

International Macroeconomics, Harvard University

BGP-620 at Harvard Kennedy School; Cross-listed as Econ 1550, FAS

Syllabus, Spring 2021

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Times: Live lectures (remote): Mondays-Wednesdays, 10:30 am-11:45 am EST
Review session: Fridays, 10:30am - 11:45am EST.
Final exam: Wednesday, May 12, 2 pm EST.

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 in internationally integrated financial markets; monetary and fiscal policy in open economies, including at the Zero Lower Bound for interest rates; crises; international macroeconomic interdependence and policy coordination; supply relationships, inflation, 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 heavily on algebraic and graphical analysis, as is customary in economics classes.

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

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. Students must be comfortable with algebra.

Problem Sets: Seven quantitative problem sets are planned.

Grading: Problem sets -- 30%; Mid-term exam -- 25%; Final exam -- 35%; Class participation—10%.

Students are responsible for knowing what is in [the Academic Code](#) and abiding by it, including this paragraph: *“Cheating on assignments or exams, plagiarizing or misrepresenting the ideas or language of someone else as one’s own, falsifying data, or any other instance of academic dishonesty violates the standards of our community, as well as the standards of the wider world of learning and affairs...If students submit work not their own..., including from the Internet, they will be subject to discipline by the HKS Administrative Board, ranging from a warning to required withdrawal or expulsion from HKS.”*

**BGP 620/Econ 1550 – International Macroeconomics
Course Outline**

Professor Jeffrey Frankel
Harvard Kennedy School

The required text is *World Trade & Payments*, by Caves, Frankel, & Jones (10th ed., 2007), available via the [Coop](#); via the professor's [Publications](#) page; or via chapter links below (as are other readings).

Topic	Chapter in WT&P	Lecture Number & Date	PS Due Date
I. ELASTICITIES & THE TRADE BALANCE Balance of payments accounting Supply& demand for foreign exchange	15	L1 (Jan. 25)	
Export and import elasticities	16.1	L2 (Jan. 27)	
Empirical effects of devaluation on the trade balance	16.2	L3 (Feb. 1)	
II. THE KEYNESIAN MODEL National saving identity Multipliers in an open economy	17.1-17.2 17.3-17.4	L4 (Feb. 3)	Problem Set 1 Due
Large-country repercussions & Transmission of disturbances	17.5-17.6, 18.1	L5 (Feb. 8)	
Internal & external balance Feb. 15, HOLIDAY: Presidents Day	18.2	L6 (Feb. 10)	Problem Set 2 Due
III. MONEY & THE BALANCE OF PAYMENTS Monetary policy, including at the ZLB	18.3	L7 (Feb. 17)	
Reserve flows	19.1	L8 (Feb. 22)	Problem Set 3 Due

Topic	Chapter in WT&P	Lecture Number and Date	Problem Sets Due Date
IV. Globalization of Goods & Financial Markets Goods market integration & PPP	19.2-19.4	L9 (Feb. 24) March 1: Wellness Day (No Class)	
Financial integration & forward market	21.1-21.3	L10 (March 3)	
Pros & cons of financial opening	21.4, Ch. 21 Appendix	L11 (March 8)	Problem Set 4 Due
V. Fiscal & Monetary Policy under International Capital Mobility Mundell-Fleming -- with exchange rate fixed	22.1-22.3, 22.4-22.7	L12 (March 10)	
<u>Midterm exam</u>		L13 (March 15)	
Mundell-Fleming model with floating	23.1-23.2	L14 (March 17)	
Emerging Market crises	24.1-24.5, 24.7-24.9	L16 (March 24)	
VI. Interdependence and Coordination Effects of fiscal expansion in a large country Estimates of transmission International policy coordination	25.1 25.2 25.3	L17 (March 29) March 31: Wellness Day (No Class)	Problem Set 5 Due
VII. Supply and Inflation Aggregate Supply, wages & inflation	26.1	L18(April 5)	
Rational expectations & nominal anchors	26.3-26.4	L19(April 7)	

Topic	Chapter in WT&P	Lecture Number and Date	Problem Sets Due Date
Exchange rate regimes	26.5-26.6	L20(April 12)	
Case study: macroeconomics in China		L21(April 14)	Problem Set 6 Due
VIII. Expectations and Exchange Rate Models Interest parity conditions	27.1	L22(April 19)	
The monetarist/Lucas model	27.2-27.3	L23(April 23)	
The overshooting model and forecasting	27.4-27.6 28.1	L24(April 26)	Problem Set 7 Due
Risk & portfolio diversification	28.1-28.4	L25(April 28)	
<u>Final exam</u> : Wednesday, May 12 at 2 pm EST.			

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. It is available via the [Coop](#); or at the professor's [Publications](#) page; or via chapter links below (as are other readings).

