

Economics 280C

Spring 2020 Reading List

Updated: 1/9/20

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Classes are Tuesdays, 8 A.M. – 10 A.M., in 597 Evans Hall.

The International Macroeconomics Subfield

Complete coverage of the subfield requires of two courses, Economics 280B and 280C, taught by Professor Gourinchas and myself, respectively. You can take them in either order; they are highly complementary, despite a bit of necessary overlap.

This course (280C): exchange rates and international prices, old versus new Keynesian approaches, shorter-run macro-dynamics, open-economy macro policies, currency crises, the international monetary system.

Professor Gourinchas' course (280B): the role of external imbalances and external adjustment, national balance sheets, international capital movements, long-run dynamics, sovereign debt.

Textbooks

Two texts useful for both Economics 280B and 280C are:

M. Obstfeld and K. Rogoff, *Foundations of International Macroeconomics* (MIT Press, 1996).

M. Uribe and S. Schmitt-Grohé, *Open Economy Macroeconomics* (Princeton University Press, 2017).

Topics and Readings

Note: Many works are available at JSTOR. Recent working papers or pre-publication versions of published works are often at <http://www.nber.org>. I may post a few items that are difficult to find.

1. Building Blocks

The idea of this unit is to lay out some key factors that govern relationships among international prices in an open-economy setting. All of these factors play leading roles in the history of the subject. They have inspired huge literatures, of which I suggest only a small representative sample.

Varieties of Exchange Rate Arrangements: E. Ilzetzki, C. Reinhart, and K. Rogoff, "Exchange Arrangements Entering the 21st Century: Which Anchor Will Hold?" *Quarterly Journal of Economics* 134 (May 2019): 599-646.

M. Klein and J. Shambaugh, *Exchange Rate Regimes in the Modern Era* (MIT Press, 2010).

The Law of One Price: P. Goldberg and M. Knetter, "Goods Prices and Exchange Rates: What Have We Learned?" *Journal of Economic Literature* 35 (September 1997): 1243-72.

Purchasing Power Parity: A. Taylor and M. Taylor, "The Purchasing Power Parity Debate," *Journal of Economic Perspectives* 18 (Fall 2004): 135-58.

Covered Interest Parity: J.M. Keynes, *A Tract on Monetary Reform* (Macmillan, 1923), chapter III.

R. Levich, "CIP Then and Now," paper given at the BIS symposium on covered interest parity, May 2017. URL:
https://www.bis.org/events/bissymposium0517/symposium0517_open2.pdf

Uncovered Interest Parity: C. Engel, "The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence," *Journal of Empirical Finance* 3 (1996): 123-92.

2. Traditional Macro Models and Monetary Policy

Early open economy macro-models built on the Keynesian IS-LM framework, eventually building in dynamics and expectations. These models may appear rudimentary today. However, they were vital for clarifying general-equilibrium factors, and they remain valuable sources of intuition today. Thus, they merit a prominent unit in the course.

R. Dornbusch, "Expectations and Exchange Rate Dynamics," *Journal of Political Economy* 84 (December 1976): 1161-76.

C. Engel and K. West, "Taylor Rules and the Deutschmark-Dollar Real Exchange Rate," *Journal of Money, Credit, and Banking* 38 (August 2006): 1175-94.

J.M. Fleming "Domestic Financial Policies under Fixed and under Floating Exchange Rates," *IMF Staff Papers* 9 (November 1962): 369-80.

R. Mundell, "Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates," *Canadian Journal of Economics and Political Science* 29 (November 1963): 475-85.

M. Mussa, "The Exchange Rate, the Balance of Payments, and Monetary and Fiscal Policy under a Regime of Controlled Floating," *Scandinavian Journal of Economics* 78 (June 1976): 229-48.

3. New Keynesian Open Economy Models

New Keynesian models build on Old Keynesian frameworks by incorporating optimizing behavior by firms and households, including price setting by firms, in a dynamic setting. A considerable advantage is that they allow rigorous welfare analysis of policies and policy rules. The models in this section are “first-generation” frameworks where the main distortions are market power by firms and sticky prices (and in some cases goods-market segmentation).

G. Benigno and P. Benigno, "Exchange Rate Determination under Interest Rate Rules," *Journal of International Money and Finance* (2009).

