

**University of Toronto**  
**Department of Economics**

**ECO 2301 – International Monetary Theory**

**Spring 2013**

**Margarida Duarte**

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**Classes:** Thursdays 11:00am – 1:00pm, GE106

**Office hours:** Thursdays 2:00pm – 3:00pm and by appointment

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**Overview:**

The goal of the course is to provide an understanding of selected topics of current academic research in the areas of international macroeconomics and international finance.

**Reference books:**

- ▲ Foundations of International Macroeconomics, Maurice Obstfeld and Kenneth Rogoff, MIT Press, 1996. [OR]
- ▲ Recursive Macroeconomic Theory, Lars Ljungqvist and Thomas J. Sargent, MIT Press, 2<sup>nd</sup> edition, 2004. [LS]
- ▲ Open Economy Macroeconomics, Martín Uribe, 2012, mimeo. [U] Available at: [http://www.columbia.edu/~mu2166/lecture\\_notes.html](http://www.columbia.edu/~mu2166/lecture_notes.html).

**Grading:**

1. Class participation – 20%
2. Assignments – 30%
3. Class presentation – 20%
4. Report/paper – 30%

Students are required to prepare a presentation and write a short report/paper. There are two options:

- 1) Present a paper and write a referee report (no more than 4 pages) summarizing and critiquing the paper in detail. The paper need not be listed in the course outline but students need to discuss their choice with me in advance. Papers are chosen on a first-come-first-served basis. Students are required to choose the paper by February 15.
- 2) Present a research idea of your own. Pose a question, outline a model to address the question, and discuss how the project fits into the literature. Write a short paper (no more than 5 pages). You must discuss your research idea with me ahead of time.

Presentations will be scheduled for the last classes of the semester. The report/paper is due on April 5.

### **Course outline and selected readings:**

#### **1. Dynamic Models of Open Economies:**

##### *Real Models*

- ✧ U, Chapters 1-2.
- ✧ OR, Chapters 1-3.
- ✧ LS, Chapter 8.
- ✧ Cole, H. and M. Obstfeld, 1991. "Commodity Trade and International Risk Sharing," *Journal of Monetary Economics* 28, 3 – 24.
- ✧ Backus, D. and G. Smith, 1993. "Consumption and Real Exchange Rates in Dynamic Economies with Non-Traded Goods", *Journal of International Economics* 35, 297 – 316.
- ✧ Schmitt-Grohé, S. and M. Uribe, 2003. "Closing Small Open Economy Models," *Journal of International Economics* 61, 163 – 185.

##### *Monetary Models*

- ✧ OR, Chapters 8.3 and 10.
- ✧ Stockman, A.C., 1980. "A Theory of Exchange Rate Determination," *Journal of Political Economy*.
- ✧ Lucas, R.E., 1982. "Interest Rates and Currency Prices in a Two-Country World," *Journal of Monetary Economics*.
- ✧ Stockman, A.C., 1987. "The Equilibrium Approach to Exchange Rates," *Federal Reserve Bank of Richmond Economic Quarterly*.
- ✧ Obstfeld, M. and K. Rogoff, 1995. "Exchange Rate Dynamics Redux," *Journal of Political Economy* 103, 624 – 660.

#### **2. International Business Cycles: Facts and Puzzles**

- ✧ Backus, D., P. Kehoe, and F. Kydland, 1992. "International Real Business Cycles," *Journal of Political Economy*.
- ✧ Baxter, M. and M. Crucini, 1995. "Business Cycles and the Asset Structure of Foreign Trade," *International Economic Review*.
- ✧ Lewis, K., 1996. "What Can Explain the Apparent Lack of International Consumption Risk Sharing?" *Journal of Political Economy* 104 (2), 267 – 297.
- ✧ Obstfeld, M. and K. Rogoff, 2000. "Six Puzzles in International Macroeconomics," *NBER Macroannual*. With comments by C. Engel.
- ✧ Heathcote, J. and F. Perri, 2002. "Financial Autarky and International Business Cycles," *Journal of Monetary Economics* 49 (3), 601 – 627.
- ✧ Kehoe, P. and F. Perri, 2002. "International Business Cycles with Endogenous Market Incompleteness," *Econometrica*.
- ✧ Aguiar, M., and G. Gopinath, 2008. "Emerging Market Business Cycles: The Cycle is the Trend," *Journal of Political Economy* 115, 69 – 102.

