

Department of Economics, Yale University
International Finance 724b

Syllabus

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Class time: Th 3:00-6:00

Office hours: Tu, 4:45-6:15 & by apt

DESCRIPTION

This class addresses the following main topics: exchange rate determination in open economy models, failures of the law of one price and pricing to market, international business cycles transmission in general equilibrium models, exporter dynamics, short and long run adjustments of trade flows, determinants of international capital flows and multinational production. The readings for the class will be equally split between theory and empirical papers. We will discuss stylized facts and the empirical performance of the models on these facts as well as major theoretical puzzles. We will also discuss topics for new research questions on the empirical and theoretical front.

There will be no final exams but there will be 3 problem sets, 1 presentation and a take home final each counting towards 20% of the final grade.

TEXTBOOK/ CLASS NOTES

There will not be a particular reference for the course. However, a good book is Obstfeld and Rogoff, 1996, "Foundations of International Macroeconomics," MIT Press.

Useful notes can also be found in the following websites:

L. Drozd: <http://www.ssc.wisc.edu/~ldrozd/871.htm>

A. Ramanarayanan <http://sites.google.com/site/ananthramanarayanan/9613a>

M. Uribe: <http://www.columbia.edu/~mu2166/GIM/GIM.html>

Class notes will also be distributed

TOPICS AND TENTATIVE DATES

Note: the material below is quoted in the (tentative) order that they will be mentioned in class (topics and papers). Papers indicated, as 'other readings' is potential material for class presentations.

Tentative Class Schedule

International Real Business Cycles (Week 1-2)

In Class

HP filter, in class notes

Mendoza, E., 1991, "Real Business Cycles in a Small Open Economy," *American Economic Review*, 81, 797-818

Backus, D., P. Kehoe, and F. Kydland, 1992, "International Real Business Cycles," *Journal of Political Economy*, 100, 745-775.

Backus, D., P. Kehoe and F. Kydland, 1994, "Dynamics of the Trade Balance and the Terms of Trade: The J-Curve?" *American Economic Review*.

Stockman, A., and Linda L. Tesar, 1995, "Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Comovements," *American Economic Review*, 85, 168-85.

Drosz, L., and J. Nosal, 2010, "Understanding International Prices: Customers as Capital," forthcoming *American Economic Review*.

Other Readings

Backus, D., and G. Smith, 1993, "Consumption and Real Exchange Rates in Dynamic Economies with Nontraded Goods," *Journal of International Economics*, 297-316.

Baxter, M., 1993, "International Trade and Business Cycles," in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics* vol. 3, 1995.

Obstfeld, M., and K. Rogoff, 1995, "The Intertemporal Approach to the Current Account," in G. Grossman and K. Rogoff (eds.) *Handbook of International Economics* vol. 3.

International Risk Sharing and Incomplete Markets (Week 3-4)

In class

Baxter, M., and U. Jermann, 1997, "The International Diversification Puzzle is Worse than You Think," *American Economic Review*, 87, 170-180.

Heathcote, J. and F. Perri, 2007 "International diversification is not as bad as you think," manuscript. University of Minnesota.

Martin, F., and C. Horioka, 1980, "Domestic Saving and International Capital Flows," *The Economic Journal*, vol 90, No. 358, pp. 314-329.

Bai, Y., and J. Zhang, "Can Financial Frictions Account for the Cross-Section Feldstein-Horioka Puzzle?" forthcoming *Econometrica*.

Kehoe, P., and F. Perri 2000 "International Business Cycles with Endogenous Incomplete Markets," *Econometrica*.

Heathcote, J., and F. Perri, 2002, "Financial Autarky and International Real Business Cycles," *Journal of Monetary Economics*, 49, 601-627.

Other Readings

Baxter, M., and M. Crucini, 1993, "Explaining Saving-Investment Correlations," *American Economic Review*.

Corsetti, G., L. Dedola and Sylvain Leduc, 2008, "International Risk Sharing and the Transmission of Productivity Shocks," *Review of Economic Studies*, 75, 443–473.

