

Economics 543: International Finance
Fall Semester, 2009
Office Hours: 5:40 - 6:30 MW (or by appointment)

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Required Text:

Krugman and Obstfeld, International Economics (latest edition). (K&O hereafter)

Supplementary Macroeconomic Texts: (You do not need to purchase these.)

Study Guide to Krugman and Obstfeld Text. Some exercises have answers provided.

Gordon, Macroeconomics (any edition).

We begin with the theory of open economy macroeconomics; this will take about 3/4 of the semester. Once the basic foundations are laid, we can proceed to various applications of the theory. Previously, the topics have included: U.S. current account and the foreign debt; and the European monetary union. This semester, the topics may be different, and the reading list will be modified accordingly. Other sections of International Finance may emphasize different applications, such as economic development or topics from the corporate finance literature.

Asterisks (*) denote optional reading. Required reading (and some optional reading) for the three topics will be available on my web page. Exercises and exams will cover both the required reading and my lectures. My lectures will often deviate significantly from the required reading; so, I strongly advise you to get someone's lecture notes if you miss a class. *This reading list is quite likely to be revised as the course progresses.*

Active learning – working exercises and discussing your answers with other students – is the best way to master the material in this course; passive study – reading the textbook over and over, and continuously reviewing the lecture notes – is not an efficient use of time. I will assign exercises (see my webpage) to be turned in, but do not wait for me. You will find plenty of exercises at the end of each chapter in K&O, and reading the Financial Times will suggest others that are of current interest. I strongly encourage you to form small study groups of no more than three or four students. Agree on a set of questions, actually write out the answers, and then check each other's work. Try to justify your answers to the other group members, and come to me (or the TA) when disagreements arise.

We will have a midterm exam and a final. The date for the midterm is given below. The final exam will be twice as important as the midterm in determining your course grade. I only use performance on the exercises in borderline cases. Homework turned in late may not be graded. I have purposely de-emphasized the grading aspect because I want the exercises to be a cooperative learning experience, and not a competitive sorting device. You will be making a very serious mistake however if you do not take the exercises seriously.

I. Open Economy Macroeconomics and Exchange Rate Determination: the theory

1. National Income Accounting and the Twin Deficits –

K&O, Chapter 1: What's it all about?

K&O, Chapter 12: Learning “econo-speak”. What's the trade deficit got to do with savings?

How is the budget deficit related to savings? Should we worry about either?

2. The Market for Foreign Exchange –
K&O, Chapter 13: What are exchange rates? How do they affect interest rates?
K&O, Chapter 14: How do financial markets clear? How do financial markets “speak”?
3. Price Levels, Exchange Rates and Economic Activity in the Short Run –
K&O, Chapter 16: How are E and Y determined? How are they affected by macroeconomic policy and financial market expectations?

Midterm Exam (covering material through Chapter 16, excluding Chapter 15):

Your midterm exam will be on Wednesday, October 21st. I announce the exam on the first day of class so that you have plenty of time to plan accordingly. I will only allow exceptions in cases of real emergency.

4. Intervention in the Market for Foreign Exchange –
K&O, Chapter 17: What are central banks doing, and why are they doing it? Can we believe what they say? Can we make any sense out of press accounts of exchange rate crises?
5. Fixed versus Flexible Exchange Rate Regimes –
*K&O, Chapter 18: History of regime switches, 1870 - 1973; highly recommended.
K&O, Chapter 19: To float or not to float? That is the question for some central banks.
Able and Bernanke, *Macroeconomics*, Section 15.3, “The Conduct of Monetary Policy: Rules versus Discretion.” (available on my webpage.)
*Romer, *Advanced Macroeconomics*, 1996, Section 9.4, “The Dynamic Inconsistency of Low Inflation Monetary Policy.” (A more technical treatment than Able and Bernanke’s.)
6. Computer simulations of a two-country version of the K&O model. How can more complicated models be analyzed? (No required reading! Will not be on the exam, relax and enjoy.)

II. Open Economy Macroeconomics and Exchange Rates: some applications

7. **Topic 1: US Current Accounts, Debt and the Dollar** –
Chinn, Menzie, “Getting Serious about the Twin Deficits,” CSR NO. 10, Council on Foreign Relations, September 2005. (On my web page.)
Lane and Milesi-Ferretti, “Examining Global Imbalances,” IMF Finance and Development, 2006. (Internet link: <http://www.imf.org/external/pubs/ft/fandd/2006/03/lane.htm>)
*Lane and Milesi-Ferretti, “A Global Perspective on External Positions,” IMF Working Paper, 04/161. (Available on IMF web page.)
*Obstfeld, Maurice and Kenneth Rogoff, “Global Current Account Imbalances and Exchange Rate Adjustments,” *Brookings Papers on Economic Activity*, 1, 2005.

8. Topic 2: Global Financial Crisis –

De Michelis, Andrea, “Overcoming the Financial Crisis in the United States, OECD Working Paper No. 669

Introduction and Section 1.

[http://www.oalis.oecd.org/oalis/2009doc.nsf/LinkTo/NT00000C92/\\$FILE/JT03259982.PDF](http://www.oalis.oecd.org/oalis/2009doc.nsf/LinkTo/NT00000C92/$FILE/JT03259982.PDF)

Bernanke, Ben, “The Crisis and the Policy Response,” Stamp Lecture, Jan. 13, 2009

and

FRB, “Recent Balance Sheet Trends”

http://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm

The following papers describe the new Fed facilities in more detail:

*Gavin, William, “More Money: Understanding Recent Changes in the Monetary Base”, FRBStLouis Review, March/April, 2009.

<http://research.stlouisfed.org/publications/review/09/03/Gavin.pdf>

*OECD paper, Section 2.

The following recommended papers can be found on the IMF web page:

<http://www.imf.org/external/np/exr/key/finstab.htm>

*Note by IMF Staff for the Group of Twenty, Meeting of Deputies, Jan. 31, 2009.

*IMF Staff, Appendix III to “Fiscal Policy for the Crisis”: Five Case Studies of Fiscal Policy During Financial Crises. (The Great Depression, Japan: Banking Crisis in 1997, Korea: Economic Crisis in 1997, Savings and Loan Crisis in the US, Nordic Banking and Economic Crises)

9. Topic 3: The Future of the Euro Project –

If time permits, no required reading.

Final Exam:

Dates for the final exam and the conflict exam can be found on the Registrar’s web page. You must take the exam for the section in which you are enrolled. Conflict exams must be approved by your Dean’s office. Exams will not be administered on any other day; so, plan your holiday travel accordingly.