

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.

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. Rogo (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-*

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

Obstfeld and Rogo (1996) Chapters 9 and 10.

Obstfeld and Rogo (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 Rogo (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 Rogo (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 Rogo (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. Rogo (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 Rogo (1996) Chapter 7.

E. International Policy Coordination

Rogo, 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. Rogo (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. Rogo (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. Rogo (1996) "The Intertemporal Approach to the Current Account," in G. Grossman and K. Rogo (eds.) *Handbook of International Economics*, vol. 3. Amsterdam: North-Holland.
- Obstfeld and Rogo (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.

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. Rogo (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.
- Rogo, 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 Rogo (1996) Chapters 9.1 to 9.3 and 10.
- Obstfeld and Rogo (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.

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. Rogo (1989) "A Constant Recontracting Model of Sovereign Debt," *Journal of Political Economy* **97**, 155–178.

Bulow, J. and K. Rogo (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 Rogo (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. Rogo (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.

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 Rogo (1996) Chapter 7.

E. International Policy Coordination