

260D: Topics in International Macroeconomics

Professor Paul R. Bergin
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class meeting: M,W 12:10-1:30 PM, Wellman 109
office hours: M,W 9:30-11:00AM, 1141 SSH

The first objective of this course is to familiarize advanced Ph.D. students with recent developments in international macroeconomics. The course will focus on intertemporal models of the current account and exchange rate, a body of work which has come to be known as the “New Open Economy Macroeconomics.” The course will deal with the theory, testing, and applications of these models. The second objective is to help students explore potential areas for dissertation topics.

With these objectives in mind, students will be graded upon the following:

- 1) Two 20-30 minute class presentations of a paper from the reading list. (20% total) Please provide a handout of your slides for the other students in the class to study from.
 - 2) Participation in class discussions (10%)
 - 3) A 6-8 page paper/research proposal, due in class June 3. (30%) The paper should include the following sections:
 - (i) introduction (defines the main question and explains why it is important),
 - (ii) literature review (what has been done so far and what questions remain unsolved), and
 - (iii) methodology (type of model, econometrics, data sources, and a list of potential problems that may be encountered).
 - 4) A comprehensive final exam. (40%) Thursday June 11, 10:30AM-12:30PM, Wellman 109
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Links to PDF journal articles are on the class website:

<http://www.econ.ucdavis.edu/faculty/bergin/Econ260d>, along with lecture slides.

* required reading ♦ student presentation

1) What Determines Nominal and Real Exchange Rates? (4 lectures)

a) Tests of Purchasing Power Parity

- * Alan M. Taylor & Mark P. Taylor, 2004. "The Purchasing Power Parity Debate," *Journal of Economic Perspectives*, American Economic Association, vol. 18(4), pages 135-158, Fall.
- Frankel, J. and A.K. Rose, 1996, "A Panel Project on Purchasing Power Parity: Mean Reversion Within and Between Countries," *Journal of International Economics* 40, February, 209-224.
- Lothian, J.R. and M.P. Taylor, 1996, "Real Exchange Rate Behavior: the Recent Float from the Perspective of the Past Two Centuries," *Journal of Political Economy* 104, 488-509.
- O'Connell, P, 1998, "The Overvaluation of Purchasing Power Parity," *Journal of International Economics*, 44, February, 1-19.

b) Aggregation Bias Debate

- * Imbs, Jean, H. Mumtaz, Morten Ravn and Helene Rey, 2005, "PPP Strikes Back: Aggregation and the Real Exchange Rate," *Quarterly Journal of Economics* 70, 1-43.

- Engel, Charles and Shiu-sheng Chen, 2005, "Does Aggregation Bias Explain the PPP Puzzle?" *Pacific Economic Review* 10, 49-72.
- Carvalho, Carlos and Fernanda Nechio, 2008, "Aggregation and the PPP Puzzle in a Sticky Price Model," Working Paper.

c) Exchange Rates and Macroeconomic Fundamentals:

- Meese, Richard and Kenneth Rogoff, 1983, "Empirical Exchange Rate Models of the Seventies: Do they fit out of sample?" *Journal of International Economics* 14, 3-24.
- Flood, Robert and Andrew Rose, 1999, "Understanding Exchange Rate Volatility Without the Contrivance of Macroeconomics," *The Economic Journal* 109, 660-672.
- Engel, Charles and Kenneth West, 2005. "Exchange Rates and Fundamentals," *Journal of Political Economy* 113, June 2005, 485-517.
- * Engel, Charles, Kenneth West, and Nelson C. Mark, 2008, "Exchange Rate Models are Not as Bad as You Think," NBER Macroeconomics Annual (draft posted on website)
- Bacchetta, Philippe and Eric van Wincoop (2006), "Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?" *American Economic Review* 96, 552-576.

d) Balassa-Samuelson theory of real exchange rates

- * Bergin, Paul, Reuven Glick and Alan Taylor, 2006, "Productivity, Tradability, and the Long Run Price Puzzle," *Journal of Monetary Economics* 53 (8), 2041-2066.
- James R. Lothian & Mark P. Taylor, 2008. "Real Exchange Rates Over the Past Two Centuries: How Important is the Harrod-Balassa-Samuelson Effect?," *Economic Journal*, 118(532), 1742-1763. (One website)
- ◆ Papell, David and Ruxandra Prodan, 2006, Additional Evidence of Long Run Purchasing Power Parity with Restricted Structural Change, *Journal of Money, Credit, and Banking*, August, 1329-1349.

