit		
Debit		

9. The European investor buys ordinary registered shares which are traded on the stock exchange of country N, in the amount of 80 thousand dollars. The investor pays for dollars purchased from European banks and as a result these banks spend funds on their dollar accounts in banks of country N.

	Item	Total
Credit		
Debit		

Balance of payments of country N (million dollars)

Items	Credit	Debit	Total
I. Current account			
1. Export of goods			
2. Import of goods			
3. Tourism			
4. Investment income			
5. Total			
II. Unrequited payments			
6. Official transfers			
III. Balance of current account			
7. Total			
IV. Capital flow			
8. Direct investments			
9. Portfolio investments			
10. Bank loan			
11. Total			
Items	Credit	Debit	Total
V. Basic balance			
12. Current payments – long-term capital			
VI. Private short-term capital			
13. Liabilities to foreign companies (banks)			
VII. Official reserve assets and liabilities			
14. Short-term liabilities to official foreign companies (banks)			
VIII. Total			
15. Total receipts and payments			

Topic 3. REGULATION OF INTERNATIONAL MONETARY RELATIONS.

FOREIGN EXCHANGE POLICY

Keyterms: *market and state exchange controls, foreign exchange policy, forms of foreign exchange policy, exchange restrictions, exchange clearings, foreign exchange policy of countries*

Exchange controls are a form of state regulation of international economic relations aimed at regulating international settlements and the procedure for conducting transactions with currency and currency values in order to counterbalance the balance of payments, change the structure of imports or limit it, reduce foreign payments, and concentrate foreign exchange resources in state hands.

A special system of legal norms and means provides exchange controls.

National foreign exchange policy is a set of measures taken in international monetary, credit and other economic relations, which are aimed at maintaining a stable exchange rate of the national currency, maintaining a positive balance of payments and forming sufficient foreign exchange reserves.

Legally, the foreign exchange policy is issued within the framework of national currency legislation, international norms, and bilateral and multilateral agreements.

Depending on the aims and methods of conducting the foreign exchange policy is subdivided into:

- Structural foreign exchange policy
- Current foreign exchange policy

Foreign exchange policy is implemented through the use of its instruments:

- currency intervention;
- discount policy;
- regulation of the currency exchange rate based on its devaluation and revaluation;
- double foreign exchange market;
- diversification of official foreign exchange reserves;
- exchange restrictions.

Independent work of students

The main issues of the practical class.

1. Foreign exchange policy of Ukraine.
2. Exchange controls in Ukraine.

3. Exchange restrictions applied in Ukraine.

The main issues for self-studying.

1. Importance and consequences of exchange restrictions.
2. Authorities of exchange controls in Ukraine.
3. Control of foreign exchange transactions.

Topics for reports.

1. History of currency clearing.
2. Foreign exchange policy and global financial crises.

Self-practice exercises

Exercise 1. *In what forms the structural and current foreign exchange systems are implemented?*

	Form
Structural foreign exchange policy	
Current foreign exchange policy	

Exercise 2. *Describe the features of all foreign exchange policy instruments.*

Form of foreign exchange policy	Features
Currency intervention	
Discount policy	
Double foreign exchange market	
Devaluation and revaluation	
Diversification of official foreign exchange reserves	
Exchange restrictions	

Topic 4. FOREIGN EXCHANGE MARKETS

Keyterms: *foreign exchange market, forward interbank transactions, foreign exchange transaction, value date, transaction date, spot market, forward transactions, swap contracts, exchange forward transactions, futures, option call, option put, currency arbitrage.*

A foreign exchange market is a set of all foreign exchange transactions, settlements and loan extension of foreign currency under certain conditions.

Foreign exchange transactions are transactions of foreign exchange market agents for the purchase and sale of agreed amounts of cash and non-cash currency of one country for the currency of another country at an agreed exchange rate on a given date.

Foreign exchange transactions are divided into:

- transactions with immediate delivery of currency or foreign exchange spot transactions. They can be divided into transactions with a value date today (today or abbreviated as tod), tomorrow (tomorrow or abbreviated as torn) and a value date after two business banking days – transactions on spot terms;

- foreign exchange forward transactions are divided into forwards, swaps, futures, options;

Participants in the foreign exchange market are commercial banks, central banks, currency exchanges, brokerage firms, or brokerage houses, large corporations.

The value date is the date of the agreement terms fulfilment, i.e. the physical transfer of funds.

A transaction date is the date of the transaction when the seller agrees to sell and the buyer purchase foreign currency.

A forward contract is an agreement between a bank and a client to buy or sell a certain amount of foreign currency on time (within the stipulated period) at the rate that is determined at the time of the transaction. The forward exchange rate, which is fixed at the conclusion of the contract, is based on the spot exchange rate at the date of the transaction, adjusted for forward points called “premium” (pr) or “discount” (dis).

The forward exchange rate is set by adding a premium (report) to the spot exchange rate or subtracting a discount (deport) from it. The premium/discount is calculated using the formula:

$$P_{m/dis} = (S * \Delta R * D) / (B * 100)$$

where S is the spot rate; ΔR – difference in interest rates (interest rate of the quote currency – interest rate of the base currency) D – number of days in the period; B – the base number of days in a year (360 or 365) R – the interest rate of the base currency.

If the interest rate for the currency, which is the base currency, is higher than the interest rate for the quote currency, then the forward rate will be lower than the spot rate, respectively, the forward points will be deducted from the spot rate (the currency will be quoted on the forward market at a discount). If the interest rate for the currency, which is the base currency, is lower than the interest rate for the quote currency, then the forward rate will be higher than the spot rate (the currency will be quoted on the forward market with a premium).

A foreign exchange swap is an exchange of flows of two currencies over a certain period in the future between parties to a transaction.

A foreign exchange option is a bilateral transfer agreement (for the buyer) and the obligation (for the seller) to buy or sell a certain amount of foreign currency at a fixed rate on the agreed date or period. Depending on the nature of the foreign exchange transactions, there are:

- Call option;
- Put option.

A call option – is a contract that gives the option buyer the right to buy a standard amount of the underlying asset.

A put option – is a contract that gives the option buyer the right to sell a standard amount of the underlying asset.

A foreign exchange future is a contract for the delivery of a certain asset at an agreed date in the future if it takes into account certain requirements:

- all terms and conditions of the contract are standardized (set by the exchange);

- the parties to the contract make a cash deposit and maintain the required amount of the deposit until the date of the contract performance, which guarantees its fulfilment;
- the contract performance carries out through the clearinghouse or the clearing bank.

A currency arbitrage is an agreement to make a profit from the difference that exists at a given time in the exchange rates of the same currency in different foreign exchange markets. There are simple (the arbitrageur uses the difference in the rates of one currency, fixed in the foreign exchange markets of two countries) and compound currency arbitrage (transactions are carried out simultaneously with several currencies in different foreign exchange markets).

Independent work of students

The main issues of the practical class.

1. Foreign exchange market structure.
2. Foreign exchange market of Ukraine.
3. Foreign exchange market instruments – solving the problems of:
 - the forward premium definition;
 - calculation of the financial result for forward transactions, futures and options for obtaining arbitrage profit.

The main issues for self-studying.

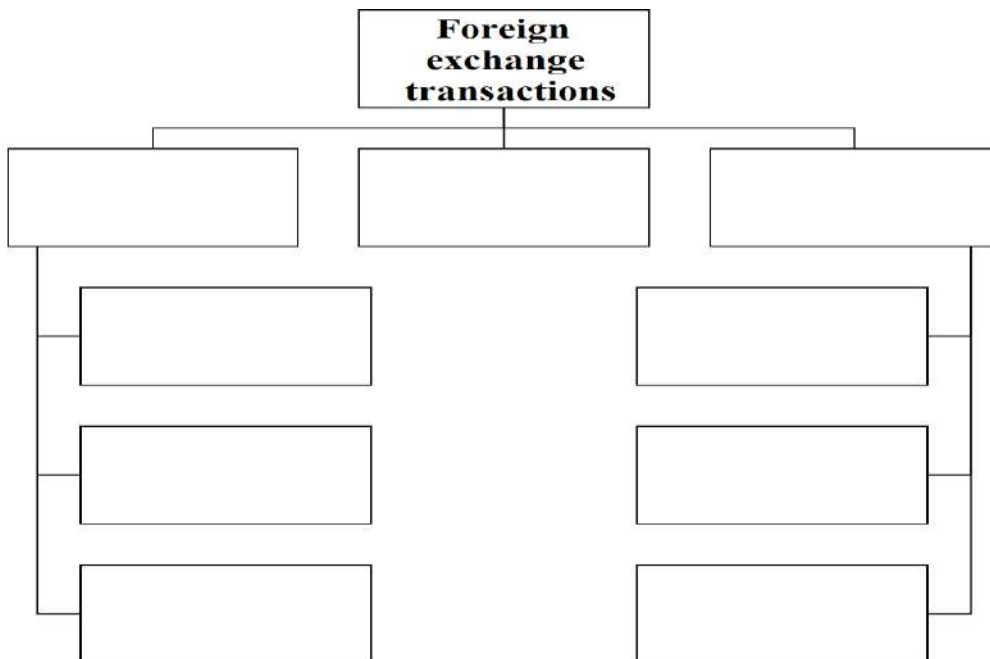
1. Practice concluding transactions in the market of foreign exchange spot transactions. Orders applied in the market of foreign exchange transactions.
2. Interest rate forwards:
 - forward transactions;
 - forward rate transactions.
3. Futures strategies and hedging.
4. Option premium.
5. Option strategies and option hedging.

Topics for reports.

1. Financial intermediaries in the international financial market.
2. Problems of state regulation of the international market.
3. Instrumentation of the foreign exchange market.
4. Instrumentation of the capital market.
5. Transactions with gold in international financial markets.

Self-practice exercises

Exercise 1. Name the types of foreign exchange transactions you know.



Exercise 2. List the principal currencies of the Forex market

1. US dollar - USD, \$
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____

Exercise 3. Name the value date, period, and completion date for the transactions listed and complete the table.

