

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

**ECO 2301 – International Monetary Theory**

**Spring 2019**

**Margarida Duarte**

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**Classes:** Thursdays 11:00am – 1:00pm, WO25

**Office hours:** Thursdays 1:00pm – 2:00pm and by appointment

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**Overview:**

The goal of the course is twofold: 1) to introduce students to the main workhorse models in open-economy macroeconomics and their ability to account for empirical facts, and 2) to provide an understanding of selected topics of current academic research in the areas of international macroeconomics and international finance.

**Reference books:**

- Open Economy Macroeconomics, Martín Uribe and Stephanie Schmitt-Grohé, 2016, mimeo. [US] Available at: <http://www.columbia.edu/~mu2166/book/>.
- Recursive Macroeconomic Theory, Lars Ljungqvist and Thomas J. Sargent, MIT Press, 2<sup>nd</sup> edition, 2004. [LS]
- Foundations of International Macroeconomics, Maurice Obstfeld and Kenneth Rogoff, MIT Press, 1996. [OR]

**Grading:**

For M.A. students:

1. Referee report – 40%
2. Final exam – 45%
3. Class participation – 15%

For Ph.D. students:

1. Class presentation – 40%
2. Final exam – 45%
3. Class participation – 15%

## Course outline and selected readings:

### 1. Real Business Cycles in Open Economies: (small open economy and two-country models)

- US, Chapters 2-4.
- 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., P. Kehoe, and F. Kydland, 1992. "International Real Business Cycles," *Journal of Political Economy*.
- 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.
- Baxter, M. and M. Crucini, 1995. "Business Cycles and the Asset Structure of Foreign Trade," *International Economic Review*.
- Schmitt-Grohé, S. and M. Uribe, 2003. "Closing Small Open Economy Models," *Journal of International Economics* 61, 163 – 185.
- 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.

#### *Additional readings*

- Bai, Y. and J. Zhang, 2010. "Solving the Feldstein-Horioka Puzzle with Financial Frictions," *Econometrica* 78 (2), 603 – 632.
- Corsetti, C., L. Dedola, and S. Leduc, 2008. "International Risk Sharing and the Transmission of Productivity Shocks," *Review of Economic Studies*.
- Engel, C. and J. Wang, 2011. "International Trade in Durable Goods: Understanding Volatility, Cyclicalities, and Elasticities," *Journal of International Economics* 83, 37 – 52.
- Garcia, J., R. Pancrazi, and M. Uribe, 2010. "Real Business Cycles in Emerging Countries?" *American Economic Review* 100, 2510 – 2531.
- Gao, X., V. Hnatkovska, and V. Marmer, 2014. "Limited Participation in International Business Cycle Models: A Formal Evaluation," *Journal of Economics Dynamics and Control*.
- Gourinchas, P., and H. Rey, 2007. "International Financial Adjustment," *Journal of Political Economy*.
- Heathcote, J. and F. Perri, 2002. "Financial Autarky and International Business Cycles," *Journal of Monetary Economics* 49 (3), 601 – 627.
- Karabarbounis, L., 2014. "Home Production, Labor Wedges, and International Business Cycles," *Journal of Monetary Economics* 64, 68 – 84.
- Kollmann, R., 2012. "Limited Asset Market Participation and the Consumption Real Exchange Rate Anomaly," *Canadian Journal of Economics*.

- 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.
- 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.

## 2. Sovereign Default

- US, chapter 13.
- Aguiar, M. and M. Amador, 2015. “Sovereign Debt,” *Handbook of International Economics*.
- Aguiar, M. and G. Gopinath, 2006. “Defaultable Debt and Current Account Sustainability,” *Journal of International Economics*.
- Arellano, C., 2008. “Default Risk and Income Fluctuations in Emerging Economies,” *American Economic Review*.
- Hatchondo, J. C., L. Martinez, and Sosa Padilla, 2016. “Debt dilution and sovereign default risk,” *Journal of Political Economy*.
- Chatterjee, S. and Eyigungor, B., 2012. “Maturity, Indebtedness and Default Risk,” *American Economic Review*.

### *Additional Readings:*

- Aguiar, M. and M. Amador, 2011. “Growth in the Shadow of Expropriation,” *QJE*.
- Aguiar, M. and M. Amador, 2016. “Fiscal Policy in Debt Constrained Economies,” *Journal of Economic Theory*.
- Aguiar, M., M. Amador, and G. Gopinath, 2009. “Investment Cycles and Sovereign Debt Overhang,” *Review of Economic Studies* 76(1), pp. 1 – 31
- Aguiar, M., M. Amador, H. Hopenhayn, and I. Werning, 2016, “Take the Short Route: Equilibrium Default and Debt Maturity,” mimeo.
- Arellano, C. and A. Ramanarayanan, 2012. “Default and the maturity structure in sovereign bonds,” *Journal of Political Economy*.
- Bianchi, J., J. C. Hatchondo, and L. Martinez, 2018. “International Reserves and Rollover Risk,” *American Economic Review*.
- Bianchi, J., P. Ottonello, and I. Presno, 2018. Fiscal Policy, Sovereign Risk, and Unemployment,” mimeo, Minneapolis Fed.
- Bocola, L., G. Bornstein, and A. Dovis, 2018. “Quantitative Sovereign Default Models and the European Debt Crisis,” mimeo, Stanford University.
- Chatterjee, S. and Eyigungor, B., 2014. “Debt Dilution and Seniority in a Model of Defaultable Sovereign Debt,” mimeo, Philadelphia Fed.
- Chatterjee, S. and Eyigungor, B., 2017. “Endogenous Political Turnover and Fluctuations in Sovereign Default Risk,” mimeo, Philadelphia Fed.
- Cuadra, G., J. Sanchez, and H. Sapriza, 2010. “Fiscal Policy and Default Risk in Emerging Markets,” *Review of Economic Dynamics* 13, 452 – 469.

