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Introduction

Lucrezia Reichlin and Kenneth D. West

The International Seminar on Macroeconomics (ISOM) meets every June in a different European city, bringing together American and European economists to study a variety of topics within "macroeconomics" defined very broadly. The tradition started in 1978. During the first half of its life it was popularly known as the "Gordon-deMenil seminar." Jeffrey Frankel is now overall codirector of ISOM, with Francesco Giavazzi as his European counterpart. Since 2004, the NBER has been the sole sponsor of ISOM, and the proceedings are published by the University of Chicago Press as the *NBER International Seminar on Macroeconomics*. We continue to work with a local host in a different European country each summer and to divide the authors and discussants equally between Americans and Europeans.

This volume contains a selection of the papers originally presented at the thirty-second seminar, which took place in Cyprus on June 12–13, 2009. The meeting was kindly hosted by the Central Bank of Cyprus. In 2009 the program was organized by Lucrezia Reichlin and Kenneth D. West. The papers published here have gone through the usual refereeing process for NBER conference volumes. NBER ISOM 2009 is the sixth annual installment, appearing as a companion volume to the *NBER Macroeconomics Annual*.

Overview of the Volume

The seven papers published in the thirty-second volume of ISOM, as usual, cover quite a range of topics. This volume also includes an eighth chapter that publishes some panel comments on monetary policy in a low interest rate environment. While the subject matter of the seven papers ranges widely, one can weave some overarching themes.

The seven chapters fall into three categories and are listed here in the order in which the papers were presented at the conference. Part I deals

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with financial crisis, part II with international economic puzzles, and part III with exchange rates and financial development. Part IV briefly introduces the panel comments.

Part I: Financial Crisis

The first session is on financial crisis. The two papers in the session take a historical perspective and address two interesting issues.

The paper "Free Flows, Limited Diversification: Openness and the Fall and Rise of Stock Market Correlations, 1890–2001" by Dennis Quinn and Hans-Joachim Voth addresses the classical topic of the portfolio home bias puzzle and provides new insights into the subject. The paper provides evidence, based on a new data set that extends the Quinn-Toyoda measure of capital account openness to cover over 110 years of data for 16 countries, that the lack of international portfolio diversification in part reflects restrictions on capital mobility. Investors historically did not take advantage of the hypothesized gains from international diversification because they were not allowed to do so. In particular, the authors find that the low historical correlation in equity returns is associated with periods in which capital controls were very restrictive.

In "The End of Gatekeeping: Underwriters and the Quality of Sovereign Bond Markets, 1815–2007," Marc Flandreau, Juan Flores, Norbert Gaillard, and Sebastián Nieto-Parra study the role of the "middleman" in accounting for changes of patterns, over the past two centuries, in sovereign debt issuance. The paper is the first to study the operation of primary markets over the long run and promises to shed light on an issue that has been central in the recent crisis. The findings, based on new data on several episodes of foreign currency sovereign debt issues in leading capital markets, show that changes in the pattern of sovereign debt issuance can be found in the rising role of rating agencies.

Part II: International Economics Puzzles

This part focuses on international economics puzzles. The paper "The Feldstein-Horioka Fact" by Domenico Giannone and Michele Lenza addresses the classical topic of the Feldstein-Horioka puzzle and shows that a partial explanation for the puzzle can be found once one takes into account general equilibrium mechanisms. The authors show that the general equilibrium explanation turns out to be significant once one allows the global shocks to have heterogeneous effects across countries. Once these effects are controlled for, the saving-retention coefficient remains high in the 1970s but decreases since the 1980s when capital mobility increased in OECD countries.

For floating exchange rates between developed countries with roughly similar inflation rates, the current value of the exchange rate is often a better predictor of the future value than predictions that rely on economic models. This puzzle was first noted by economists Richard Meese and Kenneth Rogoff over 25 years ago and seems to have stood the test of time. In "Can Parameter Instability Explain the Meese-Rogoff Puzzle?" Philippe Bacchetta, Eric van Wincoop, and Toni Beutler consider a particular explanation for this puzzle: perhaps the economic models are right, but the parameters of those models change over time in a fashion that makes it hard to use the models to make accurate predictions. The authors conclude that, in fact, such parameter change is unlikely to explain the puzzle.

Part III: Exchange Rates and Financial Development

These papers consider various topics in exchange rates and development. In "International Reserves and Underdeveloped Capital Markets," Kathryn Dominguez considers the finding that, on net, capital tends to flow from developing to developed countries. This is surprising because capital should flow in the direction in which returns are higher, which in turn should be where capital is more scarce, that is, developing countries. Dominguez argues that a major factor explaining the capital flow is that governments in developing countries accumulate foreign reserves in part to compensate for imperfections in private capital markets.

"The Nontradable Goods' Real Exchange Rate Puzzle" by Lukasz Drozd and Jaromir Nosal considers the role of tradables and nontradables in real exchange rate fluctuations. In a 1999 article in the *Journal of Political Economy*, Charles Engel showed that real exchange rate movements come more from movements in tradables than in nontradables prices. Drozd and Nosal document this fact for a broad set of data. They attempt to use a simple real business cycle model (called a "standard" model by the authors) to explain this regularity but conclude in the end that such a model is inadequate.

Finally, "External Balance in Low-Income Countries" considers the determinants of the current account balance, the real exchange rate, and net foreign assets in a broad set of developing countries. Authors Lone Christiansen, Alessandro Prati, Luca Antonio Ricci, and Thierry Tressel present a complex set of results that are not easily summarized. The flavor of the analysis can perhaps be conveyed via the findings for one type of variable (structural reforms): domestic financial liberalization is associated with higher account balances and net foreign asset positions; capital account liberalization is associated with an appreciation of the real exchange rate.

Part IV: Panel Discussion: "Monetary Policy in a Low-Interest-Rate Environment"

The panelists were asked to prepare a 15-minute presentation on any aspect of their choosing that relates to the broad topic of monetary policy in a low interest rate environment. Huw Pill discusses the principles that should guide monetary policy in a low interest rate environment. Vincent Reinhart discusses quantitative easing policies of the Fed. Volker Wieland describes rationales for quantitative easing and refers to the Japanese experience as well as the most recent policies by the European Central Bank and the Fed. John Williams considers lessons from research and policy of the last decade.