

Viktoria Hnatkovska

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Course Description: This is an introductory course in International Finance. We start by defining main concepts and developing a theoretical framework for the study of current account, international asset allocations and capital flows, as well as nominal and real exchange rates. This framework is then used to examine the contemporary issues in the field: emergence of global imbalances; globalization of financial markets; financial crisis; currency unions. Economics 101 and 102 are prerequisites for this course. It will be assumed that you are familiar with basic microeconomic and macroeconomic principles; as well as with basic math.

Text:

1. The main textbook for the course is "*International Economics: Theory and Policy*", 8th edition, by Paul Krugman and Maurice Obstfeld, Addison-Wesley, 2008, Chapters 12-22.
2. I will also use lecture notes that will draw on the abovementioned textbook. I will post these notes on the course webpage.
3. Additional readings from *The Economist*, *Financial Times*, *World Economic Outlook*, etc. will be assigned in the duration of the course and posted on the course webpage. These reading are NOT optional. I will assume that everyone is familiar with the readings when assigning problem sets and setting up the exams.

Grading: Homeworks and class participation (20%), two Midterm exams (20% each), a **cumulative** Final exam (40%).

Course requirements:

- The first Midterm exam is scheduled for Monday, February 7, 2:00p.m. - 3:00p.m. The second Midterm exam is scheduled for Wednesday, March 16, 2:00p.m. - 3:00p.m. You must write both midterm exams at their scheduled time as no make-up exams will be given. If you have to miss one of the midterm exams, I will shift 10% of that Midterm weight onto the Final exam, but you will lose the remaining 10%. If you miss both Midterm exams, you will loose 30% of your overall grade, as only 10% can be shifted to the Final.

Also, if you perform poorly on one of the Midterms you will have a chance to improve your overall grade by shifting some of that Midterm weight onto the Final exam. In particular, for one of the Midterm exams and a Final you will get 20% - 40% OR 10% - 50% grade allocation, whichever gives you a higher grade. For re-weighting I will use the Midterm exam with the lower grade.

- Final exam will be scheduled during exams period.
- There will be six or seven problem sets assigned in the duration of the course. These exercises will give you an opportunity to apply the concepts and theory presented in class and make sure you understand the topics. I advise that you work through all of the problems to prepare for the exams. No late problem sets will be accepted and there will be no make-up problem sets.

Course outline: (subject to change in the duration of the course)

Each of the topics below should be covered in approximately 1 week of classes. Readings that are advised but not required are denoted with (*).

I. Current Account

1. **National income accounting for an open economy and the balance of payments**, Chapter 12 and lecture notes.

- This section presents the key accounting concepts used to describe a country's level of production and its international transactions. We also discuss the issues of current account and trade balance sustainability.

2. **Basic theory of current account determination**, lecture notes.

- In this section we discuss the agents' consumption, savings and investment decisions, and their implications for the trade balance and current account.
- *Obstfeld, Maurice and Kenneth Rogoff (2005). "The Unsustainable US Current Account Position Revisited", NBER WP 10869.

II. Exchange rates

3. **Exchange rates and the foreign exchange market: An asset approach**, Chapter 13 and Appendix to chapter 13.

- This section shows how the exchange rate between any two currencies depends on the interest rates in the two countries and the expectations of the future exchange rates.

4. **Money, interest rates and exchange rates**, Chapter 14.

- This section studies how interest rates and expectations of the future exchange rates are determined. In particular, we will discuss the theories of demand and supply of money and will use them to determine equilibrium interest rates.

5. **Price levels and the exchange rate in the long run**, Chapter 15 and Appendix to chapter 15.

- This section presents the theory of exchange rates determination over long horizons. In particular, we will discuss the theory of Purchasing Power Parity (PPP) and its performance in the data. We will also show how the monetary approach can be modified to account for the factors underlying PPP.

- *Cumby, R (1996). “Forecasting Exchange Rates and Relative Prices with the Hamburger Standard: Is What You Want What You Get With McParity?”, NBER Working Paper No. 5675.

III. Exchange rates, current account and the macroeconomy

6. Output and the exchange rate in the short run, Chapter 16.

- In this section we combine the theory of exchange rate determination with the theory of output determination in the short run.

7. Fixed exchange rates and foreign exchange intervention, Chapter 17.

- In this section we study why and how central banks intervene in the foreign exchange market to fix exchange rates; and how macroeconomic policies work when exchange rates are fixed.

8. The International Monetary System - 1870-1973, Chapter 18.

- This section discusses the evolution of monetary and exchange rate arrangements (so called international monetary system) during 1870-1973 period. In particular, we will study (i) the gold standard era, (ii) the interwar period, and (iii) post-World War II period (including Bretton Woods agreement).

9. Macroeconomic policy and coordination under floating exchange rates, Chapter 19.

- In this section we will discuss and contrast the pros and cons of the floating versus fixed exchange rate regimes.

10. Optimum currency areas and the European experience, Chapter 20 (time permitting).

- This section describes the Europe’s experience of monetary unification to illustrate the economic costs and benefits of fixed exchange rate arrangements and currency unification schemes, more generally.

11. The global capital market: Performance and policy problems, Chapter 21 (time permitting).

- In this section we discuss the main developments in the international financial markets over the past 20-30 years and outline their causes and consequences.
- *Rodrik, D. (2000). “How Far Will International Economic Integration Go?”, *Journal of Economic Perspectives*, Volume 14, Number 1, pages 177-186.
- *Prasad, E., K. Rogoff, S-J. Wei, and M. Ayhan Kose (2003). “Effects of Financial Globalization on Developing Countries: Some Empirical Evidence”, *International Monetary Fund, Occasional Paper No. 220*.
- *Aizenman, J. (2005) “Financial Liberalization: How Well Has it Worked for Developing Countries?” *FRB San Francisco Economic Letter*.
- *Obtfeld, Maurice and Kenneth Rogoff (2000). “The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?” in B. Bernanke and K. Rogoff (eds.), *NBER Macroeconomic Annual 2000*, Cambridge, MIT Press.

12. **Developing countries: growth, crisis and reform**, Chapter 22 (time permitting).

- This section studies the macroeconomic problems faced by developing countries and the repercussions of these problems for the rest of the world.