

Spring 2023

# International Finance

Instructor: Ching-Yi Lin

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The objective of this course is to familiarize advanced graduate students with major research questions in international macroeconomics. The course will focus on determination of the account and exchange rate, business cycle comovement, and monetary policy.

## Grading

- 1) One 30 minute class presentations of a paper from the reading list. (20%)  
Please provide a handout of your slides for the other students in the class to study from.
- 2) Participation in class (10%)
- 3) A brief literature review of a topic in international macroeconomics. (20%)
- 4) A Midterm (25%) and a Final (25%)

## Course outline

### Part I:

1. Introduction and Review of International Economics II
2. Balance of payments adjustment mechanisms
3. foreign exchange markets' theories of balance of payments policy
4. international monetary mechanisms

## Reference

International Economics by R. Feenstra and A. Taylor,

International Economics – Theory and Policy by Krugman and Obstfield

International Monetary Economics by McCallum

## Part 2

1. Intertemporal Models of the Current Account
2. the Saving and Investment Puzzle
3. International Business Cycles
4. International Risk Sharing and Portfolio Diversification
5. Exchange Rate Determination
6. Monetary Policy in the open economy
7. Financial Frictions and Shocks
8. Optimal Monetary Policy and International Coordination

### Topic 1: Intertemporal Models of the Current Account

- Sheffrin, Steven, and Wing-Thye Woo (1990) "Present Value Tests of an Intertemporal Model of the Current Account" *Journal of International Economics* 29, 237-253.
- ✧ Bergin, Paul R. and Steven Sheffrin (2000) "Interest Rates, Exchange Rates and Present Value Models of the Current Account," *The Economic Journal* 110 (April), 535-558.
- Gruber, Joseph W. (2004) "A Present Value Test of Habits and the Current Account," mimeo, Johns Hopkins University (November).
- Nason, James M. and John H. Rogers (2006) "The Present Value Model of the Current Account Has Been Rejected: Round up the Usual Suspects?" *Journal of International Economics* 68, 159-187 (working paper version).
- Engel, Charles and John Rogers (2006) "The U.S. Current Account Deficit and the Expected Share of World Output," *Journal of Monetary Economics* 53, 1063-1093.
- Campa, J.M. and A. Gavilan (2006), "Current Accounts in the Euro Area: An Intertemporal Approach," working paper.
- Kano, T. (2009). Habit formation and the present-value model of the current account: yet another suspect. *Journal of International Economics* 78, 72-85.
- ◆ Hoffmann, M. (2010) What drives China's Current Account? Mimeo, University of Zurich

## Topic 2: The Saving and Investment Puzzle

- Feldstein, Martin, and Charles Horioka (1980) “Domestic Savings and International Capital Flows,” *Economic Journal* 90 (358) June, 314-329.
- Baxter, Marianne and Mario Crucini (1993) “Explaining Saving-Investment Correlations,” *American Economic Review*, 83 (3) June, 416-36.
- Nason, James M. and John H. Rogers (2002) “Investment and the Current Account in the Short Run and the Long Run,” *Journal of Money Credit and Banking*, 34, 967-86.
- ✧ Glick, Reuven and Kenneth Rogoff (1995) “Global Versus Country-Specific Productivity Shocks and the Current Account,” *Journal of Monetary Economics*, 35 (1) February, 159-192.
- ✧ Arezki, Rabah, Valerie A. Ramey, and Liugang Sheng, 2017, “News Shocks in Open Economies: Evidence from Giant Oil Discoveries,” *Quarterly Journal of Economics* 132(1), 103-155.

## Topic 3: International Business Cycles

- ✧ Backus, David K., Patrick J. Kehoe and Finn E. Kydland (1992) “International Real Business Cycles,” *Journal of Political Economy*, 100 (4) August, 745-775.
- Stockman, Alan C. And Linda L. Tesar (1995) “Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Comovements,” *American Economic Review*, 85(1) March, 168-85.
- Corsetti, Giancarlo, Luca Dedola and Sylvain Leduc (2008) “International Risk Sharing and the Transmission of Productivity Shocks,” *Review of Economics Studies*, 443-473.
- Burstein, Ariel, Chris Kurz and Linda Tesar (2008) “Trade, Production Sharing and the International Transmission of Business Cycles,” working paper version.

Charles Engel, Jian Wang (2009) *International Trade in Durable Goods: Understanding Volatility, Cyclicity, and Elasticities*, NBER working paper # 13814.

