

**International Finance: Reading List**  
**Economics 642: Winter 2005**  
**Linda Tesar**

This is a doctoral level course in international finance and macroeconomics. Topics covered in the course include the intertemporal approach to the current account, international business cycles, international risksharing and home bias, purchasing power parity, models of exchange rate determination, balance of payments crises, financial market contagion and alternative exchange rate regimes.

**Sources:**

General reference materials for the course are:

*Foundations of International Macroeconomics*, by Maurice Obstfeld and Kenneth Rogoff, Cambridge, MA, MIT Press, 1996. (Denoted by FIM in the readings below.)

*The Handbook of International Economics*, ed. by Gene Grossman and Kenneth Rogoff, North Holland - Elsevier Press, 1996 (denoted HIE.)

*Recursive Macroeconomic Theory*, by Lars Ljungqvist and Thomas J. Sargent, Cambridge, MA MIT Press, 2000.

The Handbook will be placed on reserve in Foster Library. Articles can be downloaded from the journal websites (link from the Economics Department homepage to Foster Library to the journals collection), from JSTORE, Science Direct, ProQuest or from the NBER Working papers site (<http://www.nber.org/>). If you have trouble locating a particular article, please let me know and I will make copies available.

**Requirements:**

1. Term Paper (50% of final grade). The paper should be an original piece of research on a topic in the field of international finance. The paper may not be jointly submitted for this course and another graduate course. You should plan to meet with me regularly in the first weeks of the semester to help select a paper topic. You should have selected a topic by the 6<sup>th</sup> week of class. Papers are due the last day of finals.
2. Final exam (50%)

Course Outline and Readings:

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**1. REAL MODELS OF INTERTEMPORAL TRADE AND CURRENT ACCOUNT DYNAMICS**

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**1.A. Small open economy**

FIM, chapters 1 – 3.

Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, ch. 1-3.

Obstfeld and Rogoff, “The intertemporal approach to the current account,” HIE ch. 1, sections 1 – 3.1.

Obstfeld, M., “Capital Mobility in the World Economy: Theory and Measurement,” *Carnegie-Rochester Conference Series on Public Policy* 24, 1986, pp. 55-104

Feldstein, M. and C. Horioka, “Domestic Saving and International Capital Flows,” *Economic Journal* 90, 1980.

Taylor, A., “International Capital Mobility in History: the Savings-Investment Relationship,” NBER WP 5743.

Tesar, L., “Savings, Investment and International Capital Flows,” *Journal of International Economics* 31, August 1991.

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Mendoza, E., “Real Business Cycles in a Small Open Economy: The Canadian Case,” *AER* 1991.

Schmitt-Grohe and Uribe, "Closing Small Open Economy Models" *JIE* 2003.

Obstfeld and Rogoff, "The Unsustainable US Current Account Position Revisited" NBER WP 2004.

### 1.B. Two-Country Models

- FIM, chapter 3 (in particular sections 3.2-3.5).

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

Stockman, A., and L. Tesar, "Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Co-Movements," *AER* 1995.

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

Baxter, M. "International Trade and Business Cycles," *HIE*, chapter 35.

Baxter, M. and M. Crucini, "Explaining Savings-Investment Correlations," *AER* 1992.

Costello, D. "A Cross-Country, Cross-Industry Comparison of the Behavior of Solow Residuals," *JPE* 1993.

Heathcote and Perri, "Financial Globalization and Real Regionalization" *JET* November 2004.

Burstein, Kurz and Tesar, "International Trade, Production Sharing and the Transmission of Business Cycles" Working Paper December 2004

### 2. INTERNATIONAL CONSUMPTION CORRELATIONS, GAINS FROM RISKSHARING AND HOME BIAS

FIM, Chapter 5.

Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, ch. 7.

- Lucas, R.E., "Interest Rates and Currency Prices in a Two-Country World," *Journal of Monetary Economics* 10, 1982.

Lewis, K., "Puzzles in International Financial Markets," *HIE* chapter 37, section 2.

Lewis, K., "What Can Explain the Apparent Lack of Consumption Risksharing?" *JPE* April 1996.

French, K. and J. Poterba, "Investor Diversification and International Equity Markets," *AER* 1991.

Tesar, L. and I. Werner, "Home Bias and High Turnover," *Journal of International Money and Finance*, 1994.

- Coval and Moskowitz, "Home Bias at Home: Local equity preference in domestic portfolios," *Journal of Finance*, 1999.

- Lewis, K. "Why do stocks and consumption imply such different gains from international risksharing," *Journal of International Economics* 52, 2000, pp. 1-35.

Davis, Nalewaik and Willen, "On the gains to international trade in risk financial assets," NBER WP 7795.

Chari and Henry, "Risk Sharing and Asset Prices: Evidence from a Natural Experiment" NBER WP 8988, *Journal of Finance* June 2004.

