

UNIVERSITY OF COLORADO

Department of Economics

ECON8423

International Finance

Spring 2007

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COURSE DESCRIPTION

Here are some stylized facts that we will seek to explain:

1. Real and nominal exchange rates are highly correlated.
2. Exchange-rate systems affect the real exchange rate.
3. Changes in both real and nominal exchange rates are persistent.
4. There are persistent deviations from the law of one price.
5. Forward exchange rates are poor and biased predictors of future spot exchange rates.
6. International differences in interest rates are large and persistent.
7. Portfolios are not internationally diversified.
8. The extent of international consumption risk-sharing is less than expected.
9. Savings and investment are highly correlated.
10. The trade balance is countercyclical.
11. Business cycles are highly correlated across countries.
12. Countries grow at different rates and do not seem to be converging.

EVALUATION

The assessment for this class consists of

Test: A take-home test will be distributed in class on 28 February and is due on 1 March at 16h00.

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. The presentations will take place shortly after. I must approve your choice of article no later than 28 February.

Survey: To introduce you to recent research, you are required to write a 10 to 15-page survey of a topic in international macroeconomics. The survey is due on 25 April. I must approve your choice of topic and a preliminary list of papers no later than 28 February.

Final: The final examination is cumulative and will take place in Econ Room 5. Although I believe the final will be on 7 May at 4:30 pm, it remains to be confirmed.

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

| Evaluation | Date | % |
|-------------------|------------------------|----------|
| Take Home Test | 28 February | 20 |
| Report | 19 March | 20 |
| Survey | 25 April | 20 |
| Final | 7 May 4:30pm to 7:00pm | 40 |

TEXT

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

Course Outline

READING LIST

I. INTERNATIONAL FINANCIAL MARKETS AND TRADE

A. Intertemporal Trade

Feldstein, M. and C. Horioka (1980) “Domestic Saving and International Capital Flows,” *Economic Journal* **90**, 314–329.

Obstfeld, M. (1986) “Capital Mobility in the World Economy: Theory and Measurement,” *Carnegie-Rochester Conference Series on Public Policy* **24**, 55–104.

Obstfeld and Rogoff (1996) Chapters 1 to 4.

B. Trade Across States of Nature

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.

Obstfeld and Rogoff (1996) Chapters 5 and 6.

C. International Business Cycles

Backus, D., P. Kehoe and F. Kydland (1992) “International Real Business Cycles,” *Journal of Political Economy* **100**, 745–775.

Mendoza, E. (1991) “Real Business Cycles in a Small Open Economy,” *American Economic Review* **81**, 797–818.

II. EXCHANGE RATES

A. Empirical Evidence on Exchange Rates

Devereux, M. (1997) “Real Exchange Rates and Macroeconomics: Evidence and Theory,” *Canadian Journal of Economics* **30**, 773–808.

B. Equilibrium Models of Exchange Rates

Grilli, V. and N. Roubini (1992) “Liquidity and Exchange Rates,” *Journal of International Economics* **32**, 339–352.

Obstfeld and Rogoff (1996) Chapter 8.

C. Disequilibrium Models of Exchange Rates

Dornbusch, R. (1976) “Expectations and Exchange Rate dynamics,” *Journal of Political Economy* **84**, 1161–1176.

Lane, P. (1999) “The New Open Economy Macroeconomics: A Survey,” Trinity Economic Paper Series Paper No. 3

Obstfeld and Rogoff (1996) Chapters 9 and 10.

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

D. Exchange Rate Regimes

Baxter, M. and A. Stockman (1989) “Business Cycles and the Exchange Rate Regime: Some International Evidence,” *Journal of Monetary Economics* **23**, 377–400.

Devereux, M. and C. Engel (1998) “Fixed versus Floating Exchange Rates: How Price Setting Affects the Optimal Choice of Exchange-Rate Regime,” mimeo University of British Columbia.

Helpman, E. (1981) “An Exploration in the Theory of Exchange Rate Regimes,” *Journal of Political Economy* **89**, 865–890.

Obstfeld and Rogoff (1996) Chapter 8.

III. OTHER TOPICS

A. Collapsing Regimes, Speculative Attacks, and Target Zones

Agenor, P.-R. and R. Flood (1994) “Macroeconomic Policy, Speculative Attacks, and Balance of Payment Crises,” in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.

Obstfeld and Rogoff (1996) Chapter 8.

B. International Debt

Kletzer, K. (1994) “Sovereign Immunity and International Lending,” in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.

Obstfeld and Rogoff (1996) Chapter 6.

C. International Asset Pricing

Devries, C. (1994) “Stylized Facts of Nominal Exchange Rate Returns,” in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.

