

# International Monetary Economics

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## **Prerequisites**

316-612 Macroeconomics and 316-470 Advanced Econometric Techniques (or equivalent)

## **Contact**

Three hours of lectures and seminars per week

## **Formal subject description**

This subject is concerned with recent theoretical and empirical research. Topics covered include: intertemporal approach to international macroeconomics: savings, investment and the current account: debt, deficits and growth: nominal and real exchange rate models.

## **Assessment**

Final examination worth 70% and homework assignments worth a total of 30%

## **Texts**

Luckily, there is a superb advanced textbook on international macroeconomics. All students should buy

- Maurice Obstfeld and Kenneth Rogoff. 1996. *Foundations of international macroeconomics*. Cambridge, MA: MIT Press

## **Informal subject description**

This course is designed to provide students with an advanced introduction to international macroeconomics. We will cover topics such as: savings, investment, and the current account; purchasing power parity, the real exchange rate and terms of trade; international financial markets, risk sharing, and asset pricing; money and exchange rates.

This year I am primarily going to teach 316-632 as a “topics” class. I will spend about six weeks covering background material and we will then turn to a detailed discussion of a provocative paper by Obstfeld and Rogoff:

- Maurice Obstfeld and Kenneth Rogoff. 2000. The six major puzzles in international macroeconomics: Is there a common cause? in Ben Bernanke and Kenneth Rogoff (eds). *NBER macroeconomics annual*. Cambridge, MA: MIT Press

The six puzzles referred to in the title are:

1. The home bias in international trade puzzle: why are international goods markets so segmented?
2. The Feldstein-Horioka puzzle: why are savings and investment rates so positively correlated in OECD countries? (i.e., why is international capital mobility between industrialised countries so limited?)
3. The home bias in equity portfolios puzzle: why don't stockholders avoid unnecessary exposure to idiosyncratic, home-country-specific risks?
4. The international consumption correlations puzzle: why is the correlation of consumption growth between pairs of industrial countries so *low*? If citizens completely share risks, consumption growth correlations should be near one.
5. The purchasing power parity puzzle: why do shocks to real exchange rates take so long to dissipate?
6. The exchange rate disconnect puzzle: why are exchange rate movements so volatile and so seemingly disconnected from movements in economic fundamentals?

After that, and if time is on our side, we'll try to reproduce a recent paper by Chari, Kehoe and McGrattan:

- V.V. Chari, Patrick Kehoe, and Ellen McGrattan. 2002. Can sticky price models generate volatile and persistent real exchange rates? *Review of Economic Studies*. 69(3): 533-563

## Articles that we will discuss along the way

A number of other articles will also come up for discussion at various points in the course. A representative list of these is given below:

- David Backus, Patrick Kehoe and Finn Kydland. 1992. International real business cycles, *Journal of Political Economy*. 104(6): 1227-1262
- David Backus, Patrick Kehoe and Finn Kydland. 1995. International business cycles: Theory and evidence, in Thomas Cooley (ed). *Frontiers of business cycle research*. Princeton, NJ: Princeton University Press
- David Backus and Gregor Smith. 1993. Consumption and real exchange rates in dynamic economies with non-traded goods, *Journal of International Economics*. 35(3/4): 297-316

- Caroline Betts and Michael Devereux. 1996. The exchange rate in a model of pricing to market, *European Economic Review*. 40(3/5): 1007-1021
- Caroline Betts and Michael Devereux. 2000. Exchange rate dynamics in a model of pricing to market, *Journal of International Economics*. 50(1): 215-244
- Harold Cole and Maurice Obstfeld. 1991. Commodity trade and international risk sharing: How much do financial markets matter? *Journal of Monetary Economics*. 28(1): 3-24
- Michael Devereux and Charles Engel. 2003. Monetary policy in the open economy revisited: Price setting and exchange rate flexibility, *Review of Economic Studies*. 70(4): 765-783
- Rudiger Dornbusch. 1976. Expectations and exchange rate dynamics, *Journal of Political Economy*. 84(6): 1161-1176
- Charles Engel and John Rogers. 1996. How wide is the border? *American Economic Review*. 86(5): 1112-1125
- Charles Engel. 1999. Accounting for US real exchange rate changes, *Journal of Political Economy*. 107(3): 507-538
- Eugene Fama. 1984. Forward and spot exchange rates, *Journal of Monetary Economics*. 14(3): 319-338
- Robert Kollmann. 1995. Consumption, real exchange rates, and the structure of international asset markets, *Journal of International Money and Finance*. 14(2): 191-211
- Karen Lewis. 1999. Trying to explain the home bias in equities and consumption, *Journal of Economic Literature*. 37(2): 571-608
- Robert Lucas. 1982. Interest rates and currency prices in a two-country world, *Journal of Monetary Economics*. 10(3): 335-360
- John McCallum. 1995. National borders matter: Canada-US regional trade patterns, *American Economic Review*. 85(3): 615-623
- Richard Meese and Kenneth Rogoff. 1983. Empirical exchange rate models of the seventies: Do they fit out of sample? *Journal of International Economics*. 14(1): 3-24
- Michael Mussa. 1986. Nominal exchange rate regimes and the behavior of real exchange rates: Evidence and implications, *Carnegie-Rochester Conference Series on Public Policy*. 25: 117-214
- Maurice Obstfeld and Kenneth Rogoff. 1995. Exchange rate dynamics redux, *Journal of Political Economy*. 103(3): 624-60
- Kenneth Rogoff. 1996. The purchasing power parity puzzle, *Journal of Economic Literature*. 34(2): 647-668

## Schedule of classes

- L1 Introduction
- L2 Basic concepts and the small open economy
- L3 Small open economy under uncertainty
- L4 Dynamic uncertainty
- L5 Introduction to two country models
- L6 Real asset pricing I / Lucas model
- L7 Real asset pricing II
- L8 Nominal asset pricing I
- L9 Nominal asset pricing II
- L10 International RBC models I / Backus-Kehoe-Kydland
- L11 International RBC models II
- L12 International RBC models III
- L13 Cagan hyperinflation model I
- L14 Cagan hyperinflation model II
- L15 Dornbusch overshooting model I
- L16 Dornbusch overshooting model II

### SEMESTER BREAK

- L17 Home bias in international trade (Puzzle #1)
- L18 The Feldstein-Horioka puzzle (Puzzle #2)
- L19 Home bias in equity portfolios (Puzzle #3)
- L20 International consumption correlations (Puzzle #4)
- L21 Various exchange rate puzzles (Puzzles #5 and #6)
- L22 Sticky price models of exchange rates / Chari-Kehoe-McGrattan
- L23 Sticky price models of exchange rates / Chari-Kehoe-McGrattan
- L24 Sticky price models of exchange rates / Chari-Kehoe-McGrattan