2) Monetary Policy in Open Economy Sticky Price Models (3 lectures)

a) VAR evidence on exchange rates and money shocks

- * Eichenbaum, Martin, and Charles L. Evans, 1995, "Some Empirical Evidence on the Effects of Shocks to Monetary Policy on Exchange Rates," *Quarterly Journal of Economics*, 110 (4) November, 975-1009.
- Kim, Soyoung and Nouriel Roubini, 2000, "Exchange Rate Anomalies in the Industrial Countries: A Solution with a Structural VAR Approach," *Journal of Monetary Economics* 45, 561-586. (On website.)
- Faust, Jon and John H. Rogers, 2000, "Monetary Policy's Role in Exchange Rate Behavior," *Journal of Monetary Economics* 50, 1403-1424. (On website.)
- Bjoernland, Hilde C. (2006), Monetary Policy and Exchange Rate Overshooting: Dornbusch was Right After All, working paper.

b) The Origins of New Open Economy Sticky Price Models

- * Obstfeld, Maurice and Kenneth Rogoff, 1995, "Exchange Rate Dynamics Redux," *Journal of Political Economy*, 103 (3) June, 624-660.
- Kollmann, Robert, 2001, "The Exchange Rate in a Dynamic-Optimizing Current Account Model with Nominal Rigidities: A Quantitative Investigation," *Journal of International Economics* 55, 243-262.
- Lane, Philip R. (2001) "The New Open Economy Macroeconomics: A Survey," *Journal of International Economics* 54, 235-266

c) Sticky Price Models and Real Exchange Rate Persistence

Chari, V.V., Patrick J. Kehoe, and Ellen R. McGrattan, 2002, "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" *Review of Economic Studies* 69, 533-563.

Bergin, Paul R. and Robert C. Feenstra, 2001, "Pricing to Market, Staggered Contracts, and Persistence in the Real Exchange Rate," *Journal of International Economics* 54, 333-359.

- * Lahiri, Amartya and Alok Johri, 2008, "Persistent real Exchange Rates," forthcoming in the *Journal of International Economics*.

3) Failures in the Law of One Price (4 lectures)

a) Empirical Studies of International Price Dispersion

Crucini, Mario, Chris Telmer and Marios Zachariadis, 2005, "Understanding European Real Exchange Rates," *American Economic Review* 95, 724-738.

Bergin, Paul R. and Reuven Glick, 2007, "Tradability, Productivity, and International Economic Integration," *Journal of International Economics* 73 (1), 128-151.

- ◆ Charles Engel, 1999, "Accounting for U.S. Real Exchange Rate Changes Accounting for U.S. Real Exchange Rate Changes" *The Journal of Political Economy* 107, 507-538.
- *◆ Betts, Caroline M. and Timothy J. Kehoe, 2006, "U.S. real exchange rate fluctuations and relative price fluctuations," *Journal of Monetary Economics* 53, 1297-1326. (One website)

b) Border Effects on Price Dispersion

- ◆ Engel, Charles, and John H. Rogers, 1996, "How Wide Is the Border? The American Economic Review 86, 1112-1125,
- *◆ Gorodnichenko, Yuriy and Linda Tesar (2008) "Border effect or country effect? Seattle may not be so far from Vancouver after all," *American Economic Journal: Macroeconomics* 1, 219-241.

c) Barcode Evidence on Price Dispersion:

- ◆ Broda, Christian and David Weinstein, 2008, "Understanding International Price Differences using Barcode Data," working paper.
- ◆ Gopinath, Gita and Pierre-Olivier gourinches, and Chang-Tai Hsieh, 2008, "Cross-Border Prices, Costs, and Markups, working paper.

d) Macro Models with Price Dispersion

Obstfeld, Maurice and Kenneth Rogoff, 2000, "New Directions for Stochastic Open Economy Models," *Journal of International Economics*, 50, 117-53.

Betts, Caroline and Michael B. Devereux, 1996, "The Exchange Rate in a Model of Pricing-to-Market," *European Economic Review*, 40 (3-5) April, 1007-1021.

- * Betts, Caroline and Michael B. Devereux, 2000, "Exchange Rate Dynamics in a Model of Pricing-to-Market," *Journal of International Economics* 50, 215-44.

4) Uncovered Interest Rate Parity Puzzle (2 lectures)

a) Tests of UIP

- * Engel, Charles, 1996, "The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence," *Journal of Empirical Finance*. (On website as NBER WP #5312))
- Mark, Nelson, 1985, "On time-Varying Risk Premia in the Foreign Exchange Market: An Econometric Analysis," *Journal of Monetary Economics*, 10, 365-391.

b) Theoretical Attempts to Explain the Puzzle

Obstfeld, Maurice and Kenneth Rogoff, 2001, "Risk and Exchange Rates," UC Berkeley mimeo.

