COURSE OBJECTIVES AND PREREQUISITES

This course surveys a variety of topics in international finance and open-economy macroeconomics. Among the topics covered are: (1) Theories of current account dynamics and international capital flows, (2) Theories of exchange rate determination, (3) Open-economy business cycle models, and (4) Theories of speculative attacks and exchange rate crises. Although the focus will be on theory, students are expected to understand modern econometric methods, and these methods will be used to evaluate the empirical validity of the theories we discuss. The goal of the course is to then use these theories to shed light on recent policy debates, e.g., optimal exchange rate policy and the pros and cons of international financial integration.

Although the general approach will be to survey a variety of topics, rather than focus on single one in depth, there are nonetheless several important omissions from the course. First, the course will not spend much time on issues that are of special relevance to developing economies, e.g., sovereign debt, capital market imperfections, and political economy considerations. Second, we will only touch on the vast recent literature on New Keynesian open-economy models, inspired by the Obstfeld-Rogoff (1995) ‘redux model’. Finally, the course will not do justice to the huge recent literature on international financial crises.

COURSE STRUCTURE

Most recent research in international finance and open-economy macroeconomics is motivated by the desire to resolve a variety of so-called ‘puzzles’, e.g., the home-bias puzzle, the exchange rate disconnect puzzle, the Backus-Smith puzzle, the forward discount puzzle, etc. As a result, the course is structured so as to first present the theories that underlie these puzzles, and to then discuss the empirical work that has been done on them. The goal is to bring students as close as possible to the current research frontiers in international finance.

COURSE EVALUATION

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<tr>
<th>Weight in Grade</th>
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<tr>
<td>Problem Sets</td>
<td>– 20%</td>
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<tr>
<td>Term Paper</td>
<td>– 20%</td>
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<tr>
<td>Midterm exam (Thursday, February 22)</td>
<td>– 30%</td>
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<tr>
<td>Final exam (date to be arranged)</td>
<td>– 30%</td>
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The paper should be 15-20 pages. It can be a literature review, a replication of previous results, or even the start of a thesis! The problem sets will be available as PDF files on the class webpage (at www.sfu.ca/˜kkasa/). There will be 4 problem sets. Each will consist of a couple of analytical problems and one empirical question, which will involve some simple econometric work. The necessary data sets will be posted on the class webpage.
COURSE MATERIALS

There is one required book for this course: *Foundations of International Macroeconomics*, by Maurice Obstfeld and Kenneth Rogoff (1st Edition, 1996) published by MIT Press. There are also a number of journal articles, working papers, and supplementary notes that are available for download on the course webpage. I also recommend that students acquire a copy of Nelson Mark’s textbook, entitled *International Macroeconomics and Finance* (Blackwell Publishers, 2001). This book is especially useful for empirical applications. The Obstfeld-Rogoff and Mark texts are both on reserve at the library.

COURSE OUTLINE AND READINGS

Readings marked with a (*) are downloadable from the course webpage.

I. INTERNATIONAL BORROWING AND LENDING (5 lectures)

Jan. 9 – **A Simple 2-Period Model**
Obstfeld & Rogoff, Chpt. 1 (pgs. 1-14)

Jan. 11 – **Extensions of the 2-Period Model**
Obstfeld & Rogoff, Chpt. 1 (pgs. 14-42)

Jan. 16 – **Deterministic Infinite-Horizon Models**
Obstfeld & Rogoff, Chpt. 2 (pgs. 59-78)

Jan. 18 – **Stochastic Infinite-Horizon Models**
Obstfeld & Rogoff, Chpt. 2 (pgs. 79-95)

Jan. 23 – **Empirical Evidence**

II. REAL EXCHANGE RATES AND THE TERMS OF TRADE (2 lectures)

Jan. 25 – **Non-Traded Goods and the Balassa-Samuelson Effect**
Obstfeld & Rogoff, Chpt. 4 (pgs. 199-216)
Mark, Chpt. 7

Jan. 30 – **The Terms of Trade**
Obstfeld & Rogoff, Chpt. 4 (pgs. 235-248)
Problem Set 1 due
III. EXCHANGE RATE DYNAMICS (5 lectures)

Feb. 1  –  The Partial Equilibrium Monetary Model
          Obstfeld & Rogoff, Chpt. 8 (pgs. 513-529)

Feb. 6  –  The Monetary Model (continued)
          Mark, Chpt. 3

Feb. 8  –  Empirical Evidence on the Monetary Model
          * Engel & West (2004), “Accounting for Exchange Rate Variability in Present-Value Models when the Discount Factor is Near 1”

Feb. 13 –  Complete Markets General Equilibrium Models
          Obstfeld & Rogoff, Chpt. 8 (pgs. 530-554)
          Mark, Chpt. 4

Feb. 15 –  Risk Premia in the Foreign Exchange Market
          Mark, Chpt. 6
          * Burnside et. al. (2006), “The Returns to Currency Speculation”

IV. INTERNATIONAL FINANCIAL MARKETS AND RISK-SHARING (3 lectures)

Feb. 20 –  The Complete Markets Benchmark
          Obstfeld & Rogoff, Chpt. 5 (pgs. 269-306)
          Problem Set 2 due

Feb. 22 –  Midterm Exam

Feb. 27 –  Risk-Sharing with Frictions
          Obstfeld & Rogoff, Chpt. 5 (pgs. 325-329), Chpt. 6 (pgs. 349-379)
          * Obstfeld & Rogoff (2000), ”Six Puzzles Major Puzzles in International Macroeconomics”

March 1 –  Quantifying the Gains from International Risk-Sharing
          Obstfeld & Rogoff, Chpt. 5 (pgs. 329-332)
          * Lewis (1999), “Trying to Explain Home Bias in Equities and Consumption”
          * Heathcote & Perri (2004), “The International Diversification Puzzle is Not As Bad · · · ”
          * Cochrane et. al. (2006), “International Risk Sharing is Better Than You Think · · · ”
V. OPEN-ECONOMY DSGE MODELS (FLEXIBLE PRICES) (4 lectures)

March 6 – The Benchmark Complete Markets Model
Obstfeld & Rogoff, Chpt. 7 (pgs. 496-507)
Mark, Chpt. 5

March 8 – Quantitative Implications
* Backus & Smith (1993), “Consumption and Real Exchange Rates in Dynamic · · · ”

March 13 – Exogenous Incomplete Markets

March 15 – Endogenous Incomplete Markets

VI. OPEN-ECONOMY DSGE MODELS (STICKY PRICES) (3 lectures)

March 20 – The Redux Model
Obstfeld & Rogoff, Chpt. 10
Mark, Chpt. 9
Problem Set 3 due

March 22 – Extensions of the Redux Model

March 27 – Empirical Evidence
* Chari et. al. (2002), “Can Sticky Price Models Generate Volatile and Persistent · · · ”
* Bergin (2006), “How Well Can the New Open Economy Macroeconomics Explain · · · ”

VII. SPECULATIVE ATTACKS AND EXCHANGE RATE CRISSES (3 lectures)

March 29 – First-Generation Models
Obstfeld & Rogoff, Chpt. 8 (pgs. 558-566)
Mark, Chpt. 11 (pgs. 256-262)

April 3 – Second-Generation Models
Mark, Chpt. 11 (pgs. 262-269)

April 5 – Imperfect Common Knowledge and Global Games

April 9-13 – FINAL EXAM (exact date not yet decided)
Problem Set 4 due
Term Paper due