

International Financial Policy 33502

Fall 2009

Christian Broda

[Link to Syllabus](#)

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[Online FX Trading](#)

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Course Outline and Readings

WEEK 1 (Sept 26)

Part 1: Overview / Course Outline and Administrative briefing

- ["Global Finance, Past and Present"](#) Alan Taylor IMF Finance and Development, March 2004. This paper should serve as background reading for the course, it gives you a historical perspective of the evolution of capital markets, and discusses themes that will appear in the course. For a more thorough investigation of these issues please see ["Globalization and Capital Markets"](#) ; Obstfeld, Maurice; Taylor, Alan M.
- Barclay's Global Investor ["Currency Aspects of International iShares"](#)
- Data you should get familiar with: [Exchange Rates](#) - [Interest Rates](#)

Additional readings (these readings also provide good background material, and should help you understand the importance of this course both for financial markets, and for understanding the impact that financial development has on the macroeconomic performance of countries. For those more inclined to finance I recommend the three readings, and for those more inclined to economics, the last two):

- [JPMorgan's Exchange Rate Outlook](#) (January 9th, 2008)
- [JPMorgan's Exchange Rate Outlook](#) (March 28th, 2007)
- FT on the importance of carry trades for hedge fund returns in recent years ([February 15th, 2008](#) and [March 14th, 2007](#))
- [Understanding the rise of China](#) , The Economist (March 2008).
- ["Financial Globalization, Growth and Volatility in Developing Countries"](#) Prasad, Rogoff, Wei and Kose.

- ["Globalization, Macroeconomic Performance, and the Exchange Rate of Emerging Economies"](#) Obstfeld, Maurice.

Part 2 : The Exchange Rate as an Asset Price: UIP and CIP

- KO Chapter 13 (6th and 7th Edition), "Exchange rates and Foreign Exchange Market: An asset approach"

WEEK 2 (October 3)

Part 1 : Empirical UIP (Carry Trades and Central Bank Watch) and The Portfolio Balance model*

- ["The Forward Premium Puzzle: Different tales from developed and emerging economies"](#) Bansal and Dahlquist (2000). This is a good example of our empirical understanding of UIP. You have to read this paper carefully, not only because it will be useful for your assignment 1, but also because in one way or another UIP is a building block for other parts of the course, so you don't want to stay behind with this concept. You should be able to read up to section 2.3.3 in the paper.
- [This is a harder paper](#) on evaluating the gains from carry trade strategies. This is an [ETF that does this type of strategy](#).
- (*) Unfortunately none of the standard textbooks have a clear exposition about the portfolio balance model. You should do the [exercise](#) comparing the Argentine stock market returns and the US stock market returns to get a better sense of the concepts of risk aversion and risk premium. We will see in class the usefulness of augmenting the UIP setup with risk in explaining recent movements of the EUR/USD rate.
- A completely different way of testing your skills on expected returns and risk aversion is by playing the [online version of deal-or-no-deal game](#). After choosing suitcases "the bank" will calculate a certain offer for you to take or keep playing. Figure out whether the offer is larger/smaller than the expected return and whether you are risk neutral or risk averse. If you do this systematically you will understand whether its the policy of the game to entice you to keep playing early on by giving you relatively unattractive payoffs after opening the first suitcases.
- ["Micro Effects of Macro Announcements"](#) Anderson et al (AER, 2003). This paper is the state-of-the-art of our understanding about how macroeconomic news impact exchange rates. The paper gets quite technical, all you need to read and understand is table 1 (and figure 2) and table 2. We will use this paper in class to guide our decision of what currencies to buy/sell.
- Unwinding of Carry trades saga
 - [First scare: Market Watch \(Feb 27, 2007\)](#)
 - [Then came August.](#) and March ([CMS Forex \(March, 2008\)](#))
 - And this is where we are today: [JPMorgan carry trades](#)
 - To read daily FX comments by UBS go to [this link](#)

ASSIGNMENT #1 (About understanding UIP and carry trades in practice)

Part 2: Real Exchange Rate Determination and Long-Run Fundamentals

- KO Chapter 15 "Price levels and Exchange rates in the Long run"
- [How much is the Chinese currency undervalued?](#) Chang and Shao, China Economic Review (2004) This is the article that you will use in your assignment #2. You should become familiar with the details of this short paper.
- [To what extent does productivity drive the dollar?](#); Current Issues in Economics and Finance New York; 8; 2001;
- [Food for thought](#); *Anonymous*, The Economist;
- [Grappling with the Strong Euro](#) ; *Anonymous*, The Economist

Additional Readings:

- ["The purchasing power parity debate"](#) Taylor and Taylor, NBER wp 10607
- [JPMorgan's](#) and [Goldman's](#) real exchange rate models.

