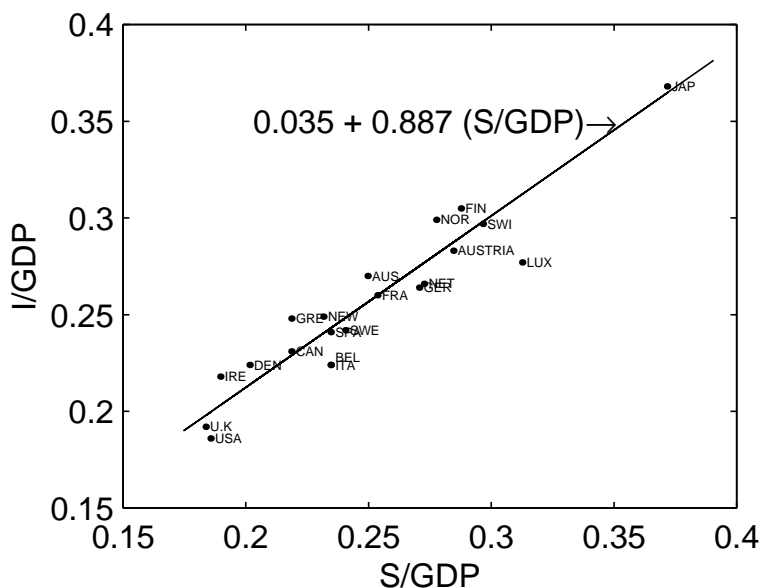


Economics 170  
**International Macroeconomics**  
 Handout 3

## International Capital Market Integration

### The Feldstein and Horioka correlation

Figure 1: Saving and Investment Rates for 16 Industrial Countries, 1960-1974 Averages



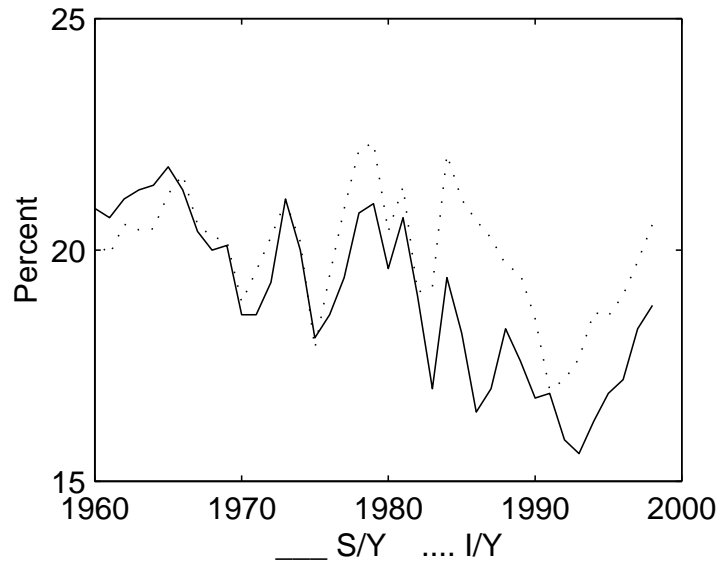
Source: M. Feldstein and C. Horioka, “Domestic Saving and International Capital Flows,” *Economic Journal* 90, June 1980, 314-29.

Feldstein and Horioka estimated the following equation:

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

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

Figure 2: 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](http://www.bea.doc.gov).

### Interest Rate Differentials

Table 1: 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."

Table 2: Decomposition of the real interest rate differential for selected countries: September 1982 to January 1988

Country	$r - r^*$	$i - i^* - fd$ (1)	$f - s^e$ (2)	$\% \Delta e^e$ (3)
Germany	-1.29	.35	4.11	-6.35
Switzerland	-2.72	.42	3.98	-8.35
France	-.48	-1.74	7.47	-6.26
Mexico	-20.28	-16.47	6.04	-3.32

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

Table 3: International capital mobility in the 1990s  
Domestic Interbank minus Eurocurrency 3-month bid interest rates:

Country	1/1/82- 1/31/87	2/1/87- 6/30/90	7/1/90- 5/31/92	6/1/92- 4/30/93
France	-2.27	-.11	.08	-.01
Italy	-.50	.29	.56	.36
Germany	.17	.05	-.05	.07
Japan	-.07	-.60	.09	.17

Source: M. Obstfeld, "International Capital Mobility in the 1990s," in Kenen, *Understanding Interdependence: The Macroeconomics of the Open Economy*, Princeton University Press, 1995, table 6.1.

Figure 3: Interest Differentials in the Long Run

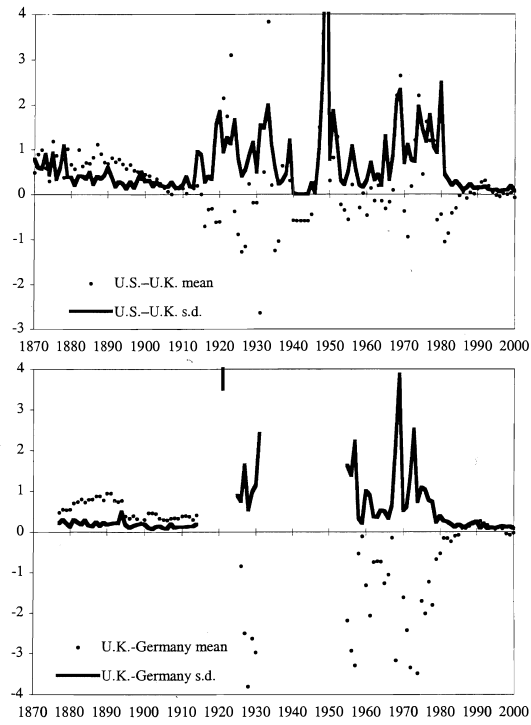


Fig. 3.5 Exchange-risk-free nominal interest differentials since 1870: A, U.S.-U.K.; B, U.K.-Germany

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.<sup>46</sup>

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

Source: 'Globalization and Capital Markets,' by M. Obstfeld and A. Taylor, in *Globalization in Historical Perspective*, edited by M. Bordo, A. Taylor, and J. Williamson, The University of Chicago Press, 2003, page 153.