Lewis, K. (1995) “Puzzles in International Financial Markets,” in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, vol. 3, Amsterdam: North-Holland.

D. International Growth

Barro, R. (1991) “Economic Growth in a Cross-Section of Countries,” *Quarterly Journal of Economics* **106**, 101–121.

Obstfeld and Rogoff (1996) Chapter 7.

E. International Policy Coordination

Rogoff, K. (1985) “Can International Monetary Policy Coordination Be Counterproductive?,” *Journal of International Economics* **18**, 199–217.

Extended Course Outline

TEXTS

- Dixit, A. and V. Norman (1980) *Theory of International Trade*, London: Cambridge University Press.
- Frankel, J. and A. Razin (1992) *Fiscal Policies and the World Economy*, Cambridge: The MIT Press.
- Grossman, G. and E. Helpman (1991) *Innovation and Growth in the Global Economy*, Cambridge: The MIT Press.
- Grossman, G. and K. Rogoff (1995) *Handbook of International Economics*, vol. 3, Amsterdam: North-Holland.
- Jones R. and P. Kennen (1985) *Handbook of International Economics*, vol. 1 and 2, Amsterdam: North-Holland.
- Obstfeld, M. and K. Rogoff (1996) *Foundations of International Macroeconomics*, Cambridge: The MIT Press.
- Turnovsky, S. (1997) *International Macroeconomic Dynamics*, Cambridge: The MIT Press.
- van der Ploeg, F. (1994) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd.

READING LIST

I. INTERNATIONAL FINANCIAL MARKETS AND TRADE

A. Intertemporal Trade

- Barro, R., G. Mankiw and X. Sala-i-Martin (1995) “Capital Mobility in Neoclassical Models,” *American Economic Review* **85**, 103–115.
- Blanchard, O. (1985) “Debt, Deficits, and Finite Horizons,” *Journal of Political Economy* **93**, 233–247.
- Buiter, W. (1981) “Time Preference and International Lending and Borrowing in an Overlapping-Generations Model,” *Journal of Political Economy* **89**, 769–797.
- Feldstein, M. and C. Horioka (1980) “Domestic Saving and International Capital Flows,” *Economic Journal* **90**, 314–329.
- Frankel and Razin (1992) Chapters 1, 4 and 5.
- Obstfeld, M. (1986) “Capital Mobility in the World Economy: Theory and Measurement,” *Carnegie-Rochester Conference Series on Public Policy* **24**, 55–104.
- Obstfeld, M. and K. Rogoff (1996) “The Intertemporal Approach to the Current Account,” in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, vol. 3. Amsterdam: North-Holland.
- Obstfeld and Rogoff (1996) Chapters 1 to 3.

- Persson, T. (1985) “Deficits and Intergenerational Welfare in Open Economies,” *Journal of International Economics* **19**, 67–84.
- Svensson, L. and A. Razin (1985) “Current Account Dynamics and the Terms of Trade: The Harberger-Laursen-Metzler Effect,” *Journal of Political Economy* **91**, 97–125.
- Sen, P. (1994) “Savings, Investment, and the Current Account,” in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.

B. Trade Across States of Nature

- Cole, H. (1987) “Financial Structure and International Trade,” *International Economic Review* **29**, 237–259.
- 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.
- Dixit, A. (1987) “Trade and Insurance with Moral Hazard,” *Journal of International Economics* **23**, 201–220.
- Lewis, K. (1996) “What Can Explain the Apparent Lack of International Consumption Risk Sharing?,” *Journal of Political Economy* **104**, 267–297.
- Obstfeld, M. (1994) “Are Industrial-Country Consumption Risk Globally Diversified?,” in L. Leiderman and A. Razin (eds.) *Capital Mobility: The Impact on Consumption, Investment, and Growth*, Cambridge: Cambridge University Press.
- Obstfeld and Rogoff (1996) Chapter 5.
- Stockman, A. (1988) “On the Role of International Financial Markets and their Relevance for Economic Policy,” *Journal of Money, Credit, and Banking* **20**, 205–226.
- Svensson, L. (1988) “Trade in Risky Assets,” *American Economic Review* **78**, 375–394.

C. International Business Cycles

- Backus, D. and P. Kehoe (1992) “International Evidence on the Historical Properties of Business Cycles,” *American Economic Review* **82**, 864–888.
- 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.
- Baxter, M. (1995) “International Trade and Business Cycles,” in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, vol. 3. Amsterdam: North-Holland.
- Baxter, M. and M. Crucini (1993) “Explaining Saving–Investment Correlations,” *American Economic Review* **83**, 416–436.
- Mendoza, E. (1991) “Real Business Cycles in a Small Open Economy,” *American Economic Review* **81**, 797–818.
- Stockman, A. and L. Tesar (1995) “Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Comovements,” *American Economic Review* **85**, 168–185.