For the same profile view of the platform used in class [save this file](#).

For the [Economic Data Release Calendar](#) of Weeks April 7- 11 and April 14 - 18, 2008.

WEEK 3 (October 10)

Part 1: Real Exchange Rate Determination and Long-Run Fundamentals (continued)

- [How exchange rates affect stock prices](#) (Journal of Finance, 1994)

Part 2: The Importance of Real Exchange Rates

- KO, Chapter 15 (6th and 7th Edition)
- Goldfajn and Valdes, ["The Aftermath of Appreciations"](#) QJE February 1999.
- [Wall Street Journal article](#) on the Fed and exchange rate pass-through (April 2005)
- Crockett and Goldberg ["The dollar and US Manufacturing"](#) (November 1998)

ASSIGNMENT #2 (Calculating the Extent of the Chinese Overvaluation)

WEEK 4 (October 17)

Part 1: Intervention in Currency Markets

- [The new global balance -- Part II](#) (Barclays Capital)
- KO pages 481-490, 505-511 (6th Edition) or pages 447-453, 463-468 (7th Edition)
- ["Meddling in the currency market,"](#) The Economist 11/20/99
- ["Intervention: divine or comic,"](#) The Economist 10/21/00
- ["Rescuing the euro,"](#) The Economist 5/13/00
- Krugman, P. ["Currency Crises,"](#) March 1997.
- Notes on Currency Crisis, HBS. (in course package)

Part 2: Speculative Attacks and Financial Contagion

- “ Hong Kong's Financial Crisis--1997-98 ; Whitman, John;Cascales, Maria J. (in course package)
- “Private Sector Behavior During the Crisis,” International Capital Markets 3/93 (in course package)
- “Tactics for Defending ERM Parities,” International Capital Markets 3/93 (in course package)
- “Mechanics of Speculative Attacks,” International Capital Markets 3/03 (in course package)

Additional readings:

- Krugman, P. ["On the Asian currency crisis"](#) 1998
- [“ The Economics of Currency Crisis: An introduction,”](#) Economic Policy Review, Federal Reserve Bank of New York (2000)

WEEK 5 (October 24)

Midterm Exam

ASSIGNMENT #3 (Taking FX positions with what we've learnt so far) [Online Trading](#)

WEEK 6 (October 31)

May 8th: Please Send FXCM Account and Password to [Jaime de Jesus Filho](#)
[\[jaimejesus@uchicago.edu\]](mailto:jaimejesus@uchicago.edu)

Part 1: Exchange Rate Regime Choice

- KO Chapter 12, Chapter 16 (6th and 7th Edition);
- ["Monetary Policy in a world of Mobile Capital"](#) Ben Bernanke, Cato Journal Winter 2005.
- [“Japan's Financial Crisis and Economic Stagnation,”](#) Takeo Hosi and Anil Kashyap, Journal of Economic Perspectives Winter 2004, volume 18 no. 1, pp. 3-26.
- Japanese Monetary Policy: A Case of Self-Induces Paralysis? (Ch. 7) by Bernake, Ben. (in course package)
- [Japan's still trapped](#), by Paul Krugman, web commentary,
- ["Another false dawn?"](#) The Economist 3/24/01

Part 2 : Currency Areas and The Euro

- KO, Chapters 19 and 20 (6th and 7th Edition)
- “No single currency regime is right for all countries or at all times,” Jeffrey Frankel, NBER working paper (in course package)
- [" Germany's euro test"](#), The Economist 6/14/03
- "The euro, trade and growth", The Economist 7/12/03
- "Euro-zone Economy Labors under Host of Factors", WSJ 5/19/03 (in course package)
- “The Perils of Convergence”, The Economist 4/5/03

WEEK 7 (Nov 7)

(NOTE: Both Monday sections are rescheduled to be held jointly with the Saturday class this week)

Part 1 : Emerging Markets: A View from Wall Street

Invited Lecturer: Pablo Goldberg (Co-Head Emerging Markets Reserach, Merrill Lynch, New York)

"[Advanced emerging markets – A reassessment of an asset class](#)", November 2009, Barclays Capital.

