

BGP-620: International Macroeconomics Syllabus, Spring 2018

Harvard Kennedy School, Harvard University

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Times: Lectures: Tuesdays-Thursdays 2:45-4:00, Littauer 280.
Prof. office hours: Tuesday 4:15-5:15 and Wednesday 1:15-2:30 p.m., Littauer 217.
Review session: Fridays, 1:15-2:30, Littauer 382.

Final exam: Wednesday, May 2, 2-5:00, Littauer 382.

Prospectus

Topics covered: What is the role of monetary and fiscal policy in an open economy? What determines the balance of payments, the level of economic activity, and inflation? Should countries fix their exchange rates, or let them float? How does the globalization of financial markets affect these and other policy questions?

This course deals with the macroeconomics of open economies. The emphasis will be on models appropriate to major countries. Topics include the foreign exchange market, devaluation, and import and export elasticities; the simultaneous determination of the trade balance, national income, the balance of payments, money flows and price levels; capital flows and our increasingly-integrated financial markets; monetary and fiscal policy in open economies; international macroeconomic interdependence and policy coordination; supply relationships and nominal anchors for monetary policy; currency unions, the determination of exchange rates in international money markets; and international portfolio diversification.

Nature of the approach: The course is a relatively comprehensive treatment of standard textbook models in the area of open-economy macroeconomics. Although real-world examples are sprinkled throughout, the course relies very heavily on algebraic and graphical analysis, as is customary in economics classes.

Who should take the course: Only those who are quite comfortable with algebraic and graphical analysis should enroll. This is not an appropriate course for students who want some basic general exposure to international economics.

Prerequisites: Familiarity with the principles of economics and with intermediate-level macroeconomics is necessary, particularly standard models of monetary and fiscal policy and their effects on interest rates and income. API-101 and API-121, respectively, satisfy the prerequisites for micro and macroeconomics, as do Econ 1010a (or 1011a) and 1010b (or 1011b) in FAS. Some knowledge of international trade theory and econometric techniques is also desirable, but definitely not essential. Students must be comfortable with algebra.

Problem Sets: Seven quantitative problem sets are planned. For each problem set, students can choose whether to work alone or in groups, *but must indicate which* option they have chosen when handing in the problem set. Those who work alone will receive a small point boost on that problem set.

Grading: Problem sets -- 25%; mid-term exam -- 25%; final exam -- 50%.

Please check the dates for the exams, especially the final exam. If you cannot take the exams, you should not enroll in the course.

Spring 2018

BGP 620 – International Macroeconomics

Course Outline

Prof. Jeffrey Frankel, Harvard Kennedy School

Friday sessions will consist of review, extensions, applications, and questions and answers regarding the week's topic.

The required text is *World Trade & Payments*, by R.Caves, J.Frankel, and R.Jones (10th edition, Addison Wesley, 2007). Additional readings are available via links on the course webpage.

<u>Topic</u>	<u>Chapter in WT & P</u>	<u>Lecture number and date</u>	<u>PS due dates (approx.)</u>
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ELASTICITIES & THE TRADE BALANCE			
Balance of payments accounting	15	1 Jan. 23	
Supply and demand for foreign exchange	16.1	2 Jan. 25	
Export and import elasticities			
Empirical effects of devaluation on the trade balance	16.2	3 Jan. 30	
THE KEYNESIAN MODEL			Problem set 1
National saving identity; fiscal multiplier in an open economy.	17.1-17.2	4 Feb. 1	<u>due</u>
Export multiplier; & the transfer problem.	17.3 } 17.4	5 Feb. 6	
Large-country repercussions & Transmission of disturbances.	17.5-17.6 18.1	6 Feb. 8	Problem set 2
Expenditure-reducing policies vs. -switching policies	18.2	7 Feb. 13	<u>due</u>
MONEY & THE BALANCE OF PAYMENTS			Problem
Monetary factors	18.3	8 Feb. 15	set 3
Reserve flows & the gold standard	19.1 } Appendix A	9 Feb. 20	<u>due</u>
Purchasing Power Parity	19.2-19.4	10 Feb. 22	

