

ECO365 - INTERNATIONAL MONETARY ECONOMICS Winter 2011

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Overview

This course presents International Monetary Economics theory and applies it towards gaining an understanding of recent events and current policy issues. The theory presented in this course covers a broad range of topics including exchange rate determination, monetary and fiscal policy in an open economy (that is, an economy that trades goods and assets with the rest of the world), balance of payments crises, the choice of exchange rate systems, and international debt. The insights provided by these theoretical frameworks will enable us to discuss topics such as the US current account deficit and global financial imbalances, the Chinese exchange rate regime, proposed changes in the international financial architecture, the single currency in Europe, the Asian and Argentine financial crises, global financial imbalances, and the role of international factors on a nation's employment, wage and economic performance.

Course materials

Paul R. Krugman and Maurice Obstfeld, "International Economics: Theory and Policy" (8th edition, Addison-Wesley, 2009), ISBN: 0-321-48883-0. Further readings from the financial press (such as The Economist) will be assigned and discussed during the course.

Marking Scheme

- Final exam: 50%
- Midterm test: 30%
- 2 Problem sets: 10% each

If your score on the final is better than on the midterm, then the midterm does not count and its weight is automatically shifted towards the final. The same holds for each problem set, if your score on the final is better than on the problem set, then its weight is automatically shifted towards the final

The midterm will be written on February 16.

Missing a Midterm: There will not be a make-up test. Your midterm mark will be a zero, which means that midterm's weight will automatically be shifted towards the final.

The first problem set has to be delivered in class on February 2.

The second problem set has to be delivered in class on March 23.

Not handing in a problem set: If you miss the deadline for a problem set, your score is 0%, but due to the max-rule this is not a penalty (because weight is automatically shifted to the final).

Optional Questions: I will assign optional questions from the textbook for each chapter. An asterisk (*) next to a question indicates that it is especially useful. A set of brief answers to these questions will be provided. Students will not be asked to submit their solutions for marking. But the payoff to students who conscientiously work through them is that a number of the questions to appear on the midterm test and the final examination will be derivatives of the assigned problems. These set of questions will be posted under "optional problems" in the class website.

Appeals regarding the grading of a test must be submitted to me or to an Economics Department secretary in writing within one week of your receipt of the graded work. The original test must accompany the appeal. I will re-grade the entire test. Note that this may lead to a lower overall grade. Your complaint has to be in writing and in detail.

Class Attendance is not required. However, students are responsible for all material covered in class, in the textbook, and in the required readings posted on the class website.

Class participation is encouraged and will count positively on marginal adjustments.

Plagiarism: I take academic honesty very seriously. Plagiarism is a severe academic offense. Please review the University's Code of Behavior on Academic Matters regarding what constitutes an academic offense.

Email policy: Please use e-mails for appointments, administrative or urgent matters. Emails are NOT to be used for questions about the course, lectures, tutorials etc. Instead, you are encouraged to come to my office hours and use the discussion board. You must use your U of T e-mail as non-U of T emails are sometimes automatically quarantined as 'junk e-mail'.

U of T Double Sided Printing Initiative: To conserve paper, please print double-sided (learn how at: printdoublesided.sa.utoronto.ca).

Course Outline

All supplementary course materials (readings, announcements, solutions, etc.) will be posted on the class website. **Please check the class website frequently to stay up to date with the course.**

You are responsible for all readings in the folder “*Required Readings*” in the course website even if they were not covered in class.

KO below refers to the textbook for the course (Krugman and Obstfeld).

1. National Income Accounting and the Balance of Payments: This section introduces accounting concepts used by economists to describe a country’s level of production and its international transactions.

- *KO* Ch.12
- Optional reading:
 - Rogoff, Ken, “Managing the World Economy”, *The Economist*, August 1, 2002
 - Stanley Fisher, “Globalization and Its Challenges”, Richard T. Ely Lecture, *American Economic Review*, May 2003, pp 1-30.

2. Intertemporal Trade and the Current Account Balance: Understanding the current account. What moves the current account? Does the current account matter? Foreign debt sustainability.

- Lecture Notes
- Optional reading:
 - Obstfeld, Maury and Ken Rogoff, “Perspectives on OECD Economic Integration: Implications for US Current Account Adjustment”, Federal Reserve Bank of Kansas City, Symposium, 2000, and also “The Unsustainable US Current Account Position Revisited”, October 2004.
 - Cavallo, Michele, “International Financial Integration and the Current Account Balance”, FRBSF Economic Letter, June 2006.

3. Exchange Rates and the Foreign Exchange market: Exchange rates, real exchange rates. Mechanics of foreign exchange markets.

- *KO* Ch.13
- Optional reading:
 - Bank for International Settlements, Triennial Central Bank Survey, Foreign Exchange and Derivatives Market Activity, March 2005
 - Froot, Ken and Richard Thaler “Anomalies: Foreign Exchange”, *Journal of Economic Perspectives*, Summer 1990

4. Price levels and Exchange Rates: Economic determinants of exchange rates. Purchasing power parity, current account and exchange rates, supply and demand for money.

