

ECON 5700: Macroeconomic and Financial Risk Management
2023-24 Spring
Department of Economics, HKUST

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Description

Macroeconomic and financial risk is the likelihood that changes in macroeconomic or financial conditions like interest rates, exchange rates, sovereign credit rating, government policy or regulation, political stability, commodity prices, or equity prices will affect the economic profit or investment return of an entity. For instance, if the central bank tightens monetary policy by increasing interest rates, the cost of borrowing will rise and it will lower profit for a firm which relies on debt financing. The rising interest rates also lower the investment return for bondholders. If a country devalues its currency or defaults on its sovereign debt, creditors or investors from foreign countries will realize investment loss. This course introduces fundamental concepts of macroeconomic and financial risk management. It focuses on the identification, quantification, and management of various macroeconomic and financial risks. It evaluates and applies different tools and procedures, comprising quantitative measures and qualitative assessment, to measure and manage risk. Problems and challenges that arise in risk management process are also addressed.

Prerequisite

ECON 5280

Assessment Scheme

Case Study Analysis	20%	Group work, due on April 17*
Test 1	40%	To be held in the class on March 13**
Test 2	40%	To be held in the class on May 8**

*Please form a group of maximum 5 members. Please email the group information (names and student numbers) to the instructor by Feb 16 (the last date of add/drop period).

**An absence from a test without a valid reason (including sickness or unexpected family emergencies) and a documentary proof will result in zero mark for the test. There will be no makeup test for Test 1. If you miss Test 1, the weight of Test 1 will be added to Test 2.

Program Intended Learning Outcomes (PILOs)

Upon successful completion of this course, students will be able to:

1. Analyze qualitatively and quantitatively economic and financial risk exposures for financial institutions. (PILG 2, 4, 12)
2. Apply risk management tools and procedures to manage economic and financial risks. (PILG 2, 4, 12)
3. Address problems and challenges in the risk management process. (PILG 4, 12)

Course Outline

1. Foundation of Risk Management (Weeks 1-3)

- Identification of Macroeconomic and Financial risks
- Introduction to Risk Measurement and Management tools
- Delineating Efficient Portfolios
- Capital Asset Pricing Model
- Risk-Adjusted Performance Measurement
- Multi-Factor Models of Risk and Return

2. Quantitative Methods for Risk Management (Weeks 3-4)

- Time Value of Money
- Probability
- Basic Statistics
- Estimating Volatilities and Correlations for Risk Management

3. Mechanics and Valuation of Financial Products (Weeks 6-9)

- Interest Rates and Valuation of Bonds
- Determination of Forward and Future Prices
- Mechanics and Properties of Options
- Options Pricing: Binomial Model, Black-Scholes-Merton Model, Greek Letters

4. Risk Management Models for Macroeconomic and Financial Risk (Weeks 9-12)

- Value-at-Risk and Stress Testing
- Hedging Strategies Using Futures Contracts
- Risk Metrics and Hedges for Fixed Income Securities
- Managing Foreign Exchange Risk
- Managing Credit Risk
- Managing Operational Risk
- Country and Sovereign Risk Measurement

Teaching Materials

There is no required textbook. We use lecture slides for teaching. All teaching materials (including lecture slides and supplementary reading materials) are downloadable from CANVAS.

The content of the course draws on various sources, including books, academic and professional journals. Please refer to the following list for your reference.

References (available from HKUST library, either online access or hardcopy)

- Allen, L., Boudoukh, J., Saunders, A., (2004). *Understanding Market, Credit and Operational Risk: The Value at Risk Approach*, New York: Wiley-Blackwell.
- Allen, S., (2013). *Financial Risk Management: A Practitioner's Guide to Managing Market and Credit Risk*, 2nd Edition, New York: John Wiley & Sons.
- Amenc, N., Le Sourd, V., (2003). *Portfolio Theory and Performance Analysis*, West Sussex, England: John Wiley & Sons.
- Damodaran, A. (2015). *Country Risk: Determinants, Measures and Implications - The 2015 Edition*.
- Hull, J., (2014). *Options, Futures, and Other Derivatives*, 9th Edition, New York: Pearson.
- Hull, J., (2015). *Risk Management and Financial Institutions*, 4th Edition, Hoboken, NJ: John Wiley & Sons.
- Lam, J., (2014). *Enterprise Risk Management: From Incentives to Controls*, 2nd Edition, Hoboken, NJ: John Wiley & Sons.
- Miller, M., (2013). *Mathematics and Statistics for Financial Risk Management*, 2nd Edition, Hoboken, NJ: John Wiley & Sons.
- Schroeck, G., (2002). *Risk Management and Value Creation in Financial Institutions*, New York: John Wiley & Sons.
- Tuckman, B. (2011). *Fixed Income Securities*, 3rd Edition, Hoboken, NJ: John Wiley & Sons.

Academic Policy

Dishonesty or plagiarism will not be tolerated. Any student violating HKUST Academic Integrity and Honor Code (<https://registry.hkust.edu.hk/resource-library/regulations-student-conduct-and-academic-integrity>) will be subjected to disciplinary procedure.