Terms of transaction					
Name	Standard designation	Date of the transaction	Value date	Period	Date of the transaction completion
Overnight	o/n	Today			
Tom/next	t/n	Today			
Tom/week	t/w	Today			
Spot:					
Spot/next	s/n	Today			
Spot/1 week	s/w	Today			
Name	Standard designation	Date of the transaction	Value date	Period	Date of the transaction completion
Spot/ month	1 m	Today			
Spot/3 month	3 m	Today			
Spot/6 month	6 m	Today			
Spot/1 year	12 m	Today			

Exercise 4. Name the types of financial futures and complete the table.

Types of financial futures	
According to parties	According to objects
1.	1.
2.	2.
3.	3.
4.	4.

Exercise 5. Highlight the features of the futures and forward markets according to the presented criteria. Complete the table.

Features of the futures and forward markets		
Criteria	Futures market	Forward market
Participants		
Communication method		
Intermediaries		
Place and method of transaction		
Nature of the market and the number of currency quotes		
Special deposit		

Transaction amount		
Currency delivery		
Currency position		

Exercise 6. Describe the options types by the buyer and seller. Identify differences in key indicators.

	Option buyer	Option seller
Call option (purchase)		
Put option (selling)		

Practical exercises

1. The two banks concluded agreements on foreign exchange transactions on spot terms, on Monday, August 15, 2017, and on Thursday, August 19, 2017. What days will the value date fall on? What days do we consider the dates of the agreement?

2. Calculate the size of the forward premium (discount) on the Swiss franc, the 90-day forward rate of which is \$ 1,102, and the spot rate is \$ 1,100.

3. Suppose that the spot rate of the British pound £ is \$ 1.73. And in a year the spot rate is expected at \$ 1.66. Define the percentage change in the pound (what is the name of this process)?

4. Define the 180-day forward premium (discount) for the euro € against the US dollar \$ if the current exchange rate for these currencies is € 0.895. And the annual interest rates on deposits in € and \$ are 6 % and 8 %, respectively.

5. Define the 90-day forward premium (discount) for the euro € against the US dollar \$, if the current exchange rate of these currencies is 0.88 €. And the annual interest rates on deposits in € and \$ are 6.5 % and 3.8 %, respectively.

6. Suppose that a currency arbitrageur (speculator) bought a put option to sell British pounds £. The option premium is \$ 0.04 per £ 1. The contract performance rate is \$ 1.8 per £ 1. The spot rate at the moment of the option (selling pounds) is £ 1 = \$ 1.59. What is the profit/loss of arbitrageurs if the contract value is £ 31,250?

7. Suppose that a currency arbitrageur (speculator) bought a call option to buy British pounds £. The option premium is \$ 0.02 per £ 1. The contract performance rate is \$ 1.45 per £ 1. The spot rate at the moment of the option (buying pounds) was £ 1 = \$ 1.46. What is the profit/loss of arbitrageurs if the contract value is £ 50,000? Will the arbitrageur use the option?

8. Suppose that the American speculator has sold a call option at Canadian dollars. The option premium is \$ 0.01 per 1 Can. \$. Contract performance rate: 1Can. \$ = \$ 0.76. The spot rate at the moment of the option was 1Can. \$ = \$ 0.82. Suppose that in order to exercise the option the speculator has to buy Canadian dollars at the spot rate that has currently formed in the market. What is the net profit/loss of the seller if the contract amount is 50,000 Can. \$?

9. Suppose that the American speculator sold the put option at Canadian dollars. The option premium is \$ 0.03 per 1 Can. \$. Contract performance rate: 1Can. \$ = \$ 0.75. The spot rate at the moment of the option was 1Can. \$ = \$ 0.72. Suppose that the speculator sold the Canadian dollars received on the option at the spot rate that has currently formed in the market. What is the net profit/loss of the seller if the contract amount is 50,000 Can. \$.

Topic 5. THE EXCHANGE RATE AND THE FACTORS THAT AFFECT IT.

FOREIGN EXCHANGE MARKET THEORIES

Key terms: *exchange rate, quoting, nominal exchange rate, real exchange rate, purchasing power parity, interest parity, Fisher effect, forward exchange rates.*

An exchange rate is the ratio of the exchange of two monetary units in the foreign exchange market, which is formed depending on the supply and demand of a particular currency, as well as on several other factors.

Determining the exchange rate of the national currency in a foreign currency at a given moment is called **quoting**. Central and largest world commercial banks carry currency quotes out.

The following factors explain the necessity for the exchange rate:

1. Mutual exchange of currencies in goods trade, services, in the flow of capital and credits.
2. Comparison of world and national markets prices, as well as cost indicators of different countries, expressed in national or foreign currencies.
3. Periodic revaluation of foreign currency accounts of firms and banks.

Exchange rates can be classified according to the following criteria:

- type of parties involved in the transaction;
- type of foreign exchange markets;
- method of calculation;
- transaction time;
- degree of government intervention;
- forms of international settlements.

The nominal exchange rate is the exchange rate that is valid in a given country. The nominal rate is a certain price of the national currency when it is exchanged for a foreign one and vice versa, it is calculated as the ratio of the national currency to the exchange rates of the main trading partners' countries, considering the trade-weighted basis of these countries in the foreign exchange transactions of a given state:

$$E_n = F / D,$$

where E_n – nominal exchange rate;

F – foreign currency;

D – national currency.

The real exchange rate is not properly exchange rate. It can be defined as the ratio of the prices of the goods of two countries, expressed in the relevant currencies:

$$Er = En (Pf / Pd),$$

where Er – the real exchange rate;

Pf – price index of a foreign country;

Pd – price index within the country.

Nominal and real effective exchange rates assess the state of the national currency exchange rate.

Like any price, the exchange rate deviates from the cost basis – the purchasing power of currencies (the volume of commodity weight purchased per currency) – under the influence of supply and demand of currency. The ratio of such supply and demand depends on some factors:

1. Inflation rate.
2. Balance of payments position.
3. Difference in interest rates in different countries.
4. Activity of foreign exchange markets and speculative foreign exchange transactions.
5. Degree of certain currency use in the European market and international settlements.
6. Acceleration or delay also affected the exchange rate ratio of currencies in international payments.
7. Degree of currency confidence in the national and world markets.
8. Foreign exchange policy.

The Law of One Price states that in competitive markets free of transportation costs and formal trade barriers, identical goods must sell for the same price, expressed in the same currency.

If P_d^i is the price of an identical product in national currency units when it is sold in a given country, and P_f^i is the price of the same product in foreign currency when it is sold abroad, the law of one price can be formulated as follows:

$$P_d^i = (E_{d/f}) * P_f^i.$$

Thus,

$$E_{d/f} = P_d^i / P_f^i.$$

The purchasing power parity theory shows that the exchange rate will be equal to the ratio of price levels in two countries. Consequently, the fall in the purchasing power of the national currency (which is manifested in an increase in the national price level) will associate with a proportional devaluation of the national currency in the international foreign exchange market.

In symbols, can be formulated the purchasing power parity theory as follows:

$$E_{d/f} = P_d / P_f,$$

where P_d and P_f are the price of an identical commodity basket, respectively, in national and foreign currencies.

This formula refers to the absolute PPP. The relative PPP considers the percentage change (or growth rate) in the exchange rate over a given period as the difference in the percentage change (growth rate) in the price level in two economies. The relative PCP moves from the exchange rate level and price level to their changes (their growth rates):

$$\frac{E_{d/f,t} - E_{d/f,t-1}}{E_{d/f,t-1}} = \pi_d - \pi_f,$$

where $\pi_t = \frac{P_t - P_{t-1}}{P_{t-1}}$ – inflation for the corresponding period.

The international foreign exchange market will be in balance when deposits in all currencies bring the same expected return rate. The condition of return equality on deposits in any two currencies, which is measured in equal currency, is called a condition of interest parity:

$$R_d = R_f + \left(\frac{E_{d/f}^e - E_{d/f}}{E_{d/f}} \right),$$

where R_f – interest rate on deposits in foreign currency,

R_d – interest rate on deposits in national currency,

$E_{d/f}$ – the current exchange rate of the national currency, which is measured directly,

$E_{d/f}^e$ – the expected exchange rate of the national currency, which is measured directly:

$$\left(\frac{E_{d/f}^e - E_{d/f}}{E_{d/f}} \right),$$

expressed as a percentage is the rate of devaluation of the national currency.

Combining this "expected" version of the relative PPP with the percentage parity condition, we get the Fisher effect:

$$R_d - R_f = \pi_d^e - \pi_f^e.$$

If, as the PPP shows, the expected currency devaluation involves compensating for differences in inflation rates between countries, the difference between interest rates should be equal to the expected difference in inflation rates.

Forward exchange rates expectation theory is the theory that the forward exchange rate matches the forecast spot rate if the foreign exchange market participants ignore the risks.

Independent work of students

The main issues of the practical class.

1. Impact of interest rates on exchange rates.
2. Impact of inflation expectations on the exchange rate.
3. Forward rate and future current rate of the currency.
4. Factors affecting the current exchange rate of the Ukrainian hryvnia.

The main issues for self-studying.

1. Analysis of the behavior of reserve currencies exchange rates.
2. Methods for forecasting exchange rates: fundamental and technical analysis.

Topics for reports.

1. Dynamics of changes in the exchange rate of Ukraine for the period from 2000 to 2009.
2. Dynamics of changes in the exchange rate of Ukraine for the period from 2010 to 2017.

Self-practice exercises

Exercise 1. Describe the factors affecting the exchange rate of the country and complete the table.

Factors	Characteristic
Inflation rate	
Balance of payments position	
Difference in interest rates in different countries	
Foreign exchange market activities and speculative foreign exchange transactions	
Degree of use of a certain currency in the European market and in international settlements	
Acceleration or delay in international payments.	
Degree of currency confidence in the national and world markets	
Foreign exchange policy	

Exercise 2. Name the types of exchange rates according to the given criteria and complete the table.

Classification of exchange rates		
Criteria	Types of exchange rate	Characteristic
1. According to methods of quotation	direct	
	indirect	
2 According to quotation terms	spot exchange rate	
	forward exchange rate	
	cross rate	
3. According to the mechanism of regulation	floating exchange rate	
	fixed exchange rate	
	mixed exchange rate	
4. According to the parties of the transaction	buying rate	
	selling rate	

Exercise 3. List the economic functions the exchange rate performs.

internationalization of monetary relations

Exercise 4. Describe the theory of the foreign exchange market.

