

International Finance

Stellenbosch University

First semester 2020

- Course instructor: Hylton Hollander
- Time: Tuesdays, 11h00–13h00
- Venue: Room 207B, Schumann Building
- Office: Room 519, Schumann Building
- Office hours: by appointment (you can reach me by phone at 021 808 2478 or preferably by email: hylton@sun.ac.za)

1 Overview

In this International Finance course we will study the basic theory, the major issues and the institutional and practical aspects of international macroeconomics. The balance-of-payments accounts, the foreign exchange market, and international capital mobility form the core of the course. From here, we will be able to discuss policy issues related to excessive global trade imbalances, sovereign debt crises, international financial crises, exchange rate regimes, and the evolving international monetary system.

Having completed the module successfully, the diligent student should have the necessary background and tools to understand and analyse the role of exchange rates and the balance of payments in an open economy on both the theoretical and policy levels, and have a working knowledge of the major international financial events and issues of the recent past. More importantly, our goal is to reassess conventional wisdom, appraise heterodox ideas, and filter real-time news about the global economy and the position of our country therein.

2 Literature

The main textbook that we will refer to for most of the course is:

- *International Macroeconomics*, by Stephanie Schmitt-Grohé, Martín Uribe, and Michael Woodford. Columbia University, 2019. Available at: columbia.edu

I will also draw from:

- Appleyard, D.R. and Field, A.J., 2014. *International Economics*, 8th ed. McGraw-Hill. Available at: [SU library](#) (Chapters 19-21 are available under [Readings](#).)

And to a lesser extent:

- *Handbook of International Economics*, Volume 4, Pages 391-740 (2014), Edited by Gita Gopinath, Elhanan Helpman and Kenneth Rogoff. Available at: sciencedirect.com

3 Grading and Preparation

- Grades will be based on a group project (20%), four assignments (20%), in-class evaluation (10%), and a final exam (50%).
- You will be required to do four weekly assignments. These assignments will be done as group activities after each lecture. These activities will involve a short summary (max. 400 words), basic data work, and a 5-10 minute presentation. The purpose of this is to help build the necessary skills needed for the private sector.
- Participation in discussions on the course content and class activities (forum, FNB trading game) will form part of in-class evaluation. Preparation before each class is therefore essential.
- There is no midterm test (only an exam). A supplementary exam will be scheduled for students that are either sick in the exam (with a medical certificate) or that qualifies for a rewrite. All supplementary exams are written in a condensed time frame (i.e. within one calendar week).

- For the group project requirements, please see the learn.sun.ac.za course page.

International Finance 871

This course runs a parallel Masters level stream (International Finance 871). The Masters course will emphasise the following outcomes:

- (i) Analyse, on both the theoretical and policy levels, the role of exchange rates and the balance-of-payments in an open economy modelling approach.**

Here, Masters students must be able to derive and manipulate theoretical models to study policy relevant questions on exchange rate regimes and balance-of-payments dynamics. Although Honours students must show competent understanding of the open economy models studied, they are not required to be able to derive or manipulate mathematical models used for open economy modelling.

- (ii) Operate in the private sector with a working knowledge of the major international financial events and issues of the recent past.**

Masters students must be able to analyse and interpret a broader range of contemporary international macroeconomic issues, over-and-above the generalized themes in the course outline, namely: “twin deficits”, exchange rate regimes, international financial crises, and the international monetary system. For example, Masters students must be able to understand how gross versus net capital flows help a practitioner interpret international financial spillovers. Masters students must also show an ability to apply methodological frameworks to interpret current trends and international macroeconomic themes.

- (iii) Pursue a doctor of philosophy degree in open economy macroeconomic theory and policy.**

A diligent Masters student who completes the International Finance 871 track will be able to comfortably begin a PhD in the field of Open Economy Macroeconomics

(contingent on receiving an adequate grade for Masters Macroeconomics and Masters Econometrics courses).

