

University of Toronto
Department of Economics

ECO 2301 – International Monetary Theory

Spring 2011

Margarida Duarte

Classes: Thursdays 11:00am – 1:00pm, GE100

Office hours: Fridays 11:00am – 12:00pm 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. Topics covered include: the intertemporal approach to the current account; international business cycle models, international risk sharing and capital flows; monetary exchange rate models; and macroeconomic policy in open economies.

Reference books:

- Foundations of International Macroeconomics, Maurice Obstfeld and Kenneth Rogoff, MIT Press, 1996. [OR]
- International Macroeconomics and Finance, Nelson Mark, Blackwell Publishing, 2001.
- Handbook of International Economics, Vol. 3, Gene Grossman and Kenneth Rogoff (eds), North-Holland, 1995.
- Recursive Macroeconomic Theory, Lars Ljungqvist and Thomas J. Sargent, MIT Press, 2nd edition, 2004. [LS]

Grading:

1. Report – 30%
2. Class presentation – 20%
3. Final exam – 50%

Students are required to choose a paper on which to write a report (between 5 and 10 pages long) and make a class presentation. The paper should be a recent working paper (last 5 years) or a very recent published paper (last 2 years). The paper need not be listed in the course outline but students need to discuss their choice with me in advance. The report is due on the day of the class presentation. Presentations will be scheduled for the last classes of the semester. Papers are chosen on a first-come-first-served basis. Students are required to choose the paper by February 17.

Course outline and selected readings:

1. Real Models of Small and Large Open Economies:

- 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.

2. Monetary Models of Exchange Rate Determination with Flexible Prices:

- OR, Chapter 8.3.
- 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*.

3. International Business Cycles:

3.1. Real Business Cycles:

- OR, Chapters 4, 5.
- 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*.
- 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.
- Kehoe, P. and F. Perri, 2002. "International Business Cycles with Endogenous Market Incompleteness," *Econometrica*.
- 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*.
- Engel, C. and J. Wang, 2008. "International Trade in Durable Goods: Understanding Volatility, Cyclicalities, and Elasticities," *Journal of International Economics*, forthcoming.

- Raffo, A., 2009, “Technology Shocks: Novel Implications for International Business Cycles,” mimeo.

3.2. New Open Economy Macroeconomics:

- OR, Chapter 10.
- 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.
- Obstfeld, M. and K. Rogoff, 2000. “New Directions for Stochastic Open Economy Models,” *Journal of International Economics*.
- 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.
- 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.
- Dotsey, M. and M. Duarte, 2008. “Nontraded Goods, Market Segmentation, and Exchange Rates,” *Journal of Monetary Economics*.

4. More on Exchange Rates:

- Fama, E., 1984. “Forward and Spot Exchange Rates,” *Journal of Monetary Economics* 14, 319 – 338.
- Alvarez, F., A. Atkeson, and P. Kehoe, 2000. “Money, Interest Rates, and Exchange Rates with Endogenously Segmented Markets,” *Journal of Political Economy*.
- Engel, C., and K. West, 2005. “Exchange Rates and Fundamentals,” *Journal of Political Economy*.
- Alvarez, F., A. Atkeson, and P. Kehoe, 2009. “Time-Varying Risk, Interest Rates, and Exchange Rates in General Equilibrium,” *Review of Economic Studies*.
- Fahri, E., and X. Gabaix, 2008. “Rare Disasters and Exchange Rates,” mimeo.
- Colacito, R., and M. Croce, 2010. “Risks for the Long Run and the Real Exchange Rate,” *Journal of Political Economy*, forthcoming.

5. More on International Relative Prices:

- Corsetti, C., and L. Dedola, 2005. “The Macroeconomics of International Price Discrimination,” *Journal of International Economics* 67, 129 – 155.
- Imbs, J., H. Mumtaz, H. Rey, and M. Ravn, 2005. “PPP Strikes Back: Aggregation and the Real Exchange Rate,” *Quarterly Journal of Economics*.
- Burstein, A., M. Eichenbaum, and S. Rebelo, 2005. “Large Devaluations and the Real Exchange Rate,” *Journal of Political Economy* 113, 742 – 784.
- Atkeson, A. and A. Burstein, 2008. “Trade costs, Pricing-to-Market, and International Relative Prices,” *American Economic Review*.

- Carvalho, C., and F. Nechio, 2008. "Aggregation and the PPP Puzzle in a Sticky-Price Model," *American Economic Review*, forthcoming.
- Drozd, L., and J. Nosal, 2009. "Understanding International Prices: Customers as Capital," *American Economic Review*, forthcoming.
- Burstein, A. and N. Jaimovich, 2009, "Understanding Movements in Aggregate and Product-Level Real Exchange Rates," mimeo.
- Gopinath, G., P.-O. Gourinchas, C.-T. Hsieh, and N. Li, 2010, "International Prices, Costs, and Markup Differences," *American Economic Review*, forthcoming.

6. Global Imbalances, International Financial Adjustment, and Valuation Effects:

- 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*.
- McGrattan, E. and E. Prescott, 2010. "Technology Capital and the U.S. Current Account," *American Economic Review*.

7. 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*.