

**International Monetary and Financial Relations
Economics 5510/6510**

Girton
Fall 2014
Off. OSH 344

Office Hours: Tue/Wed. 4-6pm
and by appointment
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Course Prerequisites: Introductory Economics, both Macro and Micro

Overview of the Course

The assigned text for the course is International Monetary and Financial Economics, by Joseph Daniels and David VanHoose (D&V), 2014. Chapters from the textbook and other readings are recommended for each class meeting. I have tried to find material on the Web. Other recommended readings are from the supplemental reading list.

You will be responsible for the material covered in class lectures. The recommended readings are intended to introduce and review the material covered in the lectures. In addition, you are expected to keep abreast of international financial and monetary developments by regular reading of current periodicals. We will use current events to illustrate and illuminate broader principles.

The main emphasis in the course is on the development of your ability to understand and analyze international monetary and financial issues and to critically evaluate alternative views and proposals.

Grades will be determined by the following:

Class Participation	10%
Quizzes and Exercises (both take-home and in-class); Short papers and Book reviews (due on or before the last class meeting); and/or Term paper (required for graduate credit) (Written work will receive up to two points per page.)	50%
Final Exam	<u>40%</u>
	100%

OUTLINE OF LECTURE TOPICS AND READING ASSIGNMENTS

PART 1: INTRODUCTION TO INTERNATIONAL MONEY AND FINANCE, AND THE EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM

Aug. 26 INTRODUCTION TO INTERNATIONAL MONETARY AND FINANCIAL RELATIONS

D&V Ch 1

1. Objectives of course
2. Why the difference between international and 'domestic' economics?
3. What is the difference between "Real Trade Theory" and International Monetary and Financial Economics"?
What is the difference between Micro-economics and Macro-economics?
What is the distinction between Money and Finance?
What are the roles of Banks and other Financial Intermediaries in the Monetary and Financial Systems?
4. Importance of the Financial System: The Role of the Financial System in Economic Growth and Development
5. Outline of course:
 - I. International Balances, Exchange Rates, and the Evolution of the International Monetary System
 - II. International Financial Markets, Institutions and Instruments.
 - III. Balance of Payments and Exchange Rate Determination
 - IV. Open Economy Macroeconomics - A Framework of Analysis
 - V. Macroeconomic Policy in a Global Economy

Sept. 2 THE BALANCE OF PAYMENTS AND EXCHANGE RATES D&V Ch. 2

See also: Balance of Payments of the United States, at www.bea.gov, Balance of Payments," at www.newyorkfed.org; "Balance of Payments," at www.Wikipedia.org; Balance of Payments Manual, at www.imf.org

The Balance of Payments Accounts

1. BOP accounts and National income accounts
2. Accounting relationships and market equilibrium conditions in goods, money, and non-monetary financial claims

FOREIGN EXCHANGE MARKETS, EXCHANGE RATES, AND PRICES

See also: For a wealth of information on foreign exchange markets

www.newyorkfed.org; "Foreign Exchange Markets," at www.ibfx.com; "Foreign Exchange Markets," at www.wikipedia.org; Palgrave's: "Real Exchange Rates," Menzie Chinn; "Nominal Exchange Rates," Richard Baillie; "Terms of Trade," Ronald Findlay; "Purchasing Power Parity," Lucio Sarno

1. Alternative definitions of exchange rates
2. The supply and demand for foreign exchange
3. Official exchange market intervention
4. Open market and exchange market operations
5. The central role of sterilization operations

**Sept. 9 EVOLUTION OF THE INTERNATIONAL MONETARY SYSTEM AND
ALTERNATIVE INTERNATIONAL ADJUSTMENT MECHANISMS**

HANDOUT: History of Prices in the United States

D&V Ch. 3

See also: Jastram, The Golden Constant, Eichengreen - see several books listed in the Readings; From Palgrave's: "Gold Standard," Lawrence Officer; "Bretton Woods," Peter Kenen; "Specie-Flow Mechanism," William Allen; "International Monetary Institutions," Stanley Black; "Monetary Policy, History of," Michael Bordo; "Monetary Economics, History of," Robert Dimand

INTERNATIONAL ADJUSTMENT

1. Alternative international adjustment mechanisms
2. Alternative international monetary and financial systems/orders

THE INTERNATIONAL MONETARY SYSTEM BEFORE BRETTON WOODS

1. Price determination under alternative international monetary systems
2. International adjustment under a gold standard
3. International factors in the Great Depression

