ECON2532: Advanced Topics in International Macroeconomics and Finance

Fall 2019

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Course Overview: This is an advanced graduate-level course in international macroeconomics and finance. The course focuses on applied theory and empirical stylized facts. This course is targeted to advanced second year PhD students in economics and related disciplines. The course prerequisites are:

1. The first year PhD sequence in macroeconomics.
2. A PhD level introductory course in finance. For Harvard PhD students the requirement is fulfilled by ECON2723 Asset Pricing I.

The course assumes familiarity with basic theoretical modeling techniques such as dynamic optimization and general equilibrium modeling. Similarly, the course assumes familiarity with basic empirical methods and with econometric software of your choice (Matlab, Stata, Python, etc.). Students without the necessary familiarity with these techniques are welcome to take the course, but should expect to have to fill the gaps on their own (and with the help of their classmates!).

Objectives: Given the target audience above, the course has three main objectives.

1) To introduce and investigate both classic and new economic issues at the frontier of current research in international macroeconomics and finance. The purely pedagogical part of the course aims to make you familiar with the questions, the current state of research, and the tools currently being used.

2) To create a mental framework and intuitive understanding of important and active questions. What makes a question interesting? What makes a paper a good paper? How to develop a reasoned view of new (and perhaps yet un-modeled) issues in international economics? This objective is less direct and less formal, but aims to transition the students into full-time researchers.

3) To kick-start students on independent research. For those interested in applied work the course makes you familiar and tries to connect you with existing data at the frontier of the field, both public and proprietary. For those interested in theoretical work the course staff acts as a sounding board for early research ideas.

There is no required textbook for the course since we will mainly read and discuss papers on the reading list. The following textbooks are useful background references:

- Obstfeld M., Rogoff K. (1996), Foundations of International Macroeconomics, MIT Press.
- Evans, M. (2011), Exchange-Rate Dynamics, Princeton University Press.
- Uribe, M. and S. Schmitt-Grohe (2017), Open economy macroeconomics, Princeton Uni. Press.

Grading: a final exam (100%). The exam will be held in class or during the reading period or the final exam week (exact dates will be announced).

Reading List

1) **Basic Facts About Exchange Rates and Fundamentals**

UIP:

Fama, E. F. 1984. Forward and Spot Exchange Rates. Journal of Monetary Economics 14 (3): 319–38.

Lustig, H., N. Roussanov and A. Verdelhan. 2011. Common Risk Factors in Currency Markets. Review of Financial Studies, 24(11), 3731-3777.

Tarek, A. H., R. C. Mano. 2019. Forward and Spot Exchange Rates in a Multi-Currency World. The Quarterly Journal of Economics, 134(1), 397–450.

CIP:

Du, W., A. Tepper, and A. Verdelhan. 2018. Deviations from Covered Interest Rate Parity. The Journal of Finance, 73(3), 915–57.

Exchange Rate Disconnect:

Meese, R. A., and K. Rogoff. 1983. Empirical Exchange Rate Models of the Seventies: Do They Fit out of Sample? Journal of International Economics, 14(1), 3–24.

Rossi, B. 2013. Exchange Rate Predictability. Journal of Economic Literature, 51(4), 1063–1119.

Sarno, L., M. P. Taylor. 2002. The Economics of Exchange Rates. Cambridge University Press. Chapter 4.2.

Lilley A., M. Maggiori, B. Neiman, J. Schreger. 2019. Exchange Rate Reconnect: Exchange Rates and Capital Flows. Work in Progress.

International Risk Sharing: Backus and Smith Condition

Backus, D. K., and G. W. Smith. 1993. Consumption and Real Exchange Rates in Dynamic Economies with Non-Traded Goods. Journal of International Economics 35(3), 297–316.

Cole, H. L., and M. Obstfeld. 1991. Commodity Trade and International Risk Sharing: How Much Do Financial Markets Matter? Journal of Monetary Economics 28(1), 3-24.

2) Theories of Currency Risk Premia in Complete Markets

Farhi, E. and X. Gabaix. 2016. Rare Disasters and Exchange Rates, Quarterly Journal of Economics, 131(1), 1-52.

Colacito, R. and M. Croce. 2011. Risks for the Long Run and the Real Exchange Rate, Journal of Political Economy, 119(1), 153-181.

3) Frictions, Imperfect Substitutability and Portfolio Balance

Gabaix, X. and M. Maggiori. 2015. International Liquidity and Exchange Rate Dynamics, Quarterly Journal of Economics, 130(3), 1369-1420.

Kouri, P.J.K. 1976. The Exchange Rate and the Balance of Payments in the Short Run and in the Long Run: A Monetary Approach, Scandinavian Journal of Economics, 78(2), 280-304.

Hau, H., M. Massa, and J. Peress. 2010. Do Demand Curves for Currencies Slope Down? Evidence from the MSCI Global Index Change. The Review of Financial Studies 23 (4), 1681–1717.

4) Basic Facts About Exchange Rates and Prices

Cavallo, A., B. Neiman, and R. Rigobon. 2014. Currency Unions, Product Introductions, and the Real Exchange Rate. The Quarterly Journal of Economics 129(2), 529-595.

Gopinath, G., O. Itskhoki, and R. Rigobon. 2010. Currency Choice and Exchange Rate Pass-through. American Economic Review 100(1), 304–36.

