

**International Financial Markets**  
**Kiel Institute for International Economics**  
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*MATERIALS*

The textbook for the course is International Financial Markets: Prices and Policies, by Richard M. Levich, (McGraw-Hill Irwin, 2<sup>nd</sup> Edition). Photocopies of additional readings will be made available on the first day of class.

*COUSE REQUIREMENTS AND GRADING*

Your grade will be based on your performance on a final exam. Practice problem sets and handouts will be distributed during the course.

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**COURSE OUTLINE**

[Lecture numbering is approximate]

**I. The Gains from Trade on International Financial Markets and the Structure of Foreign Exchange Markets [Lecture 1]**

*Sources:*

Class notes.

Textbook: Chapter 3 “Market Structure and Institutions.”

**II. International Parity Conditions in Exchange Markets**

**A. Purchasing Power Parity [Lecture 2]**

*Sources:*

Textbook: Chapter 4 “International Parity Conditions: Purchasing Power Parity.”  
“Big MacCurrencies” *The Economist* April 20, 2002

“How Wide is the Border?” Engle, C. and J. Rogers, *American Economic Review* December 1996.

Engel, C., “Accounting for U.S. real exchange rate changes,” *Journal of Political Economy* June 2000.

**2. Interest Rate Parity [Lecture 3]**

*Sources:*

Textbook: Chapter 5 “International Parity Conditions: Interest Rate Parity and the Fisher Parities.”

Feldstein, M. and C. Horioka, “Domestic Saving and International Capital Flows,” *Economic Journal* 90, 1980.

R. Lucas, “Why Doesn’t Capital Flow from Rich to Poor Countries?” *American Economic Review* May 1990

### III. Exchange Rate Determination and Exchange Market Efficiency

#### 1. Models of Exchange Rates: Do They Work? [Lecture 4-5]

*Sources:*

Textbook: Chapter 6 “Spot Exchange Rate Determination.” (a brief review of the monetarist model and the overshooting model)

Meese, R. and K. Rogoff, “Empirical exchange rate models of the Seventies: Are any fit to Survive?” *Journal of International Economics* 14, 1983.

Mark, N., “Exchange Rates and Fundamentals: Evidence on Long-Horizon Predictability“ *AER* 1995.

#### 2. The Efficiency of Foreign Exchange Markets [Lecture 5-6]

*Sources:*

Textbook: Chapter 7 “Foreign Exchange Market Inefficiency.”

Kenneth A. Froot and Richard H. Thaler, “On the Efficiency of Foreign Exchange Markets,” *Journal of Economic Perspectives* 4, no. 3 (Summer 1990), pp. 179-92.

#### 3. Forecasting Exchange Rates

*Sources:*

Textbook: Chapter 8 “Exchange Rate Forecasting.”

### IV. International Asset Markets and the Gains from Diversification

#### A. International Bond Markets [Lectures 7]

*Sources:*

Textbook: Chapter 14 “Bond Portfolios.”

#### B. International Equity Markets and Home Bias [Lecture 8-9]

*Sources:*

Textbook: Chapter 15 “Equity Portfolios.”

Tesar, L. and I. Werner, “Home Bias and High Turnover,” *Journal of International Money and Finance*, 1994.

Handout on Home Bias.