

School of Economics and Finance

## **ECON 413 INTERNATIONAL ECONOMICS**

Trimester Two 2009

### **COURSE OUTLINE**

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#### **Names and Contact Details**

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Office Hour: to be arranged.

#### **Trimester Dates**

**Teaching Period: Monday 13 July to Friday 16 October 2009**

**End of Year Study Period: Monday 19 October to Monday 26 October 2009**

**Examination Period: Tuesday, 27 October to Saturday 14 November 2009 (inclusive)**

**Note: Students who enrol in courses with examinations should be able to attend an examination at the University at any time during the formal examination period.**

**Withdrawal dates:** Information available via

<http://www.victoria.ac.nz/home/admisenrol/payments/withdrawalsrefunds.aspx>

#### **Class Times and Room Numbers**

Lectures will be held

Monday 1.40 – 3:30 pm

RWW 128

## **Course Objectives**

The objective of this course is to provide an introduction to modern developments in international macroeconomics. The course is composed of two parts. In the first half of the course, we examine how prices and flexible exchange rates are determined in international markets. In the first topic, we look at the relationship between goods prices in different countries and exchange rates. In the second topic we examine the relationship between interest rates and exchange rates. In the third topic, we look at commodity prices, with a focus on intertemporal price relationships and the economics of the oil market. This half of the course will focus on several empirical issues that have arisen in the analysis of exchange rates, interest rates, and prices. Students will be expected to complete some empirical and numerical exercises.

The second half of the course will investigate a set of standard dynamic intertemporal models of the economy, in an international setting. The models have microeconomic foundations and provide a basis for understanding current account issues. This section of the course is based on Obstfeld and Rogoff's classic text, "Foundations of Macroeconomics." One of the goals is to give students a thorough exposure to the formal models that have become the backbone of modern macroeconomics and international economics.

## **Course Content and Readings**

**Textbook** for the course is:

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International Macroeconomics*, Cambridge, MIT Press, 1996, Pp 804 + xxiii.

*This book will only be used in the second half of the course.*

### **Part 1: Exchange rates, prices, and interest rates.**

#### **(1) Purchasing Power Parity and the real exchange rate: an empirical and historic overview.**

Balassa, B. (1964) The Purchasing Power Parity Doctrine: A Reappraisal. *Journal of Political Economy* v72 584 - 596

Flood, Robert P and Mark P. Taylor (1996) Exchange Rate Economics: What's Wrong with the Conventional Macro Approach? Pp 261 – 294 in

Frankel, Jeffrey A., Giampaolo Galli and Alberto Giovannini (1996) *The Microstructure of Foreign Exchange Markets* (Chicago and London: The University of Chicago Press.)

\*Meese, Richard A. and Kenneth Rogoff (1983) "Empirical Exchange Rate Models of the Seventies: Do They Fit Out of Sample?" *Journal of International Economics* 14(1-2), 3 - 24.

\*Rogoff, Kenneth (1996) "The Purchasing Power Parity Puzzle" *Journal of Economic Literature* 34(2) (June 1996) 647-668.

Alan Taylor (2004) "The Purchasing Power Parity Debate," *Journal of Economic Perspectives* 18(4) 135-158

#### **Basic time series issues**

I shall distribute lecture notes on the minimum amount of time series analysis that is needed to understand some of the issues that arise when estimating time-series models of the exchange rate.

The standard reference is the incomparable text

Hamilton, James (1996) *Time Series Analysis* particularly chapter 17.

#### **(2) Are real exchange rates mean reverting: econometric issues**

\*Kapetanios, G. Y. Shin and A Snell (2003) "Testing for a unit root in the non-linear STAR framework", *Journal of Econometrics* 112 359-379

\*Taylor, Alan (2001) "Potential pitfalls for the purchasing-power parity puzzle? Sampling and specification biases in mean-reversion tests of the law of one price." *Econometrica* 69(2) 473-498.

\*Taylor, M, Peel and Sarno (2001) "Non-linear mean reversion in real exchange rates: toward a solution to the purchasing power parity puzzles." *International Economic Review* 42(4) 10-15-1042

### (3) Interest Rate Parity Conditions and the Efficiency of Foreign Exchange Markets

\*Chinn, Menzies and Guy Meredith (2004) “Monetary Policy and long-horizon uncovered interest parity” *IMF Staff Papers* 51(3) 409-430

\*Coleman, Andrew and Ozer Karagedikli (2008) “The relative size of New Zealand exchange rate and interest rate response to news,” Motu WP 2008/12

Faust, R, J Rogers, S Wang and J Wright (2007), “The high frequency response of exchange rates and interest rates to macroeconomic announcements,” *Journal of Monetary Economics* 54, 1051-1068.