- ◆ Alessandria, George, Joseph Kaboski, and Virgiliu Midrigan (2010) The Great Trade Collapse of 2008-09: An Inventory Adjustment? NBER WP 16059, and forthcoming in the American Economic Review.
- ◆ Levchenko, Andrei, Logan Lewis, and Linda L. Tesar (2010) The Collapse of International Trade During the 2008-2009 Crisis: In Search of the Smoking Gun, NBER Working paper 16006.
- ◆ Eaton, J., S. Kortum, and B. Neiman, (2016): "Obstfeld and Rogoff's International Macro Puzzles: A Quantitative Assessment," Journal of Economic Dynamics and Control 72, 5-23.

#### Topic 4: International Risk Sharing and Portfolio Diversification

- Jonathan Heathcote and Fabrizio Perri (2013). "The International Diversification Puzzle Is Not as Bad as You Think," Journal of Political Economy 121, 1108-1159.
- Lucas, Robert E., Jr. 1982. "Interest Rates and Currency Prices in a Two-Country World." Journal of Monetary Economics 10, 335-59.
- Cole, Harold L., and Maurice Obstfeld. 1991. "Commodity Trade and International Risk Sharing: How Much Do Financial Markets Matter?" Journal of Monetary Economics 28, 3-24.
- Nicolas, Kollmann, Robert, and Martin, Philippe, 2010. "International portfolios, capital accumulation and foreign assets dynamics," Journal of International Economics, Elsevier 8, 100-112,

#### Topic 5: Exchange Rate Determination

- ✧ Alan M. Taylor & Mark P. Taylor (2004). "The Purchasing Power Parity Debate," Journal of Economic Perspectives, American Economic Association, vol. 18(4), pages 135-158, Fall.
- Imbs, Jean, H. Mumtaz, Morten Ravn and Helene Rey (2005) "PPP Strikes Back: Aggregation and the Real Exchange Rate," Quarterly Journal of Economics 120, 1-43.
- Engel, Charles and Shiu-sheng Chen (2005), "Does Aggregation Bias Explain the PPP Puzzle?" Pacific Economic Review 10, 49-72.
- Carvalho, Carlos and Fernanda Nechio (2010), "Aggregation and the PPP Puzzle in a Sticky Price Model," Working Paper.

- Meese, Richard and Kenneth Rogoff (1983) "Empirical Exchange Rate Models of the Seventies: Do they fit out of sample?" *Journal of International Economics* 14, 3-24.
- Flood, Robert and Andrew Rose (1999) "Understanding Exchange Rate Volatility Without the Contrivance of Macroeconomics," *The Economic Journal* 109, 660-672.
- Engel, Charles and Kenneth West (2005). "Exchange Rates and Fundamentals," *Journal of Political Economy* 113, June 2005, 485-517.
- Engel, Charles, Kenneth West, and Nelson C. Mark (2008) "Exchange Rate Models are Not as Bad as You Think," forthcoming in *NBER Macroeconomics Annual*.
- Bacchetta, Philippe and Eric van Wincoop (2006), "Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?" *American Economic Review* 96, 552-576.
- ✧ Betts, Caroline M. and Timothy J. Kehoe (2006) "U.S. real exchange rate fluctuations and relative price fluctuations," *Journal of Monetary Economics* 53, 1297-1326.
- Charles Engel (1999) "Accounting for U.S. Real Exchange Rate Changes" *The Journal of Political Economy* 107, 507-538.
- ◆ Berka, Martin, Michael B. Devereux and Charles Engel, 2018, "Real Exchange Rates and Sectoral Productivity in the Eurozone," *American Economic Review* 108 (6), 1543-81.
- ◆ Lilley, Andrew, Matteo Maggiori, Brent Neiman, and Jesse Schreger, 2019, "Exchange Rate Reconnect," NBER Working Paper #26046.

#### Topic 6: Monetary Policy

- ✧ Obstfeld, Maurice and Kenneth Rogoff, (1995) "Exchange Rate Dynamics Redux," *Journal of Political Economy*, 103 (3) June, 624-660.
- Kollmann, Robert (2001) "The Exchange Rate in a Dynamic-Optimizing Current Account Model with Nominal Rigidities: A Quantitative Investigation," *Journal of International Economics* 55, 243-262.

- Chari, V.V., Patrick J. Kehoe, and Ellen R. McGrattan (2003) “Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?” *Review of Economic Studies* 69, 533-563.
- Bergin, Paul R. and Robert C. Feenstra (2001) “Pricing to Market, Staggered Contracts, and Persistence in the Real Exchange Rate,” *Journal of International Economics* 54, 333-359.

Lahiri, Amartya and Alok Johri (2008) “Persistent real Exchange Rates,” forthcoming in the *Journal of International Economics*.