- DAVIS, A., 2019. "Efficient Sovereign Default," *Review of Economic Studies*.
- D'ERASMO, P., and E. MENDOZA, 2017, "Optimal Domestic (and External) Sovereign Default," mimeo, Philadelphia Fed.
- HATCHONDO, J. C. and L. MARTINEZ, 2009. "Long-duration bonds and sovereign defaults," *Journal of International Economics*.
- HATCHONDO, J. C., L. MARTINEZ, and F. ROCH, 2017. "Fiscal rules and the sovereign default premium," mimeo.
- MENDOZA, E. and Z. V. YUE, 2012. "A General Equilibrium Model of Sovereign Default and Business Cycles," *Quarterly Journal of Economics*.
- ROCH, F., and H. UHLIG, 2016, "Dynamics of Sovereign Debt Crises and Bailouts," mimeo.
- Z. V. YUE, 2007. "Sovereign Default and Debt Renegotiation," *Journal of International Economics*.

### 3. Nominal Exchange Rates:

- 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*.
- 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.
- OBSTFELD, M. and K. ROGOFF, 1995. "Exchange Rate Dynamics Redux," *Journal of Political Economy* 103, 624 – 660.
- ENGEL, C. 2015. "Exchange Rates and Interest Parity," *Handbook of International Economics* 4, 453 – 522.
- 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.
- GABAIX, X. and M. MAGGIORI, 2015. "International Liquidity and Exchange Rate Dynamics," *Quarterly Journal of Economics*.

### *Additional readings*

- 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.
- 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., 2016. “Exchange Rates, Interest Rates, and the Risk Premium,” *American Economic Review*.
- Engel, C., and K. West, 2005. “Exchange Rates and Fundamentals,” *Journal of Political Economy* 113, 485 – 517.
- Fahri, E., and X. Gabaix, 2016. “Rare Disasters and Exchange Rates,” *Quarterly Journal of Economics*.
- Fama, E., 1984. “Forward and Spot Exchange Rates,” *Journal of Monetary Economics* 14, 319 – 338.
- Itskhoki, O. and D. Mukhin, 2017. “Exchange Rate Disconnect in General Equilibrium,” mimeo, Princeton University.
- 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.
- Schmitt-Grohé, S. and M. Uribe, 2018. “Exchange Rates and Uncovered Interest Differentials: The Role of Permanent Monetary Shocks,” mimeo, Columbia University.

#### 4. International Capital Flows and Global Imbalances

- Caballero, R., E. Farhi, and P.O. Gourinchas, 2008. “An Equilibrium Model of ‘Global Imbalances’ and Low Interest Rates,” *American Economic Review* 98: 358-393.
- Jeanne O. and Gourinchas P., 2013. “Capital Flows to Developing Countries: the Allocation Puzzle”. *Review of Economic Studies*.
- Mendoza E., V. Quadrini and V. Rios-Rull, 2009. “Financial Integration, Financial Development and Global Imbalances,” *JPE* 117(3).
- Lorenzoni, G., 2015. “International Financial Crises,” in *Handbook of International Economics*, vol.4.

#### *Additional readings*

- Alfaro, L., S. Kalemli-Ozcan, and V. Volosovych, 2014. “Sovereigns, Upstream Capital Flows and Global Imbalances,” *Journal of the European Economic Association*, Vol. 12, No. 5: 1240–1284.
- Azzimonti, M., E. de Francisco, V. Quadrini, 2014. “Financial Globalization, Inequality and the Rising of Public Debt,” *American Economic Review*.
- Bengui, J., E. Mendoza, and V. Quadrini, 2012. “Capital Mobility and International Sharing of Cyclical Risk,” *Journal of Monetary Economics*.
- Brunnermeier, M., P.O. Gourinchas, and O. Itskhoki, 2018. “Consumption-led Growth,” mimeo, Princeton University.
- David, J., E. Henriksen, and I. Simonovska, 2016. “The Risky Capital of Emerging Markets,” mimeo, USC.
- Fahri, E. and I. Werning, 2017. “Fiscal Unions,” *American Economic Review*.

- Maggiori, M., 2017. "Financial Intermediation, International Risk Sharing, and Reserve Currencies," *American Economic Review* 107, no.10: 3038-3071.
- Mendoza, E. and V. Quadrini, 2010. "Financial Globalization, Financial Crises and Contagion," *Journal of Monetary Economics*.
- Mendoza, E., V. Quadrini, and J. V. Rios-Rull, 2009. "On the Welfare Implications of Financial Globalization without Financial Development," *International Seminar on Macroeconomics Annual*, R. Clarida & F. G. Giavazzi, eds.
- Quadrini Vincenzo and Fabrizio Perri, 2018. "International recessions", *American Economic Review*.