This course will cover recent topics in international finance, and international macroeconomics, including international imbalances, intertemporal models, exchange rates, currency crises and international integration. We will review the empirical evidence, the methodologies adopted to conduct the analyses in the literature and discuss the most recent discoveries. The reading list is intended to give a general overview of possible empirical issues in the field and encompasses more topics than can be covered in a single semester. The lectures will go through selective recent papers or book chapters, which are mostly provided below or will be added to the list as we go along. Readings and lecture notes will be posted on Black Board.

Learning Goals and Assessment

The learning objectives of this course are to:

a. have a thorough understanding of the recent topics in the field;

b. develop a good knowledge of the quantitative and empirical methods that have proven to be useful analyzing the impact of real and financial linkages in international macro research;

c. demonstrate the ability to use empirical data and econometrics with a statistical software to generate empirical results common in the literature

d. demonstrate the ability to design and conduct original research in the field

e. develop writing skills consistent with the requirement of professional publication

f. develop the ability to present the work clearly consistent with the requirement of the profession

Assessment
The grade for the course will be determined by

- class assignments (30%)
- exam (35%)
- term project consisting of oral presentation and written paper (30%); further details are provided below.
Class assignments will assess learning goal (c); the exam will measure learning goals (a) and (b); the term paper will evaluate learning goals (d), (e) and (f).

Field Requirement: This course can be combined with Econ 81100 (Monetary Theory and Policy) or Econ 81500 (Topics in Macroeconomics) or Econ 86100 (International Trade) or Econ 84100 (Economic Development I) to make a field.

Prerequisites: First year courses in macro, micro and econometrics. Knowledge of applied macroeconometrics is strongly desirable. Good references are J. Cochrane’s time series lecture notes https://faculty.chicagobooth.edu/john.cochrane/research/papers/time_series_book.pdf, and Applied Econometric Time Series by W. Enders, which is also available as pdf online. Among the time series methods frequently used in the lecture will be unrestricted vector autoregression, structural vector autoregression, unit roots, vector-error-correction models, cointegration, panel unit-root tests, dynamic panel models (GMM).

REFERENCE BOOKS

(E) Evans, Martin, Exchange Rate Dynamics, Princeton and Oxford, 2011
(OR) Obstfeld, Maurice, and Kenneth Rogoff, Foundations of International Macroeconomics, the MIT Press, 1996.

Handbooks

Others:
COURSE OUTLINE

I. INTRODUCTION: INTERNATIONAL FINANCIAL MARKETS, PARITY CONDITIONS AND NATIONAL ACCOUNTING IDENTITIES

Basic Relations
Lecture Notes

Overview papers:

International Imbalances

II. INTERTEMPORAL APPROACH TO THE CURRENT ACCOUNT

A. One good models: the role of output and government spending shocks.
*Obstfeld and Rogoff (OR), Chapter 1;
B. Capital Accumulation, Investment and the Current Account

**Assignment 1 Two-period model**

III. EMPIRICAL EVIDENCE ON INTERTEMPORAL CURRENT ACCOUNT MODELS

*Business cycles facts and measurement: Chapter 1 (US).*

A. **Empirical approaches to tests of intertemporal models**
* Uribe and Schmidt (US), Chapter 2 and 3
* Obstfeld and Rogoff (OR), Chapters 1-3;
* Grossman and Rogoff (GR), Chapter 34;
* Glick, R. and K. Rogoff (1995) “Global vs. country-specific productivity shocks and the current account”, *Journal of Monetary Economics*;

**Assignment 2: Optimal Intertemporal Current Account**
B. The Feldstein-Horioka Puzzle: why are savings and investment highly correlated in open economies?

*Obstfeld and Rogoff (Ch.3)


C. International imbalances and current account adjustment

Caballero, Fahri and Gourinchas, P. “Global imbalances and low real interest rates”, AER 2007


D. Capital flows: the financial account of the balance of payments


Doytch, N. and M. Uctum (2011) “Does the world-wide shift of FDI from manufacturing to services accelerate economic growth? A GMM estimation study”, Journal of International Money and


**IV. FLEXIBLE EXCHANGE RATES AND EXCHANGE RATE DYNAMICS**

A. Exchange rate building blocks: Monetary approach, sticky prices, modelling the real exchange rates, portfolio balance models

Dornbusch, Rudiger (D) “Money, Prices, and Payments Adjustment,” Chapter 7.
Obstfeld and Rogoff (OR), Chapter 8;
*Obstfeld and Rogoff (OR), Chapter 9;

B. Empirical evidence on exchange rates

(i) Nominal exchange rates:
CaZorzi, M., J. Muck and M. Rubaszek (2016) “Real exchange rate forecasting and PPP: this time the random walk loses” *Open Economies Review*.