Foreign exchange rate theory	Characteristic

Practical exercises

1 The British confectionery company «Candy» bought 20 tons of strawberry jam from the American company «Sheri» of £ 2 per 1 kg. The rate of the pound sterling increased from \$ 2.0 to \$ 2.2 per £ 1.

Determine who will benefit from such an increase in the exchange rate of the British currency. What is the amount of additional profit (loss) per 1 kg of jam from such a change in exchange rates?

2 The American wants to compare the return on dollar deposits, which brings in 10 % per annum, with the return on a deposit in euros, which offer 5 % per annum. Suppose the current exchange rate is \$ 0.6 per euro, and the expected exchange rate in a year is \$ 0.7 per euro. Where would it be more profitable for him to put his \$ 1,000?

3 Calculate the dollar rate of return for the following asset types:

a) a painting whose market price has risen from \$ 200,000 to \$ 250,000;

b) a bottle of rare French wine, whose price has risen from \$ 180 to \$ 216 over the year;

c) deposit of £ 10,000, at an interest rate of 10 % and changes in the exchange rate for the year from \$ 1.5 to \$ 1.38 per pound.

What will be the rate of return if all dollar prices go up by 10 % at the same time?

4. Suppose that the dollar exchange rate against the euro and the pound sterling is equally fluid. However, the euro tends to devalue unexpectedly against the dollar, when the return on other forms of assets unexpectedly rises and the pound sterling unexpectedly devalues under the same conditions? If you are a resident of the American currency, which currency, euro or pound, would you consider riskier? Why?

Topic 6. TYPES OF FOREIGN EXCHANGE RISKS AND THEIR MEASUREMENTS.

FOREIGN EXCHANGE RISK MANAGEMENT

Keyterms: *foreign exchange risk, transaction risk, translational risk, economic foreign exchange risk, closed and open foreign exchange position, long and short foreign exchange position, limiting, hedging, diversification of foreign exchange portfolio.*

By the nature and place of origin, foreign exchange risks are divided into *transaction risks; translation risks; economic risks.*

Transaction risk relates to trading transactions, as well as money transactions for financial investments and dividend payments. This risk may arise when signing agreements to make payments or receiving funds in foreign currency in the future.

Translational risk relates to the revaluation of assets and liabilities and profits of foreign affiliates in the national currency, and can also arise during the export or import of investments. It affects the balance sheet indicators, reflecting the statement of income received after recalculating the amounts of investments in the national currency. You can consider translational risk when drawing up accounting and financial reports.

Economic risk associates with the possibility of income loss on future contracts because of changes in the general economic status of both partner countries and the country where the company is located. First of all, it is due to the need to carry out constant settlements for export and import transactions, the intensity of which may depend on exchange rate fluctuations. The economic foreign exchange risks are divided into two types:

- direct that provides profit reduction on future transactions due to depreciation of the exchange rate;
- indirect, associated with the loss of a certain part of the competitiveness of domestic producers in comparison with foreign.

In economic practice, certain types of foreign exchange risk very often intertwine, and therefore the total amount of risk can be determined only when forming the final balance sheet i.e. as a transaction risk.

Because of foreign exchange transactions in banks, the ratio of balance sheet and off-balance sheet claims and liabilities for each foreign currency is constantly changing. This ratio is called the *foreign exchange position*.

Assets and off-balance sheet claims are assets that are accounted for on a certain day in the balance sheet, i.e. are currently at the bank disposal, and assets that the bank will receive in the future (purchase of a certain currency through forwards, futures, options transactions and future receipts in currency as income).

Balance sheet and off-balance sheet liabilities are the bank's liabilities for a certain day in the balance sheet to customers and counterparties and the future bank's liabilities (sale of a certain currency in forwards, futures, options transactions, future losses in a certain currency).

A foreign exchange position is considered *closed* if the amount of currency purchase coincides with the amount of currency sold. When the amount of claims and liabilities does not match, the foreign exchange position is considered *open*.

The long foreign exchange position is the number of assets and off-balance sheet claims that exceed the amount of balance sheet and off-balance sheet liabilities in each foreign currency. A bank with such a position may suffer losses in case of an increase in the rate of the national currency against the foreign one (indicated with a “+” sign).

The short currency position is the number of balance sheet and off-balance sheet liabilities that exceed the number of assets and off-balance sheet claims in each foreign currency. A bank with such a position may suffer additional losses in case of an increase in the exchange rate of foreign currency against the national one (indicated with a “-” sign).

Hedging is a method of minimizing the changes risk in the price of assets or investments (for example, stocks). A derivative is a derivative financial instrument, a contract, the price of which is determined by the value of the underlying asset. A derivative certifies the right or obligation to purchase or sell in the future an underlying asset (securities, goods or services) on terms determined by it at a specified price and on time. The most common derivatives are forwards, options, futures and swaps.

Independent work of students

The main issues of the practical class.

1. The concept of foreign exchange risk that accompanies foreign exchange transactions.
2. Classification of foreign exchange risks.
3. Foreign exchange risk assessment. The concept of foreign exchange position.
4. General approaches to foreign exchange risk management.

The main issues for self-studying.

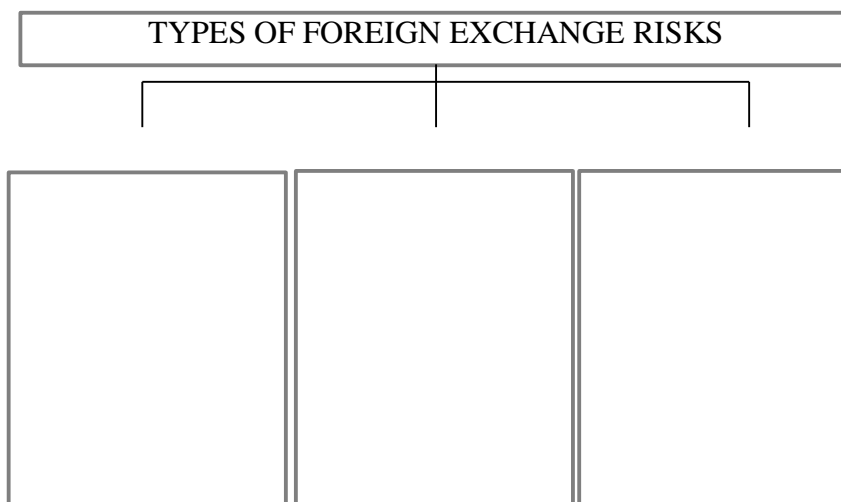
1. Banking foreign exchange risks.
2. Management of the commercial bank's foreign exchange position.
3. Measurement of economic foreign exchange risk considering the economic conditions of the country.
4. Correlation of exchange rates and currency portfolio.

Topics for reports.

1. Possibilities of conducting currency arbitrage by commercial banks of Ukraine.
2. Features of the futures market in the financial market of Ukraine. Experience of the London Futures Exchange.

Self-practice exercises

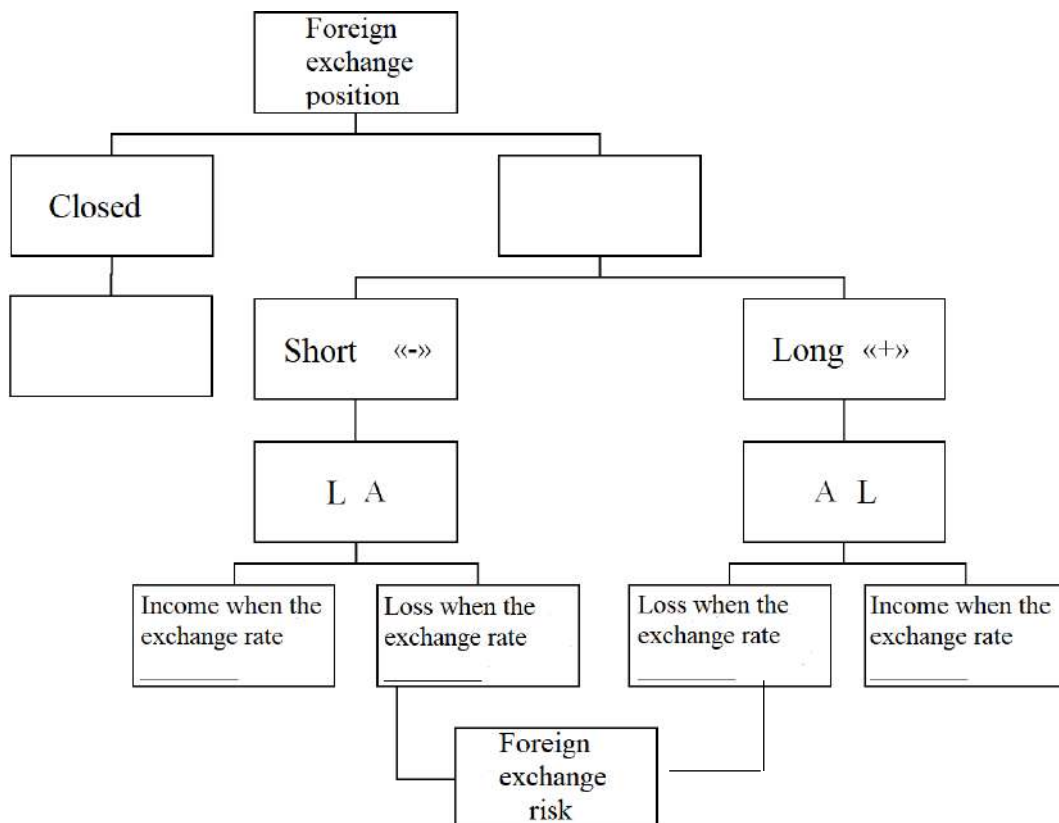
Exercise 1. Explain the point of the given foreign exchange risks



Exercise 2. What are the potential consequences of foreign exchange risks for the company?