- ⤴ Corsetti, C., L. Dedola, and S. Leduc, 2008. “International Risk Sharing and the Transmission of Productivity Shocks,” *Review of Economic Studies*.
- ⤴ Raffo, A., 2008. “Net Exports, Consumption Volatility and International Business Cycle Models,” *Journal of International Economics*.
- ⤴ Raffo, A., 2010, “Technology Shocks: Novel Implications for International Business Cycles,” mimeo.
- ⤴ Bai, Y. and J. Zhang, 2010. “Solving the Feldstein-Horioka Puzzle with Financial Frictions,” *Econometrica* 78 (2), 603 – 632.
- ⤴ Kollmann, R., 2010, “Limited Asset Market Participation and the Consumption Real Exchange Rate Anomaly,” mimeo.
- ⤴ Engel, C. and J. Wang, 2011. “International Trade in Durable Goods: Understanding Volatility, Cyclicalities, and Elasticities,” *Journal of International Economics* 83, 37 – 52.
- ⤴ Corsetti, G., L. Dedola, and F. Viani, 2011. “Traded and Non-traded Goods Prices, and International Risk Sharing: An Empirical Investigation,” NBER International Seminar in Macroeconomics.
- ⤴ Gao, X., V. Hnatkovska, and V. Marmer, 2012. “Limited Participation in International Business Cycle Models: A Formal Evaluation,” mimeo.

### 3. International Relative Prices:

#### *Real Exchange Rates: Facts and Puzzles*

- ⤴ Mussa, M., 1986. “Nominal Exchange Rate Regimes and the Behavior of Real Exchange Rates: Evidence and Implications,” *Carnegie-Rochester Series on Public Policy* 25, 117 – 214.
- ⤴ Rogoff, K., 1996. “The Purchasing Power Parity Puzzle,” *Journal of Economic Literature* 34, 647 – 668.
- ⤴ Panos, M., R. Nobay, and D. Peel, 1997. “Transactions Costs and Nonlinear Adjustment in Real Exchange Rates: An Empirical Investigation,” *Journal of Political Economy* 105, 862 – 879.
- ⤴ Engel, Charles, 1999. “Accounting for U.S. Real Exchange Rate Changes,” *Journal of Political Economy* 107, 507 – 538.
- ⤴ Chari, V.V., P. Kehoe, and E. McGrattan, 2002. “Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?,” *Review of Economic Studies* 69 (3), 533 – 563.
- ⤴ Burstein, A., M. Eichenbaum, and S. Rebelo, 2005. “Large Devaluations and the Real Exchange Rate,” *Journal of Political Economy* 113, 742 – 784.
- ⤴ Steinsson, J., 2008. “The Dynamic Behavior of the Real Exchange Rate in Sticky-Price Models,” *American Economic Review*, 519 – 533.
- ⤴ Carvalho, C., and F. Nechio, 2010. “Aggregation and the PPP Puzzle in a Sticky-Price Model,” *American Economic Review*.

#### *Price Discrimination and Exchange Rate Pass-Through*

- ⤴ Corsetti, C., and L. Dedola, 2005. “The Macroeconomics of International Price Discrimination,” *Journal of International Economics* 67, 129 – 155.
- ⤴ Atkeson, A. and A. Burstein, 2008. “Trade costs, Pricing-to-Market, and International Relative Prices,” *American Economic Review*.

- ♣ Gopinath, G., and R. Rigobon, 2008. “Sticky Borders,” *Quarterly Journal of Economics*.
- ♣ Gust, C., S. Leduc, and N. Sheets, 2009. “The Adjustment of Global External Imbalances: Does Partial Exchange Rate Pass-Through to Trade Prices Matter?” *Journal of International Economics* 79 (2), 173 – 185.
- ♣ Burstein, A. and N. Jaimovich, 2009, “Understanding Movements in Aggregate and Product-Level Real Exchange Rates,” mimeo.
- ♣ Gopinath, G. and O. Itskhoki, 2010. “Frequency of Price Adjustment and Pass-Through,” *Quarterly Journal of Economics*, 675 – 727.
- ♣ Gopinath, G., O. Itskhoki, and R. Rigobon, 2010. “Currency Choice and Exchange Rate Pass-Through,” *American Economic Review*, 304 – 336.
- ♣ Gopinath, G., P.-O. Gourinchas, C.-T. Hsieh, and N. Li, 2011, “International Prices, Costs, and Markup Differences,” *American Economic Review*, 2450 – 2486.
- ♣ Drozd, L., and J. Nosal, 2012. “Understanding International Prices: Customers as Capital,” *American Economic Review*.

#### 4. Nominal Exchange Rates:

##### *Basic readings*

- ♣ Meese, R., and K. Rogoff, 1983. “Empirical Exchange Rate Models of the Seventies: Do They Fit Out of Sample?” *Journal of International Economics* 14, 3 – 24.
- ♣ Fama, E., 1984. “Forward and Spot Exchange Rates,” *Journal of Monetary Economics* 14, 319 – 338.
- ♣ Engel, C., N. Mark, and K. West, 2007. “Exchange Rate Models Are Not as Bad as You Think,” NBER Macroannual. With comments by K. Rogoff.

