

UNIVERSITY OF COLORADO

Department of Economics

**ECON8423**

**International Finance**

Spring 2014

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## **COURSE DESCRIPTION**

*ECON 8423* is a graduate course in open-economy macroeconomics and international finance. We will discuss a number of topics in these areas. Here is a partial list of issues that will be discussed:

1. Real and nominal exchange rates are highly correlated.
2. Exchange rates are volatile and persistent.
3. Forward exchange rates are poor and biased predictors of future spot exchange rates.
4. International differences in interest rates are large and persistent.
5. Portfolios are not internationally diversified.
6. The extent of international consumption risk-sharing is less than expected.
7. Savings and investment are highly correlated.
8. The trade balance and the current account are countercyclical.
9. Business cycles are highly correlated across countries.

## EVALUATION

The assessment for this class consists of

**Test:** A take-home test will be distributed in class on 5 March and is due on 6 March at noon.

**Report:** You are required to write a 3-page referee report of an article in international macroeconomics. You will be presenting both the article and the report in class. The report is due on 19 March in class. The presentations will take place shortly after. I must approve your choice of article no later than 26 February.

**Survey:** To introduce you to recent research, you are required to write a 10-page survey of a topic in international macroeconomics. The survey is due on 30 April. I must approve your choice of topic and a preliminary list of papers no later than 26 February.

**Final:** The final examination is cumulative.

The tentative schedule and the grade distribution are displayed in the table below.

<b>Evaluation</b>	<b>Date</b>	<b>%</b>
Take Home Test	5 March	20
Report	19 March	20
Survey	30 April	30
Final	7 May 1:30 to 4:00pm	30

## TEXTS

Feenstra, R. and A. Taylor (2012) *International Macroeconomics*, Second Edition, New York:Worth Publisher.

Mark, N. (2001) *International Macroeconomics and Finance: Theory and Econometric Evidence*. Malden: Blackwell Publishers Inc.

Obstfeld, M. and K. Rogoff (1996) *Foundations of International Macroeconomics*. Cambridge: The MIT Press.

Vegh, C. (2013) *Open Economy Macroeconomics in Developing countries*. Cambridge: The MIT Press.

# Course Outline

## 1. INTRODUCTION

### 1.1 *The Six Major Puzzles in International Macroeconomics*

Obstfeld, M. and K. Rogoff (2000) The six major puzzles in international macroeconomics: Is there a common cause? *NBER Macroeconomics Annual* **15**, 339–390.

### 1.2 *The National Income Accounts and the Balance of Payments*

**Mark** Chapter 1.

**Feenstra and Taylor** Chapter 5.

## 2. THE INTERTEMPORAL APPROACH TO THE CURRENT ACCOUNT

**Obstfeld and Rogoff** Chapters 1 to 3.

**Boileau** Section 1 Notes.

Blanchard, O. (1985) Debt, deficits, and finite horizons. *Journal of Political Economy* **93**, 233–247.

Nason, J. and J. Rogers (2005) The present-value model of the current account has been rejected: Round up the usual suspects. *Journal of International Economics* **68**, 159–187.

Taylor, A. (2002) A century of current account dynamics. *Journal of International Money and Finance* **21**, 725–748.

## 3. INTERNATIONAL CAPITAL FLOWS

Barro, R., G. Mankiw and X. Sala-i-Martin (1995) Capital mobility in neoclassical models. *American Economic Review* **85**, 103–115.

Lane, P. and G. Milesi-Ferretti (2001) Long term capital movements. mimeo.

Lucas, R. (1990) Why doesn't capital flow from rich countries to poor countries. *American Economic Review* **80**, 92–96.

## 4. INTERNATIONAL RISK SHARING

**Obstfeld and Rogoff** Chapter 5.

Backus, D. and G. Smith (1993) Consumption and real exchange rates in dynamic economies with non-traded goods. *Journal of International Economics* **35**, 297–316.

