

**International Finance**  
**Econ 5451**  
**2022-2023 Term 2**

**Instructor: Prof. Shu Lin**

**Class Time: Wed 9:30-12:15**  
**Office Hours: by appointment**  
**Office Phone: 3943 4300**

**Venue: Yasumoto Int'l Acad Park LT6**  
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**COURSE DESCRIPTION**

The course aims to provide students with a solid understanding of modern theories and empirics of international finance and open economy macro. Students will be expected to develop a good grasp of both the analytical tools and the relevant applied policy issues. The topics will be covered in this course include: exchange rate regimes and determination, current account determination, puzzles in international macroeconomics, international financial integration, international monetary policy spillover, financial crises, among others.

**TEXTS**

**Required:**

Krugman, Obstfeld, and Melitz. *International Finance: Theory and Policy*. 11<sup>th</sup> Edition. Pearson.

**Optional:**

Stephanie Schmitt-Grohe, Martin Uribe, and Michael Woodford. *International Macroeconomics*. Princeton University Press.

Mark, Nelson. 2001. *International Macroeconomics and Finance: Theory and Econometric Methods*. Wiley-Blackwell.

**GRADING POLICY**

There will be 3 homework assignments, a group presentation, and a final exam. Each homework assignment will account for 10% of your total grade. Students are required to complete the homework assignments independently and turn in the completed assignments by the specified deadlines. The group research presentation will account for 15%, and the final exam will account for 55% of the final grade. The final exam date will be the **last week of class**.

GROUP PRESENTATION: Each group will be formed by 4-5 students. Each group is responsible to choose an INTERNATIONAL FINANCE topic for their presentation. Students are expected to collect related background materials, review existing views on this issue, and use the analysis tools learned in class to present their own analysis/views/evaluations on the policy issues. The expected duration of each presentation is about 20-30 minutes (depending on number of groups). The presenting group is also required to answer the questions raised by the instructor and other students

during and after the presentation. Grade on presentation will be assigned based on the coverage and quality of the presentation and how well the presenting group handles the questions.

Some Examples of Potential Topics:

Financial Crises, The Currency Board System in Hong Kong, Exchange Rate and the Current Account (Global Imbalances), Common Currency in the Euro Zone, Exchange Rate and Financial Issues in China or other countries, etc.

### **GRADE DESCRIPTORS**

A / A-	Outstanding/Generally outstanding performance on all learning outcomes.
B+ / B / B-	Substantial performance on all learning outcomes, OR high performance on some learning outcomes which compensates for less satisfactory performance on others, resulting in overall substantial performance.
C+ / C / C-	Satisfactory performance on the majority of learning outcomes, possibly with a few weaknesses.
D+ / D	Barely satisfactory performance on a number of learning outcomes
F	Unsatisfactory performance on a number of learning outcomes, OR failure to meet specified assessment requirements.

### **CLASS PARTICIPATION**

This is your education! I have generally found that students that come to all the classes make A's and students who skip out all the time make D's and F's.

Please be adult, be responsible, be respectful and be kind in the classroom.

This includes:

1. Come to class on time and stay to the end. If you must leave early, let me know at the beginning of the class and leave quietly. If you get here late, enter quietly.
2. Don't chat during the lectures. This is a distraction to those of us who are engaged in learning.
3. Be respectful of others who may have different views and backgrounds than your own. Do not use derogatory or vulgar language in the classroom. It is the University's policy that students attending classes should be well taken care of. Since all students have the right to attend classes, those students who have chosen not to attend classes should respect the wish of others who want to attend classes.
4. Turn off your cell phones.

**Note: If you miss a lecture, it is your own responsibility to get notes from a classmate. I do not repeat lectures during office hours.**

### **MAKE-UP POLICY**

No makeup tests will be administered. No late homework assignment will be accepted.

### **HONESTY IN ACADEMIC WORK**

The Chinese University of Hong Kong places very high importance on honesty in academic work submitted by students, and adopts a policy of *zero tolerance* on cheating in examinations and plagiarism. Any related offence will lead to disciplinary action including termination of studies at the University.

Attention is drawn to University policy and regulations on honesty in academic work, and to the disciplinary guidelines and procedures applicable to breaches of such policy and regulations. Details may be found at [http://www.cuhk.edu.hk/policy/academic\\_honesty/](http://www.cuhk.edu.hk/policy/academic_honesty/).

### **SUCCESSFUL STUDENT STRATEGIES**

1. Attend each class.
2. Read text before class.
3. Ask questions, when material is unclear.
4. Review notes and text after class.
5. Do all the homework assignments and study in advance of the next exam.