II. EXCHANGE RATES

A. Empirical Evidence on Exchange Rates

- Abuaf, N. and P. Jorion (1990) “Purchasing Power Parity in the Long Run,” *Journal of Finance* **45**, 157–174.
- Engel, C. (1993) “Real Exchange Rates and Relative Prices: An Empirical Investigation,” *Journal of Monetary Economics* **32**, 35–50.
- Fama, E. (1984) “Forward and Spot Exchange Rates,” *Journal of Monetary Economics* **23**, 319–338.
- Frankel, F. and A. Rose (1995) “Empirical Research on Nominal Exchange Rates,” in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, vol. 3. Amsterdam: North-Holland.
- Froot, K. and R. Thaler (1990) “Anomalies — Foreign Exchange,” *Journal of Economic Perspectives* **4**, 179–192.
- Hodrick, R. (1987) *The Empirical Evidence on the Efficiency of Forward and Futures Foreign Exchange Markets*, Chur: Harwood Academic Publishers.
- Lothian, J. and M. Taylor (1996) “Real Exchange Rate Behavior: The Recent Float from the Perspective of the Past Two Centuries,” *Journal of Political Economy* **104**, 488–509.
- Mark, N. (1990) “Real and Nominal Exchange Rates in the Short and in the Long Run: An Empirical Investigation,” *Journal of International Economics* **28**, 115–136.
- Rogoff, K. (1996) “The Purchasing Power Parity Puzzle,” *Journal of Economic Literature* **34**, 647–688.

B. Disequilibrium Models of Exchange Rates

- Beaudry, P. and M. Devereux (1995) “Money and the Real Exchange Rate with Sticky Prices and Increasing Returns,” *Carnegie-Rochester Conference Series on Public Policy* **43**, 55–101.
- Betts, C. and M. Devereux (1996) “The Exchange Rate in a Model of Pricing to Market,” *European Economic Review* **40**, 1007–1021.
- Dornbusch, R. (1976) “Expectations and Exchange Rate dynamics,” *Journal of Political Economy* **84**, 1161–1176.
- Lane, P. (1999) “The New Open Economy Macroeconomics: A Survey,” Trinity Economic Paper Series Paper No. 3
- Obstfeld and Rogoff (1996) Chapters 9.1 to 9.3 and 10.
- Obstfeld and Rogoff (1995) “Exchange Rate Dynamics Redux,” *Journal of Political Economy* **103**, 624–660.

C. Equilibrium Models of Exchange Rates

- Hodrick, R. (1989) “Risk, Uncertainty, and Exchange Rates,” *Journal of Monetary Economics* **23**, 433–459.
- Kareken, J. and N. Wallace (1981) “On the Indeterminacy of Equilibrium Exchange Rates,” *Quarterly Journal of Economics* **96**, 207–222.

- Grilli, V. and N. Roubini (1992) “Liquidity and Exchange Rates,” *Journal of International Economics* **32**, 339–352.
- Lucas, R. (1982) “Interest Rates and Currency Prices in a Two-Country World,” *Journal of Monetary Economics* **10**, 335–360.
- Obstfeld, M. (1981) “Macroeconomic Policy, Exchange-Rate Dynamics, and Optimal Asset Accumulation,” *Journal of Political Economy* **89**, 1142–1161.
- Stockman, A. (1980) “A Theory of Exchange Rate Determination,” *Journal of Political Economy* **88**, 673–398.
- Schlagenhauf, D. and J. Wrase (1995) “Liquidity and Real Activity in a Simple Open Economy Model,” *Journal of Monetary Economics* **35**, 431–462.
- Svensson, L. (1985) “Currency Prices, Terms of Trade, and Interest Rates: A General Equilibrium Asset-Pricing, Cash-in-Advance Approach,” *Journal of International Economics* **18**, 17–41.

D. Exchange Rate Regimes

- Helpman, E. (1981) “An Exploration in the Theory of Exchange Rate Regimes,” *Journal of Political Economy* **89**, 865–890.
- Baxter, M. and A. Stockman (1989) “Business Cycles and the Exchange Rate Regime: Some International Evidence,” *Journal of Monetary Economics* **23**, 377–400.
- Devereux, M. and C. Engel (1998) “Fixed versus Floating Exchange Rates: How Price Setting Affects the Optimal Choice of Exchange-Rate Regime,” mimeo University of British Columbia.
- Flood, R. and A. Rose (1995) “Fixing Exchange Rates: A Virtual Quest for Fundamentals,” *Journal of Monetary Economics* **36**, 3–37.
- Greenwood, J. and S. Williamson (1988) “International Financial Intermediation and Aggregate Fluctuations under Alternative Exchange Rate Regimes,” *Journal of Monetary Economics* **23**, 401–431.
- Obstfeld and Rogoff (1996) Chapter 8.
- Obstfeld and Rogoff (1995) “The Mirage of Fixed Exchange Rates,” *Journal of Economic Perspectives* **9**, 73–96.
- Stockman, A. (1983) “Real Exchange Rates under Alternative Nominal Exchange Rate Systems,” *Journal of International Money and Finance* **2**, 147–166.
- Svensson, L. (1992) “An Interpretation of Recent Research on Exchange Rate Target Zone,” *Journal of Economic Perspectives* **6**, 119–144.

