

NEWSLETTER ON INTERNATIONAL FINANCE RESEARCH - 2008

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Introduction

This is an annual newsletter about the most recent papers on international finance published in the top 10 journals on economics.

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1. Sources:

This list of journals is based on the journal rankings calculated by Kalaitzidakis et al (2003). The top research journals containing papers related to international finance were chosen for this Newsletter¹. The list of journals is:

1	American Economic Review
2	Econometrica
3	Journal of Political Economy
4	Quarterly Journal of Economics
5	Review of Economic Studies
6	Journal of Monetary Economics
7	Review of Economics and Statistics
8	European Economic Review
9	Journal of Economic Dynamics and Control
10	Economic Journal

The list of topics that defines the International Finance area is based on Marianne Baxter's course on international finance at Boston University, Department of Economics. These topics and their related papers are listed in section 3.

The information about papers published in each journal was retrieved from IDEAS: <http://ideas.repec.org/>

2. The Trend Topic in 2008: Exchange Rate Determination

The topic “nominal and real exchange rate determination” was identified as the trend topic in 2008 because 16 related papers were published in the top research journals during 2008. A

¹ Kalaitzidakis, P., T. Stengos and T. Mamuneas. (2003). “Ranking of Academic Journals and Institutions in Economics.” *Journal of The European Economic Association*, 1(6), pp. 1346-1366

brief description of each paper is presented below. Papers are listed alphabetically. Full references are described in Section 4.

Aizenman and Riera-Crichton adopt a panel regression methodology in order to evaluate the impact of international reserves, terms-of-trade shocks, and capital flows on the real exchange rate. It is found that international reserves cushion the impact of terms-of-trade shocks on the real exchange rate. Additionally, financial depth reduces the buffer role of international reserves in developing countries.

Atkeson and Burstein build a model of international trade and international relative prices to account for several features of terms of trade and real exchange rate fluctuations in industrialized countries. The model is based on a quantitative framework for international trade which assumes imperfect competition and variable markups. The model is able to reproduce deviations from relative purchasing power parity similar to those observed in the data because firms choose to price-to-market.

Caballero, Farhi and Gourinchas provide a framework to analyze global equilibrium and its response to a variety of relevant shocks and structural changes. In particular, it sheds light on three empirical facts: the persistent US current account deficit, the declining real interest rate and the increasing importance of US assets in global portfolios.

Corsetti, Dedola and Leduc (Journal of Monetary Economics) investigate the general equilibrium link between exchange-rate volatility and local currency price stability in a quantitative framework that encompasses both price discrimination and nominal rigidities. The quantitative properties are studied in a standard international business cycle framework with traded and nontraded goods, incomplete asset markets, and various degrees of nominal price rigidities.

Crucini and Shintani use a novel data set on local currency prices of individual retail goods and services in major cities and several countries to shed new light on the determinants of real exchange rate persistence. It is found that nontradable goods are relevant to explain high persistence and that the border effect is small.

Dotsey and Duarte build a two-country general equilibrium model of exchange rates that features two roles for nontraded goods: as final consumption and as an input into the production of final tradable goods. The model is driven by shocks to productivity in the intermediate traded goods sector and the nontraded goods sector. This model explains the high volatility of real exchange rates along with the low volatility of nontradable goods prices.

Fitzgerald presents a multi-country flexible-price model in order to explain the expenditure share in domestic goods through a gravity equation with trade costs. The model is estimated and its predictions explain both qualitatively and quantitatively the failure of exchange rate volatility to feed into inflation.

Fratzschler employs an event-study methodology in order to assess whether exchange rate communication (oral intervention) has been an effective policy tool for monetary authorities to influence exchange rates. For the Euro–Dollar and the Dollar–Yen exchange rates, the article finds that both oral intervention events and actual intervention events have been

highly successful over the short to medium-run. The reason for this success is that interventions primarily function through a coordination channel.

Goldberg and Hellerstein present a new structural approach for exchange rate pass-through measurement. In particular, they propose an identification method to select among data on prices and quantities.

Karame, Patureau and Sopraseuth estimate an open-economy model with flexible prices and credit market frictions (limited participation) in order to evaluate the way in which monetary shocks are transmitted to the exchange rate. The model is estimated using the simulated method of moments approach so as to match a set of second-order moments considered as a 'summary' of fluctuations in the German economy during the flexible exchange rate period (1971–1998). The results confirm the empirical relevance of the limited participation model.

Lothian and Taylor use data since 1820 for the US, France and the UK to test for the presence of the Harrod-Balassa-Samuelson effect in the real exchange rate in a nonlinear framework and allowing for shifts in volatility across nominal regimes. A statistically significant effect for the Sterling–Dollar is found. Also there is significant evidence of nonlinear reversion towards long-run equilibrium and downwards shifts in volatility during fixed nominal exchange rate regimes.

Molodtsova, Nikolsko-Rzhevskyy and Papell, estimate Taylor rule interest rate reaction functions with real-time data for the United States and Germany from 1979 through 1998 and then use these specifications as fundamentals for evaluating out-of-sample predictability of the United States Dollar - Deutsche Mark (USD/DM) nominal exchange rate. Positive evidence of out-of-sample predictability is found with real time data.

Nakamura analyzes price comovements in a large panel data set in order to understand the pass-through from exchange rate to prices. His results suggest that most of the observed price variation arises from retail-level rather than manufacturer-level shocks.

