

INTERNATIONAL ECONOMICS: FINANCE

Note: there will be an EViews tutorial on Friday Jan 30 from 5:30-7:00pm in the SSRL.

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Office Hours: W 9:30-3:30; by appointment

Course: Econ 672-001

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Course Objective

This course will introduce you to the standard models and tools used in exchange rate economics and open economy macroeconomics. The object is to develop a "tool kit" of common approaches to the macroeconomics of open economies, so that actual policy questions can be approached with theoretical flexibility and economic insight.

Topics include the following. The functioning of spot and forward markets for foreign exchange. Models of expectations formation, with an emphasis on implications for exchange rate behavior. The overshooting and portfolio-balance models of exchange rate determination. Comparative static and comparative dynamic macroeconomic analysis of the open economy. The effects of devaluation and commercial policies on output, inflation, and the balance of payments.

Course Organization

The course will begin with models of flexible exchange rates. For a bit more than half the semester, we will model the role of capital flows, expectations formation, and attitudes toward risk in the determination of flexible exchange rates. We will then apply these concepts to the analysis of macroeconomic policy under fixed exchange rates. The interests of the class can dictate the depth of coverage of individual topics as well as the overall pace of the course, so be sure to speak up!

This class will use the [Blackboard](#) courseInfo software. Look there for the syllabus, lecture notes, and homework. We will also use a listserv mailing list. For this course, you must subscribe to econ-672-L. (Refer to the [subscription instructions](#).) I recommend that you use your AU account to subscribe: you can always set your AU account to forward mail to your commercial account. All students are expected to monitor their course email, which may contain homework problems, reading assignments, and grade reports. All students are expected to adhere to **basic email etiquette**: be respectful, quote appropriately, and do not use HTML. (To repeat: please **turn off HTML formatting of your email**. I filter HTML messages a spam and may not receive them.)

Course Prerequisites

Macroeconomic Theory (Econ-501 or Econ-702) and Mathematical Economics (Econ-505 or Econ-705). are prerequisite to this course. **No exceptions.** I also consider a commitment to upholding the [Academic Integrity Code for American University](#) to be prerequisite to participation in this course.

Recommended Background

Econ-523 is recommended but not required. Also, I recommend that you read one of the following texts during the first week of class; they are on reserve. Historically, students who omit this background reading early in the course have trouble later.

Krugman, P., and M. Obstfeld, *International Economics* (NY: Harper Collins, 1994) Ch. 12--19.

Williamson, J., 1983, *The Open Economy and the World Economy* (New York: Basic Books), ch. 7--10.

Software

Submit algebraic homeworks as Scientific Notebook (.tex) files. (I also accept [LaTeX format](#), if you know what you're doing.) Submit econometric homeworks as Google Docs by enabling sharing with econ672@gmail.com. (Note: use the PNG file format for your images.)

I have arranged for SN to be available free on campus as an EagleNet application. It is also available at a very attractive [student price](#), including an inexpensive single semester license. Scientific Notebook includes a tutorial, which you should complete during the first week of class.

Use of econometric software is part of this course. The assignments are based on features that are in EViews, which is available in the SSRL (Hurst Building). You can use other software if you wish, but it is up to you to figure out how to duplicate the EViews functionality.

I have ensured that EViews is available for you in the Hurst Lab. As an American University student, you can also buy it for about the price of a textbook. (Caution: do **not** buy the crippled student version of EViews: it will be useless to you, as it does not support programming.)

Grading

Grading will be based on homework (15 percent), a midterm exam (35 percent), and a cumulative final exam (50 percent). There is no "extra credit".

Exams

Exams are take without the aid of textbooks or of notes of any kind, and no collaboration will be allowed on exams. I offer no makeup exams. (Exams may missed with a doctor's excuse; the grade will then be calculated from the remaining exams.) Exams presume a thorough knowledge of the (graded and ungraded) homework assignments given throughout the semester.

MIDTERM EXAMINATION: 3 March 2009

FINAL EXAMINATION: you will find the date of our final examination on the [final exam schedule](#). (The AU schedule of classes *always* determines the date and time of the final, so please check your schedule of classes.)

Homework

Homework must be submitted in an approved file format. (See the discussion of course [Software](#).) Homework will occasionally cover new material or extensions not covered in class, and mastery of this material will be assumed in all classes subsequent to its assignment.

All homework should be typed and submitted to my teaching assistant Heath Henderson at econ672@gmail.com. Always copy me on any email to my teaching assistant, including these assignment submissions. Be sure to include your last name, the assignment number, and the course number in the **subject line** of your email. (For example: LastName HW#1, Econ 672.)

