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ECO553: International Macroeconomics and Finance

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Office hours Fisher 306, by appointment

Lectures M 4:30-7:30pm in Fisher B06 (status quo time, may be adjusted)

Overview: This is a second-year Ph.D. course on International Macroeconomics and Finance. The objective of this course is twofold: (1) introduce students to the modern models, tools and methods in International Macroeconomics and (2) discuss the areas of active research in the field and help students navigate among possible topics for dissertation research.

Readings: Below is an extensive reading list in International Macroeconomics. We will be able to cover only a part of it and you are advised to keep reading on your own should you choose to specialize in International Macro. All readings are based on journal articles. There is no textbook for the course, but you are expected to be comfortable with the basic material in Obstfeld and Rogoff "Foundations of International Macroeconomics" textbook, which can be used for background reading.

Please check for the updates to the reading list during the semester.

Requirements: There will be three problem sets which in particular would involve numerical solution of models using MATLAB (or other suitable software). You will be also asked to work through a research paper from the reading list and present your findings in class towards the end of the semester. Finally, there will be a take home exam to be turned in by January 10.

Part I
Intertemporal Trade

1 International Real Business Cycles and Puzzles

E. Mendoza (1991) "Real Business Cycles in a Small Open Economy," AER, 81(4).

D. Backus, P. Kehoe and F. Kydland (1992) "International Real Business Cycles," JPE, 100: 745-775.

M. Aguiar and G. Gopinath (2007) "Emerging Market Business Cycles: The Cycle is the Trend" JPE, 115(1).

M. Obstfeld and K. Rogoff (2000) "Six Puzzles in International Macroeconomics," NBER Macroannual. With comments by C. Engel.

Additional readings:

V.V. Chari, P. Kehoe and E. McGrattan (2005) "Sudden Stops and Output Drops," AER P&P, 95: 381–387.

Blanchard and Kahn (1980) "The Solution of Linear Difference Models under Rational Expectations," Econometrica, 48(5).

Correia, Neves and Rebelo (1995) "Business Cycles in Small Open Economies," EER, 39: 1089-1113.

S. Schmitt-Grohe and M. Uribe (2003) "Closing Small Open Economy Models," JIE, 61(1).

D. Backus and P. Kehoe (1992) "International Evidence on the Historical Properties of Business Cycles," AER, 82(4).

D. Backus, P. Kehoe and F. Kydland (1994) "Dynamics of the Trade Balance and the Terms of Trade: The J-Curve," AER, 84(1).

A. Stockman and L. Tesar (1995) "Tastes and Technology in a Two-Country Model of the Business Cycle," AER, 85(1).

D. Backus and G. Smith (1993) "Consumption and real exchange rates in dynamic economies with non-traded goods," JIE 35: 297-316.

2 International Risk-sharing and Portfolio Choice

2.1 International risk-sharing and portfolio home bias

Kenneth French and James Poterba (1991) "Investor Diversification and International Equity Markets," AER P&P 81(2): 222-226. URL: http://www.jstor.org/stable/2006858.

Robert Lucas (1982) "Interest rates and currency prices in a two-country world," JME 10(3): 335-359.

Harold Cole and Maurice Obstfeld (1991) "Commodity trade and international risk sharing : How much do financial markets matter?" JME 28(1): 3-24.

Karen Lewis (1999) "Trying to Explain Home Bias in Equities and Consumption," JEL 37 (2): 571-608. URL: http://www.jstor.org/stable/2565213.

Heathcote and Perri (2009) "International Diversification Puzzle is not as bad as you think," working paper.

M. Devereux and A. Sutherland (2009) "Country Portfolios in Open Economy Macro Models," JEEA forthcoming.

C. Tille and E. van Wincoop (2010) "International Capital Flows," JIE 80: 157–175.

Additional readings:

Marianne Baxter and Urban Jermann (1997) "The International Diversification Puzzle Is Worse Than You Think," AER 87(1): 170-180.

Anna Pavlova and Roberto Rigobon (2007) "Asset Prices and Exchange Rates," RFS 20(4): 1139-1180.

T. Berriel and S. Bhattarai (2008) "Hedging against the Government: a Solution to the Home Asset Bias Puzzle," unpublished.

Eric van Wincoop and Frank Warnock (2010) "Can trade costs in goods explain home bias in assets?" JIMF 29(6): 1108-1123.

Couerdacier and Gourinchas (2008) "When Bonds Matter: Home Bias in Goods and Assets," working paper.

Mendoza, E., and V. Quadrini (2010) "Financial globalization, financial crises and contagion," JME 57(1): 24-39.