Cole, H. and M. Obstfeld (1991) Commodity trade and international risk sharing: How much do financial market matters? *Journal of Monetary Economics* **28**, 3–24.

Lewis, K. (1996) What can explain the apparent lack of international consumption risk sharing? *Journal of Political Economy* **104**, 267–297.

## 5. INTERNATIONAL BUSINESS CYCLES

**Mark** Chapter 5.

Ambler, S., Cardia, E., and C. Zimmermann (2004) International business cycles: What are the facts? *Journal of Monetary Economics* **51**, 257–276.

Backus, D., P. Kehoe and F. Kydland (1994) Dynamics of the trade balance and the terms of trade: The J-curve. *American Economic Review* **84**, 84–103.

Backus, D., P. Kehoe and F. Kydland (1992) International real business cycles. *Journal of Political Economy* **100**, 745–775.

Correia, I., Neves, J., and S. Rebelo (1995) Business cycles in a small open economy. *European Economic Review* **39**, 1089–1113.

Heathcote, J. and F. Perri (2002) Financial autarky and international business cycles. *Journal of Monetary Economics* **49**, 601–627.

Uribe, M. and S. Schmitt-Grohe (2003) Closing small open economy models. *Journal of International Economics* **61**, 163–185.

## **6. EXCHANGE RATES**

**Mark** Chapters 3 and 4.

**Obstfeld and Rogoff** Chapters 8 and 9.

Devereux, M. (1997) Real exchange rates and macroeconomics: Evidence and theory. *Canadian Journal of Economics* **30**, 773–808.

Engel, C. and K. West (2005) Exchange rates and fundamentals. *Journal of Political Economy* **113**, 485–517.

Gourinchas, P.O. and H. Rey (2007) International financial adjustment. *Journal of Political Economy* **115**, 665–703.

Lucas, R. (1982) Interest Rates and Currency Prices in a Two-Country World. *Journal of Monetary Economics* **10**, 335–360.

## **7. NOMINAL RIGIDITIES**

**Mark** Chapters 8 and 9.

**Obstfeld and Rogoff** Chapter 10.

Chari, V., Kehoe, P., and E. McGrattan (2002) Can sticky price models generate volatile and persistent real exchange rates? *Review of Economic Studies* **69**, 533–563.

Lane, P. (2001) The New Open Economy Macroeconomics: A Survey. *Journal of International Economics* **54**, 235–266.

Obstfeld and Rogoff (1995) Exchange Rate Dynamics Redux. *Journal of Political Economy* **103**, 624–660.

## **8. SOME ISSUES IN DYNAMIC TRADE**

### **8.1 International Prices**

- Burstein, A. and A. Atkeson (2007) Pricing-to-market, trade costs, and international relative prices. mimeo.
- Crucini, M., Telmer, C., and M. Zachariadis (2005) Understanding European real exchange rates. *American Economic Review* **95**, 724–738.
- Engel, C. (1993) Real exchange rates and relative prices: An empirical investigation. *Journal of Monetary Economics* **32**, 35–50.
- Gopinath, G., P.O. Gourinchas, C.T. Hsieh, and N. Li (2010) International Prices, Costs and Markup Differences. Mimeo UC Berkeley.
- Imbs, J., Mumtaz, H., Ravn, M., and H. Rey (2005) PPP strikes back: Aggregation and the real exchange rate. *Quarterly Journal of Economics* **120**, 1–43.