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

### **3. THE LAW OF ONE PRICE, PPP AND EXCHANGE RATE PASS-THROUGH**

FIM, Chapter 4 and Chapter 10, pp. 711-712.

Engle, C. and J. Rogers, "How Wide is the Border?" *AER* December 1996.

Rogoff, K., "The Purchasing Power Parity Puzzle," *Journal of Economic Literature*, June 1996.

Gorodnichenko and Tesar, "A Re-examination of the Border Effect in tests of PPP" Working paper, September 2004.

Engel, C., "Accounting for U.S. real exchange rate changes," *JPE* June 2000.

Engel, C., "Long-run PPP may not hold after all," *JIE* 57 (2000), pp. 243-273.

Lewis, K., "Puzzles in International Financial Markets," HIE chapter 37, section 1.

Burstein, Eichenbaum and Rebelo, "Why is inflation so low after large devaluations? NBER Working paper 8748.

Burstein, Eichenbaum and Rebelo, "Large devaluations and the real exchange rate," UCLA working paper.

#### 4. NOMINAL EXCHANGE RATES

##### 4.1 Flexible price models and the empirical evidence:

FIM, Chapter 8, Sections 8.1-8.3.

Lucas, R.E., "Interest Rates and Currency Prices in a Two-Country World," *Journal of Monetary Economics* 10, 1982.

Svensson, L.E.O., "Currency Prices, Terms of Trade and Interest Rates: A General Equilibrium Asset-Pricing, Cash-in-Advance Approach," *JIE* 1985

Meese, R. and K. Rogoff, "Empirical exchange rate models of the Seventies: Are any fit to Survive?" *JIE* 14, 1983.

Frankel, J. and A. Rose, "Empirical Research on Nominal Exchange Rates," *HIE* chapter 33.

Kilian and Taylor, "Why is it so difficult to beat the random walk forecast of exchange rates" *JIE* 2003.

Mark, N., "Exchange Rates and Fundamentals: Evidence on Long-Horizon Predictability" *AER* 1995.

Kilian, L., "Exchange Rates and Monetary Fundamentals: What do we learn from long-horizon regressions?" forthcoming in the *Journal of Applied Econometrics*.

##### 4.2 Alternative models

*FIM*, Chapter 9.

See also Nelson Mark, chapter 9.

Obstfeld and Rogoff, "Exchange Rate Dynamics Redux," *JPE* 1995.

Obstfeld and Rogoff, "The six major puzzles in international macroeconomics: Is there a common cause?" NBER Working Paper 7777, 2000.

Betts, C. and M. Devereux, "Exchange rate dynamics in a model of pricing-to-market," *JIE* February 2000.

Chari, Kehoe and McGrattan, "Monetary Shocks and Real Exchange Rates in Sticky Price Models of International Business Cycles," *REStud* 2002.

Alvarez, F., A. Atkeson, and P. Kehoe, "Money, interest rates, and exchange rates with endogenously segmented asset markets," *JPE* 2002.

## **5. BALANCE OF PAYMENTS CRISES, SUDDEN STOPS AND CONTAGION**

FIM pp. 379-389.

Garber, P., and L. Svensson, "The Operation and Collapse of Fixed Exchange Rate Regimes," *HIE* chapter 36.

Krugman, P., "A Model of Balance of Payments Crises," *JMCB*, 1979.

Forbes and Rigabon, "No Contagion, Only Interdependence: Measuring Stock Market Comovements," *Journal of Finance* October 2002.

Kodres and Pritsker, "A Rational Expectations Model of Financial Contagion," *Journal of Finance* 2002.

Bekaert, Harvey and Ng, "Market integration and contagion," NBER WP 9510.

Chari and Kehoe, "Hot Money," *JPE* 2003

Chari and Kehoe, "Financial crises as herds: Overturning the critiques," NBER WP 9658

Arellano and Mendoza, "Credit frictions and sudden stops in small open economies: An equilibrium business cycle framework for emerging markets crises," NBER WP 8880.

Mendoza and Smith, "Margin calls, trading costs and asset prices in emerging markets: The financial mechanics of the sudden stop phenomenon," NBER WP 9286.

Calvo, G. and E. Mendoza, "Reflections on Mexico's Balance of Payments Crisis: A Chronicle of a Death Foretold," *JIE* 1996.

Calvo and Mendoza, "Rational contagion and the globalization of securities markets," *JIE* June 2000.

## **6. EXCHANGE RATE BASED STABILIZATIONS**

Mendoza, E. and M. Uribe, "Devaluation Risk and the Syndrome of Exchange-Rate-Based Stabilizations and the Uncertain Duration of Currency Pegs," NBER Working Paper 7014, 1999.

Burstein, Neves and Rebelo, "Distribution Costs and Real Exchange Rate Dynamics During Exchange-Rate-Based Stabilizations," NBER Working Paper 7862.