

INTERNATIONAL FINANCE

Finance 933, Spring 2009

116 SHDH

Monday 1:30 – 4:30

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

The Final exam is tentatively scheduled for April 27.

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 exam, however.

TOPICS AND READINGS

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

1. Basic International Model

*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

2. General Equilibrium Models of International Business Cycles

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. C. R. Harvey and P. Ruiz, 2003. *Are Correlations in International Stock Returns Justified by Subsequent Changes in National Outputs?*, *The Journal of International Money and Finance*, 22 (2003), 777-811.

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,

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, 2002, *International Business Cycles with Endogenous Incomplete Markets*, *Econometrica*, vol 70(3), 907-928.

Atkeson Andrew, 1991, *International lending with moral hazard and risk of repudiation*, *Econometrica*, vol, 59., 1069-1089.

Mele, Antonio, 2008, *Repeated Moral Hazard and Recursive Lagrangeans*, manuscript

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 Consumption Correlation 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.

3. Nominal Exchange Rate Basics

*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
- *Engel, Charles; West, Kenneth D, 2005, *Exchange Rates and Fundamentals*, Journal of Political Economy, vol. 113, no. 3, June pp. 485-517
- *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

4. Uncovered Interest Parity and the Carry-Trade

4.1 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
- *Burnside Craig, Martin Eichenbaum , Isaac Kleshchelski and Sergio Rebelo, *The Returns to Currency Speculation*, Working Paper 12489.
- *Lustig Hanno, and Adrien Verdelhan, *The Cross-Section of Foreign Currency Risk Premia and US Consumption Growth*, American Economic Review, 2007.
- *Brandt, Michael W., John H. Cochrane, and Pedro Santa-Clara, *International Risk Sharing is Better Than You Think, or Exchange Rates are Too Smooth*, *Journal of Monetary Economics* 53, 2006, 671-698.
- Lustig Hanno, Adrien Verdelhan and Nick Roussanov. *Common Risk Factors in Currency Markets*, manuscript
- Dave Backus, Silverio Foresi Telmer Chris, 2001, *Affine Term Structure Models and the Forward Premium Anomaly*, *Journal of Finance* 56, 279-304.
- 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
- 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).

4.2 “Peso Problems,” Rare Events, and Learning

*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.

Karen Lewis, “Peso Problem,” 2007, *The New Palgrave Dictionary of Money & Finance* Engel, Charles; Hamilton, James D, 1990, *Long Swings in the Dollar: Are They in the Data and Do Markets Know It?* American Economic Review, vol. 80, no. 4, September, pp. 689-713

Evans, Martin D D; Lewis, Karen K, 1995, *Do Long-Term Swings in the Dollar Affect Estimates of the Risk Premia?* Review of Financial Studies, vol. 8, no. 3, Fall, pp. 709-42

*Brunnermeier, Markus K., Stefan Nagel and Lasse Pedersen, *Carry Trades and Currency Crashes*, with, NBER Macroeconomics Annual 2008, Vol. 23

Bates, David S, 1996, *Dollar Jump Fears, 1984-1992: Distributional Abnormalities Implicit in Currency Futures Options*, Journal of International Money and Finance, vol. 15, no. 1, February, pp. 65-93

Jakub W. Jurek, 2007, *Crash-Neutral Currency Carry Trades*, Working paper, Princeton University

5. International managerial decisions: Exports, Corporate Governance, and Financing

5.1 Exports, profitability, and business cycles

Melitz, Marc J, 2003, *The Impact of Trade on Intra-industry Reallocations and Aggregate Industry Productivity*, Econometrica, vol. 71, no. 6, November, pp. 1695-1725

* Ghironi, Fabio; Melitz, Marc J, 2005, *International Trade and Macroeconomic Dynamics with Heterogeneous Firms*, Quarterly Journal of Economics, vol. 120, no. 3, August, pp. 865-915

Atkeson, Andrew; Burstein, Ariel, 2006, *Innovation, Firm Dynamics, and International Trade*, UCLA working paper

5.2 Firm financing

a) Financing/dual listings/ADR programs

*Karolyi, G. Andrew, 2006, Review of Finance, " The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom"

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).

Chaplinsky, S. and L. Ramchand, 2000, “The Impact of Global Equity Offerings,” *Journal of Finance*, 55, 2767-2789.

b) 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.

c) **International Cost of Capital Basics**

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.

d) **International Cost of Capital: Industry or Country Factors?**

Heston, Steven L; Rouwenhorst, K Geert, 1994, Does Industrial Structure Explain the Benefits of International Diversification? *Journal of Financial Economics*, vol. 36, no. 1, 1994, pp. 3-27

Bekaert, Geert; Hodrick, Robert J; Zhang, Xiaoyan, 2005, *International Stock Return Comovements*, NBER Working Papers: 11906

6. International Portfolio Choice

* Adler, M. and B. Dumas, 1983, "International Portfolio Choice and Corporation Finance: a Synthesis," *The Journal of Finance*, 38, 925-984.

Black, Fisher, 1990, Equilibrium Exchange Rate Hedging, *Journal of Finance*, Volume: 45, Issue: 3.

Judd Kenneth L. Judd1 and Sy-Ming Guu, 2001, *Asymptotic methods for asset market equilibrium analysis*, *Economic Theory* 18, 127–157.

Courdacier, Nicolas, 2008, Do Trade Costs in Goods Markets Lead to Home Bias in Equities?, manuscript, London School of Business

*Baxter, Marianne; Jermann, Urban J; King, Robert G., 1997, *Nontraded Goods, Nontraded Factors, and International Non-diversification*, *Journal of International Economics*. Vol. 44 (2). p 211-29. April

French and Poterba, 1991, *International diversification and international equity markets*, *American Economic Review*, 81: 222-226

Cooper, Ian; Kaplanis, Evi, 1994, *Home Bias in Equity Portfolios, Inflation Hedging, and International Capital Market Equilibrium*, *Review of Financial Studies*. Vol. 7 (1). p 45-60.

6.1. Capital Flows

Rey, H, Gourinchas P.O., 2007, *International Financial Adjustment*, with, *Journal of Political Economy*, 115:4, pp. 665- 703, August.

VanWincoop, E. and Tille C., 2008, *International Capital Flows*, manuscript

6.2. 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

Alvarez Fernando, Andrew Atkeson, and Patrick J. Kehoe, 2002, *Money, interest rates, and exchange rates with endogenously segmented markets*. *Journal of Political Economy* 110 (1, February): 73—112.

Alvarez, Fernando, Andy Atkeson and Pat Kehoe, 2008, Time-Varying Risk, Interest Rates, and Exchange Rates in General Equilibrium Federal Reserve Bank of Minneapolis, Research Department Staff Report 371.

7. Segmentation/ Limited Participation / Home country bias

7.1. Home bias

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.

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.

7.2. Welfare Gains from International Diversification

Cole, Harold L; Obstfeld, Maurice, 1991, *Commodity Trade and International Risk Sharing: How Much Do Financial Markets Matter?* *Journal of Monetary Economics*, vol. 28, no. 1, August 1991, pp. 3-24

*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.

*Lewis, Karen K, 2000, *Why Do Stocks and Consumption Imply Such Different Gains from International Risk Sharing?* *Journal of International Economics*, vol. 52, no. 1, October pp. 1-35

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.

8. 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.

Van Nieuwerburgh, Stijn; Veldkamp, Laura; 2008, *Information Immobility and the Home Bias Puzzle*, *Journal of Finance*, forthcoming 2008