**Assignment 3: Exchange rate model and overshooting**

(ii) The Microstructure Approach to Exchange Rates


(iii) Real exchange rates and PPP:

Obstfeld and Rogoff (OR) Chapter 4 (sections 1 and 2).


*Clarida, R. and J. Gali (1994) “Sources of Real Exchange-Rate Fluctuations: How Important
Are Nominal Shocks?" Carnegie-Rochester Conference Series on Public Policy. Vol. 41
(0) 1-56 http://papers.nber.org/papers/w4658

monetary policy on exchange rates”, The Quarterly Journal of Economics, 110, 4, 975-
1009.


of general relativity: the first tests” Journal of International Money and Finance, 24,
293-316.

57 243-273.

*Lothian, J. and M. P. Taylor (1996) “Real exchange rate behavior: the recent float from the

84, 139-150.

regimes: three natural experiments (manuscript).

*Kilian, L. and M.P. Taylor (2003) “Why is it so difficult to beat the random walk forecast of

Engel, C., M. Nelson, K. West (2007) “Exchange rate models are not as bad as you think”,
NBER Macroeconomics Annual, Vol.22, 381-441

*Imbs, J. H. Mumtaz, M. Ravn, H. Rey (2005):”PPP strikes back: aggregation and the real

real exchange rates”, mimeo, UCLA and Stanford,

(iii) Pricing-to-market and exchange rate pass-through

Economics, 29, 271-36.


Goldberg, P. and M. Knetter (1997) “Goods prices and exchange rates: what have we learned?”,
JEL 35: 1243-1272

margins, imported inputs and trade exposure”, REStat

large devaluations”, Journal of Monetary Economics, 54, 2, 346-68.

Corsetti, G., L. Dedola and S. Leduc (2008) “High exchange rate volatility and low pass-

(iv) Empirical research on FX Carry trades


Breedon, F., Rime, D. and P. Vitale (2016) “Carry trades, order flows and the forward bias puzzle”, *Journal of Money, Credit and Banking*, 48, 6, 1113-34.

Assignment 4: Purchasing Power Parity

IX. CURRENCY CRISES, FINANCIAL AND BALANCE OF PAYMENTS CRISES

Earlier Literature
O&R Ch. 8.4, 9.5.


Third Generation Crisis models:
The Crisis of 2007-8

Crisis and international trade/external debt

5. Sovereign debt
Classical theory

Sovereign debt: Recent extensions

VI. FINANCIAL INTEGRATION, GLOBALIZATION AND WORLD INCOME

O&R Ch 7.
Sachs, J. D. “Institutions don’t rule: direct effects of geography on per capita income”, [http://papers.nber.org/papers/w9490](http://papers.nber.org/papers/w9490)

V. EXCHANGE RATE REGIMES

VII. THE NEW OPEN ECONOMY MACROECONOMICS

O&R Ch.10
Dixon, Huw (1994) “Imperfect competition and open economy macroeconomics” (VP) Chapter 2

(1) Open Economy DSGE

(2) Popular Closed Economy DSGE for references:
TERM PAPER

The paper should be around 8 to 10 type-written pages, double-spaced, normal sized fonts (10-12 points), and margins (1 inch all around). It will be on a relevant topic in international economics, which may or may not be covered in class. The paper should be preferably an empirical examination of a subject relevant to this class. Think of your paper as the primary ingredient for your dissertation. It may be in either of the following forms (i) An attempt for replication of the results of a published paper; (ii) application of the methodology in a published paper to another data; (iii) a critical review of a collection of articles, and analysis of the issues using data. However, you are more likely to get a better grade if you attempt options (i) and (ii).

The subject you choose must be approved by me in advance. The preparation of your paper requires three steps: (i) A brief proposal: about a page, stating what you plan to write about, motivation, what you expect to find, references and the data you will use; (ii) Presentation: you will present your paper in class; (iii) Final version of the paper.

Possible topics:

- **Financial Crises**: what were the common causes and differences of the financial crises in the 1990s, beginning 2000 in Asia, Latin America, Europe and the 2008? Is there a relation between asset price inflation and financial crises. The role of fiscal policy. Are economies worsened by more integrated (open) financial or goods markets? Why are current accounts countercyclical? do global imbalances lead to crises? Global financial crisis: European debt and financial crisis (how do the sovereign and banking crises feed each other);

- **Income inequality and crises**: what role did the worsening of income distribution play in the business cycles and in particular in the 2008 crises? Is there a connection between: International capital markets and inequality; fiscal/monetary policy and inequality? Does increased inequality lead to increased asset prices? To global imbalances?

