

Syllabus for Econ 309, International Finance (This version: September 6, 2010)
Yao Tang, Fall 2010
Department of Economics
Bowdoin College

Lecture time: Monday 10:00 - 11:25, Wednesday 10:00 - 11:25

Place: Druckenmiller-024

Contact Information

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Please note, I may not check emails frequently during evenings and weekends.

Course Description and Objectives

In this course, we will examine three key issues in international finance and international macroeconomics: exchange rate determination, balance of payments, and exchange rate regimes. We will also cover a few special current topics, i.e. the global imbalances, China's exchange rate regime, and the currency carry trade associated with the Japanese Yen. Besides studying economic models of international finance, a crucial part of the course involves empirical evaluation of these models. The two essential prerequisites are intermediate macroeconomics and a solid understanding of linear regression.

Key Dates

October 20, in-class midterm

October 29, submit a topic for your research paper

Two days after the final exam, your research paper is due.

Evaluation: your course grade is based on

assignments, 10%

one midterm exam, 25%

final exam, 30%

one research paper, 25%

a 15-minute in-class presentation of your research paper, 5%

class participation, 5%

wildcard article (optional), 2%

You should talk to me about the topic of your research paper sometime in October, and submit a topic by October 29. Before your in-class presentation of the paper, please make an appointment with me so that we can work on your presentation.

While all of you have written numerous term papers by this time, I recommend that you have a look at Cochrane (2005), a 13-page short paper, for some tips on writing economics papers. His tips on writing and presentation are originally intended for Ph.D. students, but most of them are useful to undergraduate students as well. For those who are interested, Deirdre McCloskey's "Economical Writing" is a longer but still enjoyable read.

To encourage students to connect learning in this course to real-world issues, each student has the option of bringing into class a wildcard article from newspapers, magazines or similar media outlets. Some examples of media outlets are The Economist, the New York Times, the Wall Street Journal, and Fortune Magazine. The articles must be recent, i.e. published within three months, and related to the content of the course. We will have at most one wildcard article each lecture and each student can choose to bring in at most one article. A student who brings in an article should email the class and the instructor the day before the lecture, indicating the intention but without revealing the title of the article. The instructor or the economics academic coordinator can help to make photocopies before the class. The class will spend the first 10 minutes of the lecture reading and discussing the article. The student who brings in the article should prepare one or two questions to facilitate discussion. Students will be graded based on the relevance of the articles and quality of question(s).

Academic Honesty

Students should be familiar with the Bowdoin College Academic Honor Code, available at <http://www.bowdoin.edu/studentaffairs/student-handbook/college-policies/index.shtml>. In particular, for the assignments, students are encouraged to work together but they must each hand in their own copy of answers.

Textbook and Course Materials

Required textbook:

- Robert C. Feenstra and Alan M. Taylor, *International Macroeconomics*, Worth Publishers; Unbonded edition (June 1, 2009)

Other readings (available on Blackboard or through library reserve, * indicates optional):

1. David K. Backus, Patrick J. Kehoe, Finn E. Kydland, 1992, International Real Business Cycles, *The Journal of Political Economy*, Vol. 100, No. 4
2. Guillermo A. Calvo and Carmen M. Reinhart, 2002, Fear of Floating, *The Quarterly Journal of Economics*, Vol. 117, No. 2
3. William R. Cline and John Williamson, 2008, Estimates of the equilibrium exchange rate of the Renminbi: Is there is consensus and, if not, why not? in *Debating China's Exchange Rate Policy* (edited by by Morris Goldstein and Nicholas R. Lardy), The Peterson Institute for International Economics, 1st edition
4. * John H. Cochrane, 2005, Writing Tips for Ph.D. Students, mimeo, University of Chicago
5. Ray C. Fair, 2010, Estimated Macroeconomic Effects of a Chinese Yuan Appreciation, Cowles foundation Discussion Paper No. d1755
6. * Milton Friedman and Robert A. Mundell, 2001, One World, One Money? Policy Options, Volume 22, Issue 4
7. * Morris Goldstein and Nicholas R. Lardy, 2009, The Future of China's Exchange Rate Policy (Policy Analyses in International Economics 87), The Peterson Institute for International Economics; 1st edition
8. Òscar Jordà and Alan M. Taylor, 2009, The carry trade and fundamentals: nothing to fear but FEER itself, NBER Working Paper 15518
9. Paul Krugman, 1999, Analytical afterthoughts on the Asian crisis, mimeo, MIT
10. Karen K. Lewis, 1999, Trying to Explain Home Bias in Equities and Consumption, *Journal of Economic Literature*, Vol. 37, No. 2
11. Robert E. Lucas, Jr., 1990, Why Doesn't Capital Flow from Rich to Poor Countries? *American Economic Review*, Vol. 80, No. 2, Papers and Proceedings of the Hundred and Second Annual Meeting of the American Economic Association
12. Richard K. Lyons, 2001, *The Microstructure Approach to Exchange Rates*, MIT Press