### **TENTATIVE LECTURE TOPICS**

1. Exchange Rate Basics and Exchange Rate Determination in the Short-Run (*Chapters 3-4 of KOM*)
2. From the Short-Run to the Long-Run: Sticky Prices and Exchange Rate Overshooting (*Chapter 4 of KOM*)
3. Long-run Determinants of the Real Exchange Rate: PPP and the Flexible Price Monetary Approach (*Chapter 5 of KOM, Chapters 3 and 7 of NM*)
4. Output and the Exchange Rate in the Short Run: the AA-DD-XX Model (*Chapter 6 of KOM*)
5. Exchange Rate Regimes (*Chapter 7 of KOM*)
6. Currency Crises and Bank Runs (*Chapters 7 of KOM, Chapter 11 of NM, and Handouts*)
7. International Monetary System (*Chapter 8 of KOM*)
8. Global Imbalances (*Chapter 1 of SUW*)
9. Current Account Sustainability (*Chapter 2 of SUW*)
10. Applied Policy Issues in International Finance (*Handouts*)
11. Group Presentations

**The instructor reserves the right to make changes to the syllabus, including but not limited to the teaching mode arrangement and the test date, when unforeseen circumstances occur. These changes will be announced as early as possible so that students can adjust their schedules.**

## READING MATERIALS

### 1. NON-TECHNICAL BOOKS

Golden Fetters: The Gold Standard and the Great Depression, 1919-39, Oxford University Press, 1992, by Barry Eichengreen.

International Monetary Arrangements for the 21st Century, Washington, DC: The Brookings Institution, 1994, by Barry Eichengreen.

Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System. Oxford University Press, 2011, by Barry Eichengreen.

How Global Currencies Work: Past, Present, and Future Princeton University Press, 2017, by Barry Eichengreen, Livia Chitu, and Arnaud Mehl.

Renminbi Internationalization: Achievements, Prospects, and Challenges. Brookings Institution Press and the Asian Development Bank Institute, 2015, by Barry Eichengreen and Masahiro Kawai.

Globalizing Capital: A History of the International Monetary System (Second Edition). Princeton University Press, 2008, by Barry Eichengreen.

Manias, Panics, and Crashes: A History of Financial Crises. Palgrave Macmillan; 7th edition, 2015, by Charles P. Kindleberger and Robert Aliber.

### 2. JOURNAL ARTICLES BY TOPICS

#### Exchange Rate Regimes

Calvo, G. A., and Reinhart, C. M. 2001. Fear of floating. *Quarterly Journal of Economics*.

Obstfeld, M., and Rogoff, K. 1995. The mirage of fixed exchange rates (No. w5191). NBER Working Paper.

Reinhart, C. M., and Rogoff, K. 2002. The modern history of exchange rate arrangements: a reinterpretation (No. w8963). NBER Working Paper.

Levy-Yeyati, E., and Sturzenegger, F. 2003. To float or to fix: evidence on the impact of exchange rate regimes on growth. *American Economic Review*, 1173-1193.

Rose, A. K. 2011. " Exchange Rate Regimes in the Modern Era": Fixed, Floating, and Flaky. *Journal of Economic Literature*, 652-672.

Baxter, M., and Stockman, A. C. 1989. Business cycles and the exchange-rate regime: some

- international evidence. *Journal of monetary Economics*, 23(3), 377-400.
- Frankel, J. A. 1999. No single currency regime is right for all countries or at all times (No. w7338). NBER Working Paper.
- Tornell, A., and Velasco, A. 2000. Fixed versus flexible exchange rates: Which provides more fiscal discipline?. *Journal of Monetary Economics*, 45(2), 399-436.
- Shambaugh, J. C. 2004. The effect of fixed exchange rates on monetary policy. *The Quarterly Journal of Economics*, 301-352.
- Flood, R. P., and Rose, A. K. 1999. Understanding exchange rate volatility without the contrivance of macroeconomics. *The Economic Journal*, 109(459), 660-672.
- Flood, R. P., and Rose, A. K. 1999. Understanding exchange rate volatility without the contrivance of macroeconomics. *The Economic Journal*, 109(459), 660-672.
- Lin, S., and Ye, H. 2011. The role of financial development in exchange rate regime choices. *Journal of International Money and Finance*, 30(4), 641-659.
- Lin, S., Shi, K., and Ye, H. 2018. Exchange rate volatility and trade: The role of credit constraints. *Review of Economic Dynamics*, Vol. 30.
- Aghion, P., Bacchetta, P., Ranciere, R., and Rogoff, K. 2009. Exchange rate volatility and productivity growth: The role of financial development. *Journal of Monetary Economics* 56(4).
- International Monetary Fund. 2004. A new look at exchange rate volatility and trade flows (No. 235). *International Monetary Fund Staff Paper*.
- Mu, Xiaoyi and Haichun Ye. 2013. Current account adjustment in developing countries: The role of exchange rate regimes. *Economic Inquiry* 51.
- Menzie Chinn and Shang-Jin Wei. 2008. A Faith-based Initiative: Does a Flexible Exchange Rate Regime Really Facilitate Current Account Adjustment? *Review of Economics and Statistics*.

