SIMON FRASER UNIVERSITY
Department of Economics

Econ 842 – INTERNATIONAL MONETARY ECONOMICS
Syllabus – Spring 2014

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Office Hours: Tue. 10:30 – 11:30
Thu. 1:00 – 2:00
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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 not discuss the 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

		Weight in Grade
Problem Sets	–	20%
Term Paper	–	20%
Midterm exam **(Tuesday, February 25)**	–	30%
Final exam **(date to be arranged)**	–	30%

The paper should be 10-15 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/k̃kasa/). There will be 3 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. 7   –   **Course Overview/A Simple 2-Period Model**
Obstfeld & Rogoff, Chpt. 1 (pgs. 1-14)

Jan. 9   –   **Extensions of the 2-Period Model**
Obstfeld & Rogoff, Chpt. 1 (pgs. 14-42)

Jan. 14   –   **Deterministic Infinite-Horizon Models**
Obstfeld & Rogoff, Chpt. 2 (pgs. 59-78)

Jan. 16   –   **Stochastic Infinite-Horizong Models**
Obstfeld & Rogoff, Chpt. 2 (pgs. 79-95)

Jan. 21   –   **Empirical Evidence**
    *   Ventura (2002), "Towards a Theory of Current Accounts"
    *   Ghosh (1995), "Capital Mobility Amongst the Major Industrialized Countries"
    *   Glick & Rogoff (1995), "Global vs. Country-Specific Productivity Shocks and the ⋯ "
    *   Rey & Gourinchas (2007), "International Financial Adjustment"
    *   Caballero et. al. (2008), "An Equilibrium Model of Global Imbalances ⋯ "
    *   Mendoza et. al. (2009), "Financial Integration, Financial Development & Global Imbalance

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

Jan. 23   –   **Non-Traded Goods and the Balassa-Samuelson Effect**
Obstfeld & Rogoff, Chpt. 4 (pgs. 199-216)
Mark, Chpt. 7
    *   Rogoff (1996), "The Purchasing Power Parity Puzzle"
    *   Engel (1999), "Accounting for U.S. Real Exchange Rate Changes"
    *   Canzoneri et. al., (1999), "Relative Labor Productivity and the Real Exchange Rate ⋯ "
    *   Kocherlakota & Pistaferri (2007), "Household Heterogeneity and Real Exchange Rates"

Jan. 28   –   **The Terms of Trade**
Obstfeld & Rogoff, Chpt. 4 (pgs. 235-248)
Problem Set 1 due

III. EXCHANGE RATE DYNAMICS (5 lectures)

Jan. 30   –   **The Partial Equilibrium Monetary Model**
Obstfeld & Rogoff, Chpt. 8 (pgs. 513-529)

Feb. 4   –   **The Monetary Model (continued)**
Mark, Chpt. 3

Feb. 6   –   **Empirical Evidence on the Monetary Model**
* Engel (2006), "Exchange Rate Models"
* Engel & West (2005), "Exchange Rates and Fundamentals"
* Engel & West (2004), "Accounting for Exchange Rate Variability in Present-Value Models when the Discount Factor in Near 1"
* Engel et. al. (2007), "Exchange Rate Models Are Not as Bad as You Think"
* Bacchetta & van Wincoop (2006), "Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?"
* Djeutem & Kasa (2013), "Robustness and Exchange Rate Volatility"

Feb. 11-13   –   **Spring Break (No Class)**

Feb. 18   –   **Complete Markets General Equilibrium Models**
Obstfeld & Rogoff, Chpt. 8 (pgs. 530-554)
Mark, Chpt. 4
Lucas (1982), "Interest Rates and Currency Prices in a Two-Country World"

Feb. 20   –   **Risk Premia in the Foreign Exchange Market**
Mark, Chpt. 6
* Engel (1996), "The Forward Discount Anomaly and the Risk Premium: A Survey"
* Burnside et. al. (2007), "Understanding the Forward Premium Puzzle"
* Evans & Chakrabory (2008), "Can Perpetual Learning Explain the Forward Premium?"

Feb. 25   –   **Midterm Exam (Closed Book)**

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

Feb. 27   –   **The Complete Markets Benchmark**
Obstfeld & Rogoff, Chpt. 5 (pgs. 269-306)
Problem Set 2 due

March 4   –   **Risk-Sharing with Frictions**
Obstfeld & Rogoff, Chpt. 5 (pgs. 325-329), Chpt. 6 (pgs. 349-379)
* Baxter et. al. (1998), "Nontrade Goods, Nontraded Factors and Intl. Nondiversification"
* Obstfeld & Rogoff (2000), "Six Puzzles Major Puzzles in International Macroeconomics"
* Veldkamp & van Nieuwerburgh (2006), "Information Immobility and Home Bias"

March 6   –   **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"
* Gourinchas & Jeanne (2013), "Capital Flows to Developing Countries: The Allocation F
* Gourinchas & Jeanne (2006), "The Elusive Gains from International Financial Integratio
* Heathcote & Perri (2007), "The International Diversification Puzzle is Not As Bad ⋯ "
* Obstfeld (1994), "Risk-Taking, Global Diversification and Growth"

V. OPEN-ECONOMY DSGE MODELS (4 lectures)

March 11   –   **The Benchmark Complete Markets Model**
Obstfeld & Rogoff, Chpt. 7 (pgs. 496-507)
Mark, Chpt. 5

March 13   **Quantitative Implications**
*   Backus, Kehoe & Kydland (1992), "International Real Business Cycles"
*   Backus & Smith (1993), "Consumption and Real Exchange Rates in Dynamic ⋯ "

March 18   –   **Exogenous Incomplete Markets**
*   Baxter & Crucini (1995), "Business Cycles and the Asset Structure of Foreign Trade"
*   Schmitt-Grohe & Uribe (2003), "Closing Small Open-Economy Models"

March 20   –   **Endogenous Incomplete Markets**
*   Kehoe & Perri (2002), "Intl. Business Cycles with Endogenous Incomplete Markets"
*   Bai & Zhang (2010), "Solving the Feldstein-Horioka Puzzle with Financial Frictions"

VI. SPECULATIVE ATTACKS AND EXCHANGE RATE CRISES (3 or 4 lectures)

March 25   –   **First-Generation Models**
Obstfeld & Rogoff, Chpt. 8 (pgs. 558-566)
Mark, Chpt. 11 (pgs. 256-262)

March 27   –   **Second-Generation Models**
Mark, Chpt. 11 (pgs. 262-269)
*   Obstfeld (1996), "Models of Currency Crises with Self-Fulfilling Features"

April 1   –   **Imperfect Common Knowledge and Global Games**
*   Morris & Shin (1998), "Unique Equilibrium in a Model of Self-Fulfilling Attacks"

April 3,8   –   **Review/Buffer**

April 11-18   –   **FINAL EXAM (exact date not yet decided)**
Term Paper due