<u>Topic</u>	<u>Chapter in WT & P</u>	<u>Approx. lecture number and date</u>		
GLOBALIZATION OF FINANCIAL MARKETS				
Financial integration; spot & forward exchange market	21.1-21.3	11	Feb.27	<u>Problem set 4 due</u>
Emerging markets; Pros & cons of financial opening	21.4 Ch. 21 Appendix	12	Mar. 1	
FISCAL & MONETARY POLICY UNDER INTERNATIONAL CAPITAL MOBILITY				
Mundell-Fleming-- with exchange rate fixed	22.1-22.3	13	Mar. 6	
	<u>Midterm exam</u>	14	Mar. 8	
	[Spring break		March 10 - 18]	
Applications/problems of policymaking Mundell-Fleming model - with the exchange rate floating.	22.4-22.7; 24.1 23.1-23.2	15	Mar. 20	
Perfect capital mobility & Impossible Trinity	23.3-23.4	17	Mar.27	
EM countries and crises	24.2-24.5, 24.7-24.9	18	Mar.29	
INTERDEPENDENCE AND COORDINATION				
Effects of fiscal expansion in a large country	25.1			<u>Problem set 5</u>
Estimates of transmission	25.2	19	Apr. 3	<u>due</u>
International policy coordination	25.3			
SUPPLY AND INFLATION				
Aggregate Supply and wages	26.1	20	Apr. 5	<u>Problem set 6</u>
Inflation and anchors for money	26.3-26.4			<u>due</u>
Exchange rate regimes and monetary unions	26.5-26.6	21	Apr. 10	
Case study: recent macroeconomics in China		22	Apr.12	
EXPECTATIONS AND EXCHANGE RATE MODELS				
Interest parity conditions	27.1 }	23	Apr.17	<u>Problem set 7</u>
The monetarist/Lucas model	27.2-27.3	24	Apr.19	<u>due</u>
The overshooting model & forecasting	27.4-27.6, 28.1	25	Apr.24	
Currency risk & portfolio diversification	28.1-28.4	26	Apr.26	

Final exam: Wednesday, May 2, 2:00-5:00 p.m., Littauer 382.

Readings

The required textbook reading is the second half of *World Trade and Payments*, R.Caves, J.Frankel, and R.Jones, 10th ed. (Addison-Wesley), 2007.

Unless otherwise indicated, links to readings listed below are posted on the course webpage.

- * asterisk denotes recommended readings
- ** double asterisk denotes most highly required
- (L numbers correspond to scheduled lectures.)

Balance of Payments Accounting (Lecture 1)

[“Tourism and the Trade Balance: A Number of Great Import,”](#) *The Economist*, Feb. 15, 2014. **

[“The Other Deficit,”](#) *The Economist*, October 17, 2015. **

[“Beijing hails success in battle against capital flight,”](#) *Financial Times*, Aug. 8, 2017. *

The Trade Balance

The effect of currency depreciation on the trade balance (L2-L3)

[“Petri-dish economies: Poland – Few woes in Warsaw,”](#) *Economist*, April 30, 2011, p. 83. **

[“Swiss cheesemakers long for a stronger euro,”](#) *Financial Times*, August 1, 2017. *

Application of the marginal propensity to import to the Great Recession of 2008-09 (L4)

M.Bussière, G.Callegari, F.Ghironi, G.Sestieri, & N.Yamano, 2013, "[Estimating Trade Elasticities: Demand Composition and the Trade Collapse of 2008-2009.](#)" *American Economic Journal: Macroeconomics*, 5(3), July, pp. 118-51. NBER WP 17712. [Summarized](#) in *VoxEU*, 2012. **

Fiscal Policy and Keynesian Multipliers (L5-7, L13-16)

Martin Feldstein, 2009, "[Rethinking the Role of Fiscal Policy,](#)" *Amer.Ec.Rev* 99, no.2, 556-59. *

Ethan Ilzetzki, Enrique Mendoza, and Carlos Vegh, 2013, "[How Big \(Small?\) are Fiscal Multipliers?,"](#) *Journal of Monetary Economics*, vol. 60(2), 239-254. NBER WP 16479 or IMF WP 1152, 2011. [Summarized in NBER Digest](#), 2011. **

Olivier Blanchard and Daniel Leigh, 2014, "[Growth Forecasts Errors and Fiscal Multipliers,](#)" *American Economic Review*, 103, no.3, pp. 117-12. Based on [IMF Working Paper 13-1](#).

[“A stimulating question: Can emerging economies now afford counter-cyclical policies?”](#) *The Economist*, Dec. 13, 2008, p. 90.

[“Chile’s Economy: Cashing in the fruits of rigor,”](#) *The Economist*, Feb. 19, 2009. *

[“Economics focus: Much ado about multipliers,”](#) *The Economist*, Sept. 26, 2009, p. 90.

[“Fiscal Multipliers: Where does the buck stop?”](#) *The Economist*, Aug. 13, 2016, pp.50-51. **

[“Hot money flows into Argentine peso spook President Macri,”](#) *Financial Times*, May 27, 2016.

[“Swiss central bank blames strong franc as eurozone pulls away,”](#) *Financial Times*, June 16, 2017. *

Money and the Balance of Payments (L8-L9)

The gold standard and Bretton Woods (L9)

Richard Cooper, "The Gold Standard: Historical Facts and Future Prospects," abridged in B.Eichengreen, *The Gold Standard in Theory and History* (Methuen: NY), 1995, pp.251-271.

["The global monetary system: Not floating, but flailing,"](#) *The Economist*, July 5, 2014, 57-58. *

Purchasing power parity (L10)

[The Big Mac index: Interactive Currency Comparison Tool](#) [E.g., January 2018.] **

Michael Pakko and Patricia Pollard, 2003, "[Burgernomics: A Big Mac Guide to Purchasing Power Parity.](#)" Federal Reserve Bank of St. Louis *Review*, Nov/Dec., 9-28.

