INTERNATIONAL FINANCE Finance 933, Spring 2003 Steinberg-Dietrich 211 Tuesday 9:00-12:00 http://finance.wharton.upenn.edu/~jermann/FNCE_933.html

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Goal of the course

To provide an understanding of selected topics of current academic research in the areas of international finance and international macroeconomics. To teach interested students the tools for conducting research in this field. The typical target audience comprises students in their second year or later.

Readings

Most papers assigned for this course are available on the web. For published papers, http://www.library.upenn.edu link to *E-journals* and then link to *Economics* or *Finance*, for most working papers www.google.com. If you have problems finding a paper, let us know.

Requirements

(1) Midterm and Final Exam C comprising together 60% of grade; (2) Critical analysis of a research paper given by oral presentation C comprising 40% of grade. For students falling between a letter grade, a third category may be relevant: (3) Course participation.

The Midterm exam is tentatively scheduled for February 20 in class C depending on the number of students, this may be scheduled outside class time or as a takehome. The Final exam is tentatively scheduled for April 22.

Student presentations

Students will be required to choose a paper that they wish to critique from a list that will be made available. Papers are chosen on a first come first served basis. We will provide detailed information about how this presentation should be prepared.

Auditors

Any students sitting in on the course who are not registered for a grade are required to provide an oral presentation of a paper, as are registered students. No students are allowed to "sit in" without providing evidence of doing the required work. Auditors are exempt from taking the exams, however.

TOPICS AND READINGS

Papers marked with a * will be covered in class by the professor.

<u>1. Exchange Rates Basics</u>

- *Lucas, Robert E, Jr., 1982, Interest Rates and Currency Prices in a Two-Country World. Journal of Monetary Economics. Vol. 10 (3). p 335-59. November
- Dornbusch, Rudiger, 1976, *Expectations and Exchange Rate Dynamics*, Journal of Political Economy. Vol. 84 (6). p 1161-76. Dec.
- Mark, N., 1995, *Exchange rates and fundamentals: evidence on long-horizon predictability*, American Economic Review, March, 201-218
- Svensson, Lars, 1985, Currency prices, terms of trade and interest rates: a general equilibrium asset-pricing cash in advance approach, Journal of International Economics, vol 18, 17-42
- Mussa, Michael, 1982, *A model of exchange rate dynamics*, Journal of Political Economy, 74-104
- Meese, and Rogoff, 1983, *The out of sample failure of empirical exchange rate models*, in: J.A. Frenkel, ed., Exchange rates and international macroeconomics (University of Chicago Press, Chicago), chapter 3
- Stockman, Alan, New Evidence Connecting Exchange Rates to Business Cycles http://www.rich.frb.org/pubs/eq/pdfs/spring1998/stockman.pdf

2. General Equilibrium Models of International Business Cycles and Exchange Rates

2.1. Basic model with complete markets

- *Baxter, Marianne, 1995, *International Trade and Business Cycles*, National Bureau of Economic Research Working Paper: 5025. p 44. February
- *Backus, David K; Kehoe, Patrick J; Kydland, Finn E., *International Business Cycles: Theory and Evidence*, National Bureau of Economic Research Working Paper: 4493. p 23. October 1993, also in Cooley, Frontiers of Business Cycle Research.
- *Dumas, B., Harvey C. and Ruiz. P., 2002, Are Correlations of Stock Returns Justified by Subsequent Changes in National Outputs ?, http://faculty.fuqua.duke.edu/~charvey/Research/Working_Papers/W34_Are_correlations _of.pdf

