

COURSE OUTLINE:

INTERNATIONAL FINANCE

PhD course | Frankfurt University | Spring 2006 | version: March 2006

Marcel Fratzscher
European Central Bank
Kaiserstrasse 29, D-60311 Frankfurt
phone: +49 - 69 1344 6871
fax: +49 - 69 1344 7666
email: Marcel.Fratzscher@ecb.int
homepage: <http://www.marcelfratzscher.com>

Overview

This course develops core models of international finance, and surveys selected topics in international financial markets; exchange rates and purchasing power parity; international CAPM; equity and bond home biases; determinants of capital flows; sovereign debt crisis; speculative attacks and financial crises; contagion and financial linkages; exchange rate regimes and monetary policy choices; and the stability of the international financial system.

The goal is to provide a thorough foundation of the key concepts in international finance, with some of the topics also touching upon international macroeconomics and trade, while others are more finance focused. A closely related intention of the course is to give the students a good idea of the current frontier of research in selected areas of international finance, and thus ultimately to prepare them to do original work. The course assumes that students have taken the first-year macro, micro and econometrics sequences.

Requirements and grades

Students will be assessed on the basis of two elements; first, an essay/brief term paper addressing a specific question in an area of choice; and second, an empirical exercise with data using an econometric software.

Reading list

Readings for each topic provided below are preliminary. An updated and more detailed reading list, distinguishing between core/required readings (*) and additional readings, will be provided at the beginning of the course. Students are expected to have at least browsed through the required readings before class.

Time and location

Mondays and Fridays from 12.00 – 14.00, starting from 12 June onwards.

Outline and Schedule

1. International portfolio diversification in theory and practice

- French, K. and J. Poterba (1991): "Investor diversification and international equity markets", American Economic Association Papers and Proceedings 81, 222-226
- Van Wincoop, E. (1999): "How big are the potential welfare gains from international risk sharing?", Journal of International Economics 47, 109-135.
- Ahearne, A., W. Grier and F. Warnock (2004): "Information costs and home bias: an analysis of U.S. holdings of foreign equity", Journal of International Economics 62, 313-336
- Imbs, J. (2004): "The real effects of financial integration", CEPR Discussion Paper 4335.
- Pesenti, P. and E. van Wincoop (2002): "Can nontradables generate substantial home bias?", Journal of Money, Credit and Banking 34(1), p. 25-50
- Prasad, E., K. Rogoff, S. Wei and M. Kose (2004): "Financial Globalization, Growth and Volatility in Developing Countries", NBER Working Paper 10942.

2. Equity and Bond Home Bias, and International CAPM

- Lewis K., "International Home Bias in International Finance and Business Cycles", Journal of Economic Literature 37, June 1999, 571-608.
- Dumas, B and B. Solnik, "The world price of foreign exchange risk", Journal of Finance, 1995,. Vol 50 (2) p 445-79.
- Pavlova A and R. Rigobon, "Asset Prices and Exchange Rates", mimeo Sloan School, 2005
- Lewis K., "Puzzles in International Financial Markets" in Handbook of International Economics, Gene Grossman and Ken Rogoff, ed, North Holland, 1995 also NBER WP 4951;
- Obstfeld M. and K. Rogoff, "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?", NBER Macro Annual 2000, also NBER working paper 7777.

3. Risk Sharing and International Financial Markets

- Brandt M., Cochrane J. and P. Santa Clara, 2004. "International Risk Sharing is better than you think (or exchange rates are much too smooth) ", NBER WP 8404.
- Van Wincoop, E, "How Big are Potential Gains from International Risk Sharing?", Journal of International Economics 47, 1999, 109-135.
- Cole H. and M. Obstfeld, "Commodity Trade and International Risk Sharing: How much do Financial Markets Matter?", Journal of Monetary Economics 28 (August): 3-24, 1991.
- Lucas R., "Interest Rates and Currency Prices in a Two-Country World", Journal of Monetary Economics, 10, 335-59, 1982.
- Martin P. and H. Rey: "Financial Super-Markets: Size matters for asset trade".

4. Empirical Models of Nominal Exchange Rates

- Mark, N. 1995. Exchange Rates and Fundamentals: Evidence on long-horizon predictability. American Economic Review 85: 201-218.
- Gourinchas P-O and H. Rey, "International Financial Adjustment", mimeo Princeton University 2004.
- Bacchetta P. and E. van Wincoop, "Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?", NBER WP9498, Feb 2003

- Meese R. and K. Rogoff, "Empirical Exchange Rate Models of the Seventies", *Journal of International Economics* 14 3-24, 1983