Lewis, K., 1999, "Trying to Explain Home Bias in Equities and Consumption," *Journal of Economic Literature*, 571-608.

Global Imbalances (Week 4-5):

In class

Gourinchas, P., 2007, "International Financial Adjustment," *Journal of Political Economy*, 115, 665-703.

Caballero, R., E. Fahri, and P. Gourinchas, 2008, "An Equilibrium Model of 'Global Imbalances' and Low Interest Rates," *American Economic Review*, 98, 358–393.

Mendoza, E., V. Quadrini, and V. Rios-Rull. 2009. "Financial Integration, Financial Development, and Global Imbalances." *Journal of Political Economy* 117, 371-416.

Other Readings

Ferrero, A., 2007, "The Long-Run Determinants of the U.S. External Imbalances," Working Paper, Federal Reserve Bank of New York.

Obstfeld, M. and K. Rogoff (2005): "Global Current Account Imbalances and Exchange Rate Adjustments," *Brookings papers on Economic Activity*, 2005, 67-146.

Puzzles and new directions in international macroeconomics. (Week 5-6)

In Class

Obstfeld, M., and K. Rogoff, "Six major puzzles in International Macroeconomics," NBER Macro Annual, 2000, plus C. Engel "Comment."

Lewis, K., 1995, "Puzzles in International Finance," *Handbook of International Economics*, Volume 3, Grossman, Gene M., Rogoff, Kenneth, eds.

Lucas, R., 1990, "Why doesn't capital flow from rich to poor countries?" *American Economic Review*, 1990.

Rogoff, K., 1996, "The Purchasing Power Parity Puzzle." *Journal of Economic Literature* 34, 647-668.

Other Readings

Gourinchas, P. and O. Jeanne, 2009, "Capital Flows to Developing Countries: The Allocation Puzzle"

Aguiar, M. and G. Gopinath, 2007. "Emerging Market Business Cycles: The cycle is the Trend," *Journal of Political Economy*.

Uribe, M. and V. Yue. 2005. "Country Spreads and Emerging Countries: Who Drives Whom?" *Journal of International Economics*.

Obstfeld M., and K. Rogoff, 2000, "New Directions for Stochastic Open Economy Models," *Journal of International Economics*.

Bergin, P., R. Glick, and J. Wu, 2009, "The Macro-micro Disconnect of Purchasing Power Parity, NBER working paper 15624.

International Price Setting (6-7)

In class

Engel, C., and J. Rogers, 1996, "How Wide Is the Border? The American Economic Review 86, 1112-1125

Broda, C., and D. Weinstein, 2008, "Understanding International Price Differences using Barcode Data," working paper.

Gopinath, G., P. Gourinchas, and Chang-Tai Hsieh, 2010, "Cross-Border Prices, Costs, and Markups", forthcoming, American Economic Review.

Atkeson, A., and A. Burstein, 2007, "Pricing to Market in a Ricardian Model of International Trade." American Economic Review: Papers and Proceedings 97, 362-367.

Atkeson, A., and A. Burstein, 2008, "Pricing to Market, Trade Costs, and International Relative Prices." American Economic Review, 98, 1998-2031.

Other readings

Gorodnichenko, Y., and L. Tesar, 2008, "Border effect or country effect? Seattle may not be so far from Vancouver after all," American Economic Journal: Macroeconomics 1, 219-241.

Gopinath, G., and R. Rigobon, 2008, "Sticky Borders," Quarterly Journal of Economics 123, 531-575.

Manova, K., and Z. Zhang, 2010, "Export Prices across Firms and Destinations," mimeo, Stanford.

Exchange Rates (Week 7-8)

In class

Engel, C., 1999, "Accounting for U.S. Real Exchange Rate Changes Accounting for U.S. Real Exchange Rate Changes" The Journal of Political Economy 107, 507-538.

Engel, C., and K. West, 2005, "Exchange Rates and Fundamentals." Journal of Political Economy 113, 485-517.

