

# Syllabus for lecture: Financial Economics II – Global Imbalances and External Adjustment

Winter term 2022/23

Lecture: Prof. Dr. Philip Sauré  
Location: -1 341 HS VIII  
Time: Wednesday, 2:15-3:45 pm

Tutorial: Mohsen Shaeyan  
Location: -1 341 HS VIII  
Time: Wednesday, 8:15-9:45 am

The course Financial Economics II consists of four parts. It consists of selected topics that were in the past taught in the two distinct courses Financial Economics I and II. Theories based on modern micro-founded modelling and standard econometric techniques will be employed.

The first part of this course covers the principles of international risk sharing through asset trade. We initially develop and study standard theories under complete markets and then discuss the predictions in view of empirical regularities. Students acquire knowledge of common tools of economic modelling and their mapping into econometric analyses. The second part turns to imperfections of asset market of a specific form: limited enforcement of sovereign debt contracts. The costs of sovereign default is highlighted, and their determinants and magnitude are analyzed. The third and fourth part then turn to global imbalances and the process of external adjustments. Global imbalances – defined as the amount a country indebts itself vis-à-vis foreigners in a given period – serve as a policy indicator of risk and stability of the global financial system. The course reviews the factors that drive global imbalances. It distinguishes natural levels of borrowing on international markets from excessive borrowing and analyzes related risks and potential inefficiencies, resulting from debt crises or currency attacks. The course further assesses the dynamics of external adjustment, i.e., the reduction of global imbalances, in particular, the potential welfare costs involved.

Methodologically, the course connects empirical findings and the insights from theoretical modelling.

## Main Course Material

### Textbooks

Obstfeld, Maurice and Kenneth S. Rogoff. Foundations of international macroeconomics. Cambridge, MA: MIT press, 1996.

Harms, Philipp (2016): International Macroeconomics, 2nd edition, Tübingen (Mohr Siebeck).

Gopinath, Gita, Elhanan Helpman, and Kenneth Rogoff, eds. Handbook of international economics. Vol. 4. Elsevier, 2014.

Lecture slides and problems sets will be made available for registered students through JGU-LMS

(<https://lms.uni-mainz.de/moodle/my/>).

## Course Chapters

### I. International borrowing and lending under complete markets

#### *Required readings*

OR: Chapter 5 (pp. 269 – 291)

#### *Optional readings*

French, Kenneth R., and James Michael Poterba 1991. "Investor Diversification and International Equity Markets." American Economic Review 81.2 222-226.

Brennan, Michael J., and H. Henry Cao 1997: "International portfolio investment flows." Journal of Finance 52.5, 1851-1880.

Van Nieuwerburgh, Stijn, and Laura Veldkamp 2009: "Information immobility and the home bias puzzle." Journal of Finance 64.3, 1187-1215.

Obstfeld, Maurice, and Kenneth Rogoff 2000: "The six major puzzles in international macroeconomics: is there a common cause?" NBER macroeconomics annual 15, 339-390.

Coeurdacier, Nicolas, and Helene Rey 2012. "Home bias in open economy financial macroeconomics." Journal of Economic Literature 51.1 63-115.

### II. Sovereign borrowing, enforcement and the willingness to pay

#### *Required readings*

OR, pp. 349 - 362

#### *Optional readings*

Aguiar, Mark, and Manuel Amador. "Sovereign debt." Handbook of International Economics. Vol. 4. Elsevier, 2014. 647-687.

Tomz, Michael, and Mark LJ Wright. 2013. "Empirical research on sovereign debt and default." *Annual Review of Economics* pp. 5:247–72.

Eaton, Jonathan, and Mark Gersovitz 1981. "Debt with potential repudiation: Theoretical and empirical analysis." *Review of Economic Studies* 48.2 289-309.

Bulow, Jeremy, and Kenneth Rogoff 1989 "A constant recontracting model of sovereign debt." *Journal of political Economy* 97.1 155-178.