### **Financial Crises**

- Gourinchas, P. O., and Obstfeld, M. 2011. Stories of the twentieth century for the twenty-first (No. w17252). NBER Working Paper.
- Krugman, P. 1979. A model of balance-of-payments crises. *Journal of money, credit and banking*, 311-325.
- Dornbusch, R. 1987. Collapsing exchange rate regimes. *Journal of Development Economics*, 27(1), 71-83.

- Obstfeld, M. 1995. The logic of currency crises (pp. 62-90). Springer Berlin Heidelberg.
- Obstfeld, M. 1996. Models of currency crises with self-fulfilling features. *European economic review*, 40(3), 1037-1047.
- Kraay, A. 2003. Do high interest rates defend currencies during speculative attacks? *Journal of International Economics*, 59(2), 297-321.
- Lahiri, A., and Végh, C. A. 2003. Delaying the inevitable: interest rate defense and balance of payments crises. *Journal of Political Economy*, 111(2), 404-424.

### **Financial Integration and Capital Account Openness**

- Kose, M. A., Prasad, E., Rogoff, K. S., and Wei, S. J. 2006. Financial globalization: a reappraisal . NBER Working Paper No. 12484.
- Glick, R., Guo, X., and Hutchinson, M. 2006. Currency Crisis. Capital Account Liberalization, and Selection Bias. *The Review of Economics and Statistics*, 88 (4).
- Fischer, S. 2003. Globalization and its challenges. *American Economic Review*, 1-30.
- Henry, P. B. 2006. Capital account liberalization: Theory, evidence, and speculation (No. w12698). NBER Working Paper.
- Rodrik, D. 1998. Who needs capital-account convertibility?. *Essays in international finance*.
- Rodrik, D., and Subramanian, A. 2009. Why did financial globalization disappoint?. *IMF staff papers*, 56(1), 112-138.
- Stiglitz, J. E. 2002. Capital market liberalization and exchange rate regimes: risk without reward. *The Annals of the American Academy of Political and Social Science*, 579(1), 219-248.
- Summers, L. H. 2000. International financial crises: causes, prevention, and cures. *American Economic Review*, 1-16.
- Eichengreen, B. 2001. Capital Account Liberalization: What Do Cross-Country Studies Tell Us? *the world bank economic review*, 15(3), 341-365.
- Bekaert, G., Harvey, C. R., and Lundblad, C. 2005. Does financial liberalization spur growth?. *Journal of financial Economics*, 77(1), 3-55.
- Obstfeld, M. 1992. Risk-taking, global diversification, and growth. NBER Working Paper No. 4093.
- Wei, S. J., and Zhang, Z. 2007. Collateral damage: exchange controls and international trade. *Journal of International Money and Finance*, 26(5), 841-863.

Jeanne, O., Subramanian, A., and Williamson, J. 2012. *Who needs to open the capital account*. Peterson Institute.

### **Trilemma and International Transmission of U.S. Monetary Policy**

Mundell, R. A. 1963. Capital mobility and stabilization policy under fixed and flexible exchange rates. *Canadian Journal of Economics and Political Science/Revue canadienne de economiques et science politique*, 29(04), 475-485.

Lin, Shu and Haichun Ye. 2018. Foreign direct investment, trade credit, and transmission of global liquidity shocks: Evidence from Chinese manufacturing firms. *Review of Financial Studies*, Vol. 31(1).

Lin, Shu and Haichun Ye. 2018. The international credit channel of U.S. monetary policy transmission to developing countries: Evidence from trade data. *Journal of Development Economics*, Vol. 133.

Obstfeld, M., Shambaugh, J. C., and Taylor, A. M. 2008. Financial stability, the trilemma, and international reserves . NBER Working Paper No. 14217.

Obstfeld, M., Shambaugh, J. C., and Taylor, A. M. 2004. Monetary sovereignty, exchange rates, and capital controls: the trilemma in the interwar period . NBER Working Paper No. 10393.

Obstfeld, M., Shambaugh, J. C., and Taylor, A. M. 2005. The trilemma in history: tradeoffs among exchange rates, monetary policies, and capital mobility. *Review of Economics and Statistics*, 87(3), 423-438.

Obstfeld, M., and Taylor, A. M. 1997. The great depression as a watershed: international capital mobility over the long run. NBER Working Paper No. 5960.

Obstfeld, M. 2003. Globalization and Capital Markets “in Globalization in Historical Perspective, Eds. Michael D. Bordo, Alan M. Taylor, and Jeffrey G. Williamson.

Obstfeld, M., and Taylor, A. M. 2004. Global capital markets: integration, crisis, and growth. Cambridge University Press.