THE INTERNATIONAL MONETARY SYSTEM SINCE THE GREAT DEPRESSION

1. The Great Depression and Keynesian Economics
2. Negotiating the Bretton Woods System
3. Inconsistencies in the Bretton Woods System
4. Fixed exchange rates to flexible exchange rates
5. Economic development/growth and international financial crises

PART 2: INTERNATIONAL FINANCIAL MARKETS, INSTITUTIONS, AND INSTRUMENTS

Sept. 16 EXCHANGE RATES, INTEREST RATES, AND THE CENTRAL ROLE OF INTERNATIONAL FINANCIAL CAPITAL MOBILITY D&V Ch. 4

Palgrave's: "Covered Interest Parity," Alper and Ardic; "Uncovered Interest Parity," Peter Isard; "International Capital Flows," Wei

1. Interest rate parity - the arbitrage conditions
2. Covered and uncovered interest rate parity
3. Foreign exchange risk and risk premiums
4. Market efficiency and exchange rates
5. Exchange rate forecasting

INTERNATIONAL FINANCIAL INSTRUMENTS

Palgrave's: "Foreign Exchange Market Microstructure," Martin Evans

1. Bills of Exchange
2. International vs domestic monies
3. Derivatives: futures, forwards, swaps and options

- Sept. 23** **INTEREST RATES AND FINANCIAL DERIVATIVES** D&V Ch. 5
1. Present and Future Values
 2. Interest rates, inflation, and exchange rates
 3. The term structure of interest rate, inflation, and exchange rates
 4. Real interest rates and the cost of capital across countries
 5. Absolute and relative purchasing power parity
 6. Deviations from PPP
 7. PPP and international competitiveness
 8. Real exchange rates and the Terms of Trade
- Sept. 30** **INTERNATIONAL BANKING, DEBT, AND RISK** D&V Ch. 6
1. Offshore banking
 2. LIBOR
 3. Interest rate spreads and risk
 4. IBFs
 5. Country risk: Economic and Political
- INTERNATIONAL INVESTMENT AND CAPITAL FLOWS**
1. Risk and portfolio diversification
 2. The globalization of capital markets
 3. Efficiency in financial markets
 4. Direct foreign investment
- Oct. 7** **INTERNATIONAL FINANCIAL INSTITUTIONS AND INTERNATIONAL FINANCIAL CRISES** D&V Ch. 7
- Duffie, Darrel, How Big Banks Fail and What to do About it, 2011*
 ---, *“Replumbing Our Financial System: Uneven Progress”, 2012 (On Web)*
1. Exchange Market Crises
 2. Banking Crises
 3. The role of Multinational Institutions including The IMF and The World Bank
- REGULATION OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM, MORAL HAZARD, AND INTERNATIONAL FINANCIAL INSTABILITY**
1. Moral Hazard in International Money and Finance
 2. Depositor Insurance, Too Big to Fail, Moral Hazard, and Bank Regulation
 3. Uniformity vs Competition in Country Regulations
 4. Interests, Regulation and Reform
- Oct. 14** **Fall Break**

PART 3: DETERMINATES OF THE BALANCE OF PAYMENTS AND EXCHANGE RATES

- Oct. 21 ALTERNATIVE THEORIES OF EXCHANGE MARKET PRESSURE: TRADITIONAL APPROACHES TO THE BALANCE OF TRADE AND EXCHANGE RATES** D&V Ch. 8
Palgrave's "Absorption Approach to the Balance of Payments," David Vines;
1. Fixed exchange rates and the BOP
 2. Flexible exchange rates and exchange rate determination
 3. Current account and financial (capital) account transactions
 4. Elasticity and Absorptions Approaches to the current account
 5. The Portfolio Balance Approach to the capital account

- Oct. 28 The Monetary Approach to Exchange Market Pressure** D&V Ch. 9
Palgrave's: "Monetary Approach to the Balance of Payments," Blejer and Frenkel; "Exchange Market Pressure," Jager and Klaassen;
1. Monetary Approach to the Balance of Payments
 2. Monetary Approach to Exchange Market Pressure

