M.Sc. Economics

Code:		**Type:**	M.Sc. 4th semester lecture series

Title:	Open Economy Macroeconomics (Elective course)

Lecturer:	Charles Engel

ECTS:	3	**Contact hours (per semester):**	

Semester:	Summer 2010	**Frequency of the lecture:**	12 á 90 min.

Dates:	May 17th, 2010 until May 26th, 2010

Prerequisites:	

Learning objectives (What are the intended learning outcomes? Which skills will be acquired?):

The objective is to survey some of the major areas of ongoing research in open-economy macroeconomics.

Content (Which professional competence and which contents will be imparted?):

Why study open-economy macroeconomics?

1. What economies are closed? Although American macroeconomics tends to favor closed-economy models, that approach is likely to become outdated soon enough. A closed-economy model may still be a reasonable approximation for the U.S. economy, but for nowhere else. Open economies have significantly different features than close economies, so it is necessary to understand how openness affects the macroeconomy.
2. It is useful to learn the field just to learn the methodologies. Open-economy macro is necessarily general equilibrium, while closed-macro sometimes focuses on partial equilibrium behavior. Open economy models are forced to deal with agents that are not homogenous because there are at least agents in two different countries, while closed models often have representative agents. Understanding the key issues in open economy macro models requires understanding the interaction between financial markets, goods markets, and factor markets, while these interactions are often trivialized in closed macro.
3. Research in open economy macro is driven by empirical anomalies – the behavior of prices, asset pricing puzzles, risk-sharing puzzles, etc. Closed macro often ignores inconvenient empirical facts, but they are impossible to ignore in open macro because they are so prominent in the study of prices, exchange rates, current account balances, etc.

Teaching approach (Description of the learning and teaching methods):

Lecture

Workload (Definition of workload (ECTS), divided in pre-modules (e.g. pre-readings), core-modules (contact hours), post-modules (e.g. case studies)):

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Language of instruction (Information on the language of teaching):
English

Obligatory literature (E.g. scripts, books, articles, cases, papers):
See reading list attached.

Additional literature (E.g. books, articles, cases, papers):
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Mode of examination (Mode of the examinations and tests (e.g. oral or written examination, lecture, homework, papers, class participation):
Problem sets and final exam.

Grading (A maximum of 20% outside the class room):
Final exam graded on A-F scale.

Special features (E.g. excursion, guest speaker):
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Contact information:	**Office hours:**
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Course website:
https://cecnet.tuwien.ac.at/

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Reading list

This course will study international macroeconomic integration and the implications for monetary and exchange rate policies. It will balance both empirical studies and theory. Recommended readings are marked below with a '*'.

1. Basic Intertemporal Open Economy Relationships
   - *Obstfeld, Maurice, and Kenneth Rogoff. 1995. "The Intertemporal Approach to the Current Account." In Handbook of International Economics, vol. 3, Gene M. Grossman and Kenneth Rogoff, eds. (Amsterdam: Elsevier). Chapter 34, pp. 1731-1799. Earlier version published as NBER working paper no. 4893.
   - Engel, Charles, and John H. Rogers. 2006. "The U.S. Current Account Deficit and the Expected Share of World Output." Journal of Monetary Economics, vol. 53, no. 5, July 2006, pp. 1053-1093.

2. Real Exchange Rate Puzzle
   - Engel, Charles. 1993. "Real Exchange Rates and Relative Prices: An Empirical Investigation." Journal of Monetary Economics, vol. 32, no. 1, August 1993, pp. 35-50.
   - *Engel, Charles, and John H. Rogers. 1996. "How Wide is the Border?" American Economic Review, vol. 86, no. 5, December 1996, pp. 1112-1125.
   - Canzoneri, Matthew B.; Robert E. Cumby; Behzad Diba. 1999. "Relative Labor Productivity and the Real Exchange Rate in the Long Run: Evidence from a Panel of OECD Countries." Journal of International Economics, vol. 47, no. 2, April 1999, pp. 245-266.
   - *Engel, Charles. 1999. "Accounting for U.S. Real Exchange Rate Changes." Journal of Political Economy, vol. 107, no. 3, June 1999, pp. 507-538.
   - *Burstein, Ariel; Martin Eichenbaum; Sergio Rebelo. 2005. "Large Devaluations and the Real Exchange Rate." Journal of Political Economy, vol. 113, no. 4, August 2005, pp. 742-784.
   - Corsetti, Giancarlo, and Luca Dedola. 2005. "A Macroeconomic Model of International Price Discrimination." Journal of International Economics, vol. 67, no. 1, pp. 129-155.
   - Atkeson, Andrew, and Ariel Burstein. 2008. "Trade Costs, Pricing to Market, and International Relative Prices." American Economic Review vol. 98, no. 5, December 2008, pp. 1998-2031.

