

THE UNIVERSITY OF BRITISH COLUMBIA
Department of Economics

Economics 356 (001)

Introduction to International Finance and Monetary Policy in An Open Economy

Term 2 – 2013/14

Professor Gordon R. Munro

Office Hours: F, 9:00 – 10:30 and by appointment

Office: BuTo 908

Textbook: Paul Krugman, Maurice Obstfeld and Marc Melitz, *International Economics: Theory and Policy*, Ninth Edition.

There will be additional readings to which you will be directed. These can be obtained through Connect, <http://elearning.ubc.ca/connect/>

I. The International Financial System: An Overview

- (i) The market for foreign exchange introduced: spot, forward and futures
- (ii) The central role of the banking system in the foreign exchange market
- (iii) The balance of international payments: current account, and capital plus financial accounts

Text: Chapter 14, pp. 320-328; Chapter 13
Canada's Balance of International Payments

II. Determination of Equilibrium Foreign Exchange Rates

- (i) Determination of equilibrium exchange rates in the spot market, over the long run – the theory of Purchasing Power Parity, and the concept of the “Real” Exchange Rate.
- (ii) Determination of equilibrium exchange rates in the spot market in the short run – an Interest Parity approach
- (iii) Determination of equilibrium exchange rates in forward markets – another Interest Parity approach
- (iv) Systems of exchange rates: fixed, floating and managed
- (v) Government intervention in the spot market, and the impact upon the money supply: unsterilized and sterilized interventions
- (vi) The Trilemma

Text: Chapter 16; Chapter 14, pp. 328-353

Maurice Obstfeld, “The Global Capital Market: Benefactor or Menace?”, *Journal of Economic Perspectives*, vol. 12 (Fall, 1998), pp. 9-30, go to:
<http://www.jstor.org/stable/i345526>

III. Monetary Policy in an Open Economy: An Introduction

- (i) A review of the nature of money, and the control of the money supply by the central bank
- (ii) The two schools of thought in macroeconomics and the “Great Recession”: 2008 to the present.
- (iii) A review of the components of the demand for money: transactions demand; precautionary demand; asset demand and the liquidity trap
- (iv) The money supply and the exchange rate in the short run

Text: Chapter 15, pp. 354-368

IV. The Theory of Monetary Policy: A Short Run Keynesian Approach

- (i) Determinants of aggregate demand in an open economy
- (ii) Output market equilibrium in the short run: The DD schedule
- (iii) Asset market equilibrium in the short run: The AA schedule
- (iv) Equilibrium for an open economy in the short run: DD and AA schedules combined
- (v) Monetary policy under fixed and flexible exchange rate regimes in the short run. The Trilemma once again.
- (vi) The fiscal policy alternative and the Flemming – Mundell model

Text: Chapter 17, pp. 421-442