Literature & Grading:

- Masters students will be required to incorporate more empirically and theoretically heavy literature, discussed in the Handbook of International Economics (2014), in their essays. Whereas, Honours students will not be explicitly assessed on it. Moreover, as mention above, Masters students will be required to study the theoretical models more in-depth at a level commensurate to the Mathematical Economics and Dynamic Economic Theory courses.
- Masters students will be assessed with 20% greater weight on the three outcomes emphasized above compared to Honours students. The Masters students will be given more theoretically demanding in-class assessments amounting to 10% of the term mark. The exam will place more emphasis on outcomes emphasized in (i)-(ii) with approximately 20% of the marks allocated to theoretical and policy-related questions using open economy modelling approaches introduced in the course.

4 Course Outline

4.1 Introduction and overview - 04 February

- Plus: navigating the world of international macroeconomics and other helpful hints for every graduate

4.2 The balance-of-payments accounts - 11 February

- Appleyard and Field (2014), Chapter 19
- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 1, “Global Imbalances”

- SA Balance of Payments Statistics & more: [EasyData](#) and [SARB Quarterly Bulletin](#)
- Assignment 1 due 18 February

4.3 A theory of current account determination (part I) - 18 Feb.

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 2, “Current Account Sustainability”

Additional readers:

- Milesi-Ferretti, G.M., “A \$2 Trillion Question,” VOX, January 28, 2009, available online at <http://www.voxeu.org>.
- Corsetti, G. and Konstantinou, P.Th., “The \$2 trillion dollar question: How about US demand and output?,” VOX, February 18, 2009, available online at <http://www.voxeu.org>
- Avdjiev, S., McCauley, R., and Shin, H.S. “Conceptual challenges in international finance,” VOX, September 28, 2016, available online at <http://www.voxeu.org>

- Assignment 2 due 25 February

4.4 A theory of current account determination (part II) - 25 Feb.

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 3, “An Intertemporal Theory of the Current Account” (Endowment Economy)
- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 4, “The Terms of Trade, the Interest Rate, and the Current Account”

4.5 A theory of current account determination (part III) - 03 Mar.

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 5, “Current Account Determination in a Production Economy”

4.6 Exchange rate determination (part I) - 10 March

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 8, “The Real Exchange Rate and Purchasing Power Parity”

Additional readers:

- Taylor, Alan M. and Mark P. Taylor, “[The Purchasing Power Parity Debate](#),” *Journal of Economic Perspectives* 18, Fall 2004, 135-158.
- *Handbook of International Economics* (2014), Chapter 7, “[International prices and exchange rates](#)”

- Assignment 3 due 17 March

4.7 Mini-presentations and discussion session - 17 March

Recess - 21 March to 29 March

Group project - due: 05 May

[Click here for project requirements on the SUNlearn course page](#)

4.8 Exchange rate determination (part II) - 31 March

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 9, “Determinants of the Real Exchange Rate” (excl. 9.3)
- Appleyard and Field (2014), Chapter 22

Additional readers:

- Chinn, Menzie D. (2013), “Macro Approaches to Foreign Exchange Determination,” [Working Paper Series La Follette School Working Paper No. 2013-005](#)
- “[Monetary and portfolio-balance models of exchange rate determination](#),” by J. Frankel in *Economic Interdependence and Flexible Exchange Rates*, Chapter 3 (1983), Edited by Jagdeep Bhandari and Bluford Putnam (MIT Press, Cambridge).
- *Handbook of International Economics* (2014), Chapter 8, “[Exchange rates and interest parity](#)”

4.9 International capital mobility - 07 April

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 10, “International Capital Market Integration”

The foreign exchange market and international financial markets and instruments:

- Appleyard and Field (2014), Chapter 20 & Chapter 21

Additional readers:

- Lettau, M. and Madhavan, A. (2018) “[Exchange-Traded Funds 101 for Economists](#),” *Journal of Economic Perspectives*, 32(1): 135-54.
- Coeurdacier, N. and Rey, H. (2013) “[Home Bias in Open Economy Financial Macroeconomics](#),” *Journal of Economic Literature*, Vol. 51, No. 1, pp. 63-115.