3. Monetary Exchange Rate Models
   - Dornbusch, Rudiger. 1976. "Expectations and Exchange Rate Dynamics." Journal of Political Economy, vol. 84, no. 6, December 1976, pp. 1161-1176.
   - *Meese, Richard, and Kenneth Rogoff. 1983. "Empirical Exchange Rate Models of the Seventies: Do They Fit Out of Sample?" Journal of International Economics, vol. 14, no. 1-2, February 1983, pp. 3-24.
   - Engel, Charles, and Jeffrey Frankel, 1984. "Why Interest Rates React to Money Announcements: An Explanation from the Foreign Exchange Market." Journal of Monetary Economics, vol. 13, no. 1, pp. 31-39.
   - *Mark, Nelson C. 1995. "Exchange Rates and Fundamentals: Evidence on Long-Horizon Predictability." American Economic Review, vol. 85, no. 1, March 1985, pp. 201-218.

Mark, Nelson C., and Donggyu Sul. 2001. “Nominal Exchange Rates and Monetary Fundamentals: Evidence from a Small Post-Bretton Woods Sample.” Journal of International Economics, vol. 53, no. 1, February 2001, pp. 29-52.

*Engel, Charles, and Kenneth D. West. 2005. “Exchange Rates and Fundamentals.” Journal of Political Economy, vol. 113, no. 3, June 2005, pp. 485-517.

Bacchetta, Philippe, and Eric van Wincoop. 2006. “Can Information Heterogeneity Explain the Exchange Rate Determination Puzzle?” American Economic Review, vol. 96, no. 3, June 2006, pp. 552-576.

Engel, Charles, and Kenneth D. West, 2006. “Taylor Rules and the Deutschemark-Dollar Real Exchange Rate.” Journal of Money, Credit and Banking, vol. 38, no. 5, August 2006, pp. 1175-1194.

*Clarida, Richard, and Daniel Waldman, 2008. “Is Bad News about Inflation Good News for the Exchange Rate?” In John Y. Campbell, ed., Asset Prices and Monetary Policy (University of Chicago Press), pp. 371-396.

4. Purchasing Power Parity Puzzle

*Rogoff, Kenneth. 1996. “The Purchasing Power Parity Puzzle.” Journal of Economic Literature, vol. 34, no. 2, pp. 647-668.

*Engel, Charles, 2000, “Long Run PPP May Not Hold After All.” Journal of International Economics, vol. 51, no. 2, August 2000, pp. 243-273.

Taylor, Mark P.; David A. Peel; and, Lucio Sarno. 2001. “Nonlinear Mean Reversion in Real Exchange Rates: Towards a Solution to the Purchasing Power Parity Puzzles,” International Economic Review, vol. 42, no. 4, November 2001, pp. 1015-1042.

Imbs, Jean; Haroon Mumtaz; Morten O. Ravn; and, Helene Rey. 2005. “PPP Strikes Back. Aggregation and the Real Exchange Rate.” Quarterly Journal of Economics, vol. 120, no. 1, February 2005, pp. 1-43.

5. Monetary Models in Open Economies with Sticky Prices I

*Obstfeld, Maurice, and Kenneth Rogoff. 1995. “Exchange Rate Dynamics Redux.” Journal of Political Economy vol. 103, no. 3, June 1995, pp. 624-660.