Naknoi presents an alternative theory for the effect of nontradable goods on real exchange rate volatility based on endogenous tradability and exchange rate regimes. Specifically, a stochastic dynamic general equilibrium (SDGE) monetary model explaining the stylized facts is developed. The model features heterogeneous productivity, trade costs, export entry costs and sticky wages.

Reitz and Taylor use a theoretical market microstructure framework to model the transition between stable and unstable regimes for the exchange rate. Daily data is used to investigate, within this framework, the role of reported Central Bank interventions. They find that reported interventions appear to govern the transition between exchange rate regimes and thus the existence of a coordination channel of intervention effectiveness is supported.

Steinsson presents a two-country sticky-price business cycle model which yields hump-shaped dynamics for the real exchange rate after including different real shocks. These dynamics allow matching the observed real exchange rate persistence better than models based on monetary shocks.

3. Papers by Topic

I classify each paper in its two most related topics. The total number of papers is 60. Complete references are listed in Section 4.

3.1 Nominal and Real Exchange Rate Determination (16 papers)

Aizenman and Riera-Crichton	Atkeson and Burstein
Caballero, Farhi and Gourinchas	Corsetti, Dedola and Leduc (JME)
Crucini and Shintani	Dotsey and Duarte
Fitzgerald	Fratzscher
Goldberg and Hellerstein	Karamé, Patureau and Sopraseuth
Lothian and Taylor	Molodtsova, Nikolsko-Rzhevskyy and Papell
Nakamura	Naknoi
Reitz and Taylor	Steinsson.

3.2 International Business Cycles (10 papers)

Blalock, Gertler and Levine	Burstein, Kurz and Tesar
Corsetti, Dedola and Leduc (JME)	Corsetti, Dedola and Leduc (RES)
Dotsey, and Duarte	Inklaar, Jong-A-Pin and de-Haan
Ranciere, Tornell and Westermann	Steinsson
Vigfusson	Yang

3.3 Exchange Rate Regimes (7 papers)

Broner	Goldberg and Hellerstein
Nakamura	Naknoi
Rebelo and Vegh	Reitz and Taylor
Tavlas, Dellas and Stockman	

3.4 Forward Premium Puzzle (3 papers)

Adolfson, Laseen and Villani
Chakraborty and Evans
Gil-Pareja, Llorca-Vivero and Martinez-Serrano

3.5 Currency Unions (3 papers)

Favero and Giavazzi
Gil-Pareja, Llorca-Vivero and Martinez-Serrano
Inklaar, Jong-A-Pin and de Haan

3.6 Current Account Dynamics (8 papers)

Bleakley and Cowan	Burstein, Kurz and Tesar
Curcuro, Dvorak and Warnock	Caballero, Farhi and Gourinchas
Erceg, Guerrieri and Gust	Faruqee, Laxton, Muir and Pesenti
Quinn and Voth	Yang

3.7 International Asset Pricing (4 papers)

Aydemir	Fostel and Geanakoplos
González-Rozada and Levy-Yeyati	Suh and Zapatero

3.8 SDGE Models of the Open Economy (5 papers)

Erceg, Guerrieri and Gust	Ghironi
Karamé, Patureau and Sopraseuth	Leitemo and Soderstrom
Naknoi	

3.9 Monetary Policy in the Open Economy (15 papers)

Adolfson, Lassen, Linde and Villani	Bullard and Singh
Chakraborty and Evans	Devereux and Sutherland
Fitzgerald	Fratzscher
Ghironi	Gopinath and Rigobon
Leith and Wren-Lewis	Leitemo and Soderstrom
Liu and Pappa	Molodtsova, Nikolsko-Rzhevskyy and Papell
Moore and Roche	Suh and Zapatero
Tavlas, Dellas and Stockman	

3.10 Sovereign Debt and International Reserves (7 papers)

Aizenman and Riera-Crichton	Alfaro, Kalemli-Ozcan and Volosovych
Arellano	González-Rozada and Levy-Yeyati
Mendoza and Ostry	Nosbusch
Rajan	

3.11 Purchasing Power Parity (4 papers)

Crucini and Shintani	Vigfusson
Lothian and Taylor	Atkeson and Burstein

3.12 International Portfolio Choice (8 papers)

Alfaro, Kalemli-Ozcan and Volosovych	Backus, Henriksen and Storesletten
Curcuro, Dvorak and Warnock	Devereux and Sutherland
Lane and Milesi-Ferretti (AER)	Lane and Milesi-Ferretti (REaS)
Pavlova and Rigobon	Rupert

3.13 International Risk Sharing (5 papers)

Aydemir	Corsetti, Dedola and Leduc (RES)
Inklaar, Jong-A-Pin and de-Haan	Lane and Milesi-Ferretti (REaS)
Moore and Roche	

3.14 International Financial Architecture (5 papers)

Baldwin	Lane and Milesi-Ferretti (AER)
Rajan	Reinhart and Rogoff
Quinn and Voth	

3.15 Balance of Payments Crises (8 papers)

Blalock, Gertler and Levine	Bleakley and Cowan
Broner	Fostel and Geanakoplos
Pavlova and Rigobon	Ranciere, Tornell and Westermann
Rebelo and Vegh	Reinhart and Rogoff

3.16 International Policy Coordination (3 papers)

Bullard and Singh	
Liu and Pappa	
Faruqee, Laxton, Muir and Pesent	

3.17 Public Finance in the Open Economy (5 papers)

Backus, Henriksen and Storesletten	Leith and Wren-Lewis
Mendoza and Ostry	Nosbusch
Rupert	

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