

## Management of International Financial Relations

Master's in International Affairs and Governance (MIA) — Autumn 2018

November 12, 2018

Course number: 7,387,1.00  
ECTS credits: 4  
Lecture dates: November 12, 19, 26, December 3, 10 and 17  
Lecture time: Mon 14:15-18:00  
Lecture hall: 22-201  
Examination form: Decentral. Written examination: 100%, 90 minutes  
Examination date: December 17, 16:15-17:45  
Course web page: *StudyNet*

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### DESCRIPTION

This course extends insights from financial economics to examine the short-term macroeconomic adjustment in an international setting. The course covers the exchange rate and the current account, and relates their determination to world capital markets and the domestic macroeconomic conditions. Taking long-term foundations of macroeconomic conditions as given, the course adopts a monetary view to short-term macroeconomic adjustments, discusses economic policies and their effects under different exchange rate regimes—ranging from floating rates to managed and fixed rates—and presents implications for the current account and the economy as a whole.

### PREREQUISITES

International Economics and Macroeconomics II are prerequisites for this course. Knowledge of asset pricing models (portfolio choice in finance) and familiarity with (new Keynesian) macroeconomic models can help, but are not necessary. The relevant aspects will be covered in the course.

## OBJECTIVES

After completion of this course, you will be able to:

- Understand the identity of a country's net export outflows and its net capital outflows.
- Relate production (investment) and consumption (savings) decisions to net exports and capital flows.
- Use parity conditions on financial returns to determine the nominal exchange rate.
- Use parity conditions on the purchasing power of residents to determine the real exchange rate.
- Explain how household consumption typically responds to transitory changes in disposable income, how business investment typically responds to transitory changes in interest rates and aggregate demand, how the current account responds to transitory changes in disposable income and to the real exchange rate, and how therefore gross domestic product relates to disposable income and the real exchange rate.
- Describe why an appreciated real exchange rate relates to higher gross domestic product in financial markets and why a depreciated real exchange rate relates to higher output of goods and services in real-side markets.
- Analyze temporary and permanent monetary and fiscal policies under alternative exchange-rate regimes.
- Trace financial crises to government policies, speculative attacks, or financial disintermediation.
- Assess financial and macroeconomic conditions for current account sustainability.
- Relate the objectives of internal balance and external balance to monetary regimes in history.

## STRUCTURE

The course is blocked into six weekly lecture days over the course of the second half of autumn semester. The first five lecture days are split into three lecture units of 70 minutes. The sixth lecture day will review the material from a historic perspective, to help students revisit the material prior to the final examination. The examination will be decentral and written; it will be held over 90 minutes during the latter part of the sixth lecture day.

After an opening first segment that lays the real-side and monetary foundations, the second part of the course invokes economic principles of finance to develop an asset pricing approach to the nominal exchange in the short run and builds on versions of the principle of no arbitrage in global markets for goods and services (purchasing power parities) to determine the anchoring real exchange in the long run. The third block of the course then postulates plausible aggregate relationships to characterize current account and output fluctuations and assesses their dependence on the nominal exchange in the short run and the real exchange in the long run. A concluding segment of the course turns to current policy topics including global financial crises and the Great Recession of 2008, as well as causes and consequences of prevailing global imbalances.

## MATERIALS

Lecture notes become available online at *StudyNet* before each lecture.

**Textbook (required):** Krugman, Obstfeld, and Melitz (2018)

**Textbook supplement (required):** Muendler (2014)/Ch. 1, 3, 14 and 20

**Background Readings (recommended):** Caballero, Farhi, and Gourinchas (2008); Calvo and Reinhart (2002); Stiglitz (2000); Diamond and Dybvig (1983); Duffie (2010); Greenspan (2010)

The textbook supplements are chapters from my own draft textbook Muendler (2014)/Ch. 1, 3, 14 and 20. The chapters will be available for viewing prior to the respective lectures.

The readings (articles) help you review the lecture material beyond the textbook and my textbook supplement. They are available through the course web page (see link above). Web links to copyrighted readings may only work from on-campus domains.

## EXAMINATION

The examination form is decentral and written. It counts 100 percent, with a duration of 90 minutes.

The principal aid rule is that of an extended closed-book examination. The according use of aids is limited; any additional aids permitted are exhaustively listed as *supplementary aids* below. The rules for an extended closed book examination are:

- All pocket calculators of the Texas Instruments TI-30 series and mono- or bilingual dictionaries (no subject-specific dictionaries) without hand-written notes are admissible. Any other pocket calculator models and any electronic dictionaries are **inadmissible**.
- Any type of communication devices, as well as any electronic devices that can be programmed and are capable of communication—such as notebooks, tablets, PDAs, mobile telephones and others—are **inadmissible**.
- Students are responsible for the procurement of examination aids.

Supplementary aids are permitted as follows. A pen, a pencil, a ruler and an eraser are permitted in addition to the two types of electronic devices listed under the first item above.

The language of examination questions is English. The expected language of answers is English.

The examination is decentral and written. The exam will contain nine 10-minute questions and cover the material of the entire course. It will take place on the sixth lecture day. For your preparation, sample questions from examinations in related courses taught by the instructor will be available from the course web page prior to the examination.

On the first lecture day, the instructor will offer three possible alternatives for exam time and scheduling of a historic review with model and exercises: (1) to hold the review on the non-lecture day of Thu, Dec 13, 18:00-20:00, and the examination on Mon, Dec 17, 14:15-15:45; (2) to hold the review on the lecture day of Mon, Dec 17, 14:15-16:00, and the examination on Mon, Dec 17, 16:15-17:45; (3) to offer an online review lecture to be posted before Thu, Dec 13, and hold the examination on Mon, Dec 17, 14:15-15:45.

