

## INTERNATIONAL FINANCE

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*Number of sessions: 30*

*Length of each session: 1,5 h*

*Total length of the module: 45 hours*

### OBJECTIVE

The increasing interdependence of nations in a “global village” makes the understanding of the interactions of different economies necessary to today’s professionals, economists and non-economists alike. In order to provide a global picture of these interactions and increasing interdependence, this course delves into the macroeconomic aspects of international economics with special emphasis being put on monetary issues. As the tendency is for countries to become more open throughout time, doing so make them subject or potentially vulnerable to external events that can affect substantially their performance and that of the firms within them, so a good understanding of open-economy macroeconomics is crucial. Specific cases of integration schemes and monetary experiences, such as the European integration, will be also debated.

### REQUIREMENTS

A macroeconomics course and an introductory course to international economics are necessary to fully appreciate the content of this course.

### CONTENT

#### **1. Introduction**

- 1.1 Basics of international economics: Quick overview of the different trade theories (Mercantilism, Adam Smith, David Ricardo, Hecksher-Ohlin, “New Trade Theories”).
- 1.2 Balance of payments accounting principles
- 1.3 Accounting balances and disequilibrium in international transactions
- 1.4 International investment position of a nation

#### **2. Foreign exchange markets and exchange rates**

- 2.1 Functions of the foreign exchange markets
  - 2.1.1 Case study: The US dollar as the dominant vehicle currency
  - 2.1.2 The birth of new currency: the Euro. Struggle for financial hegemony?
- 2.2 Foreign exchange rates
  - 2.2.1 Equilibrium exchange rates
  - 2.2.2 Arbitrage
  - 2.2.3 The exchange rate and the balance of payments
- 2.3 Spot and forward rates, currency swaps, futures and options
  - 2.3.1 Spot and forward rates
  - 2.3.2 Currency swaps
  - 2.3.3 Foreign exchange futures and options
- 2.4 Foreign exchange risks, hedging, and speculation
- 2.5 Interest arbitrage and the efficiency of foreign exchange markets
  - 2.5.1 Uncovered and covered interest arbitrage
  - 2.5.2 Covered interest arbitrage parity
  - 2.5.3 Covered interest arbitrage margin
  - 2.5.4 Efficiency of foreign exchange markets
  - 2.5.5 Eurocurrency and offshore financial markets

### **3. Exchange rate determination**

- 3.1 Purchasing power parity: Absolute and relative
- 3.2 Empirical test of the purchasing power parity
- 3.3 Monetary approach to balance of payments under fixed and flexible exchange rates
- 3.4 Monetary approach to exchange rate determination
- 3.5 Asset market model portfolio adjustments and exchange rates
- 3.6 Exchange rate dynamics
  - 3.6.1 Exchange rate overshooting

### **4. Price adjustment mechanism with flexible and fixed exchange rates**

- 4.1 Adjustment with flexible exchange rates
- 4.2 Adjustment with fixed exchange rates
- 4.3 Derivation of demand and supply curves for foreign exchange
- 4.4 Effect of exchange rate changes on domestic prices and the terms of trade
- 4.5 Stable and unstable exchange rate markets
- 4.6 Marshall-Lerner condition
- 4.7 The gold standard: Adjustment

### **5. International money and capital markets**

- 5.1 Introduction to capital and money markets

- 5.2 Investing on a covered basis
- 5.3 The covered interest rate parity
- 5.4 Deviations from covered interest parity
- 5.5 Political risk and international money markets
- 5.6 Currency swaps and covered interest parity
- 5.7 World financial liberalization in the 1980s and 1990s

## **6. The income adjustment mechanism and synthesis of automatic adjustment**

- 6.1 Income determination in a closed economy
  - 6.1.1 Determination of the equilibrium national income
  - 6.1.2 The multiplier in a closed economy
- 6.2 Income determination in small open economy
  - 6.2.1 Import function
  - 6.2.2 Foreign trade multiplier
- 6.3 Foreign repercussions
- 6.4 Absorption approach
- 6.5 Monetary adjustment and synthesis of the automatic adjustments

## **7. International macroeconomics: Deepening certain concepts**

- 7.1 Broad picture of the open economy: International transactions and the balance of payments
- 7.2 Measuring interdependence: The international investment position of a nation
- 7.3 Financial openness and the share of foreign assets held by foreigners
- 7.4 Exchange rates, prices, and external competitiveness
- 7.5 Savings, investment, and the current account balance

## **8. External debt crisis of developing countries**

- 8.1 The extent of the debt problem
- 8.2 Mark of a debt-ridden country?
- 8.3 Public deficits and public external debt
- 8.4 Commercial bank exposure to developing country debt: The road from loan pushing to debt write-offs
- 8.5 Dealing with debt crisis
- 8.6 The Brady plan and debt reduction

## **9. Flexible versus fixed exchange rates, the European monetary system, and macroeconomic policy coordination**

- 9.1 The case for flexible exchange rates
- 9.2 The case for fixed exchange rates
- 9.3 Optimum currency areas, the European Monetary System, and the European Monetary Union
- 9.4 Currency board arrangements and dollarization

9.5 Exchange rate bands, adjustable pegs, crawling pegs, and managed floating

**10. The international monetary system, past, present, and future**

- 10.1 The gold standard and the interwar experience
  - 10.1.1 The gold standard period (1880-1914)
  - 10.1.2 The interwar experience
- 10.2 The Bretton Woods System
  - 10.2.1 The gold-exchange standard (1947-1971)
  - 10.2.2 Borrowing from the IMF
- 10.3 Operation and evolution of the Bretton Woods System
- 10.4 The US balance of payment deficits and the collapse of the Bretton Woods System
- 10.5 The international monetary system: Present and Future.
  - 10.5.1 Operation of the present system
  - 10.5.2 Current IMF operation
  - 10.5.3 Problems with the current the present rate arrangements and proposals for reform
  - 10.5.4 Financial crisis in emerging countries
  - 10.5.5 Other current international economic problems

**Grading: the grading system will be as follows**

Homework	20%
Midterm	40%
Final exam	40%

SUGGESTED READINGS

Gandolfo, G. (2002) International Finance and Open-Economy Macroeconomics. Springer, 1<sup>st</sup> Edition.

Krugman, K. and Obstfeld, M. (2002) International Economics: Theory and Policy (6th Edition)

Obstfeld, M and Taylor, A (2004) Global Capital Markets: Integration, Crisis, and Growth. Cambridge University Press.

Salvatore, D. (2004) International Economics. Wiley (8<sup>th</sup> edition).