

International Macroeconomics Prospectus

Professor: Ethan Kaplan

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This course will focus on the main area of research in international macroeconomics and international finance: the determination of the exchange rate and the determination of the current account. The exchange rate will be studied in both regular modes and crisis modes under fixed, floating and currency band models. The current account will be studied in both regular as well as crisis modes, incorporating both determinants of levels as well as sustainability issues. The course will begin with a 2-period and then an infinite horizon real-side model of current account determination. Current account determination will then be revisited in the presence of uncertainty. Uncertainty leaves open the possibility of default (Obstfeld-Rogoff, Chapters 1, 2, and 5). The course will then continue with models of sovereign default (Bulow-Rogoff, 1989). Recent theoretical as well as empirical work will be considered. Then, the course will turn from quantities to prices and from the real side to the nominal side of the economy, looking at exchange rate determination. The first topic on exchange rate determination will be PPP models. We will discuss empirical work on whether or not there is convergence to PPP in the long and short run. Then, we will look at Dornbusch's sticky-price model of exchange rate determination (Dornbusch, 1976). We will explore heterogeneous information models of flexible exchange rate determination. Krugman's currency band model (Krugman, 1991) will also be considered. The course will then consider more recent new open economy macroeconomic models of exchange rate determination, starting with Obstfeld-Rogoff (1994). Included in the new open economy macro discussion will be recent work on the impact of net asset holdings in exchange rate and current account determination. The last topic will be models of currency crisis. Starting with Krugman's first-generation model, we will consider second generation models (Obstfeld, 1996), third generation models (Aghion, Bacchetta, and Banerjee, 2001), and imperfect common knowledge models of exchange rate determination (Morris and Shin, 1998).

The course requirements will be 3 bi-weekly problems sets and one 15-20 page final research paper with 45% weighting on the homework and 40% on the paper. Also, there will be one extra session where each student presents (half an hour) one recent paper from international macroeconomics drawn from the literature (followed by lunch or dinner) on a date yet to be decided. The paper should be chosen by the student but approved by me.

Note: Starred readings will be covered in class; readings with two stars will be covered in detail; other readings are suggested for those interested in international macroeconomics and international finance.

Reading List

Textbooks:

Nelson C. Mark, *International Macroeconomics and Finance: Theory and*

Econometric Methods (Blackwell Publishers, 2001) (Denoted Mark)

Maurice Obstfeld and Kenneth Rogoff, *Foundations of International Macroeconomics* (MIT Press, 1996). (Denoted Obstfeld-Rogoff)

Section I: Real Side Models of the Current Account:

** Obstfeld-Rogoff, Chapters 1, 2 and 5

** Kraay, A. and J. Ventura, "[Current Accounts in Debtor and Creditor Countries](#)," *Quarterly Journal of Economics* 115(4), November 2000.

Jaume Ventura, "[A Portfolio View of the US Current Account Deficit](#)," *Brookings Papers in Economic Activity*, Spring 2001.

Jaume Ventura, "[Towards a Theory of Current Accounts](#)," *The World Economy* 26(4), April 2003, 483-512.

Section II: Current Account Sustainability:

Obstfeld-Rogoff, pp. 349-379.

** Bulow, Jeremy and Kenneth Rogoff, "[Sovereign Debt: Is to Forgive to Forget?](#)" *American Economic Review* 79 (March 1989), 43-50.*

Amador, Manuel, "[A Political Economy Model of Sovereign Debt Repayment](#)," mimeo, Stanford University.

Kletzer, Kenneth and Brian Wright (2000), "Sovereign Debt as Intertemporal Barter", *American Economic Review*, 90 (3): 621-39.

** Carmen M. Reinhart, Kenneth Rogoff and Miguel A. Savastano, "[Debt Intolerance](#)," in William Brainard and George Perry (eds.), *Brookings Papers on Economic Activity* 1: 2003, 1-74.

Section III: Exchange Rate Determination

** Meese, Richard and Kenneth Rogoff, "Empirical Exchange Rate Models of the Seventies: Do They Fit Out of Sample?", *Journal of International Economics* 14 (February 1983): 3-24.

Charles Engel, "[Accounting for US Real Exchange Rate Changes](#)," *Journal of Political Economy* 107(3), June 1999, 507-538.