Foreign exchange risks	Consequences

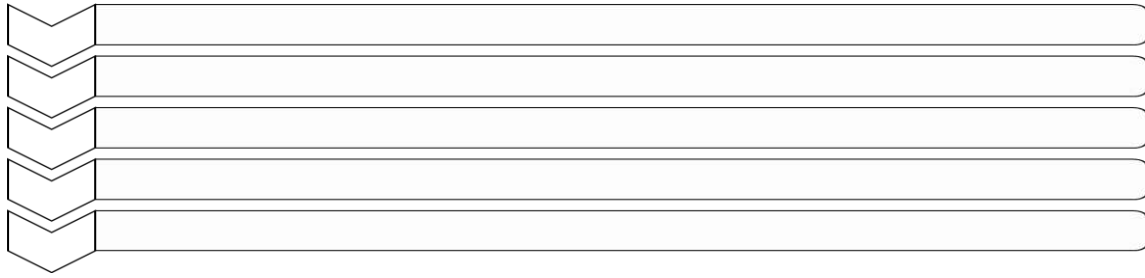
Exercise 3. Describe foreign exchange positions according to the diagram and identify how the change in the exchange rate affects the bank's income.



Exercise 4. What transactions affect the bank's open position:

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____

Exercise 5. List the primary stages of the foreign exchange risk management process.



Practical exercises

1. The firm "Zorg" until recently carried out its foreign economic transactions with only a few foreign firms. But now "Zorg" is actively expanding its partnerships with many countries of the world. Moreover, each of them is simultaneously an importer and exporter in the world market.

Recently, the financial manager of this company invited you, as an expert of the Chamber of Commerce and Industry, to advise him on the main issues of banking services for the foreign economic activity of enterprises: forward and option foreign exchange contracts, the main forms of international settlements (letters of credit, collection, net payments, etc.). The main questions were related to the risks that the company may face and ways to overcome them.

Tasks:

- Advise your client on the best foreign exchange risk insurance instruments depending on the situation that may happen in the market.
- Name the positive properties of international settlements forms for your client, if he is an exporter (importer).
- Describe the typical risks that Zorg may suffer when using each form of international settlements.

2. Define the foreign exchange position of the bank. Calculate the changes that will take place in the bank's profit if, after the purchase of \$ 3 million at the rate of 1.4952 Swiss francs, by the end of the day, the dollar rate against the Swiss franc increases to 1.5114 and the bank closed the long position by selling \$ 3 million.

Solution:

Foreign exchange transaction		Rate	Open foreign exchange position	
Bought	Sold		long	short
+3000000USD		1,4952 USD/CHF		
	135190000 JPY	135,19 USD/JPY		
+1672500GBH		1,6725 GBP/ USD		
Common position				

After closing a long position, the bank will receive _____ in the amount of _____:

	-

Conclusion:

- 3. 90-day U.S. dollar (\$) interest rate is 3.5 %
- 90-day Hong Kong dollar (HK \$) interest rate is 5 %
- 90-day forward rate of the Hong Kong dollar is \$ 0.125
- the current exchange rate of the Hong Kong dollar is \$ 0.124
- the expected exchange rate of Hong Kong dollar in 90 days is \$ 0.127

A) Suppose that the American company Santa Monica Corporation has to buy HK \$ 700,000 in 90 days to cover its accounts payable. Calculate the costs of a hedging company using forward and money market instruments. Which instrument is more beneficial?

B) What are the company's costs on a money market instrument, if we assume that the company does not have temporarily free funds and has to borrow this money?

- 4. 180-day U.S. dollar (\$) interest rate is 4 %
- 180-day Fijian (F \$) interest rate (F \$) is 5 %
- 180-day forward rate of Fijian is \$ 0,49
- the current exchange rate of Fijian is \$ 0,48
- the expected exchange rate of Fijian in 180 days is \$ 0,47

A) The American company Monte Cristo Corporation received F \$ 500,000 in 180 days and faced with the need to convert them to US dollars. Calculate the costs of a hedging company using forward and money market instruments. Which instrument is the most beneficial?

B) What are the company's costs on the money market instrument, assuming that the company always invests its temporarily free funds?

5.

	U.S. dollar \$	Jordanian dinar (JOD)
360-day deposit rate	6%	5%
360-day loan rate	5%	4%

A) Perkins Corp. will receive JOD 250,000 in 360 days. Current spot rate is 1JOD = \$ 1.48, 360-day forward rate: 1JOD = \$ 1.50. How many US dollars will Perkins receive in 360 days when using money market instruments for hedging? Suppose that all temporarily free money the company invests in a deposit.

B) Pablo Corp. will need JOD 150,000 in 360 days. Current spot rate is 1JOD = \$ 1.50, 360-day forward rate: 1JOD = \$ 1.46. What costs will Pablo suffer to purchase JOD 150,000 when using money market instruments for hedging? Suppose that the company does not have temporarily free funds.

Topic 7. GENERAL FRAMEWORK FOR INTERNATIONAL SETTLEMENTS ORGANIZATION

Key terms: *international settlements, payment methods, national and collective currencies, payment terms, monetary and financial terms, foreign trade contract, price currency, payment currency, currency clauses; forms of settlements; terms of payment, means of payment forms*

International settlements are monetary settlements between institutions, enterprises, banks and individuals associated with the inventory items and services flow in international traffic.

An international trade transaction begins with the sale of goods by an exporter to an importer. The selling process is the exchange of goods for a cash equivalent.

There is a set of *factors* that affect the international settlement's position: political and economic relations between countries; the country's position on commodity and money markets; the degree of use and effectiveness of government measures for foreign economic regulation; foreign exchange legislation; international trade rules and customs; regulation of interstate trade flows, services and capital; differences in inflation rates in individual countries; the balances of payments position; banking practice; terms of foreign trade contracts and loan agreements; currency convertibility.

The main parties of international settlements are exporters and importers, as well as banks that serve them.

In the international settlements practice, there are three *payment methods*:

- *cash payment;*
- *prepayment (advance payment);*
- *credit payment.*

A principal condition for an international trade transaction is a *foreign trade contract*, which defines the rights and obligations of the parties, their responsibility for the transaction.

The foreign trade contracts between counterparties (exporters and importers) define the main monetary and financial and payment terms of settlements: the currency

of the price and payment; the rate of their conversion; currency clauses; forms of settlements; terms of payment and means of payment forms, etc.

A price currency is a currency in which the contract price is set. It is selected from the most stable. It can be the currency of one of the States Parties to the Treaty or a third country.

A payment currency is a currency in which the payment is made. It does not necessarily match the price currency. In the latter case, the contract stipulates the conversion rate of one currency into another.

Currency clauses provide for the revision of the payment amount in accordance with the exchange rate change of a certain currency (clause currency), a group of currencies ("currency basket") or price currency to the payment currency.

Terms of payment provide for prompt payment of shipped goods or delay in payment, i.e. sale on credit.

Means of payment forms are the type of documents with which payments are made. They are divided into *financial* and *commercial*. Financial bills include bills of exchange (simple and transferable), cheques, pay slips; commercial ones include invoices, documents confirming the shipment of goods, specifications, insurance policies, etc.

Independent work of students

The main issues of the practical class.

1. Interbank correspondent relations.
2. The SWIFT system and the principles of its functioning in international settlements.
3. Conditions for opening, maintaining and closing foreign currency accounts

The main issues for self-studying.

1. The role of banks in the organization of international settlements
2. Purchase of foreign currency by banks for international settlements

3. The choice of price currency and payment currency in terms of inflation.

Topics for reports.

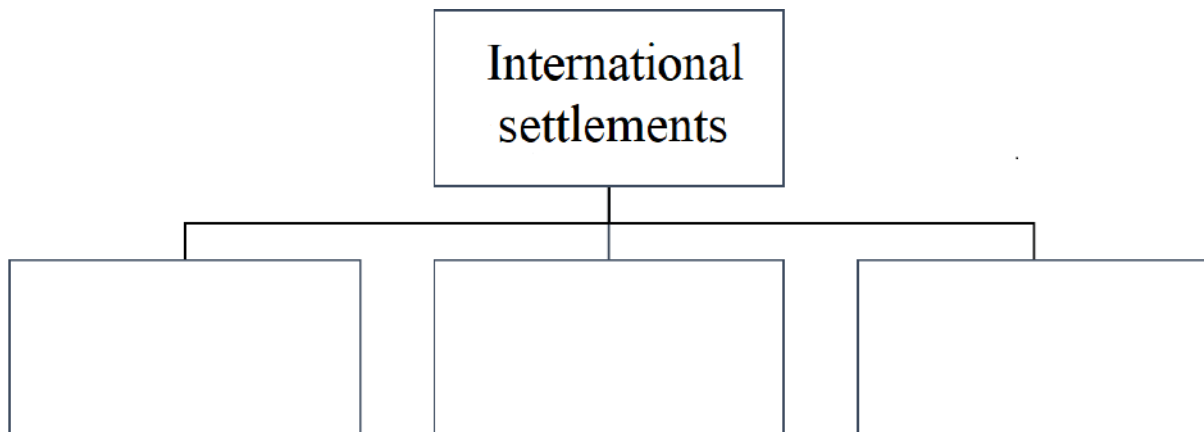
1. Regulation of international settlement transactions in Ukraine

2. Regime of current accounts in foreign currency of individuals.

3. Terms of payment as a significant element of the monetary and financial terms of the contract.

Self-practice exercises

Exercise 1. What are the features of international settlements?



Exercise 2. Describe the main elements of the monetary and financial and payment terms of foreign trade contracts:

Elements	Characteristic

Exercise 3. List the principles of the SWIFT system functioning

1. _____
2. _____
3. _____
4. _____

Exercise 4. *What documents must be applied to the commercial bank to open foreign currency accounts for legal parties (enterprises that are engaged in foreign economic activity in Ukraine):*

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____

Exercise 5. *What are the possibilities of registration of banks' correspondent relations?*

- _____
- _____

Exercise 6. *Name the means of payment forms and describe them.*

- _____

- _____

Topic 8. TERMS OF DELIVERY AND DOCUMENTS IN INTERNATIONAL TRADE

Keyterms: *basicterms; exporter, foreigntradecontract; importer; incoterms; commercial documents; insurededocuments; transportdocuments; financialdocuments.*

An exporter is a party that sells goods (provides services) to a foreign buyer in order to export them from the seller's country abroad.

An importer is a party that buys goods (services provided) from a foreign seller and imports them into the buyer's country.

A foreign trade contract is a commercial document that contains an agreement of the parties on the delivery of goods: the seller's obligation to transfer the relevant property to the buyer and the buyer's obligation to accept this property and pay the relevant amount for it, or the parties' obligations to fulfil the terms of the turnover transaction.