V. Chari, P. Kehoe, and E. McGrattan, "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" *Review of Economic Studies* 69 (August 2002): 533-63.

R. Clarida, "Reflections on Monetary Policy in the Open Economy," in *International Seminar on Macroeconomics 2008*, edited by J. Frankel and C. Pissarides (University of Chicago Press, 2009).

G. Corsetti, L. Dedola, and S. Leduc. "Optimal Monetary Policy in Open Economies," in *Handbook of Monetary Economics*, volume 3, edited by B. Friedman and M. Woodford (Elsevier, 2010).

M. Devereux and C. Engel, "Monetary Policy in the Open Economy Revisited: Price Setting and Exchange-Rate Flexibility," *Review of Economic Studies* 70 (October 2003): 765-83.

E. Farhi, G. Gopinath, and O. Itskhoki, "Fiscal Devaluations," *Review of Economic Studies* 81 (April 2014): 725-60.

J. Galí and T. Monacelli, "Monetary Policy and Exchange Rate Volatility in a Small Open Economy," *Review of Economic Studies* 72 (2005): 707–34.

M. Obstfeld and K. Rogoff, "New Directions for Stochastic Open Economy Models," *Journal of International Economics* 50 (Feb. 2000): 117-53.

4. Low Global Interest Rates and Implications for Monetary Policy

For advanced economies, real interest rates have been falling for more than three decades, they now are very low, and they are likely to remain low for some time. Why is this the case? What are the implications for monetary policy?

B. Bernanke, "The Global Saving Glut and the U.S. Current Account Deficit," remarks at the Sandridge Lecture, Virginia Association of Economists, Richmond, Virginia, March 10, 2005.

R. Caballero, E. Farhi, and P. Gourinchas, "The Safe Assets Shortage Conundrum," *Journal of Economic Perspectives* 31 (Summer 2017): 29-46.

G. Corsetti, K. Kuester, and G. Müller, "Fixed on Flexible: Rethinking Exchange Rate Regimes after the Great Recession," manuscript, July 2017.

M. Del Negro, D. Giannone, M. Giannoni, and A. Tambalotti, "Global Trends in Real Interest Rates," *Journal of International Economics* 118 (May 2019): 248-62.

G. Eggertsson, N. Mehrotra, and L. Summers, "A Contagious Malady? Open Economy Dimensions of Secular Stagnation," *IMF Economic Review* 64 (November 2016): 581-634.

A. Ferrero, "A Structural Decomposition of the U.S. Trade Balance: Productivity, Demographics and Fiscal Policy," *Journal of Monetary Economics* 57 (May 2010): 478–90.

P. Gourinchas and H. Rey, "Global Real Interest Rates: A Secular Approach," BIS Working Papers 793, June 2019. URL: <https://www.bis.org/publ/work793.pdf>

K. Holston, T. Laubach, and J. Williams, "Measuring the Natural Rate of Interest: International Trends and Determinants," *Journal of International Economics* 108 (S1, May 2017): S59-S75.

L. Metzler, "The Process of International Adjustment under Conditions of Full Employment: A Keynesian View," in R. Caves and H. Johnson, eds., *Readings in International Economics* (Richard D. Irwin, Inc., 1968).

M. Obstfeld, "Global Dimensions of U.S. Monetary Policy," *International Journal of Central Banking*, forthcoming 2020.

L. Rachel and T. Smith, "Are Low Real Interest Rates Here to Stay?" *International Journal of Central Banking* 13 (September 2017): 1-42.

L. Rachel and L. Summers, "On Falling Neutral Real Rates, Fiscal Policy, and the Risk of Secular Stagnation," *Brookings Papers on Economic Activity* (1:2019): 1-76.

5. Exchange Rates, International Asset Pricing, and Interest Parity Puzzles

Uncovered interest parity fails to hold in the data. Since the global financial crisis, covered interest parity also fails. This unit reviews evidence and explanations in the light of asset-pricing theories.

D. Backus and G. Smith, "Consumption and Real Exchange Rates in Dynamic Economies with Non-Traded Goods," *Journal of International Economics* 35 (1993): 297-316.

M. Bussière, M. Chinn, L. Ferrara, and J. Heipertz, "The New Fama Puzzle," NBER Working Paper 24342, February 2018.

W. Du, A. Tepper, and A. Verdelhan, "Deviations from Covered Interest Rate Parity," *Journal of Finance* 73 (2018): 915-57.