III. OTHER TOPICS

A. Collapsing Regimes, Speculative Attacks, and Target Zones

- Agenor, P.-R. and R. Flood (1994) “Macroeconomic Policy, Speculative Attacks, and Balance of Payment Crises,” in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.
- Burnside, C., M. Eichenbaum, and S.T. Rebelo (1999), “On the Fundamentals of Self-Fulfilling Speculative Attacks,” NBER Working Paper No. W7554.

- Cole, H.L. and T.J. Kehoe (1995) "Self-Fulfilling Debt Crisis," *Review of Economic Studies* **67**, 91–116.
- Chari, V.V. and P.J. Kehoe (2000) "Financial Crisis as Herds," Federal Reserve Bank of Minneapolis Working Paper No. 600.
- Corsetti, G., P. Pesenti, and N. Roubini (1998) "Paper Tigers? A Model of the Asian Crisis," mimeo Yale University.
- Flood, R. and P. Garber (1984) "Collapsing Exchange Rate Regimes: Some Linear Examples," *Journal of International Economics* **17**, 1–13.
- Kaminsky, G. and C. Reinhart (1999) "The Twin Crises: The Causes of Banking and Balance-of-Payments Problems," *American Economic Review* **89**, 473–500.

B. International Debt

- Bulow, J. and K. Rogoff (1989) "A Constant Recontracting Model of Sovereign Debt," *Journal of Political Economy* **97**, 155–178.
- Bulow, J. and K. Rogoff (1989) "Sovereign Debt: Is to Forgive to Forget?," *American Economic Review* **79**, 43–50.
- Kletzer, K. (1994) "Sovereign Immunity and International Lending," in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.
- Obstfeld and Rogoff (1996) Chapter 6.

C. International Asset Pricing

- Adler, M. and B. Dumas (1983) "International Portfolio Choices and Corporation Finance: A Synthesis," *Journal of Finance* **38**, 925–984.
- Harvey, C. (1991) "The World Price of Covariance Risk," *Journal of Finance* **56**, 111–157.
- Dumas, B. (1994) "Partial Equilibrium versus General Equilibrium Models of the International Capital Market," in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.
- Devries, C. (1994) "Stylized Facts of Nominal Exchange Rate Returns," in F. van der Ploeg (ed.) *The Handbook of International Macroeconomics*, Oxford: Basil Blackwell Ltd, 506–534.
- French, K. and J. Poterba (1991) "Investor Diversification and International Equity Markets," *American Economic Review* **81**, 221–226.
- Lewis, K. (1995) "Puzzles in International Financial Markets," in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, vol. 3, Amsterdam: North-Holland.

D. International Growth

- Barro, R. (1991) "Economic Growth in a Cross-Section of Countries," *Quarterly Journal of Economics* **106**, 101–121.
- Devereux, M. and G. Smith (1994) "International Risk Sharing and Economic Growth," *International Economic Review* **35**, 535–550.
- Lucas, R. (1990) "Why Doesn't Capital Flow from Rich Countries to Poor Countries," *American Economic Review* **80**, 92–96.

Grossman, G. and E. Helpman (1991) Chapter 9.

Grossman, G. and E. Helpman (1990) “Trade, Innovation and Growth,” *American Economic Review* **80**, 86–91.

Obstfeld, M. (1994) “Risk-Taking, Global Diversification, and Growth,” *American Economic Review* **85**, 1310–1329.

Obstfeld and Rogoff (1996) Chapter 7.

E. International Policy Coordination

Kehoe, P. (1987) “Coordination of Fiscal Policies in a World Economy,” *Journal of Monetary Economics* **19**, 349–376.

Kehoe, P. (1989) “International Policy Coordination May Be Undesirable,” *Review of Economic Studies* **56**, 289–296.

Devereux, M. (1988) “International Cooperation, Precommitment, and Welfare,” *International Economic Review* **31**, 439–456.

Rogoff, K. (1985) “Can International Monetary Policy Coordination Be Counterproductive?,” *Journal of International Economics* **18**, 199–217.