Foreign trade contracts include several sections that contain the subject of the contract, the designation of the parties, goods, commercial terms of the transaction, the rights and obligations of the parties, sanctions, etc. These sections of the contract are laid out in the appropriate sequence.

Incoterms is an interpretation collection of the basic terms of delivery, developed by the International Chamber of Commerce, to simplify the conclusion and negotiation of contracts, help counterparties find ways to allocate responsibility and resolve disagreements.

The basic terms of the contract determine the seller's obligations for the price specified in the contract to ensure the delivery of the goods to the respective geographic point or the shipment of the goods to vehicles, or their transfer to the transport institution.

According to international practice and the forms unification of international settlements, all documents that are provided for the delivery of goods are subdivided into the following types:

- commercial;
- transport;
- insurance;
- financial.

Independent work of students

The main issues of the practical class.

1. Characteristics of the foreign trade contract.
2. Terms of goods delivery.
3. Types of documents for international deliveries.

The main issues for self-studying:

1. In coterms rules and basic terms of delivery.
2. Features of paperwork and paper flow in international settlements.

Topics for reports:

1. Ways to rationalize settlement and credit transactions in foreign economic activity of Ukrainian enterprises.
2. The development dynamics of export/import of Ukraine.

Self-practice exercises

Exercise 1. Name the sections of the foreign trade contract, and describe them

Section of the foreign trade contract	Characteristic
Preamble	is the introductory part, which indicates the number, place and date of signing the contract, determines its parties
Subject of the contract	
Price and amount of the contract	
Delivery date	
Quality of goods	
Packaging and marking	
Payment terms	
Sending and receiving	
Insurance	
Claims	
Force Majeure	.
Arbitrage	
Legal address of the parties	

Exercise 2. What laws and regulations of the country regulate the form, procedure for registration and execution of foreign economic agreements (contracts):

- _____;
- _____;
- _____;
- _____;
- _____.

Exercise 3. Explain the three-letter abbreviations that are considered the alphabetical code of Incoterms.

EXW	1 EX WORKS
FCA	
CPT	
CIP	
DAT	
DAP	
DDP	
FAS	
FOB	
CFR	
CIF	

Exercise 4. To what extent does each party to the contract assume obligations related to the goods, under the terms of Incoterms 2010? Complete the table.

Terms of Incoterms 2010	The point of the terms	How costs and risks are distributed
EXW		
FCA, FAS, FOB		
CFR, CIF, CPT, CIP		
DAT, DAP, DDP		

Exercise 5. Define the types of documents that are provided for the delivery of goods and give examples.

Commercial documents	Are documents that indicate the monetary claims of the exporter to the importer. The main commercial document is a commercial invoice, or invoice in which...

Topic 9. DOCUMENTARY FORMS OF SETTLEMENTS

Keyterms: *aval; advice; documentary credit; documentary collection; beneficiary; issuing bank; remitting bank; endorsement; clean collection; collection against acceptance; collection against payment.*

A documentary credit (letter of credit) is an agreement according to which the bank undertakes, at the request of the client, to pay for the documents to a third party (beneficiary) in whose favour the letter of credit is opened.

Letters of credit are classified according to the following criteria:

- basis for performance (commercial letter of credit, standby letter of credit, clean letter of credit, mixed letter of credit);
- method of performance (payment letter of credit, acceptance letter of credit, letter of credit with negotiated drafts);
- possibility of revocation (revocable letter of credit, irrevocable letter of credit);
- availability of coverage (covered letter of credit, uncovered letter of credit);
- availability of confirmation (confirmed letter of credit, unconfirmed letter of credit);
- possibility of transfer (transferable letter of credit, non-transferable letter of credit);
- possibility of renewal (renewal letter of credit or revolving, non-renewal letter of credit).

The following parties are involved in settlements under a documentary credit:

- buyer-importer (the one that gives the order to open the letter of credit);
- issuing bank (bank of the buyer-importer);
- advising bank - a bank that is instructed to inform the exporter about the opening of a letter of credit in his favour and to transmit its text;
- beneficiary of the letter of credit - exporter-seller.

There are two types of collection - clean and documentary.

A clean collection is a collection of financial documents that are not accompanied by commercial documents.

A documentary collection is a collection of financial documents that are

accompanied by commercial documents, or a collection of only commercial documents.

There are four parties involved in the collection form of settlements:

- exporter (seller, principal) - the party that issues documents for collection;
- remitting bank - the bank to which the principal instructs the collection transaction;
- collecting bank, which can be any bank participating in the performance of the collection order, except for the remitting bank. This bank submits documents to the payer;
- importer (buyer, payer) - the party that makes payment or for the received goods.

A collection order has several types of instructions for issuing documents:

- to the payer against payment;
- to the payer against acceptance;
- documents without payment;
- acceptance with the delivery of documents against payment.

Independent work of students

The main issues of the practical class

1. Features of the use in the international sphere of the main form of settlements
2. Use of documentary credit.
3. Classification of letters of credit.
4. Agreement of the letter of credit terms and conditions.
5. Features of the procedure for opening and closing a letter of credit.
6. Documentary collection:
 - registration procedure;
 - rights and obligations of the parties.
7. Phases of documentary collection.
8. Disadvantages and advantages of documentary form of settlements.

The main issues for self-studying

1. Main characteristics of the reimbursement letter of credit.
2. Advantages of the letter of credit form of settlements in the foreign economic activity.
3. What normative documents in international practice regulate the letter of credit and documentary collection?

Topics for reports:

1. The use of letter of credit form of settlements in Ukraine.
2. The use of collection form of settlements in Ukraine.

Self-practice exercises

Exercise 1. What are the main functions of a documentary credit?

Functions of a letter of credit	
1.	
2.	
3.	

Exercise 2. Describe the phases of the documentary credit and complete the table

Phases of the documentary credit		
Phases	Commercial aspect of the agreement	Settlement aspect of the agreement
Phase1		
Phase2		
Phase3		

Exercise 3. Describe the sequence of actions when issuing the letter of credit according to a given diagram and complete the table.

Exercise 4. Describe the letters of credit based on performance, it is necessary to insert "yes", "no" or "partially" in the appropriate boxes.

Types of letters of credit on the basis of performance	Functions of a letter of credit			
	settlement	security	credit	information
Commercial				
Standby				
Clean				
Mixed				

Exercise 5. Describe the features of the letters of credit, depending on the method of their performance. Insert "full" or "partial" in the appropriate boxes, depending on the terms of payment.

Type of payment letter of credit	Terms of payment	
	after the presentation of documents	within a certain period after the presentation of documents
payment at sight		
payment by installments		
partial payment by installments		

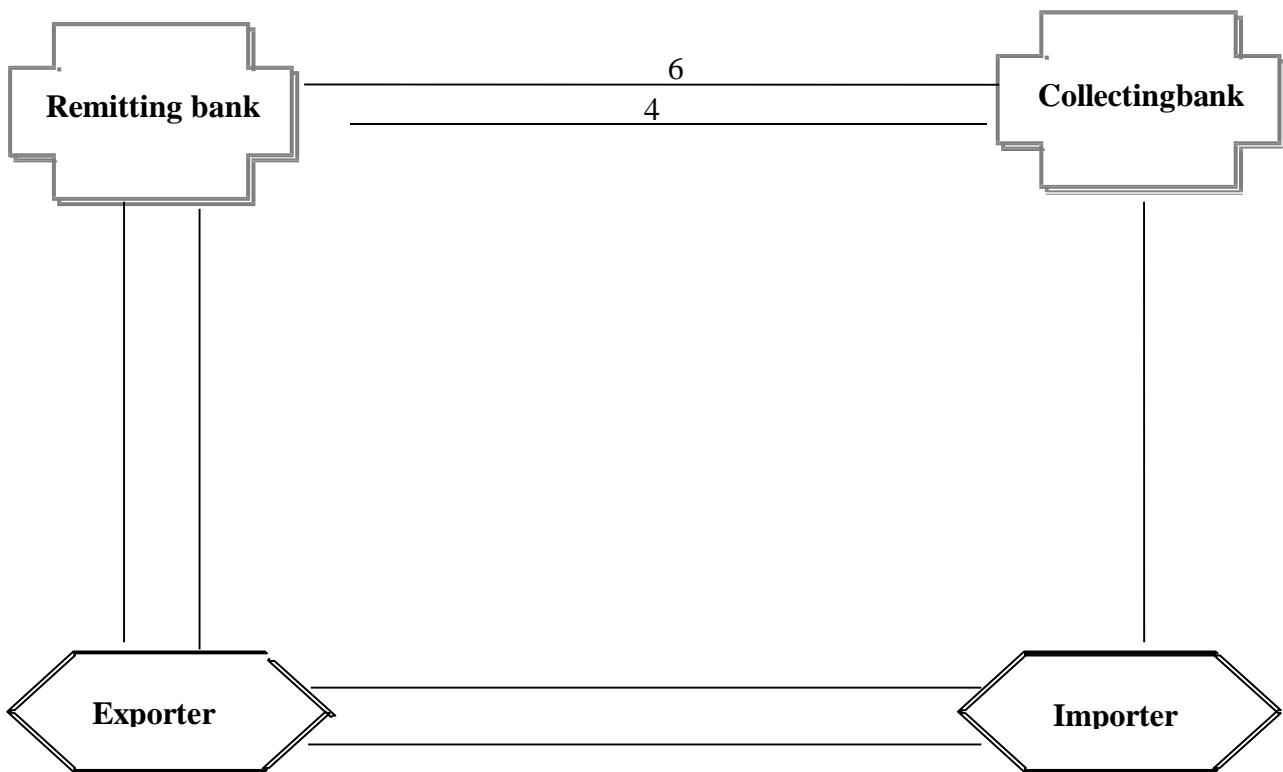
Exercise 6. Describe the features of the use of letters of credit depending on the method of their performance. Insert the participants of the transaction "beneficiary", "issuing bank", "beneficiary or third party" in the appropriate boxes depending on their functions.

Type of letter of credit	Participants and their functions		
	Bill drawer	Bill holder	Acceptor of a bill
Acceptance			
With the negotiation of drafts			

Exercise 7. Describe the letters of credit, depending on the possibility of their revocation. Depending on their functions, it is necessary to insert "yes", "no" or "partially" in the corresponding boxes of the table.