Rey, H. 2015. Dilemma not trilemma: the global financial cycle and monetary policy independence (No. w21162). NBER Working Paper.

Canova, F. (2005). The transmission of US shocks to Latin America. *Journal of Applied econometrics*, 20(2), 229-251.

Cetorelli, N., and Goldberg, L. S. 2012. Banking globalization and monetary transmission. *The*

*Journal of Finance*, 67(5), 1811-1843.

Frankel, J., Schmukler, S. L., and Serven, L. 2004. Global transmission of interest rates: monetary independence and currency regime. *Journal of International Money and Finance*, 23(5), 701-733.

Kim, S. 2001. International transmission of US monetary policy shocks: Evidence from VAR's. *Journal of Monetary Economics*, 48(2), 339-372.

Aizenman, J., Chinn, M. D., and Ito, H. 2015. Monetary Policy Spillovers and the Trilemma in the New Normal: Periphery Country Sensitivity to Core Country Conditions (No. w21128). NBER Working Paper.

Kim, S. 2001. International transmission of US monetary policy shocks: Evidence from VAR's. *Journal of Monetary Economics*, 48(2), 339-372.

### **Exchange Rates**

Engel, C. 1993. Real exchange rates and relative prices: An empirical investigation. *Journal of Monetary Economics* 32, 35-50.

Engel, C. and John Rogers, 1996. How wide is the border? *American Economic Review* 86(5), 1112-1125.

Engel, C. and John Rogers, 2001. Deviations from purchasing power parity: Causes and welfare costs. *Journal of International Economics* 55, 29-57.

Engel, C. 1995. Accounting for US real exchange rate changes (No. w5394). NBER Working Paper.

Parsley, David and Shang-Jin Wei. 1996. Convergence to the law of one price without trade barriers or currency fluctuations. *Quarterly Journal of Economics*, 111, 1211-1236.

Parsley, David and Shang-Jin Wei. 2001. Explaining the border effect: The role of exchange rate variability, shipping costs, and geography. *Journal of International Economics* 55, 87-105.

Morshed, A.K.M. Mahbub. 2007. Is there really a border effect? *Journal of International Money and Finance* 26(7), 1229-1238.

Ceglowski, Janet. 2003. The law of one price: Intranational evidence for Canada. *Canadian Journal of Economics* 36(2), 373-400.

Engel, C., and West, K. D. 2004. Exchange rates and fundamentals (No. w10723). NBER Working Paper.

Betts, C. M., and Kehoe, T. J. 2006. US real exchange rate fluctuations and relative price fluctuations. *Journal of Monetary Economics*, 53(7), 1297-1326.



Dornbusch, R. 1976. Expectations and exchange rate dynamics. *The journal of political economy*, 1161-1176.

Chari, V. V., Kehoe, P. J., and McGrattan, E. R. 2002. Can sticky price models generate volatile and persistent real exchange rates?. *The Review of Economic Studies*, 69(3), 533-563.

Obstfeld, M., and Rogoff, K. 1994. Exchange rate dynamics redux (No. w4693). NBER Working Paper.

Engel, C. 2000. Long-run PPP may not hold after all. *Journal of International Economics* 51(2), 243-273.

Crucini, M. J., Telmer, C. I., and Zachariadis, M. 2005. Understanding European real exchange rates. *American Economic Review*, 724-738.

### **Puzzles in International Macroeconomics**

Obstfeld, M., and Rogoff, K. 2001. The six major puzzles in international macroeconomics: is there a common cause?. In *NBER Macroeconomics Annual 2000, Volume 15* (pp. 339-412). MIT press.

Lewis, K.K., 1995. Puzzles in international finance, In: G. Grossman and K. Rogoff, eds. *Handbook of international economics* (North-Holland, Amsterdam).

Lucas, R. E. 1990. Why doesn't capital flow from rich to poor countries?. *The American Economic Review*, 92-96.

Rogoff, K. 1996. The purchasing power parity puzzle. *Journal of Economic literature*, 647-668.

Gourinchas, P. O., and Jeanne, O. 2013. Capital flows to developing countries: The allocation puzzle. *The Review of Economic Studies*, rdt004.

Aguiar, M., and Gopinath, G. 2004. Emerging market business cycles: The cycle is the trend (No. w10734). NBER Working Paper.

Uribe, M., and Yue, V. Z. 2006. Country spreads and emerging countries: Who drives whom?. *Journal of international Economics*, 69(1), 6-36.

Obstfeld, M., and Rogoff, K. 2000. New directions for stochastic open economy models. *Journal of international economics*, 50(1), 117-153.

Bergin, P. R., Glick, R., and Wu, J. L. 2013. The micro-macro disconnect of purchasing power parity. *Review of Economics and Statistics*, 95(3), 798-812.