WEEK 8 (November 14)

The US Current Account

- [The new global balance -- Part I](#) (Barclays Capital)
- [Blanchard and Milesi-Ferreti: Global imbalances: Past, Present and Future \(2009\)](#)
- KO Chapter 12, Chapter 16 (6th and 7th Edition);
- "A much devalued theory," The Economist 1/20/96 (in course package)
- "[Figures to fret about](#)," The Economist 11/7/98
- Survey: [The Price of Profligacy](#); Staff; Economist, Sept 2003.
- Current Accounts: [Can they Achieve Sustainability](#); Rosa-Suarez, Liliana; Ghezzi, Piero; Global Markets Research. Online; Deutsche Bank (in course package)
- "[America's deficit and the dollar](#) "; Economics focus; The Economist; Nov 29, 2003;
- [Common views of the US current account deficit.](#)

From policymakers:

- [Global Current Account Imbalances: Hard or Soft Landing?](#) Raghuraj Rajan, Director of Research, March 15, 2005.
- [Current Account](#), Alan Greenspan, Chairman Federal Reserve Board, February 4, 2005.
- [The Global Saving Glut and the US Current Account Deficit](#), Ben Bernanke, Federal Reserve Governor, March 10, 2005.
- [The Economic Report of the President](#), February 2004.

WEEK 9(Nov 21)

Growth and Capital Flows

- Abel and Bernanke Chapter 6: "Long Run Economic Growth" (in course package)
- William Easterly, The Elusive Quest for Growth, Chapter 3, "Solow's Surprise: Investment is not the Key to Growth" (in course package)
- [The impact of exchange rate movements on U.S. foreign debt](#); Cedric Tille; Current Issues in Economics and Finance New York;
- KO, Chapter 21 (6th Edition)

- ["A cruel sea of capital: A survey of global finance"](#), The Economist 5/3/03
- "Global Capital Flows: Too little, not too much," The Economist 6/24/95 (in course package)
- " Reversal of Fortune: Geography and Institutions in teh Making of the Modern World Income" Acemoglu, Johnson and Robinson (in course package)

Additional readings:

- ["Finance on the loose ,"](#) The Economist 5/13/99
- ["International Capital Flows"](#) Chapter 13 of the 2004 Economic Report of the President.
- Review of Easterly's "The Elusive Quest for Growth: Economists" by [Brad DeLong](#) and [Terry Fitzgerald](#)

WEEK 10 (Nov 30 - Dec 5)

Part 1: China's impact on World Finance

- ["On the Renminbi: The Choice between Adjustment under a Fixed Exchange Rate and Adjustment under a Flexible Rate,"](#) Jeffrey Frankel, NBER Working Paper No. 11274
- ["Putting the Cart Before the Horse? Capital Account Liberalization and Exchange Rate Flexibility in China,"](#) Eswar Prasad, Thomas Rumbaugh, and Qing Wang, IMF Policy Discussion Paper, January 2005,
- ["Economic Relationships Between the United States and China,"](#) April 14, 2005, Congressional Budget Office,
- [China's Financial-Sector Challenge,](#) Eswar Prasad and Raghuram G. Rajan, Financial Times, May 10, 2005,
- [The Chinese Approach to Capital Inflows: Patterns and Possible Explanations,](#) Eswar Prasad, Shang-Jin Wei, NBER Working Paper No. 11306,
- [IMF 2004 Article IV Report for China,](#) Box 3 on Exchange Rate Flexibility and Capital Account Liberalization and Box 4 on Reform of the Banking System

WEEK 11 (Exam week)

Final Exam (NOT OPTIONAL)