2.2. Incomplete markets, default and moral hazard

- *Baxter, Marianne, 1995, International Trade and Business Cycles, see above
- *Alvarez, Fernando and Jermann, Urban, 2001, *Quantitative Asset Pricing Implications of Endogenous Solvency Constraints*, The Review of Financial Studies, 1117-51
- *Kehoe, Patrick and Perri, Fabrizio, 2001, *International Business Cycles with Endogenous Incomplete Markets*, http://research.mpls.frb.fed.us/research/sr/sr265.html
- Atkeson Andrew, 1991, *International lending with moral hazard and risk of repudiation*, Econometrica, vol, 59., 1069-1089.
- Baxter, Marianne; Crucini, Mario J., 1995, *Business Cycles and the Asset Structure of Foreign Trade*, International Economic Review. Vol. 36 (4). p 821-54. November

Kollmann, Robert, 1996, *Incomplete Asset Markets and the Cross-Country ConsumptionCorrelation Puzzle*, Journal of Economic Dynamics & Control. Vol. 20 (5). p 945-61. May

Eaton, Jonathan, Fernandez, Raquel, Sovereign Debt, Handbook of international economics. Volume 3. Grossman, Gene M. Rogoff, Kenneth, eds., Elsevier, North-Holland. p 2031-77. 1995. Also NBER working paper 5131.

2.3. Multi-goods, nonseparabilities in utility and production

- *Backus, David, Kehoe, Patrick and Kydland Finn, 1994, *Dynamics of the trade balance and the terms of trade: The J-Curve*, American Economic Review 84:84-10,
- *Stockman, Alan C. and Tesar, Linda L., 1995, *Tastes and Technology in a Two-Country Model* of the Business Cycle: Explaining International Comovements, American Economic Review. Vol. 85 (1). p 168-85. March

2.4. Sticky price models

- *Chari, V V, Kehoe, Patrick J, McGrattan, Ellen R., 2002, *Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates*, The Review of Economic Studies
- Betts, Caroline; Devereux, Michael B., 1996, The Exchange Rate in a Model of Pricing-to-Market.. European Economic Review. Vol. 40 (3-5). p 1007-21. April
 Kollmann, Robert, 1998, *Explaining International Comovements of Output and Asset Returns: The role of money and nominal rigidities*,

http://www.imf.org/external/pubs/ft/wp/1999/wp9984.pdf

2.5. Models with segmented asset markets

*Alvarez, Fernando, Atkeson, Andrew, 1997, *Money and Exchange Rates in the Grossman -Weiss-Rotemberg Model*, Journal of Monetary Economics. Vol. 40 (3). p 619-40, December

3. Foreign Exchange Risk Premium

- *Karen Lewis, *Puzzles in International Finance*, Handbook of international economics. Volume
 3. Grossman, Gene M. Rogoff, Kenneth, eds., Handbooks in Economics, vol. 3.
 Amsterdam; New York and Oxford: Elsevier, North-Holland. p 1913-1949. 1995.
- *Backus, David K; Gregory, Allan W; Telmer, Chris I., 1993, Accounting for Forward Rates in Markets for Foreign Currency., Journal of Finance, Vol. 48 (5), p 1887-1908, December
- Alvarez, Fernando, Andy Atkeson and Pat Kehoe, 2002, Volatile Exchange Rates and the Forward Premium Anomaly: A Segmented Asset Market View,
- Hodrick, Robert J, Srivastava, Sanjay, 1986, *The Covariation of Risk Premiums and Expected Future Spot Exchange Rates*, Journal of International Money & Finance. Vol. 5 (0). p S5-21. Supp. March
- Dave Backus, Silverio Foresi Telmer Chris, 1999, *Affine models of currency pricing: accounting for the forward premium anomaly*, http://bertha.gsia.cmu.edu/files/papers/fx.pdf

- Bekaert, Geert; Hodrick, Robert J., 1992, *Characterizing Predictable Components in Excess Returns on Equity and Foreign Exchange Markets*, Journal of Finance. Vol. 47 (2). p 467-509. June
- Fama, Eugene, *Forward and Spot Exchange Rates*, Journal of Monetary Economics, 14, 319-338.
- Hansen, Lars, Hodrick R., *Risk averse speculation in the forward foreign exchange market: An econometric Analysis of Linear Models*, in: J.A. Frenkel, ed., Exchange rates and international macroeconomics (University of Chicago Press, Chicago).