- ◆ J.A. Rodriguez Lopez (2010) *Prices and Exchange Rates: a Theory of Disconnect*, forthcoming in the *Review of Economic Studies*.
- ◆ Blanco, Andres and Javier Cravino, 2019, “Price Rigidities and Relative PPP,” forthcoming in *Journal of Monetary Economics*.

#### Topic 7: Financial Frictions and Shocks

- Perri, Fabrizio and Vincenzo Quadrini, 2018, "International Recessions," *American Economic Review* 108 (4-5), 935-84.
- ◆ Schmitt-Grohe, Stephanie and Martin Uribe, 2016, “Downward Nominal Wage Rigidity, Currency Pegs, and Involuntary Unemployment,” *Journal of Political Economy* 124, October 2106, 1466-1514.
- Itskhoki, Oleg and Dmitry Mukhin, 2018, “Exchange Rate Disconnect in General Equilibrium,” NBER Working paper 23401.
- Itskhoki, Oleg and Dmitry Mukhin, 2019 “Mussa Puzzle Redux, mimeo.
- Farhi, Emmanuel and Ivan Werning, 2012, “Dealing with the Trilemma: Optimal Capital Controls with Fixed Exchange Rates,” NBER Working Paper No. 18199.
- ◆ Devereux, Michael and James Yetman, 2014, “Capital Controls, Global Liquidity Traps and the International Policy Trilemma,” *Scandinavian Journal of Economics* 116, 158-189, and NBER Working Paper No. 19091
- ◆ Devereux, Michael B, Eric Young, and Changhua Yu, 2015, “A New Dilemma: Capital Controls and Monetary Policy in Sudden Stop Economies,” NBER Working Paper 2179.
- ◆ Gourinchas, P.O. and Helene Rey, 2014. External adjustment, global imbalances and valuation effects in *Handbook of International Economics* volume 4.

- Gourinches, Pierre-Olivier and Helene Rey, 2007, “International Financial Adjustment,” *Journal of Political Economy* 115:4, 665-703.
- Tille, Cedric, 2008, “Financial Integration and the Wealth Effect of Exchange Rate Fluctuations,” *Journal of International Economics* 75, 283-294.
- ◆ Benetrix, Agustin S, Philip R. Lane, Jay C. Shambaugh, 2015, “International Currency Exposures, Valuation Effects, and the Global Financial Crisis,” NBER Working Paper 20820.

#### Topic 8: Optimal Monetary Policy and International Policy Coordination

- Bacchetta, Philippe and Eric van Wincoop (2000) “Does Exchange-Rate Stability Increase Trade and Welfare?” *American Economic Review* 90, 1093-1109.
- Kollmann Robert (2004) “Welfare effects of a monetary union: The role of trade openness.” *Journal of the European Economic Association* 2, 289-301.
- Bergin, Paul R., Ivan Tchakarov, and Hyung-Cheol Shin (2007) “Does Exchange Rate Variability Matter for Welfare? A Quantitative Investigation of Stabilization Policies,” *European Economic Review* 51 (4), 1041-1058.
- ✧ Calvo, Guillermo, Ondra Kamenik and Michael Kumhof (2008) “Trade Openness and Exchange Rate Regimes,” working paper.
- Corsetti, G., L. Dedola, And S. Leduc (2010) *Optimal Monetary Policy in Open Economies*, forthcoming in the *Handbook of Monetary Economics*, vol III, ed by B. Friedman and M. Woodford.
- ◆ Engel, Charles (2009) “Currency Misalignments and Optimal Monetary Policy: A Reexamination” working paper.
- Clarida, R., J. Gali and M. Gertler (2002) “A simple Framework for International Monetary Policy Analysis,” *Journal of Monetary Economics* 49:5, 879-904.
- Gali, Jordi and Tommaso Monacelli (2005) "Optimal Monetary Policy and Exchange Rate Variability in a Small Open Economy," forthcoming in *Review of Economic Studies* 72, 707-734. (as mimeo)

- ✧ Obstfeld, Maurice and Kenneth Rogoff (2002) “Global Implications of Self-Oriented National Monetary Rules.” *The Quarterly Journal of Economics* 117, 503-535. (On webpage as mimeo)
- Devereux, Michael B. and Charles Engel (2003) Devereux, Michael B. and Charles Engel, 2003, “Monetary Policy in the Open Economy Revisited: Price Setting and Exchange Rate Flexibility,” *Review of Economic Studies* 70, 765-783. (on webpage as mimeo)
- Benigno, Pierpaolo (2002) “A Simple Approach to International Monetary Policy Coordination,” *Journal of International Economics* 57, 177-196.