## 8.2 Trade and Foreign Direct Investment

- Atkeson, A. and A. Burstein (2010) Innovation, firm dynamics, and international trade. *Journal of Political Economy*.
- Bergin, P., R. Feenstra, and G. Hanson (2006) Outsourcing and volatility. Mimeo University of California Davis..
- Burstein, A., J. Neves, and S. Rebelo (2003) Distribution costs and real exchange rate dynamics, *Journal of Monetary Economics*.
- Contessi, S. (2007) International macroeconomic dynamics, endogenous tradability, and foreign direct investment with heterogeneous firms. Mimeo Federal Reserve Bank of St. Louis.
- Engel, C. and Wang, J. (2010) International trade in durable goods: Understanding volatility, cyclicity, and elasticities. Forthcoming at Journal of International Economics.
- Ghironi, F. and M. Melitz (2005) International trade and macroeconomic dynamics with heterogeneous firms. *Quarterly Journal of Economics* **120**, 865–915.
- Russ, C. (2007) The endogeneity of the exchange rate as a determinant of FDI: A model of money, entry, and multinational firms. *Journal of International Economics* **71**(2), 344–372.
- Zlate, A. (2010) Offshore production and business cycle dynamics with heterogeneous firms. Mimeo Federal Reserve Board.

## 8.3 Cross-Country Dispersion

- Chari, V.V., P. Kehoe, and E. McGrattan (2010) The Poverty of Nations: A Quantitative Investigation. Mimeo Federal Reserve Bank of Minneapolis.

# 9. SOME ISSUES IN INTERNATIONAL FINANCE

## 9.1 Interest Rates and Exchange Rates

- Atkeson, A., Alvarez, F., and P. Kehoe (2008) Time varying risks, interest rates, and exchange rates in general equilibrium. mimeo.
- Burnside, C., M. Eichenbaum, and S. Rebelo (2009) Understanding the forward premium Puzzle: A Microstructure Approach. *American Economics Journal: Macroeconomics*.
- Gourinchas, P.O. and H. Rey (2007) International financial adjustment. *Journal of Political Economy* **115**, 665–703.

## 9.2 International Portfolio

Baxter, M. and U. Jermann (1997) The international diversification puzzle is worse than you think. *American Economic Review* **87**, 170–180.

Engel, C. and A. Matsumoto (2009) The international diversification puzzle when prices are sticky: Its really about exchange-rate hedging not equity portfolios. *American Economic Journal: Macroeconomics* **1**, 155-188.

French, K. and J. Poterba (1991) Investor diversification and international equity markets. *American Economic Review* **81**, 222–226.

Coeurdacier, N., Kollman, R., and P. Martin (2008) International portfolios, capital accumulation, and foreign asset dynamics. mimeo.

Devereux, M. and A. Sutherland (2006) Country portfolio dynamics. mimeo.

Heathcote, J. and F. Perri (2008) The international diversification puzzle is not as bad as you think. Mimeo University of Minnesota.

Lewis, K. (1995) Puzzles in international financial markets, in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, Vol. 3, Amsterdam: North-Holland.

## 9.3 Capital Flows and Current Account

Caballero, R., E. Farhi, and P.O. Gourinchas (2008) An equilibrium model of global imbalances and low interest rates. *American Economic Review* **98**, 358–393.)

Gourinchas, P.O. and O. Jeanne (2008) Capital flows to developing countries: The allocation puzzle. mimeo.

Ohanian, L. and M. Wright (2010) Capital Flows and Macroeconomic Performance: Lessons from the Golden Era of International Finance. *American Economic Review* **Volume 100**, 68-72.

## 9.4 International Business Cycles

Aguiar, M. and G. Gopinath (2007) Emerging market business cycles: The cycle is the trend. *Journal of Political Economy* **115**, 69–102.

Burstein, A. C. Kurz, and L. Tesar (2008) Trade, production sharing, and the international transmission of business cycles. *Journal of Monetary Economics*.

Perri, F. and V. Quadrini (2010) International Recessions. Mimeo Federal Reserve Bank of Minneapolis.

## 9.5 International Risk Sharing

Brandt, M., J. Cochrane, and P. Santa-Clara (2006) International risk sharing is better than you think, or exchange rates are too smooth. *Journal of Monetary Economics* **53**, 671–698.

Corsetti, G., Dedola, L., and S. Leduc (2008) International risk sharing and the transmission of productivity shocks. *Review of Economic Studies* **75**, 443–473.