Types of letters of credit depending on the possibility of their revocation	Functions of a letter of credit			
	settlement	security	credit	information
Revocable				
Irrevocable				

Exercise 8. According to the given diagram, describe the sequence of actions when making payments using the collection and complete the table.



	Conclusion of a contract

Exercise 9. Describe the advantages and disadvantages of the letter of credit form of settlement.

	Disadvantages	Advantages
Exporter		
Importer		

Exercise 10. Describe the advantages and disadvantages of the collection form of settlement.

	Disadvantages	Advantages
Exporter		
Importer		

Practical exercises

1. A company is a client of your bank that has been carrying out export operations for six months using a letter of credit form of settlements. The company asked you about the feasibility of using a collection form of settlements with permanent counterparties.

Explain to the client how documentary collection differs from clean the collection. What form of the collection will you offer to the client? Explain to the client how the letter of credit and collection forms of settlements differ, as well as point out their positive and negative properties. What kind of settlements will you offer to the client?

2. The firm "Maybat" decided to resell the received cargo to other companies. Its leadership turned to you as an expert on foreign economic activity with a question about the possibility of using a collection form of settlements with their usual counterparties, with whom they have been working for six months, using a letter of credit form of settlements. However, there were no delays or complaints.

Explain to your client how the documentary collection differs from the clean collection. What form of the collection will you offer your client?

3. The confectionery factory settles up with the Gdansk Butter Factory using a letter of credit. The agreement between them provides for an irrevocable letter of credit in the amount of UAH 120,000. On April 10, the factory applied to the commercial bank "Credit" with a request to open an uncovered letter of credit. The correspondent agreement between the issuing bank and the executing bank for advising and other transactions with a letter of credit provides for a commission of 0.1 %.

After checking all the necessary documents of the confectionery factory, the commercial bank "Credit" opened an uncovered guaranteed letter of credit for settlements with the Gdansk Butter Factory. On April 18, the issuing bank received from the executing bank a register of documents for UAH 120,000 and other documents under the terms of the letter of credit. On the current account of the confectionery factory, the balance as of April 18 stood at UAH 30,000.

What the point of the bank's guarantee when it opens uncovered guaranteed letters of credit? What documents regulate the relationship between the parties involved in the settlements with guaranteed letters of credit? What will the commercial bank "Credit" do with the statement of the confectionery factory? What account entries should the bank make when opening a letter of credit and receiving documents from the executing bank on the payment of funds?

Topic 10. NON-DOCUMENTARY FORMS OF SETTLEMENTS

Keyterms: *advance payments; payment to an open account; bank transfer; settlements using cheques, credit cards, bills.*

An advance is a sum of money or property value that is transferred by the buyer to the seller before the shipment of the goods in order to fulfil the obligations under the contract. The advance payment can be in cash and commodity forms.

A commodity form of advance payment is the transfer by the importer to the exporter of raw materials or components necessary for manufacturing ordered equipment.

A cash advance is the payment by the buyer of the amount agreed under the contract against the payments due under the contract before the shipment of the goods (providing the service), and sometimes even before the commencement of the contract.

A payment to an open account provides for the main tenance of open accounts by partners for eachother, on which the amounts of current debt are accounted. After shipment of good sandsending documents to the importer's address, the exporter enters the amount of the goods cost on the debit of the account opened for the buyer. The importer makes the same credit entry to the exporter's account. After payment for the goods, the exporter and importer make compensatory transactions.

A bank transfer is a simple order of a commercial bank to its correspondent bank to pay the corresponding amount of money at the request and the expense of the transferor to the foreign recipient (beneficiary), indicating the method of reimbursement to the paying bank of the amount paid by him.

A cheque is a document that contains an unconditional written order from the account holder (chequegiver) to transfer the specified amount to the recipient (chequeholder). Chequesvary:

- depending on the chequegiver: *bank ra company;*
- subject to transfer: a *cheque payable to a named person, an order cheque, a cheque to bearer;*
- non-trade: a *tourist cheque, aneurocheque.*

A note payable (note/bill) is a security that is issued in strict accordance with the law and confirms an unconditional monetary obligation.

There are two types of notes that are used in international settlements:

A promissory note is a document drawn up in a clearly defined form, in which the debtor (bill drawer) undertakes to make payment to the creditor (bill holder) within a specific time frame.

A bill of exchange (draft) is a document drawn up in a clearly defined form, which contains a simple and unconditional order of the creditor (drawer) addressed to the debtor (drawee) at the right time in a certain place to pay a third party (remitter) a certain amount of money.

Endorsement is a transfer inscription on security, including notes, cheques. It certifies the transfer of rights arising from the security from one person to the new owner. As a rule, the endorsement is affixed on the back of the document or on an additional sheet - allonge. It contains the signature of the person making the endorsement - the endorser, together with an accompanying inscription (or without it).

Independent work of students

The main issues of the practical class.

1. The difference between a payment to an open account and an advance payment.
2. Types of notes. Settlement mechanism using notes.
3. Travel cheque. Mechanism for using eurocheques.

The main issues for self-studying.

1. Payments using plastic cards.
2. Advantages and disadvantages of using non-documentary forms in international settlements.

Topics for reports.

1. The use of plastic cards in payments.

2. Plastic cards as a means of payment in Ukraine. What are the types of plastic cards?

Self-practice exercises

Exercise 1. *In world settlement practice, advance payments are used if:*

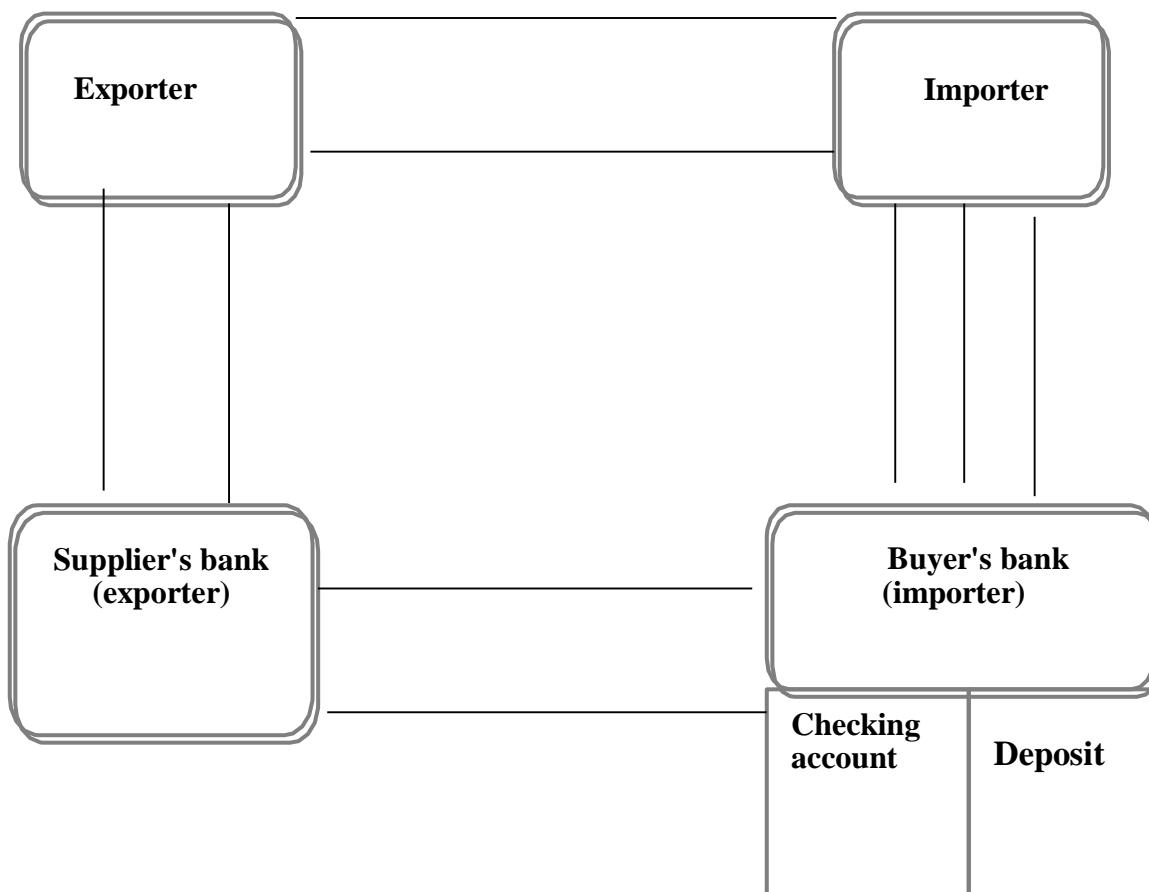
- _____;
- _____;
- _____;
- _____;
- _____.

Exercise 2. *It is advisable to use settlements using an open account if:*

- _____;
- _____.

Exercise 3. *According to the given diagram, describe the sequence of actions in the payments by cheques and complete the table:*

The mechanism of payment by cheques



	Making a payment order for depositing funds

Exercise 4. Give the characteristics of endorsements by the types given in the table.