The Globalization of Financial Markets

The growth of forex trading and other financial markets (L11)

["Finance: Trick or Treat?"](#) *The Economist*, Oct. 23, 1999, p. 91-92

["Future Perfect,"](#) *The Economist*, Nov. 27, 1999, pp. 81-82. *

Pros and cons of open financial markets (L12)

["Policing the frontiers of finance – Is foreign capital a luxury that poor countries can live without?"](#) [summary of Rodrik & Subramanian], *The Economist*, Apr. 12, 2008, p. 87.

["Economics Focus: Capital Bonanzas,"](#) [summary of Reinhart & Reinhart] *Economist*, Sept.27, 2008, p.92. **

["Capital controversy,"](#) *The Economist*, April 14, 2012, p.86.

["An on-off relationship,"](#) *The Economist*, Dec. 13, 2014. *

Carmen Reinhart and Kenneth Rogoff, 2004, "[Serial Default And The 'Paradox' Of Rich-To-Poor Capital Flows,](#)" *American Economic Review*, vol. 94, no.2, May, 53-58.

The Impossible Trinity (L17)

Maurice Obstfeld and Alan Taylor, "[International Monetary Relations: Taking Finance Seriously,](#)" *Journal of Economic Perspectives*, 31, no. 3 Summer, pp. 3-28. *

["China's 'trilemma' makes it vulnerable to more shocks,"](#) *Financial Times*, Feb. 22, 2016.

Emerging markets: inflows and crises (L18)

Guillermo Calvo, Leo Leiderman and Carmen Reinhart, "[Inflows of Capital to Developing Countries in the 1990s,](#)" *Journal of Economic Perspectives*, 10, no. 2, Spring 1996, 123-139. *

["Emerging-market debt: A run for your money,"](#) *Economist*, Aug.28, 2010, p.66.

["Brazil's economy: Wild horses – A soaring currency..."](#) *Economist*, Apr. 23, 2011.

["Economic epidemiology,"](#) *The Economist*, June 16, 2012.

["Asia's great moderation,"](#) *The Economist*, Nov. 10, 2012.

["India on the brink: How India got its funk,"](#) *The Economist*, Aug. 24, 2013, p.12. *

["Financial indulgence,"](#) *The Economist*, April 5, 2014, p.69. *

The Global Macroeconomic System

International macroeconomic policy coordination (L19)

J. Frankel, 2016, "[International Coordination](#)," [paper written for Policy Challenges in a Diverging Global Economy](#), R.Glick & M.Spiegel, eds. (Federal Reserve Bank of San Francisco); [2015 Asia Economic Policy Conference](#). HKS [RWP 16-002](#). NBER [WP 21878](#), 2016; [Summary](#) in *VoxEU*, Dec 2015. **

"[Brown and Sarkozy seek fiscal boost](#)," *Financial Times*, December 8, 2008. *

"[Fingers in the dyke](#)," *The Economist*, March 21, 2009. *

"[What a carry-on](#)" Buttonwood, *Economist* Nov.21, 2015. *

Monetary expansion, supply and inflation (L20)

"[Some like it hot: Which emerging economies are at greatest risk of overheating?](#)" *Economist*, July 2, 2011, p. 65. **

"[Argentina's inflation problem: The price of cooking the books](#)," *The Economist*, Feb.25, 2012, 47-8.

"[Nigeria's central bank chief warns on Independence](#)," *Financial Times*, June 7, 2012.

"[China drains cash to curb inflation](#)," *Financial Times*, Feb. 22, 2013.

"[The desperation of independents: Stubbornly low interest rates may mean the end of central-bank autonomy](#)," *The Economist*, August 6, 2016

"[South Korea raises rates amid inflation fears](#)," *Financial Times*, Dec. 1, 2017. *

Case Study: Recent macroeconomic policy in China (L22)

J. Frankel, 2010, "[The Renminbi Since 2005](#)," in [The US-Sino Currency Dispute: New Insights from Economics, Politics and Law](#), edited by S. Evenett (CEPR: London), 51-60. **

J.Frankel, 2015, "[Misinterpreting Chinese Intervention in Financial Markets](#)," *China-US Focus*, Sept.10.

Exchange Rates

Monetary union (L21)

Jürgen Stark, "[German prudence is not to blame for the eurozone's ills](#)," *Financial Times*, Feb.11, 2015. *

Jay Shambaugh, 2012, "[The Euro's Three Crises](#)," *Brookings P.Ec.Act.*, Spring, 157-211. [Summary](#).

J. Frankel, "[The Euro Crisis](#)" [pdf](#), *Journal of Policy Modeling*, June 2015. HKS [RWP13-015](#).

Monetary determination of exchange rates(L23-L25)

"[Rudiger Dornbusch](#)," *The Economist*, Aug. 10, 2002, p. 72.

Schools Brief: "[Monopoly Power Over Money](#)," *The Economist*, Nov.18, 1999. *

The carry trade and bias in the forward exchange market (L26)

J. Frankel, 2008, "[Carried Away](#)," *Milken Institute Review*, Q1. Or [full version](#). *

Ken Froot & Richard Thaler, 1990, "Anomalies: Foreign Exchange," *JEP* 4, no.3, Summer, 179-92.