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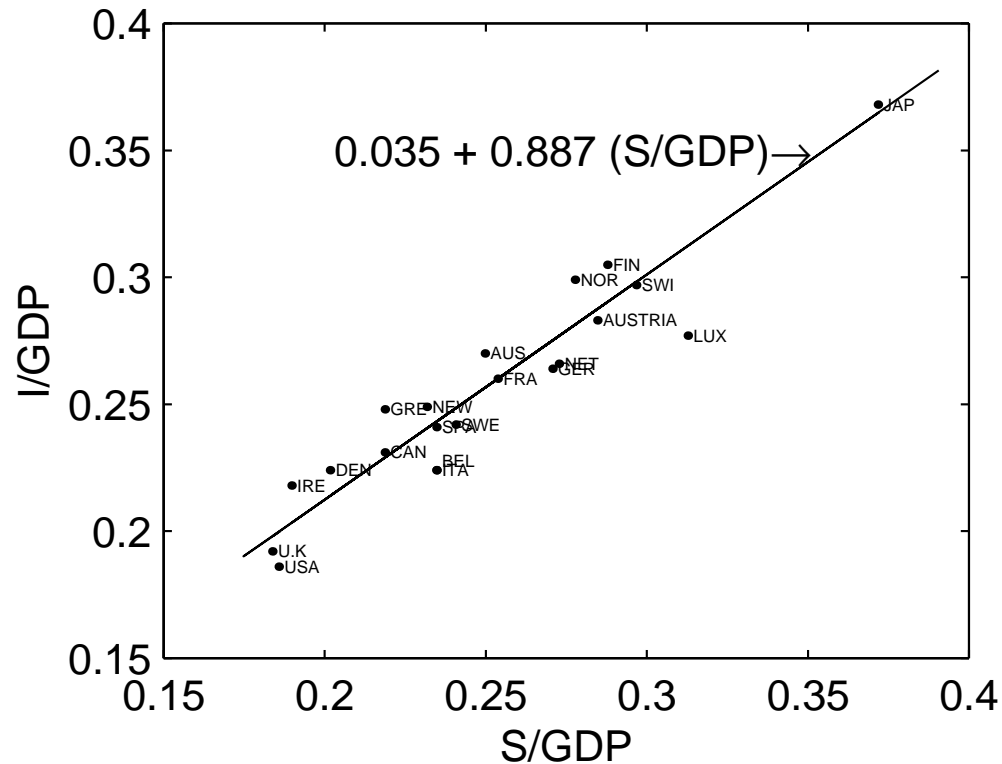
Handout 5

March 24, 2010

International Capital Market Integration

The Feldstein and Horioka correlation

Saving and Investment Rates for 16 Industrial Countries (1960-1974 Averages)



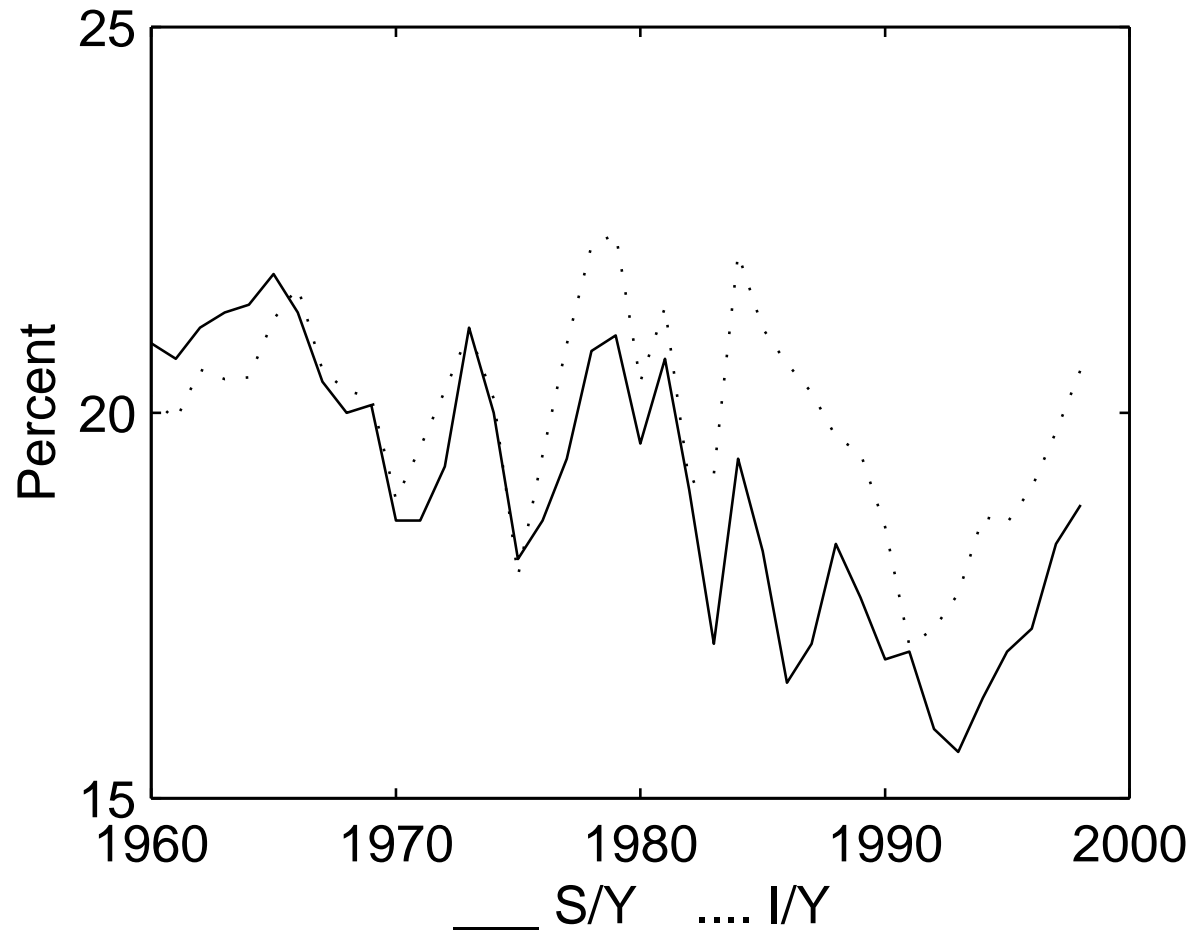
Source: M. Feldstein and C. Horioka, "Domestic Saving and International Capital Flows," *Economic Journal* 90, June 1980, 314-29.