* Bacchetta, Philippe and Eric Van Wincoop, "Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?", forthcoming, *American Economic Review*

* Kenneth Rogoff, "[The Purchasing Power Parity Puzzle](#)," *Journal of Economic Literature* 34, June 1996, 647-68.*

* Jean Imbs, Haroon Mumtaz, Morton O. Ravn, Helene Rey, "[PPP Strikes Back: Aggregation and the Real Exchange Rate](#)," forthcoming *Quarterly Journal of Economics*.*

** Engel, Charles and Kenneth West, "Exchange Rates and Fundamentals", *Journal of Political Economy* 113 (June 2005): 485-517.

** Evans, Martin and Richard Lyons, "Meese and Rogoff Redux: Micro-Based Exchange Rate Forecasting", forthcoming *American Economic Review*.

Dornbusch, Rudiger, "Expectations and Exchange Rate Dynamics," *Journal of Political Economy* 84 (December 1976): 1161-76.

Rogoff, Kenneth, "Dornbusch's Overshooting Model after 25 Years," *IMF Staff Papers* 49 (Special Issue 2002): 1-34.

<http://www.imf.org/external/pubs/ft/wp/2002/wp0239.pdf>

** Obstfeld-Rogoff, chapters 8.1-8.2, 9.1-9.4

Krugman, Paul R., "Target Zones and Exchange Rate Dynamics," *Quarterly Journal of Economics* 106 (August 1991): 669-82.

Mark, chapter 10.

Section IV: Exchange Rate Determination and New Open Economy Macroeconomics

* Lane, Philip, "The New Open Economy Macroeconomics: A Survey," *Journal of International Economics* 54 (August 2001): 235-66.

* Obstfeld-Rogoff, chapter 10.

Bowman, David, and Brian M. Doyle, "New Keynesian, Open-Economy Models and Their Implications for Monetary Policy," International Finance Discussion Papers 762, Board of Governors of the Federal Reserve System, March 2003.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=392402

Chari, V. V., Patrick J. Kehoe, and Ellen McGrattan, "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" *Review of Economic Studies* 69 (August 2002): 533-63.

** Corsetti, Giancarlo, and Paolo Pesenti, "The Simple Geometry of Transmission and Stabilization in Closed and Open Economy," manuscript, European

University Institute and FRBNY, November 2004.

Devereux, Michael B., and Charles Engel, "Monetary Policy in the Open Economy Revisited: Price Setting and Exchange-Rate Flexibility," *Review of Economic Studies* 70 (October 2003): 765-83.
<http://ideas.repec.org/a/bla/restud/v70y2003i4p765-783.html>

See also Brian Doyle's [New Open Economy Macroeconomics Homepage](#).

Maurice Obstfeld and Kenneth Rogoff, "[New Directions in Stochastic Open Economy Models](#)," *Journal of International Economics* 50(1) (February 2000), 117-153.* Also NBER WP 7313.

** Gourinchas, Pierre-Olivier, and Helene Rey, "International Financial Adjustment," manuscript, UC Berkeley and Princeton, July 2004.

* Cabellero, Ricard, Emmanuel Farhi and Pierre-Olivier Gourinchas, "An Equilibrium Model of 'Global Imbalances' and Low Interest Rates", working paper.

Section V: Currency Crises

** OR, pp. 558-67, 576-78, 648-653.

* Krugman, Paul R. "A Model of Balance-of-Payments Crises," *Journal of Money, Credit and Banking* 11 (August 1979): 311-25.

* Obstfeld, Maurice, "Models of Currency Crisis with Self-Fulfilling Features," *European Economic Review* 40 (April 1996): 1037-47.

** Morris, Stephen, and Hyun Song Shin, "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," *American Economic Review* 88 (June 1998): 587-97.

* * Phillippe Aghion, Philippe Bacchetta, and Abhijit Banerjee, "Financial Development and the Instability of Open Economies," [NBER Working Paper No. 10246](#). *Journal of Monetary Economics*, forthcoming 2004.

* Calvo, Guillermo A., and Carmen M. Reinhart, "Fear of Floating," *Quarterly Journal of Economics* 117 (May 2002): 379-408.

alvo, Guillermo A., and Frederic S. Mishkin, "The Mirage of Exchange Rate Regimes for Emerging Market Countries," *Journal of Economic Perspectives* 17 (Fall 2003): 99-118.

Chang, Roberto, and Andres Velasco, "A Model of Financial Crises in Emerging Markets," *Quarterly Journal of Economics* 116 (May 2001): 489-517.

Graciela Kaminsky and Carmen Reinhart, "[The Twin Crises: The Causes of Banking and Balance of Payments Problems](#)," *American Economic Review* 89, June 1999, 473-500. [Click here for access to data base](#).