

Financial Globalisation and the Global Financial Crisis

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Course overview

One of the central structural changes that has reshaped the global macroeconomic environment since early 1990s is the extraordinary increase in cross border financial holdings (“financial globalisation”) across countries. Financial globalisation has the potential to promote macroeconomic stability and economic growth; at the same time, it also has the scope to amplify domestic macroeconomic shocks and increase cross-border contagion dynamics.

Section 1 of this course will begin with a review of the underlying theoretical foundations for cross-border financial flows including consumption smoothing, efficient global allocation of capital, global interdependence, sustainability of current account imbalances and international risk sharing.

Section 2 will give an introduction to the measurement issues involved in capturing cross-border financial positions. This will discuss the balance of payments, its components and the determinants of its dynamics as well as those for net international investment positions. In addition, it will describe the properties and contributions of recent data developments as well as discuss stylized facts.

Section 3 will look at the geography of the international investment positions, discuss recent data developments and present empirical methods used to improve bilateral estimates of international investment positions. In addition, this part will give examples of applied research using these data to study the geography and the dynamics of cross-border investments.

Section 4 will put the focus on the currency dimension of financial globalisation. It will discuss the role of exchange rate fluctuations on the local currency value of international investments as well as on the potential stabilising role of exchange rate-induced valuation effects. Stylised facts associated with the geography and dynamics of international currency exposures will be presented.

The final two sections provide a financial globalisation perspective on the current global financial crisis and the current European financial crisis. Section 5 will probe how cross-border financial positions affected the transmission and dynamics of the global financial crisis, while Section 6 will address the specific analytical issues that arise in dealing with external imbalances and capital flows in Europe. In particular, the former will put the focus on how financial globalisation affected the crisis dynamics, global imbalances and subsequent adjustment process and the risks in international balance sheets. The latter will focus on current account imbalances, financial and trade linkages, capital flows and domestic credit growth from a European perspective.

In summary, the goal of this course is to provide a review of the baseline theoretical models and the relevant empirical evidence, together with applications to the main policy issues in open-economy macroeconomics/finance today.

Course material and references

Section 1: Theoretical Foundations of Cross-border Financial Flows

❖ Lecture Slides

- Obstfeld, Maurice and Kenneth Rogoff (1996), Foundations of International Macroeconomics, Chapters 1, 2, 4, 5.

Section 2: The Measurement of Financial Globalisation

❖ Lecture Slides

- Bénétrix, Agustín S. (2009), "The Anatomy of Large Valuation Episodes," *Review of World Economics*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2007), "The External Wealth of Nations Mark II," *Journal of International Economics*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2008), "The Drivers of Financial Globalization," *American Economic Review*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2009), "Where Did All the Borrowing Go? A Forensic Analysis of the U.S. External Position," *Journal of Japanese and International Economies*
- Lane, Philip R. (2011), "The Dynamics of Ireland's Net External Position," IIS Discussion Paper No. 388
- Lane, Philip R. (2013), "Risk Exposures in International and Sectoral Balance Sheets," mimeo.
- Zucman Gabriel (2013), "The Missing Wealth of Nations," *Quarterly Journal of Economics*.

Section 3: International Financial Trade: Bilateral Patterns

❖ Lecture Slides

- Kubelec, Chris and Filipa Sá (200), "The Geographical Composition of National External Balance Sheets: 1980–2005," *International Journal of Central Banking*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2008), "International Investment Patterns," *Review of Economics and Statistics*
- Yohei Okawa and Eric Van Wincoop (2012), "Gravity in International Finance," *Journal of International Economics*
- Milesi-Ferretti, Gian Maria, Francesco Stobbe and Natalia Tamirisa (2010), "Bilateral Financial Linkages and Global Imbalances: A View on the Eve of the Financial Crisis," IMF Working Paper No. 10/257
- Galstyan, Vahagn and Philip R. Lane (2013), "Bilateral Portfolio Dynamics During the Global Crisis," *European Economic Review*