- *KO* Ch.15
- Optional reading:

- Rogoff, Ken, “The Purchasing Power Parity Puzzle”, JEL, June 1996.
- The Big Mac Index, The Economist, May 25, 2006.

5. Money, Interest Rates, and Exchange Rates: Financial determinants of exchange rates. Interest rate parity, overshooting, trading off risk and return.

- *KO* Ch.14
- Optional reading:
 - Rogoff, Ken, “Dornbusch's Overshooting Model After Twenty-Five Years”, IMF working paper, February 2002.

6. Output and Exchange Rate Determination: This section presents a macroeconomic model of output and exchange-rate determination in the short run.

- *KO* Ch.16
- Optional reading:
 - Bernanke, Ben, “The Global Saving Glut and the U.S. Current Account Deficit”, Sandridge Lecture, Virginia Association of Economics, Richmond, Virginia, March 2005
 - IMF, World Economic Outlook, chapter 2, “Global Imbalances: A Saving and Investment Perspective”, September 2005

7. Monetary and fiscal policy with fixed and flexible rates: Fixed, pegged, floating, floating pegs, crawling pegs. How flexible are exchange rates?

- *KO* Ch.17
- Optional reading:
 - IMF’s Classification of Exchange Rate Arrangements, December 2004.
 - Calvo, Guillermo and Carmen Reinhart, “Fear of Floating”, Quarterly Journal of Economics May 2002, available as NBER WP 7993.
 - Reinhart, Carmen and Ken Rogoff, “The Modern History of Exchange Rate Arrangements: A Reinterpretation”, Quarterly Journal of Economics, February 2004.
 - Higgins, Matthew and Thomas Kliitgard, “Reserve Accumulation: Implications for Global Capital Flows and Financial Markets”, Current Issues in Economic and Finance, Federal Reserve Bank of New York, October 2004.

8. The International Monetary System: Historical background on the International Monetary system.

- *KO* Ch 18
- Optional reading:
 - Eichengreen, Barry and Nathan Sussman: “the International Monetary System in the (very) Long Run”, IMF working paper, March 2000. Summary version also available in the World Economic Outlook, May 2000, Chapter 5.
 - Krugman, Paul, “What Do We Need to Know about the International Monetary System?” Princeton Essays in International Finance, 190, 1993.

9. Exchange Rate regimes: Fixed exchange rate vs. floating exchange rates. Why do countries fix their exchange rates?

- *KO* Ch 19
- Optional reading:
 - Obstfeld, Maury and Ken Rogoff, “The Mirage of Fixed Exchange Rates”, *Journal of Economic Perspectives*, 1995, vol 9(4), pages 73-96.
 - Cavallo, Michele “To float or not to float”, FRBSF Economic Letter, January 2005.

10. Optimum Currency Areas and European Monetary Union: Should UK join the Euro? Should Canada adopt the US dollar? Should there be an Asian currency union?

- *KO* Ch 20
- Optional reading:
 - Feldstein, Martein, “The Political Economy of the European Economic and Monetary Union”, *Journal of Economic Perspectives*, 1997, vol 11(4), pages 23-42.
 - Blanchard, Olivier, “Adjustment with the Euro: The Difficult Case of Portugal”, mimeo, MIT, February 2006.

11. Emerging Markets and Financial Crisis: Performance and policy issues in international capital markets. Speculative attacks, Debts default, Argentina’s economic turmoil, the IMF and capital market liberalization.

- *KO* Ch.21 and Ch 22
- Optional reading:
 - Obstfeld, Maury “Models of Currency Crisis with Self-Fulfilling Features”, *European Economic Review*, 40(3-5), April 1996, pages 1037-47.
 - Jeanne, Olivier, “Currency Crisis, A Perspective on Recent Theoretical Developments”, *Special Papers in International Economics*, Princeton University, March 2000
 - Kaminsky, Graciela, Saul Lizondo and Carmen Reinhard, “Leading Indicators of Currency Crisis”, *IMF Working Paper 97/79*.
 - Obstfeld M. and A. Taylor, “Globalization and Capital Markets”, *NBER Working Paper 8846*, March 2002.
 - Gourinchas Pierre-Olivier and Olivier Jeanne, “The Elusive Gains from International Financial Integration”, UC Berkeley, 2006 (forthcoming)
 - A Victory by Default”, *The Economist*, March 3, 2005
 - Fischer, Stanley, “On the Need for an International Lender of Last Resort”, *Journal of Economic Perspectives*, 1999, 13(4)
 - Rogoff, Ken, “International Financial Institutions Reducing Financial Instability”, *Journal of Economic Perspectives*, 1999, 13(4)
 - IMF World Economic Outlook, chapter 3, “Building Institutions”, September 2005.
 - Yellen, Janet, “Monetary Policy in a Global Environment”, *FRBSF Economic Letter*, June 2006.