Bacchetta, Philippe and Eric van Wincoop (2007) "Random Walk Expectations and the Forward Discount Puzzle," *American Economic Review* 97, 346-350.

- * ♦ Bacchetta, Philippe and Eric van Wincoop (2006) "Incomplete Information Processing: A Solution to the Forward Discount Puzzle" working paper.

5) Optimal Monetary Policy and International Policy Coordination (3 lectures)

a) New Open Economy Models of Policy Analysis

Bacchetta, Philippe and Eric van Wincoop, 2000, "Does Exchange-Rate Stability Increase Trade and Welfare?" *American Economic Review* 90, 1093-1109. (On website as mimeo)

Bergin, Paul R., Ivan Tchakarov, and Hyung-Cheol Shin, 2007, "Does Exchange Rate Variability Matter for Welfare? A Quantitative Investigation of Stabilization Policies," *European Economic Review* 51 (4), 1041-1058.

- * Kollmann R., 2004, "Welfare effects of a monetary union: The role of trade openness." *Journal of the European Economic Association* 2, 289-301.

Calvo, Guillermo, Ondra Kamenik and Michael Kumhof, 2008, "Trade Openness and Exchange Rate Regimes," working paper.

b) An Alternative Modeling Approach

- * Engel, Charles, 2009, "Currency Misalignments and Optimal Monetary Policy: A Reexamination" working paper.

Clarida, R., J. Gali and M. Gertler, 2002, "A simple Framework for International Monetary Policy Analysis," *Journal of Monetary Economics* 49:5, 879-904.

Clarida, R., J. Gali and M. Gertler, 2001, "Optimal monetary policy in open versus closed economies," *American Economic Review* 91, 248-252. (On website as mimeo)

Gali, Jordi and Tommaso Monacelli, 2005, "Monetary Policy and Exchange Rate Variability in a Small Open Economy," *Review of Economic Studies* 72, 707-734.

c) International Policy Coordination

Oudiz, Giles and Jeffery Sachs, 1984. "Macroeconomics Policy Coordination Among the Industrial Countries," *Brookings Papers on Economic Activity* 1, 1-64.

- * Obstfeld, Maurice and Kenneth Rogoff, 2002, "Global Implications of Self-Oriented National Monetary Rules." *The Quarterly Journal of Economics* 117, 503-535. (On website as mimeo)

Devereux, Michael B. and Charles Engel, 2003, "Monetary Policy in the Open Economy Revisited: Price Setting and Exchange Rate Flexibility," *Review of Economic Studies* 70, 765-783.

Benigno, Giancarlo and Pierpaolo Benigno, 2003, "Price stability in Open Economies," *Review of Economic Studies* 70, 743-764.

Benigno, Pierpaolo, 2002, "A Simple Approach to International Monetary Policy Coordination," *Journal of International Economics* 57, 177-196.

6) Asset Valuation Effects (1 lecture)

Lane, Philip and Gian Maria Milesi-Ferretti, 2003, "International Financial Integration," *IMF Staff Papers* 03/86.

Lane, Philip and Gian Maria Milesi-Ferretti, 2005, "Financial Globalization and Exchange Rates," IMF Working Paper 05/3.

- * Gourinches, Pierre-Olivier and Helene Rey, 2007, "International Financial Adjustment," *Journal of Political Economy* 115:4, 665-703.
- Tille, Cedric, 2008, "Financial Integration and the Wealth Effect of Exchange Rate Fluctuations," *Journal of International Economics* 75, 283-294.

7) Monetary Union (2 lectures)

- Rose, Andrew, 2000. One money, one market: the effect of common currencies on trade. *Economic Policy: a European Forum* 30, 7-33.
- Glick Reuven and Andrew Rose, 2002. Does a currency union affect trade? The time series evidence, *European Economic Review* 46, 1125-1151.
- Frankel, Jeffrey, 2008, "The estimated Effects of the Euro on Trade: Why Are They Below Historical Effets of Monetary Unions Among Smaller Countries?" NBER Working paper 14542.
- Baldwin, Richard and Virginia Di Nino 2006. Euros and zeros: the common currency effect on trade in new goods, HEI Working Paper No. 21/2006.
- Bergin, Paul and Ching-Yi Lin, 2008, ""Exchange Rate Regimes and the Extensive Margin of Trade, 2008, NBER working paper 14126.
- Benigno, Pierpaolo (2004) "Optimal Monetary Policy in a Currency Area," *Journal of International Economics*, 63, 293-320.
- Engel, Charles (2000) "Local Currency Pricing and the Choice of Exchange Rate Regime," *European Economic Review*, 44, 1449-1472.