\*Froot, Kenneth A. and Thaler, Richard. (1990) “Anomalies: Foreign Exchange” *Journal of Economic Perspectives* 4(3) 179 – 192.

Flood, R and A Rose (2001) “*Uncovered interest parity in crisis: the interest rate defense in the 1990s.*” IMF working Paper 01/207 December 2001.

\*Sarno, Valente and Leon (2006) “Nonlinearity in deviations from uncovered interest parity: an explanation of the forward bias puzzle” *Review of Finance*

### (4) Commodity Prices

\*Deaton, Angus, and Guy Laroque (1992) On the Behaviour of Commodity Prices *Review of Economic Studies* 59 1 – 24

Deaton, Angus, and Guy Laroque (1996) Competitive Storage and Commodity Price Dynamics *Journal of Political Economy* 104 896 – 923

Dvir, Eyal and Kenneth Rogoff (2009) “Three epochs of oil,” NBER 14297

Hamilton, James D (2008) “Understanding crude oil prices” NBER 14492

Williams, Jeffrey C. and Brian Wright (1991) *Storage and Commodity Markets* Cambridge: Cambridge University Press)

## **Part 2 The “new” intertemporal approach to international economics.**

### (1) Introduction

Main policy issues. Summary of recent developments in international macroeconomics.

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International Macroeconomics*, Preface & Introduction.

Grossman, Gene M. and Kenneth Rogoff, eds., *Handbook of International Economics*, volume 3, Preface to the Handbook.

Stockman, Alan C., "On the Roles of International Financial Markets and Their Relevance for Economic Policy", *Journal of Money, Credit, and Banking*, August 1988 (Part 2), pp. 531-549.

## (2) Intertemporal Trade and the Current Account Balance

Trade across time. Basic economic principles that govern intertemporal trade. Two-period model of small open economy and the current account balance. Two-region world economy model and the determination of world interest rates.

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International Macroeconomics*, ch. 1.

Obstfeld, Maurice and Kenneth Rogoff, "The Intertemporal Approach to the Current Account", in G. Grossman and K. Rogoff (ed.), *Handbook of International Economics*, volume 3, ch. 34.

## (3) Dynamics of Small Open Economies

Consumption smoothing approach to the current account. Current account dynamics for a small open economy. Current account sustainability.

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International Macroeconomics*, ch. 2.

Obstfeld, Maurice and Kenneth Rogoff, "The Intertemporal Approach to the Current Account", in G. Grossman and K. Rogoff (ed.), *Handbook of International Economics*, volume 3, 1995, ch. 34.

Milesi-Ferretti, G. and A. Razin, "Persistent Current Account Deficits: a Warning Signal?", *International Journal of Finance and Economics*, Vol. 1, No. 3, 1996, pp. 161-181.

Milesi-Ferretti, G. and A. Razin, "Current Account Sustainability: Selected East Asian and Latin American Experiences", *NBER Working Paper Series*, No. 5791, October 1996.

## (4) Demographic Structure, Fiscal Policy, and the Current Account

Overlapping generations framework. Effect of demographic factors and fiscal policy on the current account balance. Integration of the overlapping generations and representative-consumer models.

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International Macroeconomics*, ch. 3.

Obstfeld, Maurice and Kenneth Rogoff, "The Intertemporal Approach to the Current Account", in G. Grossman and K. Rogoff (ed.), *Handbook of International Economics*, volume 3, 1995, ch. 34.

### **Expected Workload**

ECON 413 is a 15-point course, and on the basis of VUW having designated one point = 10 hours work, expected work load would total 150 hours. If that workload were spread over 12 weeks, hours expected would average around 12.5 hours per week. This would involve attending classes, plus reading, studying and completing assignments. The 12.5 hours would of course vary for individual students, depending on the student's previous knowledge and understanding, and the final grade at Honours level to which the student aspires.