C. Engel, "Exchange Rates and Interest Parity," in *Handbook of International Economics*, volume 4, edited by G. Gopinath, E. Helpman, and K. Rogoff (Elsevier, 2014).

E. Fama, "Forward and Spot Exchange Rates," *Journal of Monetary Economics* 14 (1984): 319-338.

Z. Jiang, A. Krishnamurthy, and H. Lustig, "Foreign Safe Asset Demand and the Dollar Exchange Rate," manuscript, March 2018. URL: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3142280

M. Obstfeld, "International Risk Sharing and the Costs of Trade," May 2007. URL: http://www.econ.berkeley.edu/~obstfeld/Ohlin_show.pdf

D. Rime, A. Schrimpf, and O. Syrstad, "Covered Interest Parity Arbitrage," manuscript, March 2019. URL: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2879904

6. Portfolio Models, Financial Frictions, and Foreign Exchange Intervention

If domestic and foreign bonds are imperfect substitutes, or if there are financial frictions, foreign exchange intervention may emerge as an additional tool for financial policy in an open economy. If so, the "trilemma" constraining monetary policy, exchange stability, and financial openness may loosen.

O. Blanchard, G. Adler, and I. de Carvalho Fiho, "Can Foreign Exchange Intervention Stem Exchange Rate Pressures from Global Capital Flow Shocks?" IMF Working Paper 15/159, July 2015.

O. Blanchard, F. Giavazzi, and F. Sa, "International Investors, the U.S. Current Account, and the Dollar," *Brookings Papers on Economic Activity* (1:2005): 1-65.

P. Cavallino, "Capital Flows and Foreign Exchange Intervention," *American Economic Journal: Macroeconomics* 11 (April 2019): 127-70.

E. Farhi and I. Werning, "Dilemma not Trilemma? Capital Controls and Exchange Rates with Volatile Capital Flows," *IMF Economic Review* 62 (2014): 569-605.

S. Fanelli and L. Straub, "A Theory of Foreign Exchange Interventions," manuscript, February 2019. URL: https://scholar.harvard.edu/files/straub/files/fxi_2019.pdf

X. Gabaix and M. Maggiori, "International Liquidity and Exchange Rate Dynamics," *Quarterly Journal of Economics* 130 (August 2015): 1369-1420.

A. Ghosh, J. Ostry, and M. Chamon, "Two Targets, Two Instruments: Monetary and Exchange Rate Policies in Emerging Market Economies," IMF Staff Discussion Note SDN/12/01, February 2012.

P. Kouri, "Balance of Payments and the Foreign Exchange Market: A Dynamic Partial Equilibrium Model," in *Economic Interdependence and Flexible Exchange Rates*, edited by J. S. Bhandari and B. H. Putnam (MIT Press, 1983).

R. Stulz, "The Demand for Foreign Bonds," *Journal of International Economics* 15 (November 1983): 225-38.

7. Pricing to Market, Exchange Rate Pass-Through, and Invoicing

With the dynamics of exchange rates and prices often far more complex than what the Law of one Price suggests, it becomes essential to consider market segmentation, market power, price rigidities, and choices of invoice currencies. While a full synthesis remains elusive, there has been important progress understanding key elements and in analyzing empirical evidence.

A. Atkeson and A. Burstein, "Trade Costs, Pricing to Market, and International Relative Prices," *American Economic Review* 98 (December 2008): 1998-2031.

A. Burstein and G. Gopinath, "International Prices and Exchange Rates," in *Handbook of International Economics*, volume 4, edited by G. Gopinath, E. Helpman, and K. Rogoff (Elsevier, 2014).

R. Dornbusch, "Exchange Rates and Prices," *American Economic Review* 77 (March 1987): 93-106.

L. Goldberg and C. Tille, "Vehicle Currency Use in International Trade," *Journal of International Economics* 76 (2008): 177-92.

G. Gopinath, "The International Price System," 2015 Jackson Hole Symposium. URL: <https://www.kansascityfed.org/~media/files/publicat/sympos/2015/2015gopinath.pdf>

G. Gopinath and J. Stein, "Banking, Trade, and the Making of a Dominant Currency," manuscript, March 2018.

P. Krugman, "The International Role of the Dollar: Theory and Prospect," in *Exchange Rate Theory and Practice*, edited by J. Bilson and R. Marston (University of Chicago Press, 1984).

