GLOBAL CAPITAL MARKETS AND CURRENCIES

Lecturer: Richard Portes

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Course code: E306 AUT11

Wednesday 1845-2130

Aims and objectives

This course deals with the international financial environment facing firms in a globalised economy. It will provide tools for assessing the impact of economic policy shocks and financial disturbances on financial markets, exchange rates, and capital flows. The course is suitable for anyone seeking the further understanding of the international macroeconomy, whose importance the current crisis has revealed. It will be especially relevant for careers in investment analysis, asset management, hedge funds, capital markets, corporate finance, and the finance/treasury function of corporates. There is little overlap with International Finance (E207) – GCMC gives the global macroeconomic context for international financing decisions.

The course will be taught by Richard Portes: http://faculty.london.edu/rportes/

Topics covered

- Exchange rates and the current account of the balance of payments
- Real exchange rates and purchasing power parity
- Nominal exchange rates, interest rates, and the carry trade
- The dollar, the euro and the RMB in the long run
- Financial globalisation
- Currency and banking crises
- Sovereign debt and default
- Sovereign debt in 2011: US, UK, euro zone, emerging markets
- International financial stability: the crisis of 2008-2009
- What to do, how to do it, what consequences?
Format and teaching methods

Teaching will be primarily in the form of lectures, with some distinguished visiting speakers (list to be posted on Portal). For each topic there will be a specific application of the tools discussed – e.g., is the US current account deficit sustainable? What determines emerging market spreads? Students will do group reports on these questions.

There will be no single set text – articles will be distributed in advance (in the course book), and there will be handouts for each session (all will be on Portal). But there will be some citations from the following textbook:


An excellent source for selected journal articles, working papers, media coverage, and commentary is www.rgemonitor.com

LBS subscribes to this website, and it is well worth it!

(If you have depressive tendencies, however, proceed with caution – Nouriel Roubini, the founder of this website, is the new holder of the title ‘Dr. Doom’, given in respect of his consistently hyper-negative assessment of the US subprime crisis, global financial turmoil, and macroeconomic prospects.)

You will also find many relevant short articles at www.VoxEU.org

NBER Working Papers are available (from LBS) at http://www.nber.org

CEPR Discussion Papers are available (from LBS) at http://www.cepr.org

IMF, BIS and OECD publications are often useful, available from their websites.

There are some good blogs that have a lot on international macroeconomics and finance – see, for example:

Econbrowser – Menzie Chinn and James Hamilton - http://www.econbrowser.com/

Pre-requisites

International Macroeconomy and Competitiveness (the MBA/EMBA core course) or equivalent prior knowledge of basic macroeconomics. See the textbook we use at London Business School: D Miles and A Scott, *Macroeconomics: Understanding the Wealth of Nations* (2nd ed., Wiley, 2004).
Assignments and assessment

Assessment will be based on one 500-word individual assignment (30%), a group report (35%), and a ‘take-home’ exam (35% - multiple choice questions and short essays).

The report will be on a topic in the ‘Applications’ specified below in the readings from sessions 1-9. The report should be downloaded onto Portal 48 hours or more before the relevant class discussion. All students are then invited to post comments or questions – this is not obligatory, but it helps you and the rest of the class to think through the issues and get your questions clear – and perhaps get some answers. 15 minutes will be devoted to discussion (not presentation) of the report in the relevant session – I shall assume that everyone has read it, and I am likely to put ‘cold call’ questions on it, especially if there isn’t much posted on Portal in response to the report.. I shall assign students to groups (hence topics) arbitrarily – you are welcome to trade places in a decentralised fashion (most economists believe in fostering ‘Pareto-improving’ trade). A trade itself shouldn’t go through me, but you must report it by email to Harvinder Saran (hsaran@london.edu) so that I will know who did what when I give marks for the reports.