- **Macro-Financial Linkages**: Does monetary policy affect banks’ risk taking? Does lax monetary policy lead to crises and if so how?; does globalization (e.g., international banking) weaken the effectiveness of monetary policy? Are highly indebted households more fragile financially (default more)? Does financial fragility vary across countries? Does higher international liquidity increase international imbalances? Do credit ratings affect volatility of private and/or sovereign assets? How does deleveraging (private and public debt) affect long-term growth, how does it correlate with crises? How do balance sheet position of financial intermediaries can generate contagion in sovereign debt markets?

- **Asset Price Volatility**: What distinguishes asset price bubbles from financial instability?
What is financial instability? Is it related to asset bubbles and currency crises? How does it affect growth? Which indicators of financial instability should Central Banks monitor and how should they react to them? How does liquidity in secondary markets affect volatility?

- **Capital markets and macroeconomic volatility**: Procyclical capital flows prevent consumption smoothing. What does this imply for the relation between capital flows and aggregate volatility in developing countries? In developed countries?

- **Capital Flows**: How do short-term vs. long-term capital flows affect the macroeconomic management? Capital flows and business cycles. Capital flows and the political economy variables. Do capital controls control capital flows? Do they affect the economy? Does portfolio investment (hot money) behave differently than foreign direct investment? Role of monetary and fiscal policies in managing the volatility of asset markets and capital flows. What is the connection between components of capital flows and exchange rates? How are flows related to the home bias phenomenon? Do demographic changes affect the composition and the direction of capital flows?

- **International Integration and business cycles**: Currency union in Asia? Do countries benefit from international integration (international trade and international capital flows) compared to a take-off in the domestic productivity? Does international integration synchronize international business cycles? Does it make them worse or better?
  - Old perception: synchronization of business cycles came from trade. Among developed countries not much synchronization, except in Europe after EMU. More evidence that monetary and financial conditions lead to more synchronization: what is the international transmission mechanism of business cycles?

- **Fiscal Policy**: Effect of fiscal policy on consumption and savings: a comparative analysis between Europe and the US or Asia. Are increases in the international synchronization in fiscal impulses responsible for the increase in international business cycles? Are external imbalances due to fiscal policy? What is the effect of public deficits on sovereign bond ratings? What is the effect of sovereign debt on growth and business cycles? Fiscal policy and fiscal consolidation and financial stability; is the conduct of fiscal policy in a low interest environment different? Is there a causal effect between unemployment (hours worked) and fiscal policy? Is Ricardian equivalence supported by the data? How is it affected when tax payers’ concern about future unemployment prospects worsen? Does the budget deficit/surplus in the US, Germany and China affect the current account deficit in developing countries?

- **Europe**: Did the European financial integration change the financial linkages with the United States and Japan? Did the mechanisms and magnitude of the international transmission of shocks via the trade channel change over time? Why is European
unemployment high and persistent? What is the future for fiscal policy in the European Monetary Union? Enlargement problems.

- **Trade and macroeconomics**: Does trade depress wages? How does trade affect business cycles? Income distribution? Which sectors benefit from trade and which sectors lose to it? Do the initial conditions matter?

- **Foreign Aid**: Various sources of help are proposed to help poor countries, such as debt forgiveness, grants, loans, access to international financial markets, access to trade. Which of these possibilities are better for development? Compare for least developed, low income, lower and upper middle income countries.

Useful web sites:
- Nouriel Roubini’s global macroeconomics and financial website [http://www.stern.nyu.edu/globalmacro](http://www.stern.nyu.edu/globalmacro) (look at “recent academic research”)

On-line data relevant for the course:

[http://www.macrohistory.net/data/[macrohistory.net]](http://www.macrohistory.net/data/[macrohistory.net])


- US data [http://www.usc.edu/schools/sppd/research/casden/research](http://www.usc.edu/schools/sppd/research/casden/research)
- Penn World Tables
http://pwt.econ.upenn.edu/

• Real-time data
http://www.phil.frb.org/econ/forecast/readow.html

• International data
https://data.oecd.org/
https://www.bis.org/statistics/index.htm?q=6%7C37

• European data
http://ec.europa.eu/eurostat/data/database

• US Economic Accounts (at the national, regional, industrial and international levels):
http://www.bea.gov/bea

• US International investment positions, balance of payments
http://www.bea.gov/bea/di1.htm
Data links at

• http://pages.stern.nyu.edu/~nroubini/WEBLINKS.HTM