13. Richard K. Lyons, 2002, Foreign exchange: macro puzzles, micro tools, Economic Review, Federal Reserve Bank of San Francisco
14. * Deirdre McCloskey, 1999, Economical Writing, Waveland Pr Inc; 2nd edition
15. Nelson C. Mark, 1995, Exchange Rates and Fundamentals: Evidence on Long-Horizon Predictability, American Economic Review, Vol. 85, No. 1
16. Richard A. Meese and Kenneth Rogoff, 1983, Empirical exchange rate models of the seventies: Do they fit out of sample? Journal of International Economics Vol.14.
17. Robert A. Mundell, 1961, A Theory of Optimum Currency Areas, American Economic Review, Vol. 51, No. 4
18. Robert A. Mundell, 2000, A Reconsideration of the Twentieth Century, American Economic Review, Vol. 90, No. 3
19. * Maurice Obstfeld, 2001, International macroeconomics: beyond the Mundell-Fleming model, NBER Working paper No. 8369
20. Maurice Obstfeld, Jay C. Shambaugh, and Alan M. Taylor, 2005, The Trilemma in History: Tradeoffs Among Exchange Rates, Monetary Policies, and Capital Mobility, Review of Economics and Statistics, Vol. 87, No. 3
21. Maurice Obstfeld and Kenneth Rogoff, 1995, The Mirage of Fixed Exchange Rates, The Journal of Economic Perspectives, Vol. 9, No. 4
22. Maurice Obstfeld and Kenneth Rogoff, 2004, The unsustainable US current account position revisited, NBER Working paper No. 10869
23. Kenneth Rogoff, 1996, The Purchasing Power Parity Puzzle, Journal of Economic Literature, Vol. 34, No. 2

Any other assigned readings and materials will be available through handouts or Blackboard. I suggest that you follow current events of the global economy by reading the economics section of *The Economist* magazine or similar sources.

Web Information

All information, including information about reading materials, will be posted on the Blackboard web page for Econ 309, accessible at <http://blackboard.bowdoin.edu/>.

Tentative Schedule of Topics

Please note that I reserve the right to drop topics from the list. However, I will not add new topics.

- **September 6, course introduction**
Feenstra and Taylor, chapter 1
- **Exchange rates**
 - September 8, the basics about exchange rate, interest rate parity
Feenstra and Taylor, chapter 2
 - September 13, purchasing power parity and deviation from it
Feenstra and Taylor, chapter 3.1 and 11.1
Rogoff (1996)
 - September 15, macroeconomic model of exchange rate: long run
Feenstra and Taylor, chapter 3.2 to 3.5
 - September 20, macroeconomic model of exchange rate: short run
Feenstra and Taylor, chapter 4.1 to 4.4
Assignment 1 due
 - September 22, forecasting exchange rate with macro models in the short run
Mese and Rogoff (1983)
 - September 27, forecasting exchange rate with macro models in the long run
Mark (1995)
 - September 29, interest rate parity and carry trade
Feenstra and Taylor, chapter 2.5 and 11.2
Jordà and Taylor (2009)
 - October 4, a microstructure view of exchange rate
Lyons (2001), chapter 1 to 3
Assignment 2 due
 - October 6, a microstructure view of exchange rate
Lyons (2002)
- **Balance of payments**
 - October 13, balance of payments
Feenstra and Taylor, chapter 5
Assignment 3 due

- October 18, financial globalization: consumption smoothing
Feenstra and Taylor, chapter 6.1 and 6.2,
Backus, Kydland and Prescott (1992)
- **October 20, in-class midterm**
- October 25, financial globalization: capital flow and efficient investment
Feenstra and Taylor, chapter 6.3
Lucas (1990)
- October 27, financial globalization: (insufficient) risk diversification
Feenstra and Taylor, chapter 6.4
Lewis (1999)

- **Exchange rate regimes and policy issues**

- November 1, exchange rate and output: the Mundell-Fleming model
Feenstra and Taylor, chapter 7.1 to 7.6
Assignment 4 due
- November 3, fixed and flexible exchange rate regimes, and the trilemma
Feenstra and Taylor, chapter 4.5, 8.1 to 8.3
Obstfeld and Rogoff (1995), and Calvo and Reinhart (2002)
- November 8, international monetary experience
Feenstra and Taylor, chapter 8.4
Mundell (2000), and Obstfeld, Shambaugh, and Taylor, (2005)
- November 10, currency crises
Feenstra and Taylor, chapter 9
Krugman (1999)
- November 15, the euro
Feenstra and Taylor, chapter 10
Mundell (1961)
Assignment 5 due
- November 17, the global imbalance
Feenstra and Taylor, chapter 11.3
Obstfeld and Rogoff (2004)
- November 22, the debate about the RMB exchange rate
Cline and Williamson (2008), and Fair (2010)

- **Student presentations**

- November 29, up to 4 student presentations (I will offer extra help to students who present on this date.)
- December 1, up to 4 student presentations
- December 6, up to 4 student presentations
- December 8, up to 4 student presentations
- date TBD, student presentations during the reading period

List of Some Possible Topics for Research Papers

- one of the PIIGGS in the European debt crisis
- the global imbalance
- constructing and implementing a carry trade strategy
- home bias in portfolio investment
- Is there a case for gold standard today?
- Is IMF adequately equipped to deal with current challenges to the international financial system?
- an empirical update of Mese and Rogoff (1983)