2.2 Endogenously incomplete financial markets

Chamberlain and Wilson. Chapter 16 of LS

Kocherlakota

Alvarez and Jermann

Atkeson. Chapter 23 of LS

Kehoe and Perri

Additional readings:

Tsyrelnikov

Bai and Zhang

3 Current Account and Inter'l Financial Adjustment

3.1 'Old' and 'new' views of Current Account (imbalances)

Obstfeld, M., and K. Rogoff (1995) "The Intertemporal Approach to the Current Account" in *Handbook of International Economics*, Vol. 3 (also available as NBER WP 4893).

Kraay, A., and J. Ventura (2000) "Current Accounts In Debtor And Creditor Countries" QJE 115: 1137-1166.

Caballero, R., E. Farhi, and P.O. Gourinchas (2008) "An Equilibrium Model of 'Global Imbalances' and Low Interest Rates," AER 98: 358-393.

E. Mendoza, V. Quadrini and V. Rios-Rull (2009) "Financial Integration, Financial Development and Global Imbalances," JPE 117(3).

Additional readings:

Obstfeld, M., and K. Rogoff (2007) "The Unsustainable US Current Account Position Revisited," in volume (also available as NBER WP 10869).

Blanchard, O., F. Giavazzi, and F. Sa (2005) "International Investors, the U.S. Current Account, and the Dollar," BPEA 1(2005): 1-49.

Kraay, A., and J. Ventura (2002) "Current Accounts in the Long and the Short Run" *NBER Macroannual*.

Dooley, M., D. Folkerts-Landau and P. Garber (2004) “The Revived Bretton Woods system,” International Journal of Finance and Economics, 9(4): 307-313; and their other writings (see NBER WPs).

Gao, K., and K. Jin (2009) “Composition and growth effects of the current account: a synthesized portfolio view,” JIE 79: 31–41.

3.2 Valuation effects

Lane, P., and G.M. Milesi-Ferretti (2001) “The External Wealth of Nations: Measures of Foreign Assets and Liabilities for Industrial and Developing Countries,” JIE 55: 263–294 (see also their JIE 2007 follow up).

Gourinchas, P.O., and H. Rey (2007) “International Financial Adjustment,” JPE 115(4).

Additional readings:

Campbell, John, and Robert Shiller (1988) “The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors,” *Review of Financial Studies*, 1: 195–228.

Gourinchas, P.O., and H. Rey (2007) “From World Banker to World Venture Capitalist: US External Adjustment and The Exorbitant Privilege,” in volume (also available as NBER WP 11563).

Curcuru, S., T. Dvorak and F. Warnock (2008) “Cross-Border Returns Differentials,” QJE 123(4): 14951530 (see also their JIE 2010 follow up).

A. Pavlova and R. Rigobon (2010) “An asset pricing view of External Adjustment,” JIE 80(1): 144–156. Also see their other papers: RFS, REStud and work in progress.

4 Sovereign Debt, Default, and Sudden Stops

Eaton and Gershovitz

Bulow and Rogoff

Aguiar and Gopinath

Mendoza and Yue

Amador…

Reinhart and Rogoff

Part II
Exchange Rates and Prices

5 International Relative Prices

5.1 PPP Puzzle

K. Rogoff (1996) “The Purchasing Power Parity Puzzle,” JEL 34: 647–668.

C. Carvalho and F. Nechio (2008) “Aggregation and the PPP Puzzle in a Sticky Price Model,” unpublished.

C. Engel (1999) “Accounting for U.S. Real Exchange Rate Changes,” JPE 107: 507–538.

C. Engel and J. Rogers (1996) “How Wide is the Boarder?” AER 86: 1112-1125.

Additional reading:

J. Imbs, H. Mumtaz, M. Ravn, H. Rey (2005) “PPP Strikes Back: Aggregation and the Real Exchange Rate,” QJE 120: 1–43.

S. Chen and C. Engel (2005) “Does ‘Aggregation Bias’ Explain the PPP Puzzle?” *Pacific Economic Review* 10: 49–72.

J. Steinsson (2008) “The Dynamic Behavior of the Real Exchange Rate in Sticky-Price Models,” AER 98: 519-533.

Y. Gorodnichenko and L. Tesar (2009) “Border effect or country effect? Seattle may not be so far from Vancouver after all,” AEJ-Macro 1: 219-241.

Broda, Christian, and David Weinstein (2007) “Understanding International Price Differences using Barcode Data”, unpublished.

G. Gopinath, P.O. Gourinchas, C.T. Hsieh and N. Li (2010) “Estimating the Border Effect: Some New Evidence,” AER forthcoming.

5.2 Pricing-to-market and exchange rate pass-through

A. Atkeson and A. Burstein (2008) “Pricing-to-Market, Trade Costs, and International Relative Prices,” AER 98: 1998–2031.