- Assignment 4 due 14 April

4.10 Mini-presentations and discussion session - 14 April

Postgraduate mini-conference - 15 April

4.11 External balance and external adjustment in open economies

- 21 April

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 6, “Uncertainty and the Current Account”
- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 7, “Large Open Economies”

Additional readers:

- Appleyard and Field (2014), Chapters 23 & Chapter 24
- *Handbook of International Economics* (2014), Chapter 10, “External Adjustment, Global Imbalances, Valuation Effects”
- Ben S. Bernanke, “The Global Saving Glut and the U.S. Current Account Deficit,” Homer Jones Lecture, St. Louis, Missouri, April 14, 2005.
- Luiz de Mello et al., 18 June 2011, The growth effect of current-account reversals, VOX EU, available online at <http://www.voxeu.org>
- Ostry et al. (2011) “Managing capital inflows: what tools to use?,” IMF, SDN/11/06
- Ostry et al. (2010) “Capital inflows: the role of control,” IMF, SDN/10/04

Recess - 27 April to 1 May

4.12 Discussion session: presentations on FNB Securities trading simulation - 05 May

- 5–10 minute presentation on trading strategy: must show evidence of applying economic theory. 5 minute Q&A.

- Additional material:
 - 2018 Guest Lecture Series (Lars Christensen): [Applied Economic Theory & Why are real yields so low?](#)
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4.13 Exam Q&A session - 12 May

Postgraduate lectures end - 15 May, Friday

Specialization: Choose one of the following themes for your group project

“Twin Deficits”: fiscal deficits and current account imbalances

- Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 14.

Additional readers:

- *Handbook of International Economics* (2014), Chapter 11, [“Sovereign Debt”](#)
- Bocola (2016) [The Pass-through of Sovereign Risk](#) (JPE)
- Bordo and Meissner (2016) [Chapter 7 - Fiscal and Financial Crises. Handbook of Macroeconomics](#)
- Borio et al (2016) [fiscal sustainability and the financial cycle](#)
- Broner et al. (2014) [Sovereign debt markets in turbulent times](#) (JME)
 - * [Comment by Wright](#) on Broner et al (2014)
- Reinhart and Rogoff (2013) [financial and sovereign debt crises](#)

- Schularick (2012) [Public debt and financial crises in the twentieth century](#)

Exchange rate regimes

- Appleyard and Field (2014), Chapter 25, 26 & 27
- “Monetary policy and nominal exchange rate determination” in Schmitt-Grohé et al. (2019) *International Macroeconomics*, Chapter 12.
- Dilemma or Trilemma:
 - Rey (2015) [“Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence”](#) (seminal article; see [“cited by” list](#) for further references)
 - Cerutti, Claessens and Rose (2017) [“How Important is the Global Financial Cycle? Evidence from Capital Flows”](#) (counterargument)
 - Ligonniere (2018) [“Trilemma, dilemma and global players”](#)
 - Short articles: [Rey \(2013\)](#) (seminal article); [Rose \(2017\)](#) (counterargument); [Klein and Shambaugh \(2013\)](#).

Additional readers:

- Short articles: [Edwards \(2015\)](#); [Rey \(2013\)](#); [Ghosh et al. \(2014\)](#); [Alfaro and Kanczuk \(2013\)](#); [Bergin et al. \(2012\)](#); [Eichengreen and Rose \(2010\)](#)
- Levy-Yeyati, E. and Sturzenegger, F:
 - (2016) [“Classifying Exchange Rate Regimes: 15 Years Later.”](#) CID Faculty Working Paper No. 319
 - (2005) [“Classifying exchange rate regimes: Deeds vs. words.”](#) European Economic Review, Vol.49, Issue 6, pp.1603-1635
 - (2003) [“To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth.”](#) American Economic Review, 93(4): 1173-1193.

