

SIMON FRASER UNIVERSITY
Department of Economics

Econ 842 – INTERNATIONAL MONETARY ECONOMICS
Syllabus – Spring 2007

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Wed. 2:00 – 3:00
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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 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

	<u>Weight in Grade</u>
Problem Sets	– 20%
Term Paper	– 20%
Midterm exam (Thursday, February 22)	– 30%
Final exam (date to be arranged)	– 30%

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)

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|---------|---|--|
| 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 <ul style="list-style-type: none">* Ghosh (1995), “Capital Mobility Amongst the Major Industrialized Countries”* Glick & Rogoff (1995), “Global vs. Country-Specific Productivity Shocks and the . . . ”* Rogers & Nason (2006), “The Present-Value Model of the Current Account Has . . . ”* Engel & Rogers (2006), “The U.S. Current Account Deficit and the Expected . . . ”* Bluedorn (2005), “Hurricanes: Intertemporal Trade and Capital Shocks”* Rey & Gourinchas (2005), “International Financial Adjustment” |

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

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|---------|---|--|
| Jan. 25 | – | Non-Traded Goods and the Balassa-Samuelson Effect
Obstfeld & Rogoff, Chpt. 4 (pgs. 199-216)
Mark, Chpt. 7 <ul style="list-style-type: none">* 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 (2006), “Household Heterogeneity and Real Exchange Rates” |
| 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 (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 is Near 1”
* Meese (1990), “Currency Fluctuations in the Post-Bretton Woods Era”
* Mark & Sul (2001), “Nominal Exchange Rates and Monetary Fundamentals: Evidence from a Small Post-Bretton Woods Sample”
* Bacchetta & van Wincoop (2006), “Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?”
- Feb. 13 – **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. 15 – **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. (2006), “The Returns to Currency Speculation”
* Evans & Chakraborty (2006), “Can Perpetual Learning Explain the Forward Premium?”

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)
* 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 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”
* Cole & Obstfeld (1991), “Commodity Trade and International Risk Sharing”
* Gourinchas & Jeanne (2006), “The Elusive Gains from International Financial Integration”
* Heathcote & Perri (2004), “The International Diversification Puzzle is Not As Bad . . . ”
* Obstfeld (1994), “Risk-Taking, Global Diversification and Growth”
* 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, Kehoe & Kydland (1992), “International Real Business Cycles”
* Backus & Smith (1993), “Consumption and Real Exchange Rates in Dynamic . . . ”
- March 13 – **Exogenous Incomplete Markets**
* Baxter & Crucini (1995), “Business Cycles and the Asset Structure of Foreign Trade”
- March 15 – **Endogenous Incomplete Markets**
* Kehoe & Perri (2002), “Intl. Business Cycles with 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**
Obstfeld & Rogoff (2000), “New Directions for Stochastic Open-Economy Models”
* Lane (2001), “The New Open Economy Macroeconomics: A Survey”
- 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 CRISES (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)
* Obstfeld (1996), “Models of Currency Crises with Self-Fulfilling Features”
- April 5 – **Imperfect Common Knowledge and Global Games**
* Morris & Shin (1998), “Unique Equilibrium in a Model of Self-Fulfilling Attacks”
- April 9-13 – **FINAL EXAM (exact date not yet decided)**
Problem Set 4 due
Term Paper due