

Topics in International Finance
ECON G31.3001-08
Vivian Zhanwei Yue

Lecture: Wed 4:00-6:00pm in Room 624 at 19 West 4th Street
October 26-December 12
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Goal of the course:

To provide a thorough understanding of selected topics of current academic research in international finance. To teach interested students the tools for conducting research in this field. The typical target audience comprises students in their second year or later. A good understanding of the material covered in the first-year Ph.D. macro courses is critical. Basic knowledge of Open Economy Macroeconomics is useful.

Reference Books for the course:

Foundations of International Macroeconomics, by Obstfeld, Maurice and Kenneth Rogoff, MIT Press, 1996.
Recursive Macroeconomic Theory, by Ljungqvist, Lars & Sargent, Thomas J., MIT Press, 2004.
International Macroeconomics and Finance, by Mark, Nelson. Blackwell Publishing, 2001.
Handbook of International Economics, Volume 3, ed by Grossman, Gene and Kenneth Rogoff, North-Holland, 1995.

Requirements

(1) Final exam, comprising 45% of grade. (2) A class presentation of a research paper that we mutually agree on, comprising 45% of grade. (3) Class participation, comprising 10% of grade.

The final exam is a two-day take home exam. It is scheduled for the week of April 23-27. The exact exam date will be determined later.

Students are required to choose a paper to present by April 4. The presentations are scheduled on class starting April 17. I will provide detailed information about how the class presentations should be prepared.

Topics and additional readings:

I outline the topics that I plan to cover in the course below. This initial summary is *subject to change*, as time goes by and as we find together the right pace for the course. The updated versions of the syllabus will be posted on the course website.

1. Business Cycles in Emerging Economies: Empirics, Theory and Methodology

Aguiar, Mark and Gopinath, Gita, 2006. "Emerging Market Business Cycles: The cycle is the Trend," *Journal of International Economics*, 69(1), 64-83.

Bai, Yan and Jing Zhang, "Can Financial Frictions Account for the Cross-Section Feldstein-Horioka Puzzle?" Mimeo, University of Michigan.

Feldstein, Martin and Charles Horioka, 1980, "Domestic Saving and International Capital Flows," *The Economic Journal*, Vol. 90, pp. 314-329.

Gourinchas, Pierre-Olivier and Helene Rey, 2005, "International Financial Adjustment," Mimeo, Princeton University

Lane, Philip R. and Gian Maria Milesi-Ferretti, 2001, "The external wealth of nations: measures of foreign assets and liabilities for industrial and developing countries," *Journal of International Economics* 55, 263–294.

*Mendoza, Enrique, 1991. "Real Business Cycles in a Small Open Economy," *American Economic Review*, 81, 797-818.

Mendoza, Enrique, 1995, "The Terms of Trade, the Real Exchange Rate, and Economics Fluctuations," *International Economic Review*, Vol 36 (1), 101-137.

Nason, James M. and John H. Rogers, 2003, "The Present-Value Model of the Current Account Has Been Rejected: Round Up the Usual Suspects," Board of Governors, *International Finance Discussion Paper No. 760*.

Neumeyer, Pablo A. and Fabrizio Perri, 2005, "Business Cycles in Emerging Markets: The Role of Interest Rates," *Journal of Monetary Economics*, 52/2, 345-380.

*Schmitt-Grohe, Stephanie and Martin Uribe, 2003. "Closing Small Open Economy Models," *Journal of International Economics*, 61, 163-185.

Tesar, Linda, 1991. "Savings, Investment and International Capital Flows," *Journal of International Economics*, 31, 55-78.

*Uribe, Martin and Vivian Z. Yue. 2006. "Country Spreads and Emerging Countries: Who Drives Whom?" *Journal of International Economics*, 69(1), 6-36.

Papers on Approximating Solution to Dynamic General Equilibrium Models

Klein, Paul, "Using the Generalized Schur Form to Solve a Multivariate Linear Rational Expectation Models," *Journal of Economic Dynamics and Control*, 24, 1405-1423.

Schmitt-Grohe, Stephanie and Martin Uribe, "Solving Dynamic General Equilibrium Models Using a Second-Order Approximation to the Policy Function,"

2. Balance of Payment Crises and Currency Crises

A. Empirical facts

Calvo, Guillermo, Alejandro Izquierdo and Luis-Fernando Majia, 2004, "On the Empirics of Sudden Stops: The Relevance of Balance-Sheet Effects," NBER Working paper No. 10520.

Frankel, Jeffrey A. and Andrew K. Rose, 1996, "Currency Crashes in Emerging Markets: An Empirical Treatment," *Journal of International Economics*, 41, 351-368.

Milesi-Ferretti, Gian Maria and Assaf Razin, 1998, "Current Account Reversals and Currency Crises: Empirical Regularities," NBER Working paper No. 6620.

