

# Lesson 1: International Financial Markets: Theoretical Framework

## 1. Introduction:

International financial markets refer to the various platforms or mechanisms that allow individuals, companies, and governments to trade financial instruments across borders. These financial instruments include stocks, bonds, currencies, commodities, and derivatives. International financial markets are critical for promoting global economic growth, facilitating cross-border trade and investment, and managing risks associated with international financial transactions.

## 2. Types of International Financial Markets:

1. **Foreign Exchange Market:** The foreign exchange market is the largest financial market globally, with an average daily trading volume of over \$5 trillion. It facilitates the exchange of currencies between individuals, companies, and governments from different countries.
2. **Stock Market:** Stock markets are platforms for buying and selling shares of companies listed on stock exchanges worldwide. International stock markets allow investors to purchase shares in companies based in different countries, providing them with diversification opportunities.
3. **Bond Market:** The bond market is a platform for buying and selling debt securities issued by governments and companies worldwide. International bond markets allow investors to diversify their portfolios by investing in bonds issued in different countries.
4. **Commodity Market:** Commodity markets are platforms for trading commodities such as gold, silver, crude oil, and agricultural products. The prices of commodities are influenced by global supply and demand factors.
5. **Derivatives Market:** The derivatives market is a platform for trading financial instruments that derive their value from an underlying asset, such as a stock or a commodity. Examples of derivatives include futures, options, and swaps.

## 3. Benefits of International Financial Markets:

1. **Improved liquidity:** International financial markets provide a platform for investors to buy and sell financial instruments, promoting liquidity.
2. **Diversification of risk:** Investors can diversify their portfolios by investing in financial instruments issued in different countries, reducing the risks associated with investing in a single market.
3. **Access to capital:** Companies and governments can access capital from international financial markets through the issuance of bonds and shares.
4. **Exchange rate management:** International financial markets provide a mechanism for managing exchange rate risk through the use of currency hedging instruments.

## **4. The Creation of International Financial Markets**

International financial markets have become an integral part of the global economy. They allow individuals, businesses, and governments to access funding from investors and financial institutions from all around the world. However, international financial markets have a long and complex history that spans several centuries. In this lesson, we will explore the origins and development of international financial markets.

1. **Origins of International Financial Markets** : The origins of international financial markets can be traced back to the 17th century when the Dutch East India Company issued bonds to finance its operations. These bonds were traded on the Amsterdam Stock Exchange, which became the first stock exchange in the world. The Amsterdam Stock Exchange allowed investors to trade securities in a regulated environment, which paved the way for the creation of other stock exchanges around the world.
2. **Development of International Financial Markets In the 19th century**, international financial markets grew rapidly, as technological advancements made it easier to communicate and trade across borders. The development of telegraphs and later, telephones, allowed traders and investors to communicate with each other in real-time. This led to the creation of new financial instruments, such as bonds and stocks issued by foreign governments and corporations.

### **3. The Bretton Woods System**

The Bretton Woods System, established in 1944, marked a turning point in the history of international financial markets. Under this system, currencies were pegged to the US dollar, which was in turn pegged to gold. This system provided stability and predictability to international financial markets, which allowed for increased investment and trade.

### **4. Globalization and Financial Liberalization**

In the latter part of the 20th century, globalization and financial liberalization led to the rapid expansion of international financial markets. Advances in technology, such as the internet, made it easier for investors to access information and trade securities across borders. This led to the creation of new financial instruments, such as derivatives, which allowed investors to hedge against risk.