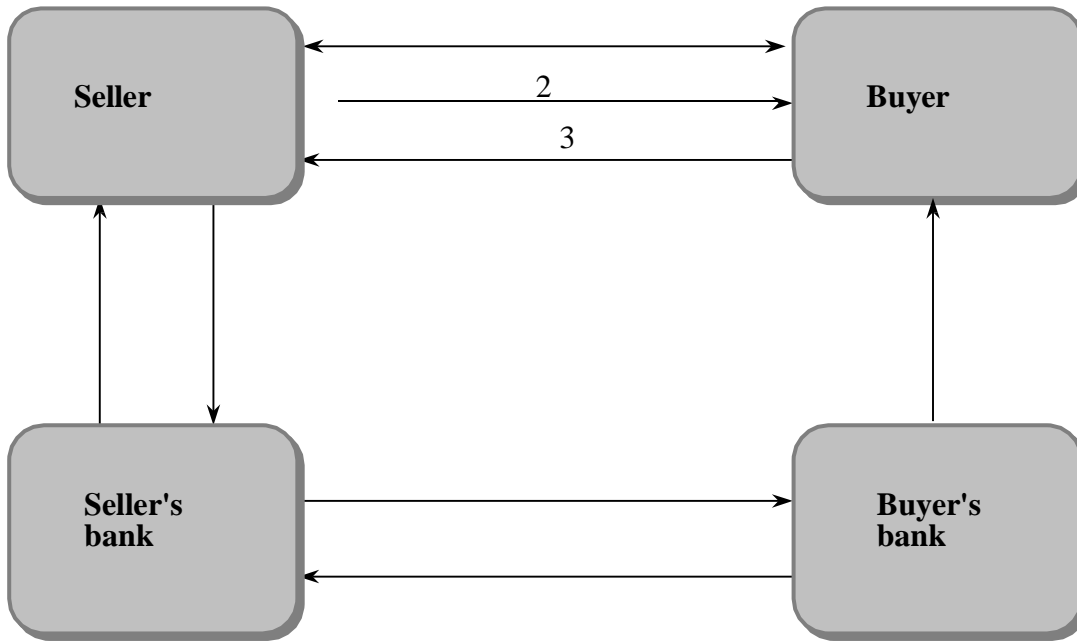
Classification of endorsements	
Type of endorsement	Characteristic
<i>Blank</i>	The owner of the cheque signs on the back of the cheque, as a result of which the cheque becomes a bearer document, and any legal owner can receive money on it from the bank
<i>Special</i>	
<i>Pledging</i>	
<i>Endorsement without recourse</i>	
<i>Endorsement by agent</i>	
<i>Order</i>	

Exercise 5. Give the characteristics of cheques by types given in the table.

Classification of cheques	
Type of cheque	Characteristic
<i>Cheque payable to a named person</i>	A cheque in favour of a specific person. Such a document cannot be transferred by ordinary endorsement. The transfer is carried out by cession (transfer inscription with the clause "not to order", notarized under the norms of civil law)
<i>Order</i>	
<i>Cheque to bearer</i>	
<i>Bank</i>	
<i>Company</i>	

Exercise 6. According to the given diagram, describe the mechanism of settlement of the buyer with the seller for the goods delivered on credit using a promissory note. Complete the table.

Settlement of a buyer with a seller for goods delivered on credit using a promissory note



Exercise 8. Describe the advantages and disadvantages of all non-documentary settlements forms.

	Advantages	Disadvantages
Advance payment		

Payment to an open account		
Bank Transfer		
Cheque		
Note payable		

Practical exercises

1. The commercial bank entered into an aval agreement with the bill drawer - the mining and processing work. The agreement provides that the guarantor of a bill is responsible for payment of promissory notes and bills of exchange for a period not exceeding 6 months from the date of presentation. The guarantor of a bill in case of non-fulfilment (partial fulfilment) by the drawer of obligations under such bills:

- promissory note in the amount of USD 100 thousand;
- bill of exchange in the amount of USD 85 thousand;
- bill of exchange in the amount of USD 125 thousand to pay at the request to

the billholder the amount of unpaid bills, a penalty of 6 % starting from the due date for unpaid bills, as well as costs related to the non-fulfilment of promissory note and bill of exchange obligations.

The bill drawer, in turn, undertakes to pay the bank a commission fee for providing the aval in the amount of 1.5% of the bill amount within three calendar days after the conclusion of the aval agreement.

These bills arrived at the bank on 5 April. The mining and processing works transferred the commission fee to the bank on Tuesday, April 12.

At the due date, bills of USD 100 and 85 thousand were paid by the bill drawer on the bill of exchange for USD 125 thousand, the bill holder protested against non-payment.

Explain

- What is an aval of bills?
- How will the bank resolve the issue of avalization of the presented bills?
- What entries will be made in the bank when concluding the aval agreement?

- How will the bank resolve the issue with a bill for USD 125 thousand?

2. The commercial bank «Dnipro» has entered into an agreement with the bill drawer – a woodworking integrated plant. The agreement provides that the guarantor of a bill is responsible for payment of promissory notes and bills of exchange for a period not exceeding 3 months from the date of presentation. The guarantor of a bill in case of non-fulfilment (partial fulfilment) by the bill drawer of obligations under such bills (Table 1), to pay at the request of the bill holder the amount of unpaid bills, a penalty of 5%, starting from the due date for unpaid bills, as well as costs related to the non-fulfilment of promissory note and bill of exchange obligations.

Table 1 DEBENTURES

Types of bills	Sum		
	I version	II version	III version
№ 1 promissory note	100 thousand euros	10 thousand euros	90 thousand euros
№ 2 bill of exchange	100 thousand euros	85 thousand euros	100 thousand euros
№ 3 bill of exchange	110 thousand euros	125 thousand euros	120 thousand euros

The bill drawer, in turn, undertakes to pay the bank a commission fee for providing the aval in the amount of 1.5 % within three calendar days after the conclusion of the aval agreement.

These bills arrived at the bank on 5 April. The woodworking integrated plant transferred the commission fee to the bank on Tuesday, April 12.

At the due date, bills № 1 and № 2 were paid by the bill drawer and on the bill of exchange № 3 the bill holder protested against non-payment.

Explain:

1. What is an aval of bills?
2. How will the bank resolve the issue of avalization of the presented bills?
3. What entries will be made in the bank when concluding the aval agreement?
4. How will the bank resolve the issue with a bill № 3?

Topic 11 LENDING TO PARTICIPANTS IN INTERNATIONAL SETTLEMENTS

Keyterms: *international credit; acceptance credit, paper credit, commercial credit, investment credit, financial credit, company credit; export crediting; import crediting, credit line; credit agreement; credit analysis; leasing; lessor; lessee; overdraft; factoring; forfeiting.*

International credit –is an economic category that expresses the relationship between the parties of the world economy (lenders and borrowers) about the provision, use and return of funds raised.

The main types and forms of credits:

1. According to the purpose: *tied international loan; commercial; investment; financial; the issue of securities.*
2. According to the forms of provision: *commodity; currency.*
3. According to the subjects of provision: *private; governmental; mixed.*
4. According to the nature of the collateral: *secured; blank.*
5. According to the terms: *overnight credit* (from 1 day to 1 month); *short-term credit* (up to 1 year); *intermediate (medium-term) credit* (up to 5-7 years); *long-term credit* (over 5-7 years)

Commercial credit is a credit as a type of settlements, i.e. payments by installments.

The main types of commercial credit are:

- *company credit;*
- *paper credit;*
- *discount credit;*
- *open credit;*
- *overdraft;*
- *acceptance credit;*
- *reimbursement;*

- *factoring*;
- *forfeiting*;
- *leasing*.

The payment terms that are decisive in lending to imports include:

- advance payment;
- letter of credit payment (payment at sight);
- collection (documents against payment);
- payment after receipt of the goods (through delay in payment).

Export crediting is required if the following payment terms are used:

- letter of credit payment (delay in payment letter of credit);
- collection (documents against acceptance);
- delay in payment.

Independent work of students

The main issues of the practical class.

1 The role of credit in securing foreign trade, its types and connection with the terms of payment.

2 Import crediting. Direct bank lending to the importer, promissory note lending and documentary credit.

3 Export crediting: short-term exporter crediting; export factoring and forfeiting; export leasing.

The main issues for self-studying.

1. World market of loan capital. Eurocurrency market.

2. Import financing.

3. Export financing.

Topics for reports.

1. Features of lending settlements based on bank credit lines.

2. Types of bank credits and organization of credit payments for export.

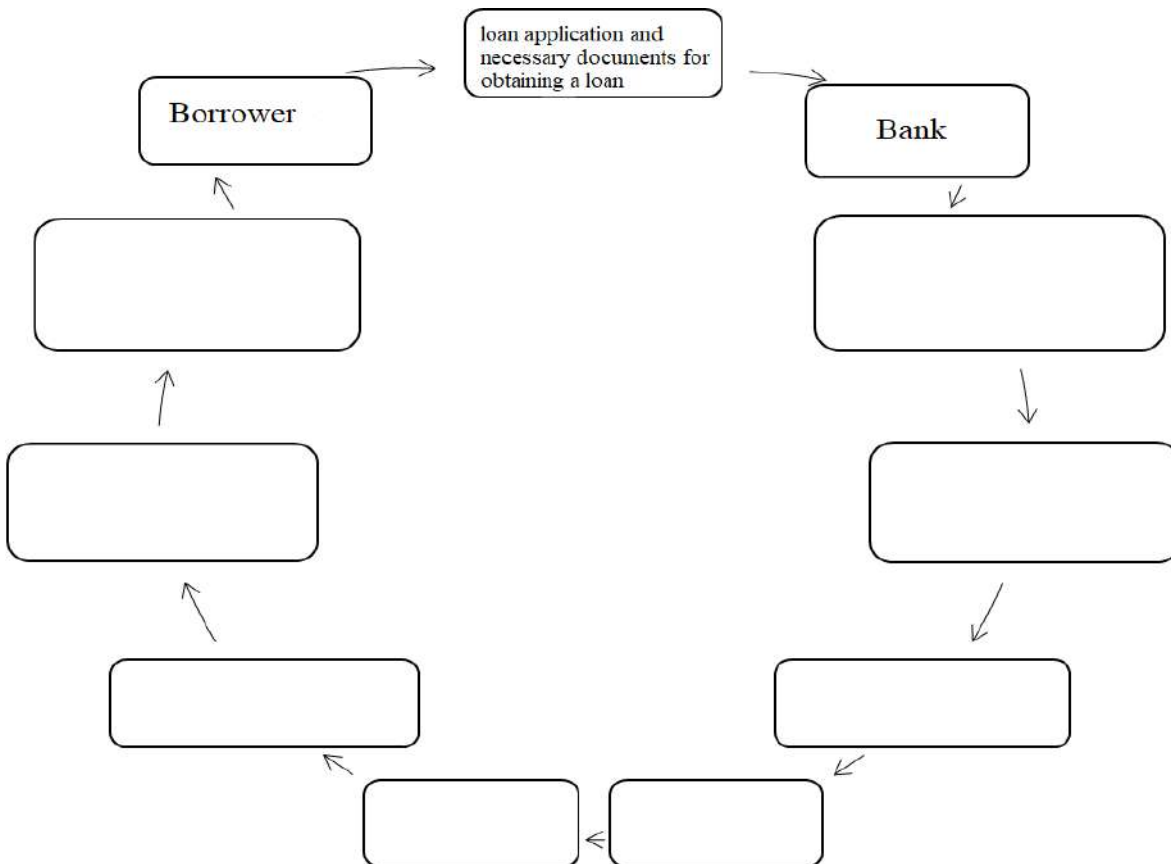
3. Problems of leasing in Ukraine.
4. Prospects for factoring in Ukraine.

