This fifteen-hour course summarizes a new, micro-finance approach to exchange rates. Historically, the fields of exchange-rate economics and microstructure finance have progressed independently. We will address the growing interaction between them and the resulting approach that has emerged. The target audience is macro and financial economists who are interested in exchange rate behavior over longer horizons (e.g., one month and longer, not intraday). Because the training of most people who work in this area does not include microstructure finance, the course is designed to ensure accessibility. For example, a central focus of the course is how trading aggregates dispersed information that is relevant to exchange rates; accordingly, the necessary information economics will be presented in detail.

The course treats both theory/methods and empirics/applications, and in the process highlights their interplay. An appealing feature of the approach is its empirically driven nature: the advent of electronic trading has made transaction data available over longer horizons, which permits analysis of traditionally macro questions (such as the disconnect between macro variables and exchange rates, the price impact of sterilized intervention, and whether participants use different exchange-rate models).

The new micro approach is quite successful, as we shall see: it can account for most of the variation in major exchange rates. Its power lies in its framework for looking beyond the obvious fact that every transaction involves a buyer and a seller. Identifying the information content of trades generates new insights and many directions for future research.

**Session 1 (Monday): Introduction to the New Micro Approach**
- Brief history of traditional approaches
- Order flow defined
- Spanning the Micro-Macro Divide

**Session 2 (Tuesday): The Field of Microstructure Finance**
- Microstructure theory: information and inventory models
- Microstructure empirical frameworks
- Modeling FX market features

**Session 3 (Wednesday): Order Flow Information and Causality**
- Empirical modeling and causality
- Dispersed information in FX markets
- Empirical evidence that FX order flow is informative
- Order flow and macro news

**Session 4 (Thursday): Underlying Demand from FX Customers**
- Where order flow comes from: FX customers
- Disaggregating flow to reveal underlying information structure
- Case: Order Flow From Currency Futures

**Session 5 (Friday): Policy Implications and Next Frontiers**
- Central bank intervention
- Transaction taxes
- The lines of future research
List of Readings

Readings for the course come from two sources: a text and a packet of supplemental readings. All students should purchase the text:


The packet of supplemental readings contains 11 articles in the following order:

Course Outline and Reading

Session 1 (Monday): Introduction to the New Micro Approach

Session 2 (Tuesday): The Field of Microstructure Finance
MAER chapters 4 and 5.

Session 3 (Wednesday): Order Flow Information and Causality
MAER chapters 2 and 7.

Session 4 (Thursday): Underlying Demand from FX Customers
Case: Order Flow from Currency Futures
MAER chapter 9.
Hau, H., and H. Rey, 2002, Order flows, exchange rates, and asset prices, typescript, Princeton University, July.

Session 5 (Friday): Policy Implications and Next Frontiers
MAER chapter 3 (pages 55-62), 8 and 10.