P. Krugman, "Pricing to Market When the Exchange Rate Changes," in *Real-Financial Linkages among Open Economies*, edited by S. Arndt and J. Richardson (MIT Press, 1987).

8. International Financial Cycles, Financial Spillovers to Emerging Markets, and Crises

Emerging market economies face particular challenges in dealing with global shocks, especially financial shocks that emanate from advanced economies. They also have home-grown problems in many cases. This unit studies international spillovers and crises, with special reference to emerging markets.

P. Aghion, P. Bacchetta, and A. Banerjee, "A Corporate Balance Sheet Approach to Currency Crises," *Journal of Economic Theory* 119 (2004): 6-30.

Bruno, V. and H. Shin, "Capital Flows, Cross-Border Banking, and Global Liquidity," *Journal of Monetary Economics* 71 (April 2015): 119-32.

G. Calvo, "Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops," *Journal of Applied Economics* 1 (November 1998): 35-54.

G. Calvo and C. Reinhart, "Fear of Floating," *Quarterly Journal of Economics* 117 (May 2002): 379-408.

R. Chang and A. Velasco, "A Model of Financial Crises in Emerging Markets," *Quarterly Journal of Economics* 116 (May 2001): 489-517.

S. Claessens, A. Kose, L. Laeven, and F. Valencia, editors, *Financial Crises: Causes, Consequences, and Policy Responses* (IMF, 2014).

D. Diamond, Y. Hu, and R. Rajan, "The Spillovers from Easy Liquidity and the Implications for Multilateralism," Mundell-Fleming Lecture, International Monetary Fund, November 2018.

C. Díaz-Alejandro, "Good-Bye Financial Repression, Hello Financial Crash," *Journal of Development Economics* 19 (September/October 1985): 1-24.

P. Gourinchas and M. Obstfeld. "Stories of the Twentieth Century for the Twenty-First." *American Economic Journal: Macroeconomics*, January 2012.

G. Kaminsky and C. Reinhart, "The Twin Crises: The Causes of Banking and Balance-of-Payments Problems," *American Economic Review* 89 (June 1999): 473-500.

P. Krugman, "A Model of Balance-of-Payments Crises," *Journal of Money, Credit and Banking* 11 (August 1979): 311-25.

G. Lorenzoni and I. Werning, "Slow Moving Debt Crises," *American Economic Review* 109 (September 2019): 3229-63.

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

M. Obstfeld, "Models of Currency Crisis with Self-Fulfilling Features," *European Economic Review* 40 (April 1996): 1037-47.

H. Rey, "Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence" 2013 Jackson Hole Symposium. URL <http://www.kc.frb.org/publicat/sympos/2013/2013Rey.pdf>

9. The International Monetary System

Countries exercise what policy autonomy they possess within an international monetary system – one that may have tighter or looser rules and credibility (or no rules at all). Because of the importance of understanding how the system has changed over time – and implications of those changes for policy -- this unit focuses on the nature and evolution of international monetary and financial relations.

B. Eichengreen, *Globalizing Capital: A History of the International Monetary System*, 2nd edition (Princeton University Press, 2008).

E. Farhi, P. Gourinchas, and H. Rey, *Reforming the International Monetary System* (London: Centre for Economic Policy Research, September 2011).

E. Farhi and M. Maggiori, "A Model of the International Monetary System," *Quarterly Journal of Economics* 133 (February 2018): 295-355.

P. Gourinchas, "The Dollar Hegemon?" manuscript, May 2019. URL: <https://www.parisschoolofeconomics.eu/IMG/pdf/chaire-bdf-sept-2019-speaker-gourinchas.pdf>

M. Obstfeld, "The International Monetary System: Living with Asymmetry," in *Globalization in an Age of Crisis*, edited by R. Feenstra and A. Taylor (University of Chicago Press, 2014).

M. Obstfeld and A. Taylor, *Global Capital Markets: Integration, Crisis, and Growth* (Cambridge University Press, 2004).

M. Obstfeld and A. Taylor, "International Monetary Relations: Taking Finance Seriously," *Journal of Economic Perspectives* 31 (Summer 2017): 3-28.