## COURSE SCHEDULE

### I. Foundations of Open-economy Macroeconomics

1. **Mon, Nov 12, 14:15-15:25:** Introduction to Open-economy Macroeconomics  
(Krugman, Obstfeld, and Melitz 2018/Ch. 1 and 13; Muendler 2014/Ch. 1 and 14)
2. **Mon, Nov 12, 15:30-16:40:** International Monetary Systems, Past and Present  
(Krugman, Obstfeld, and Melitz 2018/Ch. 19)
3. **Mon, Nov 12, 16:50-18:00:** Exchange Rates and Foreign Exchange Markets  
(Krugman, Obstfeld, and Melitz 2018/Ch. 14)

### II. Exchange Rates and International Finance

4. **Mon, Nov 19, 14:15-15:25:** An Asset Approach to the Exchange Rate  
(Krugman, Obstfeld, and Melitz 2018/Ch. 15)
5. **Mon, Nov 19, 15:30-16:40:** A Monetary Approach to the Exchange Rate  
(Krugman, Obstfeld, and Melitz 2018/Ch. 15)
6. **Mon, Nov 19, 16:50-18:00:** Monetary Policy and Exchange Rate Determination  
(Krugman, Obstfeld, and Melitz 2018/Ch. 15)
7. **Mon, Nov 26, 14:15-15:25:** Purchasing Power Parity and the Monetary Approach  
(Krugman, Obstfeld, and Melitz 2018/Ch. 16)
8. **Mon, Nov 26, 15:30-16:40:** Purchasing Power Parity and the Real Exchange Rate  
(Krugman, Obstfeld, and Melitz 2018/Ch. 16, Muendler 2014/Ch. 3)

### III. Current Account Determination and International Financial Management

9. **Mon, Nov 26, 16:50-18:00:** Flexible Exchange Rates and Output in the Short Term  
(Krugman, Obstfeld, and Melitz 2018/Ch. 17; Muendler 2014/Ch. 20, sections 1 and 2)
10. **Mon, Dec 3, 14:15-15:25:** Policy under Floating Exchange Rates  
(Krugman, Obstfeld, and Melitz 2018/Ch. 17; Muendler 2014/Ch. 20)
11. **Mon, Dec 3, 15:30-16:40:** Managed and Fixed Exchange Rates  
(Krugman, Obstfeld, and Melitz 2018/Ch. 18)
12. **Mon, Dec 3, 16:50-18:00:** Policy under Managed Exchange Rates  
(Krugman, Obstfeld, and Melitz 2018/Ch. 18; Calvo and Reinhart 2002)

### IV. International Macroeconomic Relations and Financial Crises

13. **Mon, Dec 10, 14:15-15:25:** Currency Crises  
(Krugman, Obstfeld, and Melitz 2018/Ch. 20 and 22; Stiglitz 2000)
14. **Mon, Dec 10, 15:30-16:40:** Banking and Debt Crises  
(Diamond and Dybvig 1983; Duffie 2010; Greenspan 2010)

**15. Mon, Dec 10, 16:50-18:00:** Current Account Sustainability

(Krugman, Obstfeld, and Melitz 2018/Ch. 20; Caballero, Farhi, and Gourinchas 2008)

**16. Optional:** International Financial Management (historic review with model and exercises). Three possible alternatives to be discussed and selected on the first lecture day.

1. Thu, Dec 13, 18:00-20:00, and Examination on Mon, Dec 17, 14:15-15:45.
2. Mon, Dec 17, 14:15-16:00, and Examination on Mon, Dec 17, 16:15-17:45.
3. Online review lecture (to be posted before Thu, Dec 13), and Examination on Mon, Dec 17, 14:15-15:45.

**Mon, Dec 17:** EXAMINATION (90 minutes). Time to be decided on the first lecture day.

## References

- CABALLERO, R. J., E. FARHI, AND P.-O. GOURINCHAS (2008): "Financial Crash, Commodity Prices, and Global Imbalances," *Brookings Papers on Economic Activity*, 2008(2), 1–68.
- CALVO, G. A., AND C. M. REINHART (2002): "Fear of Floating," *Quarterly Journal of Economics*, 117(2), 379–408.
- DIAMOND, D. W., AND P. H. DYBVIK (1983): "Bank Runs, Deposit Insurance, and Liquidity," *Journal of Political Economy*, 91(3), 401–19.
- DUFFIE, D. (2010): "The Failure Mechanics of Dealer Banks," *Journal of Economic Perspectives*, 24(1), 51–72.
- GREENSPAN, A. (2010): "The Crisis," *Brookings Papers on Economic Activity*, 2010(1), 201–261.
- KRUGMAN, P. R., M. OBSTFELD, AND M. J. MELITZ (2018): *International Economics: Theory and Policy*. Pearson, Boston, 11th (global) edn.
- MUENDLER, M.-A. (2014): "The Economics of Globalization," University of California, San Diego, unpublished textbook manuscript.
- STIGLITZ, J. E. (2000): "Lessons from the Global Financial Crisis," in *Global financial crises: Lessons from recent events*, ed. by J. R. Bisignano, W. C. Hunter, and G. G. Kaufman, pp. 89–107. Kluwer Academic, Boston, Dordrecht and London.