The assignment will be distributed on 26 October (due by 5.00 pm on 2 November). The take-home exam will be distributed on Portal and by email at 9.00 am Monday 28 November (due by 5.00 pm on Wednesday 30 November). The assignment and the exam may be submitted either as hard copy to Harvinder Saran in P326 or by email (gcmc@london.edu).

Although it should not be necessary, I nevertheless remind you of London Business School’s strict policies regarding plagiarism and the use of materials written by others. Individual assignments are to be done individually, with no sharing of work; undue similarities between papers will be noted. Any material drawn from written sources, whether printed or on the internet, must be properly referenced. In particular, the use of verbatim quotes without attribution normally would attract an automatic ‘fail’ (and if you were to copy something, it would usually be pretty easy to find it on the web – there is now software that does that!).
TOPICS AND READINGS

For the lectures, starred readings are essential, and I shall assume you have read them. Others are optional. Readings listed for applications are required only for those doing the report, but evidently you will get more out of the discussion if you read at least one of these. I have starred some of those to indicate priorities. The course pack will normally not include anything that is immediately available online. (Note: all NBER and CEPR working papers are available through LBS.)

1. Exchange rates and the current account of the balance of payments (28 September)

*KO, Ch. 12

Application (group report due 1 October, discussion 5 October):

Is the US current account deficit sustainable? Must the dollar eventually crash?


2. Real exchange rates and purchasing power parity (5 October)

*KO, Ch 15


Application (due 8 October, discussion 12 October):

What do the Big Mac RERs really tell us?


3. Nominal exchange rates, interest rates, and the carry trade (12 October)


**Application** (due 15 October, discussion 19 October):

*Can exchange-rate forecasting do better than a random walk?*


4. The dollar, the euro and the RMB in the long run


*M. Feldstein, ‘What’s next for the dollar?’, NBER WP 17260, July 2011.*


R. Portes, ‘Global crises and international currencies’, March 2010 (especially sections 10-19)

**Application** (due 22 October, discussion 26 October):

*Is the RMB (CNY) undervalued now (02 August USD = 6.44 CNY)?*


5. Financial globalisation (26 October)

*KO, Ch. 21 and Mathematical Postscript


Application (due 29 October, discussion 2 November):

Are the ‘global imbalances’ really dangerous?


6. Currency and banking crises (2 November)


Application (due 5 November, discussion 9 November):

Are commodity markets driven by fundamentals or financial speculation?

(and references there)


For background on commodity prices, interest rates and exchange rates, see


7. Sovereign debt and default (9 November)

*C. Reinhart and K. Rogoff, 2009, This Time is Different, hardback/paperback/Kindle, Princeton University Press. (Read as much as you can! – whatever interests you most.)


Application (due 12 November, discussion 16 November):

What are the most reliable ‘early warning indicators’ for debt crises?


8. Sovereign debt in 2011: US, UK, euro zone, emerging markets (16 November)


Other readings will be suggested closer to the date of the class.

Application (due 19 November, discussion 23 November):

What determines emerging market sovereign bond spreads?


*R. Portes et al., International Financial Stability, CEPR and ICMB, especially Chs. 2 and 11.


Application (due 26 November, discussion 30 November):

Does the CDS market give a good assessment of the financial health of banks and sovereigns?


10. What to do, how to do it, what consequences? (30 November)

L. Elliott, ‘The time is ripe for a Tobin tax’, *Guardian* 27 August 2009, at

*’Tobin tax: could it work?’, *OECD Observer* March 2002, at

*Grading financial regulatory reform, Barry Ritholtz, 25 June 2010

*Strengthening the financial system: The benefits outweigh the costs, Stephen Cecchetti and
Benjamin H Cohen, 20 August 2010

*N. Magud et al., 2011, ‘Capital controls: A meta-analysis approach’, VoxEU 24 March 2011,

*R. Portes, 2011, ‘Currency wars’, forthcoming in *Journal of International Money and

E. Farhi, P.-O Gourinchas and H. Rey, September 2011, *Reforming the International
Monetary System*, CEPR.