My TA grades the homework. You may request supplementary comments from the TA, but do not request grade changes. My TA is not authorized to make grade changes. If you wish to contest a homework grade, you may submit your homework to me for regrading of the entire assignment. It is only fair to note that although I instruct my TA to be quite generous in grading, I do not feel so constrained.

Homework is not always "required" in the sense of being collected and graded; even so, it is preparatory for subsequent classes and exams. In addition, homework will occasionally cover new material or extensions not treated in class, and mastery of this material will be assumed in all classes subsequent to its assignment.

Ongoing study groups are highly recommended. Study groups are an excellent means of mastering the course material. They are also a core part of the experience of graduate education. Besides, they are fun.

I encourage you to discuss the homework problem sets with others, but there are strict terms for such collaboration. In accord with the canons of academic honesty, you must cite all of your collaborators at the front of your submitted solutions (in writing, on the assignment). Also, you must write up solutions on your own. **To repeat: your write-up of any problem solution must be entirely your own.** The use of pre-packaged sources of solutions to the assigned problems is not permitted. You may neither copy solutions nor provide solutions to be copied. Plagiarism, cheating, and other anti-intellectual behavior will be dealt with severely and can lead to dismissal from the university.

Topics and Readings

The primary text for this course will be my online notes. In addition I will at times refer to **required** reading in [\[mark-2001-imftem\]](#). (Please do not be intimidated by the Mark text: some parts Mark's text are extremely difficult, but those parts will not be required!)

I have also requested that a number of books be available on reserve in the University Library. These are recommended reading only if you are interested in pursuing specific topics beyond the scope of this course.

Caution: I consider any marking, underlining, or writing in pencil, pen, or highlighter on any library materials

to be defacement of university property, a violation of academic integrity, and grounds for a one grade reduction in your final grade. Please treat all library materials as precious intergenerational resources that you are privileged to share.

The reading list below is intended to expose you to some recent work in several areas of International Monetary Economics. It is by no means meant to be exhaustive nor to discourage additional reading. The number of classes designated below for each topic is intended only as a rough guide: class interest and preparation will determine how quickly we get through the topics.

International Financial Institutions

Class 1

Required:

[\[krueger-1998-jel\]](#),

Recommended:

[\[neely-1999-frbslr\]](#),

The Foreign Exchange Market I: Exchange Rate Regimes and International Trade

Class 2-3

Required:

[\[mark-2001-imftem\]](#) ch.1

Recommended:

[\[cross-1998-fxmkt\]](#), Hallwood and MacDonald 2000, ch. 1,2,3,12.1; Black 1985; [\[mccallum-1996-ime\]](#) ch. 1,2; Baillie and McMahon 1989, ch. 1; [\[sarno.valente.wohar-2004-ei\]](#)

Flexible Exchange Rates I: Macroeconomic Adjustment in Equilibrium Models

Class 4-5

Required:

[\[mark-2001-imftem\]](#) ch.3.2; [\[frenkel-1976-scanje\]](#), [\[neely.sarno-2002-frbslwp\]](#);

Recommended:

Hallwood and MacDonald 2000, ch. 9.1-9.4; [\[beaugrand-1997-imfwp\]](#), [\[mccallum-1996-ime\]](#), McCallum 1996 ch. 5, 6, 8; [\[barro-1978-qje\]](#), Barro 1978; [\[bilson-1978-frenkel.johnson\]](#), [\[hoffman.schlagenhauf-1983-jme\]](#), [\[woo-1985-jie\]](#), MacDonald 1988, ch. 3; Pikoulakis 1995, ch. 2.2; Baillie and McMahon 1989, ch. 3.3;

MAFER and RE

Class 6

Required:

[\[mark-2001-imftem\]](#) ch.3; [\[hoffman.schlagenhauf-1983-jme\]](#),

Recommended:

[mccallum-1996-ime] ch. 5, 6, 8; [black-1973-psif], Bilson 1978; [woo-1985-jie], MacDonald 1988, ch. 3; Pikoulakis 1995, ch. 2.2; Baillie and McMahon 1989, ch. 3.3;

Purchasing Power Parity

Class 7

Required:

[mark-2001-imftem] ch.3.1, ch.7; Hallwood and MacDonald 2000, ch. 7; Lafrance (2002 BCR); [isard-1977-aer]; McCallum 1996, ch. 9; [dornbusch-1988-eri] ch.13; [pakko.pollard-1996-frbslr], [pakko.pollard-2003-frbslr], [parsley.wei-2007-ej],