4. Models with Purchasing Power parity deviations: goods markets imperfections.

4.1. Diversification. Static/partial equilibrium

- Rogoff, K., 1996, "The Purchasing-Power Parity Puzzle," *Journal of Economic Literature*, 34, 647-668.
- Engel, C., 1999, "Accounting for US real Exchange Rate Changes," *Journal of Political Economy*, 107, 507-538.
- Kakkar, V. and M. Ogaki, 1999, "Real Exchange Rates and Nontradables: a Relative Price Approach," *Journal of Empirical Finance*, 6, 193-215.
- * Adler, M. and B. Dumas, 1983, "International Portfolio Choice and Corporation Finance: a Synthesis," *The Journal of Finance*, 38, 925-984.

4.2. Empirical asset pricing

Harvey, C., 1991, "The World Price of Covariance Risk," The Journal of Finance, 111-158.

- Dumas, B. and B. Solnik, 1995, "The World Price of Foreign Exchange Risk," *The Journal of Finance*, 50, 445-479.
- Ferson, W. and C. Harvey, 1993, "The Risk and Predictability of International Equity Returns," *Review of Financial Studies*, 527-566.
- De Santis, G. and B. Gérard, 1997, "International Asset Pricing and Portfolio Diversification with Time-varying Risk," *Journal of Finance*, 52, 1881-1912.

4.3. Dynamic/general equilibrium

- * Dumas, B., 1992, "Dynamic Equilibrium and the Real Exchange Rate in a Spatially Separated World," *Review of Financial Studies*, 8, 709-742.
- * Michael, P., A. R. Nobay and D. A. Peel, 1997, "Transactions Costs and Nonlinear Adjustment in Real Exchange Rates: an Empirical Investigation," *Journal of Political Economy*, 105, 862-879.

5. Segmentation/ Limited Participation / Home country bias

5.1. Home bias/segmentation

- Tesar, I. And I. M. Werner, 1995, "Home Bias and High Turnover," *Journal of International Money and Finance.*
- Lewis, K., 1999, "Trying to Explain Home Bias in Equities and Consumption," *Journal of Economic Literature*, XXXVII, 571-608.

- Lewis, K., 1996, "What Can Explain the Apparent Lack of International Consumption Risk-Sharing?" *Journal of Political Economy*, 104, 267-297.
- Huberman, G., 2001, "Familiarity Breeds Investment," *Review of Financial Studies*, 14, 659-680.
- Bekaert, G. and C. R. Harvey, 1995, "Time-Varying World Market Integration," *Journal of Finance*, 50, 403-444.
- Coval, J. and T. J. Moskowitz, 1999, "Home Bias at Home: Local Equity Preference in Domestic Portfolios," *The Journal of Finance*, 54, 2045-2074.
- Errunza, V. R. and D. P. Miller, 2000, "Market Segmentation and the Cost of Capital in International Equity Markets," *Journal of Financial and Quantitative Analysis*, 35, 577-600.

5.2. Effect of segmentation

- Obstfeld, M., 1994, "Risk Taking, Global Diversification and Growth," *American Economic Review*, 84, 1310-1329.
- Basak, S., 2000, "An Intertemporal Model of International Capital Market Segmentation," Journal of Financial and Quantitative Analysis, 31, 161-188.
- Dumas, B. and R. Uppal, 2001, "Global Diversification, Growth and Welfare with Imperfectly Integrated Markets for Goods," *The Review of Financial Studies*, 14 (Spring 2001), 1, 277-305.
- Stulz, R., 1999, "Globalization of Equity Markets and the Cost of Capital," working paper, Ohio State University.