G. Gopinath and O. Itskhoki (2010) “Frequency of Price Adjustment and Pass-through,” QJE 125(2).

Additional reading:

P. Krugman (1987) "Pricing to Market when the Exchange Rate Changes," in volume.

R. Dornbusch (1987) "Exchange Rate and Prices," AER 77: 93–106.

P. Goldberg and M. Knetter (1997) "Goods Prices and Exchange Rates: What Have We Learned?" JEL 35: 1243–1272.

D. Fitzgerald and S. Haller (2009) "Pricing-to-Market: Evidence From Producer Prices," unpublished.

L. Goldberg and J.M. Campa (2010) "The Sensitivity of the CPI to Exchange Rates: Distribution Margins, Imported Inputs, and Trade Exposure," REStat forthcoming.

P. Goldberg and R. Hellerstein (2008) "A Framework for Identifying the Sources of Local-Currency Price Stability with an Empirical Application," unpublished.

5.3 Currency choice

C. Engel (2002) "Expenditure Switching and Exchange-Rate Policy," NBER Macroannual.

G. Gopinath, O. Itskhoki and R. Rigobon (2010) "Currency Choice and Exchange Rate Pass-through," AER 100(1).

Additional reading:

M. Obstfeld and K. Rogoff (2000) "New directions for stochastic open economy models," JIE 50: 117–153.

G. Gopinath and R. Rigobon (2008) "Sticky Borders," QJE 123: 531–575.

P. Krugman (1980) "Vehicle Currencies and the Structure of International Exchange," JMCB 12(3): 513–26.

P. Bacchetta and E. van Wincoop (2005) "A theory of the currency denomination of international trade," JIE 67: 295–319.

C. Engel (2006) "Equivalence Results for Optimal Pass-Through, Optimal Indexing to Exchange Rates, and Optimal Choice of Currency for Export Pricing," JEEA 4: 1249–1260.

K. Froot, D. Scharfstein and J. Stein (1993) "Risk Management: Coordinating Corporate Investment and Financing Policies," JF 48: 1629–1658.

5.4 Alternative models of real exchange rate

O. Blanchard (2007) "Adjustment within the Euro. The Difficult Case of Portugal," *Portuguese Economic Journal*, 6: 1–21.

R. Caballero and G. Lorenzoni (2008) "Persistent Appreciations and Overshooting: A Normative Analysis," REStud forthcoming.

G. Gopinath (2004) "Lending booms, sharp reversals and real exchange rate dynamics," JIE 62: 1–23.

6 Nominal Exchange Rate

6.1 Nominal exchange rate disconnect

R. Meese and K. Rogoff (1983) "Empirical Exchange Rate Models of the Seventies: Do They Fit Out of Sample?" JIE 14: 3–24.

M. Evans and R. Lyons (2005) "Meese-Rogoff Redux: Micro-Based Exchange Rate Forecasting," AER P&P.

C. Engel and K. West (2005) "Exchange Rates and Fundamentals" JPE 113: 485–517.

C. Engel, N. Mark and K. West (2007) "Exchange Rate Models Are Not as Bad as You Think," NBER Macroannual. With comments by K. Rogoff.

Additional reading:

M. Evans and R. Lyons (2002) "Order Flow and Exchange Rate Dynamics," JPE: 170–180.

6.2 Forward premium puzzle

E. Fama (1984) "Forward and Spot Exchange Rates," JME 14: 319–338.

F. Alvarez, A. Atkeson and P. Kehoe (2010) "Time varying risk, interest rates, and exchange rates in general equilibrium," REStud.

Additional reading:

H. Lustig and A. Verdelhan (2007) "The Cross-Section of Foreign Currency Risk Premia and US Consumption Growth Risk," AER. See also a comment by C. Burnside and their response.

C. Burnside, M. Eichenbaum and S. Rebelo (2009) "Understanding the Forward Premium Puzzle: A Microstructure Approach," AEJ-Macro 1: 127–154.

C. Burnside, M. Eichenbaum, I. Kleshchelski and S. Rebelo (2009) "Do Peso Problems Explain the Returns to the Carry Trade?" unpublished.

E. Farhi and X. Gabaix (2008) "Rare Disasters and Exchange Rates," unpublished.

6.3 Currency unions

J.M.C. Santos Silva and S. Tenreyro (2010) "Currency Unions in Prospect and Retrospect," *Annual Review of Economics*.

Additional reading:

Galí and Monacelli

Chari and Kehoe

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7 Two-country DSGE Models with Nominal Frictions

P. Lane (2001) "The New Open Economy Macroeconomics: A Survey," JIE 54: 235–266.

Additional reading:

V.V. Chari, P. Kehoe and E. McGrattan (2002) "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" REStud 69: 533-563.

Corsetti and Pesenti

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