

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

Winter term 2023/24

Lecture: Prof. Philip Sauré
Location: -1 331 HS IX
Time: Wednesday, 2:15 – 3:45 p.m.
Tutorial: Mohsen Shaeyan
Location: -1 331 HS IX
Time: Thursday, 12:15 – 1:45 p.m.

The course Financial Economics II consists of four parts and covers 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 the course provides a short introduction to the current account and the concept of global imbalances, which are frequently used as an indicator of risk and stability of the global financial system. The second part covers the principles of global risk sharing through international borrowing and lending. We study standard theories under complete markets and then discuss the predictions in view of the data. The third part returns to the notion of global imbalances, discussing them in light of their benefits and risks. We also look at past episodes of external adjustment. The fourth part turns to sovereign debt as a specific segment of external liability. In this asset class, market imperfections arise due to limited enforcement of sovereign debt contracts. We highlight the costs of sovereign default and discuss their determinants and magnitude.

Overall, the course aims to connect theory and empirical work. Specifically, students acquire knowledge of common tools of economic modelling and their mapping into econometric analyses.

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 available for registered students through JGU-LMS

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

Course Chapters

I. Global Imbalances

Keywords: Balance of Payments (BOP), Current Account (CA), International Investment Position (IIP), trade balance, intertemporal optimization, savings glut

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*

II. International borrowing and lending

Keywords: Risk aversion, risk sharing, CAPM, constrained optimization, consumption correlation puzzle.

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.

III. Risks of Global Imbalances and External Adjustment

Keywords: sudden stops, channels of adjustment, nominal exchange rate, real exchange rate, panel estimations, transfer effect, secondary burden.

Readings:

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

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

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

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*

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

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

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

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., H. Rey 2007. "International financial adjustment." *Journal of Political Economy*

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*

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

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.

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

IV. 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