Betts, K., and T. Kehoe, 2006, "U.S. real exchange rate fluctuations and relative price fluctuations," Journal of Monetary Economics 53, 1297-1326.

Dornbusch, R., 1976, "Expectations and Exchange Rate Dynamics," Journal of Political Economy, 6.

Chari, V.V., P. Kehoe, and E. McGrattan, 2002, "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" Review of Economic Studies 63, 533-563.

Other readings

Obstfeld, M., and K. Rogoff, 1995, "Exchange Rate Dynamics Redux," Journal of Political Economy, 103, 31.

Engel, C., 2000, "Long Run PPP May Not Hold After All," Journal of International Economics 51, 243-273.

Crucini, M., C. Telmer, and M. Zachariadis, 2005, "Understanding European Real Exchange Rates," American Economic Review, 95, 724-738.

Sovereign Default (Week 9)

In class

Eaton, J., and M. Gerkovitz, 1981, "Debt with Potential Repudiation: Theoretical and Empirical Analysis," *Review of Economic Studies*, 48, 289-309.

Eaton, J., and R. Fernandez, "Sovereign Debt," *Handbook of International Economics*, ed. Grossman G. and S. Rogoff.

Arellano C., 2008, "Default Risk and Fluctuations in Emerging Economies" *American Economic Review*, 98, 690-712.

Other readings

Aguiar, M., and G. Gopinath, 2006, "Defaultable Debt, Interest Rates and the Current Account" *Journal of International Economics*, 69, 64-83.

Arellano, C., and A. Ramanarayanan, 2009, *Default and Maturity Structure in Sovereign Bonds*, mimeo, University of Minnesota.

Bulow, J., and K. Rogoff, 1989, "Sovereign Debt: Is to Forgive or Forget," *American Economic Review*, 79, 43-50.

Capital Flows and Multinational Production (Week 10-11)

In Class

McGrattan, E., and E. Prescott, 2008, 2010. "Technology Capital and the US Current Account." *American Economic Review*, 100, 1493–1522.

McGrattan, E., and E. Prescott, 2009, "Openness, technology capital, and development," *Journal of Economic Theory*, 144, 2454-2476.

Ramondo, N., (2006) "Size, Geography, and Multinational Production," mimeo, University of Texas.

Helpman, E., M. Melitz, and S. Yeaple, 2003, "Exports vs. FDI with Heterogeneous Firms", *American Economic Review*, 94, 300-316.

Ramondo, N., and A. Rodriguez-Clare, 2008 "The Gains from Openness: Trade, Multinational Production, and Diffusion," mimeo, PSU and University of Texas.

Arkolakis C., N. Ramondo, A. Rodriguez-Clare, and Yeaple, "TBA"

Other readings

Antras, P., and E. Helpman (2004) "Global Sourcing," *Journal of Political Economy*, 112: 552-580.

Burstein, A. and A. Monge-Naranjo, 2009, "Foreign Know-How, Firm Control, and the Income of Developing Countries," *Quarterly Journal of Economics*, 124, 149-195.

Numerical Methods (will be used to analyze and solve papers presented during class)

King, R., Plosser, C., and Rebelo, S., "Production, Growth and Business Cycles: Technical Appendix," Available at

<http://www.kellogg.northwestern.edu/faculty/rebelo/htm/kprnew.pdf>

Klein, P., "Using the Generalized Schur Form to Solve a Multivariate Linear Rational Expectations Model," *Journal of Economic Dynamics and Control*, 24, 2000, 1405-1423.

Schmitt-Grohe, S. and M. Uribe, "Solving Dynamic General Equilibrium Models Using a Second-Order Approximation to the Policy Function," *Journal of Economic Dynamics and Control*, vol. 28, January 2004, pp. 755-775.

Uhlig H., (1999), "A Toolkit for Analyzing Nonlinear Dynamic Stochastic Models Easily.", In **Computational Methods for the Study of Dynamic Economies**, Ramon Marimon and Andrew Scott (editors), Oxford University Press, available at www2.wiwi.hu-berlin.de/wpol/html/toolkit/toolkit.pdf