Section 4: Financial Globalisation and Exchange Rates

❖ Lecture Slides

- Bénétrix, Agustín, Philip Lane and Jay Shambaugh (2015), "International Currency Exposures, Valuation Effects and the Global Financial Crisis," *Journal of International Economics*
- Gourinchas, Pierre-Olivier and Helene Rey (2007), "International Financial Adjustment," *Journal of Political Economy*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2005), "Financial Globalisation and Exchange Rates," in Dollars, Debt, and Deficits-60 Years After Bretton Woods, International Monetary Fund, 2005
- Lane, Philip R. and Jay Shambaugh (2010a), "Financial Exchange Rates and International Currency Exposures," *American Economic Review*
- Lane, Philip R. and Jay Shambaugh (2010b), "The Long and Short of It? Determinants of Aggregate Foreign-Currency Exposure," *Journal of International Economics*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2004), "The Transfer Problem Revisited," *Review of Economics and Statistics*

Section 5: Financial Globalisation and the Global Crisis

❖ Lecture Slides

- Lane, Philip R. and Gian Maria Milesi-Ferretti (2011), "The Cross Country Incidence of the Global Crisis," *IMF Economic Review*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2012), "External Adjustment and the Global Crisis," *Journal of International Economics*
- Lane, Philip R. and Gian Maria Milesi-Ferretti (2013), "Global Imbalances and External Adjustment after the Crisis," mimeo.
- Shin, Hyun (2011), "Global Banking Glut and Loan Risk Premium," mimeo, Princeton University.
- Lane, Philip R. (2012), "Financial Globalisation and the Crisis," *Open Economies Review*
- Milesi-Ferretti, Gian Maria and Cedric Tille (2011), "The Great Retrenchment: International Capital Flows During the Global Financial Crisis," *Economic Policy*
- Forbes, Kristin and Frank Warnock (2012), "Capital Flow Waves: Surges, Stops, Flight and Retrenchment," *Journal of International Economics*
- Obstfeld, Maurice (2011), "International Liquidity: The Fiscal Dimension," mimeo, UC-Berkeley.
- Obstfeld, Maurice (2010), "Expanding Gross Asset Positions and the International Monetary System," mimeo, UC-Berkeley.
- Obstfeld, Maurice (2011), "Financial Flows, Financial Crises and Global Imbalances," mimeo, UC-Berkeley.

Section 6: Financial Globalisation and Europe

❖ Lecture Slides

- Bénétrix Agustín and Philip R. Lane (2013), "Fiscal Shocks and the Real Exchange Rate," *International Journal of Central Banking*
- Chen, Ruo, Gian Maria Milesi Ferretti and Thierry Tresselt (2012), "Euro Area Debtor Countries: External Imbalances in the Euro Area," *Economic Policy*
- Auer, Raphael (2013), "What Drives Target2 Balances? Evidence from a Panel Analysis," *Economic Policy*
- Lane, Philip R. and Barbara Pels (2012), "Current Account Imbalances in Europe," *Moneda y Crédito*.
- Lane, Philip R. (2012), "The European Sovereign Debt Crisis," *Journal of Economic Perspectives*
- Lane, Philip R. (2013), "Capital Flows in the Euro Area," *European Economy Economic Paper No. 497*, April 2013.
- Philip R. Lane (2015), "Macro-Financial Stability under EMU," *CEPR Discussion Paper No. 10776*
- Philippon, Thomas and Philippe Martin (2014), "Inspecting the Mechanism: Leverage and the Great," *NBER Working Paper No. 20572*.
- Corsetti, Giancarlo et al (2011), "Sovereign Risk and the Effects of Fiscal Retrenchment in Deep Recessions," *FRB-Philadelphia Working Paper No. 11-43*.
- Corsetti, Giancarlo et al (2011), "Floats, Pegs and the Transmission of Fiscal Policy," *Central Bank of Chile Working Paper*.
- Blanchard, Olivier and Francesco Giavazzi (2002), "Current Account Deficits in the Euro Area. The end of the Feldstein Horioka puzzle?," *Brookings Papers on Economic Activity*.
- Honohan, Patrick and Philip R. Lane (2003), "Divergent Inflation Rates under EMU," *Economic Policy*
- Blanchard, Olivier (2007), "Adjustment within the Euro: The Difficult Case of Portugal," *Portuguese Economic Journal*
- Blanchard, Olivier (2007), "Current Account Deficits in Rich Countries," *IMF Staff Papers*
- Brown, Martin and Philip R. Lane (2011), "Debt Overhang in Emerging Europe?," *World Bank Policy Research Working Paper No. 5784*.