*Devereux, Michael B. and Charles Engel. 2003. “Monetary Policy in the Open Economy Revisited: Price-Setting and Exchange Rate Flexibility.” Review of Economic Studies, vol. 70, no. 4, October 2003, pp. 765-783.

Corsetti, Giancarlo, and Paolo Pesenti, 2005. “International Dimensions of Optimal Monetary Policy.” Journal of Monetary Economics vol. 52, no. 1, March 2005, pp. 261-305.

6. Monetary Models in Open Economies with Sticky Prices II

*Clarida, Richard; Jordi Gali; and Mark Gertler, 2002. “A Simple Framework for International Monetary Policy Analysis.” Journal of Monetary Economics, vol. 49, no. 5, July 2002, pp. 879 -904.

*Engel, Charles, 2009. “Currency Misalignments and Optimal Monetary Policy: A Reexamination.” Working paper, University of Wisconsin.

Benigno, Gianluca, 2004. “Real Exchange Rate Persistence and Monetary Policy Rules.” Journal of Monetary Economics, vol. 51, no. 3, pp. 473-502.

Gali, Jordi, and Tommaso Monacelli, 2005. “Monetary Policy and Exchange Rate Volatility in a Small Open Economy.” Review of Economic Studies, vol. 72, no. 3, July 2005, pp. 707-734.

Benigno, Gianluca, and Piepaolo Benigno. 2006. “Designing Target Rules for International Monetary Policy Coordination.” Journal of Monetary Economics, vol. 53, no. 3, April 2006, pp. 473-506.

7. Home Bias in Equity Holdings

Lucas, Robert E. 1982. “Interest Rates and Currency Prices in a Two-Country World.” Journal of Monetary Economics, vol. 10, no. 3, pp. 335-359.

*Baxter, Marianne, and Urban Jermann. 1997. “The International Diversification Puzzle is Worse Than You Think.” American Economic Review, vol. 87, no. 1, March 1997, pp. 170-180.

Lewis, Karen K. 2000. “Why Do Stocks and Consumption Imply Such Different Gains from International Risk-Sharing?” Journal of International Economics, vol. 52, no. 1, October 2000, pp. 1-35.

*Engel, Charles, and Akito Matsumoto. 2008. “The International Diversification Puzzle when Goods Prices are Sticky: It’s Really about Exchange-Rate Hedging, not Equity Portfolios,” American Economic Journal: Macroeconomics, vol. 1, no. 2, July 2009, 155-188.

8. Backus-Smith Puzzle

Backus, David K., and Gregor W. Smith. 1993. “Consumption and Real Exchange Rates in Dynamic Economies with Non-Traded Goods.” Journal of International Economics, vol. 35, no. 3-4, November 1993, pp. 297-316.

*Corsetti, Giancarlo; Luca Dedola; and, Sylvain Leduc. 2008. “International Risk Sharing and the Transmission of Productivity Shocks.” Review of Economic Studies vol. 75, no. 2, March 2008, pp. 443-473.

9. Uncovered Interest Parity Puzzle

*Engel, Charles. 1996. “The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence. Journal of Empirical Finance, vol. 3, no. 2, June 1996, pp. 123-192.

Jeanne, Olivier, and Andrew K. Rose. 2002. “Noise Trading and Exchange Rate Regimes.” Quarterly Journal of Economics, vol. 117, no. 2, May 2002, pp. 537-569.

Gourinchas, Pierre-Olivier, and Aaron Tornell. 2004. “Exchange Rate Puzzles and Distorted Beliefs.” Journal of International Economics vol. 64, no. 2, December 2004, pp. 303-333.

*Burnside, Craig; Martin Eichenbaum; Isaac Kleshchelski; and, Sergio Rebelo. 2008. “Do Peso Problems Explain the Returns to the Carry Trade?” NBER working paper no. 14054.

*Lustig, Hanno, and Adrien Verdelhan. 2007. “The Cross Section of Foreign Currency Risk Premia and Consumption Growth Risk,” American Economic Review vol. 97, no. 1, March 2007, 89-117.
Verdelhan, Adrien. 2006. “A Habit Based Explanation of the Exchange Rate Risk Premium.” Journal of Finance, forthcoming.