### **Assessment Requirements**

During the course students are required to complete assignments. Unlike the situation that exists in undergraduate papers, your final grade will be determined on the basis of your overall performance in the Honours programme. However, as a guide to the allocation of your efforts, the assessment in ECON 413 will be based on assignments 50%, and the final two-hour examination 50%.

Economics is largely learnt through practice. Consequently, the assignments are designed to introduce you to a series of skills that you will find useful at a later date. One of the skills is to try new things! The assignments will be a mix of statistical and numerical computer based exercises, as well as ways to approach problems analytically.

The final examination will comprise a mix of essay-style and mathematical/problem-style questions.

The final examination for this course will be scheduled at some time during the period from Tuesday 27 October to Saturday 14 November 2009.

*Note: Your assessed work may also be used for quality assurance purposes, such as to assess the level of achievement of learning objectives as required for accreditation and audit purposes. The findings may be used to inform changes aimed at improving the quality of FCA programmes. All material used for such processes will be treated as confidential, and the outcome will not affect your grade for the course.*

### **Communication of Additional Information**

Additional information or information on changes will be conveyed to students through e-mails and Blackboard.

## **Faculty of Commerce and Administration Offices**

### Railway West Wing (RWW) - FCA Student and Academic Services Office

The Faculty's Student and Academic Services Office is located on the ground and first floors of the Railway West Wing. The ground floor counter is the first point of contact for general enquiries and FCA forms. Student Administration Advisers are available to discuss course status and give further advice about FCA qualifications. To check for opening hours call the Student and Academic Services Office on (04) 463 5376.

### Easterfield (EA) - FCA/Education/Law Kelburn Office

The Kelburn Campus Office for the Faculties of Commerce and Administration, Education and Law is situated in the Easterfield Building - it includes the ground floor reception desk (EA005) and offices 125a to 131 (Level 1). The office is available for the following:

- Duty tutors for student contact and advice.
- Information concerning administrative and academic matters.
- Forms for FCA Student and Academic Services (e.g. application for academic transcripts, requests for degree audit, COP requests).
- Examinations-related information during the examination period.

To check for opening hours call the Student and Academic Services Office on (04) 463 5376.

## **General University Policies and Statutes**

Students should familiarise themselves with the University's policies and statutes, particularly the Assessment Statute, the Personal Courses of Study Statute, the Statute on Student Conduct and any statutes relating to the particular qualifications being studied; see the Victoria University Calendar or go to [www.vuw.ac.nz/policy](http://www.vuw.ac.nz/policy).

For information on the following topics, go to the Faculty's website [www.vuw.ac.nz/fca](http://www.vuw.ac.nz/fca) under Important Information for Students:

- Academic Grievances
- Academic Integrity and Plagiarism
- Student and Staff Conduct
- Meeting the Needs of Students with Impairments
- Student Support

## **Manaaki Pihipihinga Programme**

Manaaki Pihipihinga is an academic mentoring programme for undergraduate Māori and Pacific students in the Faculties of Commerce and Administration, and Humanities and Social Sciences. Sessions are held at the Kelburn and Pipitea Campuses in the Mentoring Rooms, 14 Kelburn Parade (back courtyard), Room 109D, and Room 210, Level 2, Railway West Wing. There is also a Pacific Support Coordinator who assists Pacific students by linking them to the services and support they need while studying at Victoria. Another feature of the programme is a support network for Postgraduate students with links to Postgraduate workshops and activities around Campus.

For further information, or to register with the programme, email [manaaki-pihipihinga-programme@vuw.ac.nz](mailto:manaaki-pihipihinga-programme@vuw.ac.nz) or phone (04) 463 5233 ext. 8977. To contact the Pacific Support Coordinator, email [pacific-support-coord@vuw.ac.nz](mailto:pacific-support-coord@vuw.ac.nz) or phone (04) 463 5842.

**Academic Integrity and Plagiarism**

<http://www.victoria.ac.nz/home/study/plagiarism.aspx>

**General University Policies and Statutes**

<http://www.victoria.ac.nz/home/about/policy/academic.aspx>

**Faculty of Commerce and Administration Offices**

<http://www.victoria.ac.nz/fca/studenthelp/Contactus.aspx>

**Manaaki Pihipihinga Programme**

[http://www.victoria.ac.nz/st\\_services/mentoring/](http://www.victoria.ac.nz/st_services/mentoring/)