5. Capital Flows and Microstructure Models

- Evans M. and R. Lyons, 2001. *Order Flow and Exchange Rate Dynamics*, NBER WP7317, and *Journal of Political Economy*
- Froot K. and T. Ramadorai, 2001. "Currency Return, Institutional Investor Flows and Exchange-Rate Fundamentals"
- Lane P. and G. M. Milesi-Ferretti, "The External Wealth of Nations: Measure of Foreign Assets and Liabilities for Industrial and Developing Countries,"
- Portes, R. and H. Rey (2005): "The determinants of cross-border equity flows", *Journal of International Economics* 65, 269-96.
- Brennan M. and H. Cao, 1997, "International portfolio investment flows", *Journal of Finance* 52, 1851-1880.
- Kraay, A., N. Loayza, L. Servén and J. Ventura (2005): "Country Portfolios", *Journal of the European Economic Association* 3, 914-945.
- Calderón, C., N. Loayza and L. Servén (2003): "Do Capital Flows Respond to Risk and Return?", *World Bank Policy Research Working Paper* 3059 (2003).
- Albuquerque, R., N. Loayza and L. Servén (2005): "World Market Integration Through the Lens of Foreign Direct Investors", *Journal of International Economics* 66, 267-295.
- Forbes, K. (2005): "The microeconomic evidence on capital controls: no free lunch", NBER Working Paper 11372.

6. Long Run Real Exchange Rates, Terms of Trade and Expenditure Switching.

- Engel C. and J. Rogers, "How Wide is the Border?" *American Economic Review* 1996 Dec, pp1112-1125;
- Imbs J, H. Mumtaz, M. Ravn and H. Rey, "PPP Strikes Back: Aggregation and the Real Exchange Rate", *QJE* 2005
- Rogoff K. "The Purchasing Power Parity Puzzle", *Journal of Economic Literature* Vol. 34, No. 2. (Jun., 1996), pp. 647-668;
- Engel C. "Accounting for US Real Exchange Rate Changes," *Journal of Political Economy* 107(3), June 1999, pages 507-38;

7. Sovereign Debt

- Kletzer K. and B. Wright, "Sovereign Debt as Intertemporal Barter", *American Economic Review*, 90, June 2000.
- Kraay, A., Loayza, N., Servén, L. and J. Ventura "Country Portfolios", 2004
- Cole H. and T. Kehoe "Self Fulfilling Debt Crises", *Review of Economic Studies* 67(1), January 2000, pages 91-116, also *Federal Reserve Bank of Minneapolis Staff Report* 211, July 1998
- Bulow J. and K. Rogoff, "A constant recontracting model of sovereign debt" *Journal of Political Economy* Vol. 97, No. 1. (Feb., 1989), pp. 155-178.

8. Financial and Currency Crises in Open Economies

- Flood, R., and P. Garber. "Collapsing Exchange Rate Regimes: Some Linear Examples." *JIE*
- Kaminsky, G. and C. Reinhart, "The Twin Crises: the causes of banking and balance of payments problems." *AER* 89, 1999, 473-500

- Mc Kinnon, R., and H. Pill. 1996. "Credible Liberalizations and International Capital Flows: The Overborrowing Syndrome," in T. Ito and A. Krueger (eds.), *Financial Deregulation and Integration in East Asia*, Chicago: Chicago University Press.
- Chari, V.V. and P. Kehoe, "Hot Money," *JPE* 111 (2003), 1262-92
- Alesina, A., and G. Tabellini. "External Debt, Capital Flight, and Political Risk." *JIE* 27

9. Financial Integration and Globalization

- Blanchard O. and F. Giavazzi: "Current Account Deficits in the Euro Area. The End of the Feldstein Horioka Puzzle?", *Brookings Papers on Economic Activity*, Fall 2002.
- Gourinchas P-O. and O. Jeanne "On the Benefits of Capital Account Liberalization for Emerging Economies".
- Acemoglu D. and J. Ventura, "The World Income Distribution", *Quarterly Journal of Economics*, May 2002.
- Edison, H., M. Klein, L. Ricci and T. Sloek, "Capital Account Liberalization and Economic Performance: Survey and Synthesis", *NBER Working paper* 9100, August 2002.
- Bekaert G., C. Harvey and C. Lundblat, "Does Financial Liberalization Spur Growth", *Duke University*, May 2002.

10. Exchange rate regimes and monetary policy choices

- Calvo, G. and C. Reinhart (2002): "Fear of floating", *Quarterly Journal of Economics* 117(2), 379-407.
- Hausmann, Ricardo, Michael Gavin, Carmen Pages, and Ernesto Stein. (1999). *Financial Turmoil and the Choice of Exchange Rate Regime*. Inter-American Development Bank, Research Department Working Paper No. 400.
- Williamson, John. (2000). *Exchange Rate Regimes for Emerging Markets: Reviving the Intermediate Option*. Institute for International Economics, Washington D.C.
- Calvo, G. and R. Mishkin (2003): "The mirage of exchange rate regimes for emerging market countries", *Journal of Economic Perspectives* 17, 99-118.