Feldstein and Horioka estimated the following equation:

$$\left(\frac{I}{Q}\right)_i = 0.035 + 0.887 \left(\frac{S}{Q}\right)_i + \nu_i; \quad R^2 = 0.91$$

where $(I/Q)_i$ and $(S/Q)_i$ are, respectively, the average investment-to-GDP and savings-to-GDP ratios in country i over the period 1960-74.

U.S. National Saving, Investment, and the Current Account as a Fraction of GNP, 1960-1998



Source: Department of Commerce, Bureau of Economic Analysis, www.bea.doc.gov.

Interest Rate Differentials

Covered Interest Rate Differentials for Selected Countries

September 1982-April 1988

	$i - i^* - fd$	
	Mean	Std. Dev.
Germany	0.35	0.03
Switzerland	0.42	0.03
Mexico	-16.47	1.83
France	-1.74	0.32

Note: The covered interest rate differential, $i - i^* - fd$, is measured by the local minus the Eurodollar 3-month interest rate less forward discount. Source: Table 2.5 of Jeffrey Frankel, "Quantifying International Capital Mobility in the 1980s."

Real Interest Rate Differential for Selected Countries: September 1982 to January 1988

Country	$r - r^*$	$i - i^* - fd$
Germany	-1.29	.35
Switzerland	-2.72	.42
France	-.48	-1.74
Mexico	-20.28	-16.47

Source: J. Frankel, "Quantifying International Capital Mobility in the 1980s," in the Das reader, tables 2.5, 2.6, 2.8, and 2.9.

Interest Differentials in the Long Run

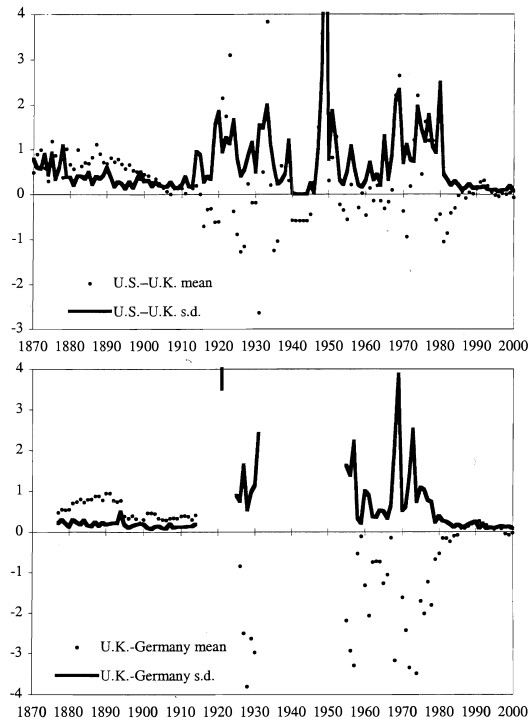


Fig. 3.5 Exchange-risk-free nominal interest differentials since 1870: *A*, U.S.-U.K.; *B*, U.K.-Germany

Sources: See text.

Notes: Annual samples of monthly data, percent per annum.

the subsequently available covered interest differentials. Differential returns are calculated as annual rates of accrual.⁴⁶

46. The U.S.-U.K. comparison is based on the data described in Obstfeld and Taylor (1998, 361n. 7), with the following amendments. From January 1975 to August 2001, the London sterling interest rate i is the three-month bank bill middle rate, from Datastream. From January 1981 to August 2001, the New York dollar interest rate i is the discount rate on ninety-day bankers' acceptances, from Datastream. Finally, from January 1981 to August 2001 spot and