- (2001) “Exchange Rate Regimes and Economic Performance.” UTDT, CIF Working Paper No. 2/01.
- Rose, A.K. (2011) “Exchange rate regimes in the modern era: fixed, floating and flaky.” *Journal of Economic Literature*, Vol 49, Number 3, pp 652-672
- Bordo, M.D. (2003) Exchange rate regime choice in historical perspective, *IMF Working Paper*, WP/03/160
- Papaioannou, M.G. (2003) “Determinants of the choice of exchange rate regimes in six Central American countries: An empirical analysis,” *IMF Working Paper*, WP/03/59
- Ghosh, A.R. et al. (1998) “Currency Boards: The ultimate fix?”, *IMF Working Paper*, WP/98/8

International financial crises

Policy spillovers, cross-border capital flows and currency crises

- *Handbook of International Economics* (2014), Chapter 12, “International Financial Crises”

Additional readers:

- Short articles: Aizenman et al. (2015); Reinhardt et al. (2014); Vesperoni et al. (2014); Aizenman et al. (2014); Brunnermeier et al. (2012); Allen et al. (2011)
- Working Papers: Dizioli et al. (2016) (China); Caceres et al. (2016), Koepke (2015) (U.S.); Ahmed et al. (2017) (EMEs)
- Forbes et al. (2017) “The spillovers, interactions, and (un)intended consequences of monetary and regulatory policies.” *Journal of Monetary Economics*, Vol. 85, pp.1-22
- Discussion: Comment on Forbes et al. (2017)
- Hofmann & Takáts (2015). BIS publication.

- Eichengreen, B. and Gupta, P. (2015) “[Tapering talk: The impact of expectations of reduced Federal Reserve security purchases on emerging markets.](#)” Emerging Markets Review, Vol. 25, pp. 1-15.
- Kaminsky, G.L., Reinhart, C.M., and Végh, C.A. (2003) “[The unholy trinity of financial contagion](#)”, Journal of Economic Perspectives, Vol 17, Number 4, pp 51-74
- Kaminsky, G.L. and Reinhart, C.M. (2000) “[On crises, contagion and confusion](#)”, Journal of International Economics, Vol 51, Number 1, pp 145-168
- Kaminsky, G.L. and Reinhart, C.M.. (1999) “[The Twin Crises: The Causes of Banking and Balance-of-Payments Problems](#),” American Economic Review, Vol 89, Number 3, pp 473-500
- IMF (1998) “Financial crises: characteristics and indicators of vulnerability,” World Economic Outlook, pp 74-97.

The international monetary system

- Low global real yields:
 - Borio et al. (2017) [Why so low for so long? A long-term view of real interest rates](#), BIS Working Papers No 685
 - Del Negro et al. (2018) [Global Trends in Interest Rates \(VoxEU.org summary\)](#)
See also: [Liberty Street Economics three post series](#)
 - Lars Christensen (2018) SU public lecture [audio with slides](#)
- General IMS literature: Appleyard and Field (2014), Chs 28 & 29

Additional readers:

- Short articles: [Cukierman \(2015\)](#); [Goldberg et al. \(2014\)](#); [Bordo & Redish \(2013\)](#); [Farhi et al. \(2011\)](#); [Fratzscher & Mehl \(2011\)](#); [Skala \(2011\)](#); [Dadush & Eidelman \(2011\)](#);

- Working papers: Borio (2014); Dorucci and McKay (2011)
 - IMF (2011) “Strengthening the International Monetary System: taking stock and looking ahead,” *IMF Strategy, Policy and Review Department* (updated review 2016 [here](#))
 - Cukierman, A., “The Crisis and the Renminbi’s international role,” VOX, January 07, 2015, available online at <http://www.voxeu.org>
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