*Kaminsky, Graciela and Carmen M. Reinhart, 1999. "The Twin Crises: The Cause of Banking and Balance-of-Payments Problems," *American Economic Review*, 89, 473-500.

B. The Krugman Model (First-Generation Models)

Burnside Craig, Martin Eichenbaum and Sergio Rebelo S, 2001, "Prospective Deficits and the Asian Currency Crisis," *Journal of Political Economy*, 109, 1155-1197.

Calvo, Guillermo, 1987, "Balance of Payments Crises in a Cash-in-Advance Economy," *Journal of Money, Credit and Banking*, 19, 19-32.

*Krugman, Paul, 1979, "A Model of Balance of Payment Crises," *Journal of Money, Credit and Banking*, 11, 311-325.

Uribe, Martin, 2005, "A Fiscal Theory of Sovereign Risk," *Journal of Monetary Economics*, forthcoming.

C. Self-Fulfilling Expectation and Crises (Second-Generation Models)

Angeletos, George-Marios and Ivan Werning, 2005, "Crises and Prices: Information Aggregation, Multiplicity and Volatility," *American Economic Review*, 96(5).

Chari, V.V., Patrick Kehoe, 2003, "Hot Money," *Journal of Political Economy*, 111, 1262-1292.

*Cole, Harold L. and Timothy Kehoe, 2000, "Self-Fulfilling Debt Crises," *Review of Economic Studies*, 67, 91-116.

Guimaraes, Bernardo and Stephen Morris, 2006, "Risk and Wealth in a Model of Self-Fulfilling Currency Attacks," Manuscript, Yale University.

Hellwig, Christian, Arijit Mukherji, Aleh Tsyvinski, 2005, "Self-Fulfilling Currency Crises: The Role of Interest Rates," *American Economic Review*, 96(5), 1769-1787.

*Morris, S. and Shin, H., 1998. "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," *American Economic Review*, 88, 587-97.

Obstfeld, Maurice, 1986, "Rational and Self-Fulfilling Balance-of-Payments Crises," *American Economic Review*, 76, 72-81.

Obstfeld, Maurice, 1996, "Models of Currency Crises with Self-Fulfilling Features," *European Economic Review*, 40, 1037-1048.

Schneider, Martin and Aaron Tornell, 2004, "Balance Sheet Effects and Financial Crises," *Review of Economic Studies*, 71, 883-913.

Uribe, Martin, 2003, "Real Exchange Rate Targeting and Macroeconomic Instability," *Journal of International Economics*, 59, 137-159.

D. Credit Frictions and Crises/Sudden Stops (Third Generation Models)

Aoki, Kosuke, Gianluca Benigno and Nobuhiro Kiyotaki, 2006, "Adjusting to Capital Liberalization", Manuscript, London School of Economics.

Allen, Franklin and Douglas Gale, 2000, "Optimal Currency Crises," *Carnegie-Rochester Conference Series on Public Policy*, 53, 177-230.

*Arellano, Cristina and Mendoza, Enrique, 2002, "Credit Frictions and 'Sudden Stops' in Small Open Economies: An Equilibrium Business Cycle Framework for Emerging Markets Crises," NBER Working paper No. 8880.

Caballero, Ricardo and Arvind Krishnamurthy, 2001, "International and Domestic Collateral Constraints in a Model of Emerging Market Crises," *Journal of Monetary Economics*

Caballero, Ricardo and Stavros Panageas, 2005, "Hedging Sudden Stops and Precautionary Recessions: A Quantitative Framework," *Journal of Development Economics*, forthcoming.

Cavallo, Michele, Kate Kisselev, Fabrizio Perri and Nouriel Roubini, 2002, "Exchange Rate Overshooting and the Costs of Floating," Manuscript, New York University.

Céspedes, Luis Felipe, Chang, Roberto, and Andres Velasco, "Balance Sheets and Exchange Rate Policy," *American Economic Review*, 94, 1183-1193.

*Chari, V.V., Patrick Kehoe and Ellen McGrattan, 2005, "Sudden Stops and Output Drops," *American Economic Review*, forthcoming.

Gertler, Mark, Gilchrist Simon and Natalucci Fabio, 2003, "External Constraints on Monetary Policy and The Financial Accelerator," NBER Working paper No. 10128.

Gopinath, Gita, 2004, "Lending Booms, Sharp Reversals and Real Exchange Rate Dynamics," *Journal of International Economics*, 1-23.

Lahiri, A. R. Singh, and Calvo Vegh, 2005, "Segmented Asset Markets and Optimal Exchange Rate Regimes," *Journal of International Economics*, forthcoming.

Mendoza, Enrique, 2005, "Sudden Stops in an Equilibrium Business Cycle Model with Credit Constraints: A Fisherian Deflation of Tobin's Q," Manuscript, University of Maryland.