Recommended:

[krugman-1989-eer], [isard-1995] ch. 4; Gilbert and Kravis (1954)

MIDTERM EXAMINATION (very approximately)

Exchange Rates and the Trade Balance

Class 9

Required:

[dornbusch-1980-oem] ch. 4.I; [rose.yellen-1989-jme],

Recommended:

[quiggen-2004-ev], Quiggin (2004 EV)

Flexible Exchange Rates II: Macroeconomic Adjustment in Models with Rigidities

Class 10

Required:

[mark-2001-imftem] ch.8; McCallum 1996, ch. 5, 6, 8.9; [dornbusch-1976-jpe], [frankel-1979-aer], [meese.rogoff-1983-jie], [dornbusch-1980-oem] ch. 11;

Recommended:

Hallwood and MacDonald 2000, ch. 9; Cavallo et al. (2004); [wilson-1979-jpe], Hooper and Morton 1982; MacDonald 4, 5; Baillie and McMahon 1989, ch. 3.4; Pikoulakis 1995, ch. 2.3, 2.4;

Flexible Exchange Rates III: Macroeconomic Adjustment in Portfolio Balance Models

Class 11

Required:

Hallwood and MacDonald 2000, ch. 10; [dornbusch-1980-oem] ch. 13, 14; [dornbusch.fischer-1980-aer],

Recommended:

Calvo and Rodriguez 1977; Kouri 1976; Frankel 1983; Pikoulakis 1995, ch. 3, 4;

The Foreign Exchange Market II: Forward Exchange and Risk Premia

Class 12

Required:

[\[mark-2001-imftem\]](#) ch.6; [\[mccallum-1994-jme\]](#)

Recommended:

Dornbusch 1983; Fama 1984; Frankel 1982; Hansen and Hodrick 1980; Levich 1984; Mussa 1979; Niehans 7, 8, 10; Aliber 1977;

Introduction to Financial Programming

Class 13

Required:

[\[mark-2001-imftem\]](#) ch.1; McCallum 1996, ch. 3; [\[dornbusch-1980-oem\]](#) ch. 1,2;

Recommended:

[\[bloem.dippelsman.maehle-2001-imf\]](#), Bloem, Dippelsman and Maehle (2001); Holman (2001); Fieleke (1996); Seskin and Parker (1998); [\[bach-1999-scb\]](#), Bach (1999 SCB); [Ritter \(2000 FRBSLR\)](#) (and [Ritter data](#)), IMF 1987;

Fixed Exchange Rates I: Macroeconomic Policy in Open Economies

Class 14

Required:

[\[dornbusch-1980-oem\]](#) ch. 3,4;

Recommended:

Bordo (1993); Grabbe (1996); Deuker and Fischer (2001); Kouparitsas (2003); McCallum 1996, ch. 7; Dornbusch 1973, 1974, 1975;

The Choice of Exchange-Rate Regime

Class 14

Required:

Nothing yet.

Recommended:

McCallum 1996, ch. 10; MacDonald 15 (the role of the labor market)

FINAL EXAMINATION

References

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- Pakko, Michael R, and Patricia S Pollard. 1996. For Here or To Go? Purchasing Power Parity and the Big Mac. *{em Federal Reserve Bank of St. Louis} Review* 78, 3--21.
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- della Paolera, Gerardo and Alan M. Taylor, *Straining at the Anchor: The Argentine Currency Board and the Search for Macroeconomic Stability*,

1880–1935 NBER Series on Long-term Factors in Economic Development The University of Chicago Press 2001 ISBN 0-226-64556-8

Gardeazabal, Javier and Marta Regulez, 1992, The Monetary Model of Exchange Rates and Cointegration: Estimation, Testing and Prediction (Lecture Notes in Economics and Mathematical Systems, Vol) Springer Verlag; ISBN: 0387556354

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Krugman, Paul, ***Currencies and Crises*** (MIT Press, 1992)

McCallum, Bennett T., 1996, ***International Monetary Economics*** (Oxford University Press) isbn 0-19-509494-8

Obstfeld, Maurice, and Kenneth Rogoff, 1996, ***Foundations of International Macroeconomics*** (Cambridge: MIT Press) isbn 0-262-15047-6

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Utz-Peter Reich ***National Accounts & Economics: A Study in Concepts*** Plagrove October 2001 isbn: 0-333-73391-6

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