5) Sticky Price Models: PCP, LCP, DCP

Engel, Charles. 2006. Equivalence Results for Optimal Pass-Through, Optimal Indexing to Exchange Rates, and Optimal Choice of Currency for Export Pricing. Journal of the European Economic Association 4(6), 1249–1260.

Devereux, M. B., and C. Engel. 2003. Monetary Policy in the Open Economy Revisited:

Price Setting and Exchange-Rate Flexibility. The Review of Economic Studies 70(4): 765–83.

Duarte, M., and M. Obstfeld. 2008. Monetary Policy in the Open Economy Revisited: The Case for Exchange-Rate Flexibility Restored. Journal of International Money and Finance 27(6): 949–57.

Omar Barbiero, Job Market Paper. Work in Progress.

6) Foreign Exchange Intervention

Gabaix, X. and M. Maggiori. 2015. International Liquidity and Exchange Rate Dynamics, Quarterly Journal of Economics, 130(3), 1369-1420.

Fanelli, S., and L. Straub. 2016. A Theory of Foreign Exchange Interventions. Working Paper.

Amador, M., Bianchi, J., Bocola, L., and F. Perri, 2015. Exchange Rate Policies at the Zero Lower Bound. Working paper.

Cavallino, P. 2017. Capital Flows and Foreign Exchange Intervention. Forthcoming, American Economic Journal: Macroeconomics.

Fratzscher, M., O. Gloede, L. Menkhoff, L. Sarno, and T. Stöhr. 2019. When Is Foreign Exchange Intervention Effective? Evidence from 33 Countries. American Economic Journal: Macroeconomics 11 (1): 132–56.

7) Capital Controls

Schmitt-Grohé, S., and M. Uribe. 2016. Downward Nominal Wage Rigidity, Currency Pegs, and Involuntary Unemployment. Journal of Political Economy 124:5, 1466-1514.

8) Global Portfolios: Stylized Facts

Home Bias

French, K. and J. Poterba. 1991 Investor diversification and international equity markets, American Economic Review, 31:222-226.

Coeurdacier N., and H. Rey. 2013. Home Bias in Open Economy Financial Macroeconomics. Journal of Economic Literature, 51(1), 63-115.

Currency Composition and Home Currency Bias

Maggiori, M., B. Neiman, and J. Schreger. 2019. International Currencies and Capital Allocation. Forthcoming, Journal of Political Economy.

Lane, P.R. and J.C. Shambaugh. 2010. Financial Exchange Rates and International Currency Exposures, American Economic Review, 100(1), 518-540.

Global Firms, Tax Havens, and Capital Flows

Coppola, A., M. Maggiori, B. Neiman, and J. Schreger. 2019. Redrawing the Map of Global Capital Flows: The Role of Cross Border Financing and Tax Havens. Working Paper.

Zucman, G. 2013. The Missing Wealth of Nations: Are Europe and the U.S. net Debtors or net Creditors? The Quarterly Journal of Economics, 128(3), 1321–1364.

Zucman G. 2018. The Missing Profits of Nations. Working Paper.

Global Imbalances

Gourinchas, P, and H. Rey. 2007a. From World Banker to World Venture Capitalist: U.S. External Adjustment and the Exorbitant Privilege. G7 Current Account Imbalances: Sustainability and Adjustment, Richard Clarida, ed. Cambridge, MA: NBER.

———, International Financial Adjustment, 2007b. Journal of Political Economy, 115(4), 665-703.

9) The International Monetary System: The Special Role of the Dollar

Krisnamurthy, A. and A. Vissing-Jorgenesen. 2012. The Aggregate Demand for Treasury Debt, Journal of Political Economy, 120(2), 233-267.

Farhi, E. and M. Maggiori,. 2018. A Model of International Monetary System. Quarterly Journal of Economics, 133(1), 295-355.

He, Z., A. Krishnamurthy, and K. Milbradt. 2018. A Model of the Reserve Asset. Working Paper.

Keynes, J.M. 1923. A Tract on Monetary Reform, London: Macmillan.

Nurkse, R. 1944. International Currency Experience: Lessons of the Interwar Period, League of Nations Paper.

10) Theory and Evidence on Sovereign Default

History and Stylized Facts

Cruces, J. J., and C. Trebesch. 2013. Sovereign Defaults: The Price of Haircuts. American Economic Journal: Macroeconomics, 5(3), 85-117.

Trebesch C., J. Meyer and C. Reinhart. 2018. Sovereign Bonds since Waterloo. Working Paper.

Hébert, Benjamin, and Jesse Schreger. 2017. The Costs of Sovereign Default: Evidence from Argentina. American Economic Review, 107 (10), 3119-45.

Theory

Bulow, J., and K. Rogoff. 1989. Sovereign Debt: Is to Forgive to Forget? American Economic Review 79(1), 43-50.

Calvo, G. A. 1988. Servicing the Public Debt: The Role of Expectations. American Economic Review 78(4), 647-661.

Harold C. L., and T. J. Kehoe. 2000. Self-Fulfilling Debt Crises. Review of Economic Studies 67(1), 91-116.

Sovereign Default and Banks

Acharya, V., Drechsler, I., and P. Schnabl. 2015. A Pyrrhic Victory? Bank Bailouts and Sovereign Credit Risk. Journal of Finance, 69(6), 2689-2739.

Gennaioli, N., Martin, A. and S. Rossi. 2014. Sovereign Default, Domestic Banks and Financial Institutions. Journal of Finance, 69(2), 819:866.