Mendoza, Enrique and Katherine A. Smith, 2006, "Margin Calls, Trading Costs, and Asset Prices in Emerging Markets: The Financial Mechanics of the Sudden Stops Phenomenon," *Journal of International Economics*, forthcoming.

Oviedo, P. Marcelo., 2003, "Macroeconomic Risk and Banking Crises in Emerging Countries," Manuscript, Iowa State University.

3. Sovereign Debt and Default

Arellano, Cristina, 2005, "Default Risk, Income Fluctuations and Real Exchange Rates," Manuscript, University of Minnesota.

*Atkeson, Andrew, 1991, "International Lending with Moral Hazard and Risk of Repudiation," *Econometrica*, 59, 1069-89. (see also Chapter 15 of T. Sargent and L. Ljungqvist, 2000, *Recursive Macroeconomic Theory*, MIT Press.)

Bai, Yan and Jing Zhang, 2005, "Financial Integration and International Risk Sharing," Mimeo, Arizona State University.

Broner, Fernando, Alberto Martin and Jaume Ventura, "Sovereign Risk and Secondary Markets," Manuscript, CREI.

*Bulow, Jeremy and Kenneth Rogoff, 1989, "Sovereign Debt: Is to Forgive or Forget?," *American Economic Review*, 79, 43-50.

Bulow, Jeremy and Kenneth Rogoff, 1989, "A Constant Reconstructing Model of Sovereign Debt," *Journal of Political Economy*, 97, 155-178.

Cole, Harold and Patrick J. Kehoe, 1998, "A General Reputation Model of Sovereign debt," *International Economic Review*,

Eaton, Jonathan and Mark Gersovitz, 1981, "Debt with Potential Repudiation: Theoretical and Empirical Analysis," *Review of Economic Studies*, 48, 289-309.

Fernandez, Raquel and Robert W. Rosenthal, 1990, "Strategic Models of Sovereign-Debt Renegotiations," *Review of Economic Studies*, 57, 331-349.

*Kletzer, Kenneth and Brian. D. Wright, 2000, "Sovereign Debt as Intertemporal Barter," *American Economic Review*, 90, 621-639.

Gertler, Mark and Kenneth Rogoff, 1990, "North-South Lending with Endogenous Domestic Financial Market Inefficiencies," *Journal of Monetary Economics*, 26, 245-266.

Tomz, Michael and Wright Mark L. J., 2005, "Sovereign Debt, Defaults and Bailouts," Manuscript, Stanford University.

Wright, Mark L. J., 2002, "Reputations and Sovereign Debt," Manuscript, Stanford University.

*Yue, Vivian Z. 2005, "Sovereign Default and Debt Renegotiation," Manuscript, New York University.

Empirical Facts

Chuhan, Puman and Federico Sturzenegger, 2003, "Default Episodes in the 1990s: What Have We Learned?" Manuscript, the World Bank and Universidad Torcuato Di Tella.

Reinhart, Carmen, Kenneth Rogoff and M A. Savastano, 2003, "Debt Intolerance," NBER Working paper.

Rose, Andrew K., 2002, "One Reason Country Pay Their Debts: Renegotiation and International Trade," Manuscript.

4. Foreign Exchange Rate Premium

Alvarez, Fernando, Andrew Atkeson, and Patrick Kehoe, 2002, "Money, Interest Rates, and Exchange Rates With Endogenously Segmented Asset Markets," *Journal of Political Economy*, 110, 73-112.

*Alvarez, Fernando, Andrew Atkeson, and Patrick Kehoe, 2005, "Time-Varying Risk, Interest Rates, and Exchange Rates in General Equilibrium" Mimeo

*Backus, David K, Allan W. Gregory, Chris I. Telmer, 1993, "Accounting for Forward Rates in markets for Foreign Currency," *Journal of Finance*, 45, 1887-1908.

Backus, David K., Silverio Foresi, Chris Telmer, 2001, "Affine Models of Currency Pricing: Accounting for the Forward Premium Anomaly," *Journal of Finance*, 56, 279-304.

Bekaert, Geert, Hodrick, Robert J., 1992, "Characterizing Predictable Components in Excess Returns on Equity and Foreign Exchange Markets," *Journal of Finance*, 47, 467-509.

Fama, Eugene, 1984, "Forward and Spot Exchange Rates," *Journal of Monetary Economics*, 14, 319-338.

Lewis, Karen, 1995, "Puzzles in International Finance," *Handbook of International Economics*, Volume 3, Grossman, Gene M., Rogoff, Kenneth, eds.,

Lustig, Hanno and Adrien Verdelhan, 2007, "The Cross-Section of Foreign Currency Risk Premia and Consumption Growth Risk," *American Economic Review*, forthcoming.