PART 4: OPEN ECONOMY MACROECONOMICS

- Nov. 4 AN OPEN ECONOMY MACROECONOMIC FRAMEWORK OF ANALYSIS** D&V Ch. 10

- Nov. 11 MACROECONOMIC POLICY WITH FIXED EXCHANGE RATES** D&V Ch. 11
1. The Keynesian Macroeconomic Model
 2. International adjustment with fixed exchange rates
 3. Domestic policy objectives
 4. Conflicts between international and domestic objectives
 5. The importance of international capital mobility
 6. Internal and external balance
 7. Monetary, Fiscal, and Commercial Policies

- Nov. 18 MACROECONOMIC POLICY WITH FLEXIBLE/FLOATING EXCHANGE RATES** D&V Ch. 12
1. International adjustment with floating exchange rates
 2. Domestic policy objectives
 3. Conflicts between international and domestic objectives
 4. Floating vs. fixed exchange rate systems
 5. Fixed, flexible, and floating exchange rates
 6. Exchange rate objectives
 7. Keynesian vs Classical Macroeconomic Theories

- Nov. 25** **ECONOMIC POLICY WITH FLEXIBLE DOMESTIC PRICES** D&V Ch. 13
1. The Classical Macroeconomic Model
 2. Determination of income, interest rates, and the terms of trade in a Classical Model
 3. Domestic and foreign shocks to the system
 4. Money and Inflation in the Classical Model

PART 5: MACROECONOMIC POLICY IN A GLOBAL ECONOMY

- Dec. 2** **MACROECONOMIC POLICY IN AN INTEGRATED WORLD ECONOMY** D&V Ch. 14
- Palgrave's: "*Dollarization*," Roberto Chang
1. The policy assignment problem
 2. Exchange Rate Volatility: Overshooting in a sticky price model; Currency Substitution; Divergent Macroeconomic Policies
 3. Theory and Implications of Currency Substitution
 4. International Competition in Money
 5. Central Bank Independence
 6. Money and Inflation in the global economy

- Dec. 9** **INTERNATIONAL POLICY COORDINATION AND MONETARY UNIONS** D&V Ch. 15
1. International Interdependencies
 2. Potential gains from international policy coordination
 3. Monetary Unions
 4. Why Monetary Unions: Optimal Currency Areas vs. Currency Substitution
 5. The EMU: economic integration, monetary union, and fiscal crises
 6. Will NAFTA lead to monetary union
 7. Exchange Rate Target Zones

- Dec. 16** **FINAL EXAM (6:00pm - 8:00pm, in classroom)**

Guide for Term Papers and Book Reviews

Papers and book reviews will be judged primarily on substance, but grammar and style are also important. Length is less important, but five to ten pages is common for short papers and book reviews. Term papers usually exceed ten pages.

Choose topics from the course that you are interested in exploring in greater depth and that appear to be important. Research the topic and focus the paper. Papers should be properly documented. All references should be given in a manner that makes it easy for me to identify sources.

Papers should be written in a clear and crisp style. The title of the paper should indicate its subject. The first paragraph must give a clear understanding of the content of the paper.

Paragraphs should usually begin with a topic sentence. Each sentence should be complete with a verb. The paper should be clearly organized with structure and direction. This is facilitated by working from an outline.

Book reviews should include a clear discussion of the following questions: Why was the book written - what is the purpose of the book? What are the major points made? What are the central arguments? What is the author arguing against? How is the book related to the course? In addition to reporting, also evaluate and critique.

The Elements of Style, by William Strunk and E. B. White, is a good brief guide to clear and effective writing. The bookstore normally has inexpensive paperback copies.

ADA Statement:

“The University of Utah seeks to provide equal access to its programs, services and activities for people with disabilities. If you will need accommodations in the class, reasonable prior notice needs to be given to the Center for Disability Services, 162 Union Building, 581-5020 (V/TDD). CDS will work with you and the instructor to make arrangements for accommodations.”

Faculty Responsibilities:

“All students are expected to maintain professional behavior in the classroom setting, according to the Student Code, spelled out in the Student Handbook. Students have specific rights in the classroom as detailed in Article III of the Code. The Code also specifies proscribed conduct (Article XI) that involves cheating on tests, plagiarism, and/or collusion, as well as fraud, theft, etc. Students should read the Code carefully and know they are responsible for the content. According to Faculty Rules and Regulations, it is the faculty responsibility to enforce responsible classroom behaviors, and I will do so, beginning with verbal warnings and progressing to dismissal from the class and a failing grade. Students have the right to appeal such action to the Student Behavior Committee.”