Cole, Harold L., and Patrick J. Kehoe 1998. "Models of sovereign debt: Partial versus general reputations." *International Economic Review* 55-70.

Amador, Manuel 2003. "A political economy model of sovereign debt repayment." Manuscript, Stanford University

Cole, Harold L., and Timothy J. Kehoe 1996. "A self-fulfilling model of Mexico's 1994–1995 debt crisis." *Journal of international Economics* 41.3-4 309-330.

Morris, Stephen, and Hyun Song Shin 1998. "Unique equilibrium in a model of self-fulfilling currency attacks." *American Economic Review* 587-597.

European Commission 2018: Debt Sustainability Monitor 2017, Institutional Paper 071

### III. Global Imbalances

*Keywords:* Balance of Payments (BOP), Current Account (CA), International Investment Position (IIP), intertemporal optimization, consumption smoothing, distortions, sudden stops, speculative attacks

*Readings:*

Harms, Chapters II and X

Gourinchas, P. O., & Rey, H. 2014. External adjustment, global imbalances, valuation effects, Chapter 10. In *Handbook of International Economics*

Calvo, G. 1998: Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops, *Journal of Applied Economics*

Arellano, Cristina, and Ananth Ramanarayanan. "Default and the maturity structure in sovereign bonds." *Journal of Political Economy* 120.2 (2012): 187-232.

Jeanne, Olivier, and Anton Korinek. "Excessive volatility in capital flows: A pigouvian taxation approach." *American Economic Review* 100.2 (2010): 403-07.

*Optional readings*

Blanchard, O. and G. Milesi-Feretti 2012: (Why) Should Current Account Balances Be Reduced? *IMF Economic Review*

Bernanke, Ben. 2005. The global saving glut and the US current account deficit. No. 77. Board of Governors of the Federal Reserve System (US)

Chinn, M.D., Prasad, E.S., 2003. Medium-term determinants of current accounts in industrial and developing countries: an empirical exploration. *Journal of International Economics* 59 (1), 47–76.

Gourinchas, P.O., Rey, H., 2007. From world banker to world venture capitalist: US external adjustment and the exorbitant privilege G7 Current Account Imbalances: Sustainability and Adjustment. University of Chicago Press, 11–66.

Gourinchas, P. O., & Rey, H. 2014. External adjustment, global imbalances, valuation effects, Chapter 10. In Handbook of International Economics

Rothenberg, A. D., and F. E. Warnock. 2011. "Sudden flight and true sudden stops." Review of International Economics

Krugman, P. (1979) "A model of balance-of-payments crises." Journal of money, credit and banking 11.3 (1979): 311-325.

#### **IV. External Adjustment – Empirics and Theory**

*Keywords:* (empirics) channels of adjustment, trade balance, nominal exchange rate, real exchange rate, panel estimations, (theory) wage, real wage, real exchange rate, varieties, Home Market Effect, transfer effect, secondary burden.

##### *Readings:*

Lane, Philip R., and Gian Maria Milesi-Ferretti. "External adjustment and the global crisis." *Journal of International Economics* 88.2 (2012): 252-265.

##### *Optional readings*

Phillips, Steven, et al. 2013 "The external balance assessment (EBA) methodology."

Lee, Mr Jaewoo, et al. 2008 *Exchange rate assessments: CGER methodologies*. No. 261. International Monetary Fund

Gourinchas, P.-O. and H. Rey 2007. "International financial adjustment." *Journal of Political Economy*

Dekle, Robert, Jonathan Eaton, and Samuel Kortum. 2008 "Global rebalancing with gravity: measuring the burden of adjustment." *IMF Staff Papers* 55.3: 511-540.

Chinn, M. D., & Wei, S. J. 2013. A faith-based initiative meets the evidence: does a flexible exchange rate regime really facilitate current account adjustment? *Review of Economics and Statistics*

Obstfeld, M., Rogoff, K., 2005. Global current account imbalances and exchange rate adjustments. Brookings Papers on Economic Activity 1, 67–123.