6. Asymmetric information/ Capital flows

- * Gehrig, T.P., 1993, "An Information-based Explanation of the Domestic Bias in International Equity Investment," *The Scandinavian Journal of Economics*, 97-109.
- * Brennan, M. J. and H. H. Cao, 1997, "International Portfolio Investment Flows," *Journal of Finance*, 52(5), 1851-80.

7. Crises/Contagion

- Bhattacharya, U. and M. Spiegel, 1991, "Insiders, Outsiders and Marker Breakdowns," *The Review of Financial Studies*, 4, 255-282.
- Caballero, R. J. and A. Krishnamurthy, 1998, "Emerging Market Crises: An Asset Market Perspective," NBER working paper n° 6843.
- Allen, F. and D. Gale, 1998, "Optimal Financial Crises," *The Journal of Finance*, LIII, 1245-1284.
- Allen, F. and D. Gale, 2000, "Optimal Currency Crises," working paper, The Wharton School.
- Morris, S. and H. S. Shin, 1998, "A Theory of the Onset of Currency Attacks," in *Asian Financial Crisis: Causes, Contagion and Consequences*, Agenor, Vines and Weber, eds., Cambridge University Press.
- * Morris, S. and H. S. Shin, 1997, "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," *American Economic Review*, 88, 587-597.
- Allen, F. and D. Gale, 2000, "Financial Contagion," Journal of Political Economy, 108, 1-33.

8. International Corporate Finance/ Investor Recognition of Corporate Multinationalism

a. Investor recognition of corporate multinationalism/acquisitions/corporate diversification

- Yeung, B. and R. K. Morck, 1991, "Why Investors Value Multinationality," *Journal of Business*, 64.
- Doukas, J. and N. G. Travlos, 1988, "The Effect of Corporate Multinationalism on Shareholders' Wealth: Evidence from International Acquisitions," *Journal of Finance*, 43, 1161-1175.
- Diermeier, J. and B. Solnik, 2001, "Global pricing of equity: analysts and asset managers take note: a corporation's stock price is influenced by international factors in proportion to the extent of the company's foreign activities," *Financial Analysts Journal*, 57, 4, 37-47.
- * Bodnar, G. M., C. Tang and J. Weintrop, "Both Sides of Corporate Diversification: The Value Impacts of Geographic and Industrial Diversification," Weiss Center for International Financial Research, working paper 98-2, 1998.

b. Exposure/hedging/investor recognition

- * Bodnar, G., B. Dumas and R. C. Marston, 2002, "Passthrough and Exposure," *Journal of Finance*, 57, 199-232.
- Griffin, J. M. and R. M. Stulz, 2001, "International Competition and Exchange Rate Shocks: A Cross-Country Industry Analysis of Stock Returns," *The Review of Financial Studies*, 14, 215-241.

c. Financing/dual listings/ADR programs

- Karolyi, G. A. "Why do companies list shares abroad? A survey of the evidence and its managerial implications," New York University Salomon Brothers Center, 1998, *Financial Markets, Institutions and Instruments*, 7, Number 1, Blackwell Publishers, Boston.
- Karolyi, G. A. and R. M. Stulz, 2001, "Are Financial Assets Priced Locally or Globally?" in G. Constantinides, M. Harris and R. Stulz, eds, *Handbook of the Economics of Finance* (North Holland).
- Dodge, C., G. A. Karolyi and R. M. Stulz, 2001, "Why Are Foreign Firms Listed in the U.S. Worth More?" NBER working paper n°8538.
- * Chaplinsky, S. and L. Ramchand, 2000, "The Impact of Global Equity Offerings," *Journal of Finance*, 55, 2767-2789.

d. Investor protection/governance

- La Porta, R., F. Lopez-de-Silanes, A. Shleifer and R. Vishny, 1998, "Corporate Ownership Around the World," *Journal of Finance*, 471-517.
- * Rajan, R. and L. Zingales, 1998, "Financial Dependence and Growth," *American Economic Review*, 88, 559-586.