Self-practice exercises

Exercise 1. What are the ways of lending to international trade?

Short-term	<ul style="list-style-type: none"> • overdraft in foreign currency • • • •
Medium-term	
Long-term	

Exercise 2. Using the diagram below, describe the sequence of actions for bank lending.



Exercise 3. What types of commercial credits do you know? Describe them.

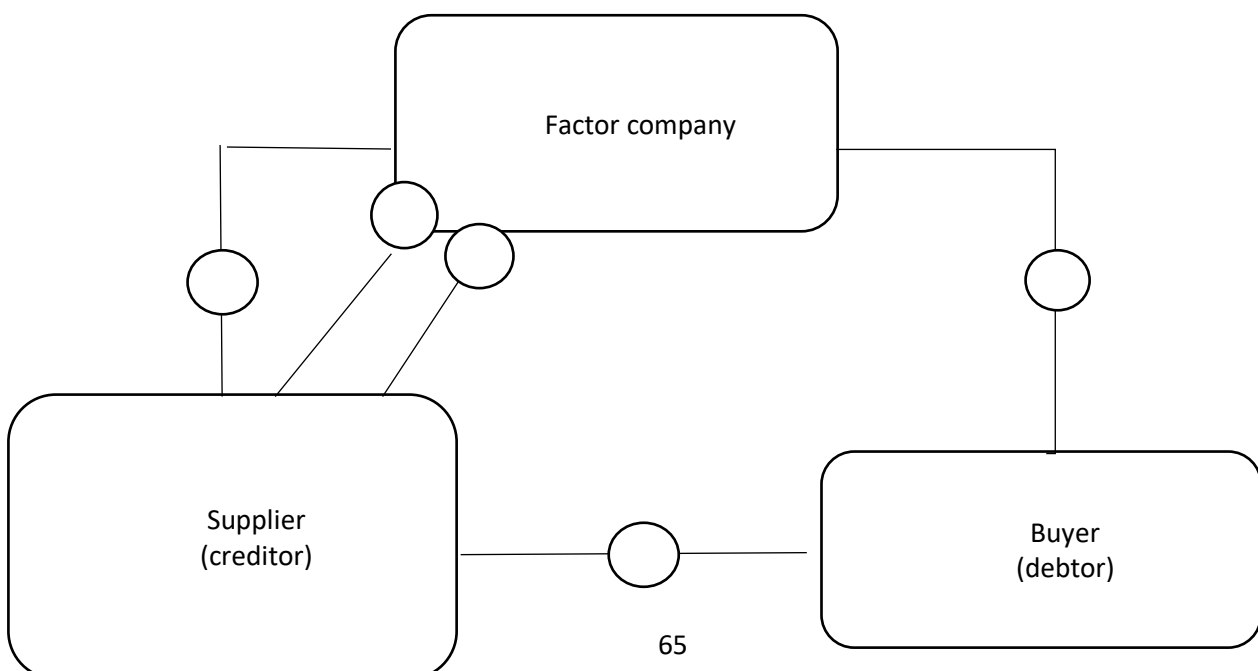
Types	Features
company credit	
paper credit	
discount credit	
open credit	
overdraft	
acceptance credit	
reimbursement	
factoring	
forfeiting	
leasing	

Exercise 4. What are the main types of factoring?

According to the types of transactions

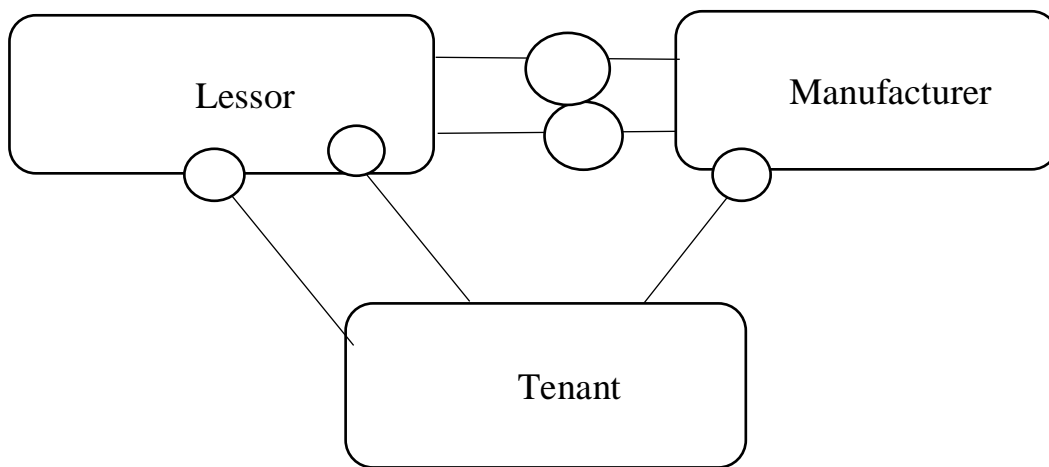
According to the degree of the debtor awareness

Exercise 5. Describe the sequence of actions on the diagram when organizing a factoring transaction and complete the table.



- 1 _____
- 2 _____
- 3 _____
- 4 _____
- 5 _____

Exercise 6. Describe the sequence of actions for leasing using the diagram.



- 1 _____
- 2 _____
- 3 _____
- 4 _____
- 5 _____

Exercise 7. Write the advantages and disadvantages of for faiting for exporters

Advantages of for faiting	Disadvantages of for faiting

Topic 12. BANK GUARANTEE AS A TOOL TO ENSURE THE FULFILLMENT OF OBLIGATIONS IN INTERNATIONAL SETTLEMENTS

Key terms: *bank guarantee; surety; payment obligation; principal; guarantor bank; beneficiary; advising bank; implied guarantees; revocable bank guarantee; irrevocable bank guarantee.*

A *bank guarantee* is the obligation of the bank to pay the corresponding amount of money in case of non-fulfilment or violation by the counterparties of the contract terms.

The bank guarantee can be issued as a *surety* or as an *obligation* to make a payment.

The surety is one form of a guarantee and is an agreement according to which one person (the surety) assumes responsibility to the creditor to fulfill the obligation of the debtor fully or partially. The surety has an accessory nature and is valid only if there is the primary obligation.

The payment obligation is a form of guarantee that creates a non-accessory, abstract obligation regarding the beneficiary. The guarantor remains obligated even when the obligation, which forms the basis of the contract, is lost for some reason. He must, without objection, make payment on demand.

A *principal* is the order giver under the guarantee, that empowers his bank to issue a guarantee, it also gives instructions to his bank about what kind of guarantee should be provided (its type, amount, expiry date, special terms, etc.).

A *guarantor bank* is a bank issuing a guarantee (principal's bank).

A *beneficiary* is a person in favour of whom the guarantee is issued.

An *advising bank* is a bank that advises the beneficiary of the guarantee received from the guarantor bank.

Implied guarantees are when the guarantor bank and the advising bank are not correspondents and an intermediary bank (common correspondent) or several intermediary banks are also involved in the operation.

Bank guarantees are divided into two types – *revocable* and *irrevocable*.

A revocable bank guarantee –is a guarantee that can be withdrawn or its terms and conditions can be changed without prior notification to the beneficiary. Such a guarantee does not contain a firm commitment of the bank to the beneficiary and, therefore, is not sufficient security for the beneficiary.

An irrevocable bank guarantee cannot be withdrawn, and its terms and conditions cannot be changed without the consent of the beneficiary.

Revocable and irrevocable bank guarantees are divided into conditional and unconditional.

In international practice, there are two types of bank guarantees –*payment* and *contractual* guarantees.

Payment guarantees are used for settlements on an open account and in the form of collection, for settlements on the terms of commercial credit.

Contractual guarantees provide payments under any agreements (for example, an agreement on the supply of goods, an agreement on the provision of a particular service, etc.) and are issued by banks to protect the interests of the importer.

Independent work of students

The main issues of the practical class.

1. Bank guarantees and peculiarities of their use in international settlement transactions.
2. Types of bank guarantees. General principles and legal support of bank guarantees.

The main issues for self-studying:

1. Operation of bank guarantees
2. Issuance of bank guarantees
3. Use of a bank guarantee

Topics for reports:

1. Features of providing bank guarantees in Ukraine.
2. «Uniform Rules for Contractual Guarantees».

Self-practice exercises

Exercise 1. Describe what is the accessory nature of the surety:

➤ _____

➤ _____

➤ _____

Exercise 2. Analyze the main points that distinguish a surety from a guarantee.

Surety	Payment obligation

Exercise 3. Name the documents that banks require from clients when deciding on a guarantee.

➤ _____

➤ _____

➤ _____

➤ _____

➤ _____

Exercise 4. What is the legal use of a bank guarantee? Why a bank guarantee is barely used?

Practical exercises

1. Give expert advice to your bank's clients on the following issues. Explain the difference between surety and payment obligation.

Client A of your bank exports raw materials to Italy and he received an offer from new clients from Poland. What kind of bank guarantee can you recommend?

Customer B of your bank wants to import printing equipment from Germany and wants to choose the type of contractual guarantee.

How and under what terms and conditions can a bank guarantee be issued? Explain the features of using a contractual guarantee.

2. Ukrainian confectionery factory pays the butter factory by letter of credit. The agreement between them provides for an irrevocable letter of credit in the amount of UAH 150,000. On April 7, the factory applied to a commercial bank with a request to open an uncovered letter of credit. The correspondent agreement between the issuing bank and the executing bank for advising and other transactions with the letter of credit provides for a commission of 0.1%

After checking all the necessary documents of the confectionery factory, the commercial bank opened an uncovered guaranteed letter of credit. On April 18, the issuing bank received from the executing bank a register of documents for UAH 120,000 and other documents stipulated by the terms of the letter of credit. On the current account of the confectionery factory, the balance as of April 18 stood at UAH 30,000

What is the point of the bank's guarantee when it opens uncovered guaranteed letters of credit? What documents regulate the relationship between the parties involved in settlements with guaranteed letters of credit?

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