##### *Nominal Exchange Rate Behavior and Uncovered Interest Parity*

- ♣ Alvarez, F., A. Atkeson, and P. Kehoe, 2002. “Money, Interest Rates, and Exchange Rates with Endogenously Segmented Markets,” *Journal of Political Economy* 110, 73 – 112.
- ♣ Devereux, M. and C. Engel, 2002. “Exchange Rate Pass-Through, Exchange Rate Volatility, and the Exchange Rate Disconnect,” *Journal of Monetary Economics*, 913 – 940.
- ♣ Duarte, M., 2003. “Why Don’t Macroeconomic Quantities Respond to Exchange Rate Variability?,” *Journal of Monetary Economics* 50, 889 – 913.
- ♣ Duarte, M. and A.C. Stockman, 2005. “Rational Speculation and Exchange Rates,” *Journal of Monetary Economics* 52, 3 – 29.
- ♣ Engel, C., and K. West, 2005. “Exchange Rates and Fundamentals,” *Journal of Political Economy* 113, 485 – 517.
- ♣ Dotsey, M. and M. Duarte, 2008. “Nontraded Goods, Market Segmentation, and Exchange Rates,” *Journal of Monetary Economics*.
- ♣ Alvarez, F., A. Atkeson, and P. Kehoe, 2009. “Time-Varying Risk, Interest Rates, and Exchange Rates in General Equilibrium,” *Review of Economic Studies*.

- ⤴ Bacchetta, P. and E. van Wincoop, 2010, “Infrequent Portfolio Decisions: A Solution to the Forward Discount Puzzle,” *American Economic Review* 100, 870 – 904.
- ⤴ Colacito, R., and M. Croce, 2011. “Risks for the Long Run and the Real Exchange Rate,” *Journal of Political Economy* 119 (1), 153 – 181.
- ⤴ Engel, C., 2011, “The Real Exchange Rate, Real Interest Rates, and the Risk Premium,” mimeo.
- ⤴ Fahri, E., and X. Gabaix, 2011. “Rare Disasters and Exchange Rates,” mimeo.

#### 5. International Financial Adjustment and Integration:

- ⤴ Lane, P. and G.M. Milesi-Ferretti, 2004. “Financial Globalization and Exchange Rates,” IMF Working Paper.
- ⤴ Kollmann, R., 2005. “International Portfolio Equilibrium and the Current Account,” mimeo.
- ⤴ Gourinchas, P.O. and H. Rey, 2007. “International Financial Adjustment,” *Journal of Political Economy*.
- ⤴ Caballero, Farhi, and Gourinchas, 2008. “An Equilibrium Model of “Global Imbalances” and Low Interest Rates,” *American Economic Review*.
- ⤴ Mendoza, E., Quadrini, V., and J. Ríos-Rull, 2009. “Financial Integration, Financial Deepness and Global Imbalances, *Journal of Political Economy*.
- ⤴ Devereux, M., and A., Sutherland, 2010. “Country Portfolios in Open Economy Macro Models,” *Journal of the European Economic Association*, forthcoming.
- ⤴ Perri, F. and V. Quadrini, 2011. “International Recessions,” mimeo.

#### 6. Macro Applications of Models of International Trade:

- ⤴ Eaton, J. and S. Kortum, 2001. “Technology, Trade, and Growth: A Unified Framework,” *European Economic Review*.
- ⤴ Eaton, J. and S. Kortum, 2002. “Technology, Geography, and Trade,” *Econometrica*.
- ⤴ Melitz, M., 2003. “The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity,” *Econometrica*.
- ⤴ Ghironi, F. and M. Melitz, 2005. “International Trade and Macroeconomic Dynamics with Heterogeneous Firms,” *Quarterly Journal of Economics* 120, 865 – 915.
- ⤴ Alvarez, F., and R.E. Lucas, 2006. “General Equilibrium Analysis of the Eaton-Kortum Model of International Trade,” mimeo.
- ⤴ Alessandria, G., and H. Choi, 2007. “Do Sunk Costs of Exporting Matter for Net Export Dynamics?” *Quarterly Journal of Economics* 122, 289 – 336.
- ⤴ Chaney, T., 2008. “Distorted Gravity: The Intensive and Extensive Margins of International Trade,” *American Economic Review* 98, 1707 – 1721.
- ⤴ Yi, K., 2010. “Can Multi-Stage Production Explain the Home Bias in Trade?,” *American Economic Review*.
- ⤴ Alessandria, G., Kaboski, J., and V. Midrigan, 2010, “Inventories, Lumpy Trade, and Large Devaluations,” *American Economic Review* 100 (5), 2304 – 2339.
- ⤴ Alessandria, G., Kaboski, J., and V. Midrigan, 2010, “The Great Trade Collapse of 2008-09: An Inventory Adjustment?” *IMF Economic Review* 58, 254 – 294.

- ⤴ Levchenko, A., L. Lewis, and L. Tesar, 2010. “The Collapse of International Trade During the 2008-2009 Crisis: in Search of the Smoking Gun,” IMF Economic Review 58 (2).
- ⤴ Gopinath, G., O. Itskhoki, B. Neiman, 2011. “Trade Prices and the Global Trade Collapse of 2008-09,” mimeo.