Links to readings listed below are available 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) [WTP Ch.15](#)**

[“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.*

“China Concerns: [Tourism deficit leaves current account vulnerable to trade shock,](#)” *Financial Times*, June 14, 2018.**

[“Pakistan’s economy: In need of re-stitching,”](#) *The Economist*, June 16, 2018.*

[“A milder infection: The Philippine peso is the champion of emerging-market currencies,”](#) *The Economist*, July 23, 2020. **

The Trade Balance

The Effect of Currency Depreciation on the Trade Balance (Lectures 2-3) [WTP Ch.16](#) **

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

[“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 (Lect. 4)

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.

Keynesian Multipliers (L5-6) [WTP 17](#) ** & **Mundell-Fleming Model** (L12-15) [WTP 22-23](#) **

Ethan Ilzetzki, Enrique Mendoza, & Carlos Vegh, 2013, "[How Big \(Small?\) Are Fiscal Multipliers?](#)" *JME*, 60(2), 239-254. NBER WP 16479 or IMF WP 1152. [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 WP 13-1](#).

[“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,”](#) *FT*, June 16, 2017. *

[“Argentine businesses battle to survive 40% interest rates,”](#) *Financial Times*, June 11, 2018. *

[“Japan’s economic troubles offer a glimpse of a sobering future,”](#) *The Economist*, Dec.7, 2019. **

Money, the Balance of Payments & the Bretton Woods System (L8) [WTP 18](#) **

[“The global monetary system: Not floating, but flailing,”](#) *The Economist*, July 5, 2014.

[“What comes after Bretton Woods II? The world’s monetary system is breaking down,”](#) *The Economist*, Aug. 15, 2019.*

The Globalization of Goods and Financial Markets

Purchasing Power Parity (L9) [WTP 19](#)

[The Big Mac index: Interactive Currency Comparison Tool](#) [updated twice a year] **

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

The Growth of Forex Trading and Other Financial Markets (L10)

[“Finance: Trick or Treat?”](#) *The Economist*, Oct. 23, 1999.

[“Future Perfect,”](#) *The Economist*, Nov. 27, 1999. *

Pros and Cons of Open Financial Markets (L11) [WTP 21](#) **

[“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.

[“Economics Focus: Capital Bonanzas,”](#) [Summary of Reinhart & Reinhart] *Economist*, Sept.27, 2008. **

[“Capital controversy,”](#) *The Economist*, April 14, 2012.

[“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 (L15)

Maurice Obstfeld and Alan Taylor, 2017 [“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 (L16) [WTP 24](#) ** [Optional: [WTP 20](#)]

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

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

[“Brazil’s economy: Wild horses – A soaring currency...”](#) *The Economist*, Apr. 23, 2011.

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

[“Asia’s great moderation,”](#) *The Economist*, Nov. 10, 2012.

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

[“Emerging markets debt: The well runs dry,”](#) *The Economist*, March 5, 2016. p.65-67.

[“Emerging markets face a dollar double whammy,”](#) Urjit Patel, *Financial Times*, June 4, 2018.*

[“Lira plunges as rates freeze raises fears over Erdogan’s economic role,”](#) *Financial Times*, July 25, 2018.*

[“Investors Are in Retreat, and the Poorest Countries Are Paying for It”](#) *NY Times*, Dec. 20, 2018. **

The Global Macroeconomic System (L17) [WTP 25](#) **

J.Frankel, 2016, "[International Coordination,](#)" *for Policy Challenges in a Diverging Global Economy*, R. Glick & M. Spiegel, eds. (Federal Reserve Bank of San Francisco). 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 (L18) [WTP 26](#)

- [“Some like it hot: Which emerging economies are at greatest risk of overheating?”](#) *The Economist*, July 2, 2011.**
- [“Argentina’s inflation problem: The price of cooking the books,”](#) *The Economist*, Feb.25, 2012.
- [“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.*
- [“India’s central bank faces a major test of its independence,”](#) *The Economist*, Nov 3rd 2018.*

Case Study: Recent Macroeconomic Policy in China (L21)

- 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 (L20)

- Jay Shambaugh, 2012, "[The Euro’s Three Crises](#),” *BPEA*, Spring, 157-211. [Summary](#).
- Jürgen Stark, "[German prudence is not to blame for the eurozone's ills](#),” *Financial Times*, Feb.11, 2015.*
- [“Making sense of West Africa’s new currency](#),” *The Economist*, January 4, 2020.***
- Alain Faujas, “Unpacking West Africa’s transition to the Eco,” [The Africa Report](#), Jan. 6, 2020.
- Or [Jeune Afrique](#).*

Monetary Determination of Exchange Rates (L22-L24) [WTP 27](#)

- Schools Brief: "[Monopoly Power Over Money](#),” *The Economist*, Nov.18, 1999.*
- “Venezuela -- [The half life of a currency](#): Hyperinflation is hard to grasp,” *The Economist*, 9/13/2018.
- [“Rudiger Dornbusch](#),” *The Economist*, Aug. 10, 2002, p. 72.
- [“One-way baht: For 15 years two currencies have outperformed all others](#),” *The Economist*, Dec. 7, 2019. **

The Carry Trade and Risk (L25) [WTP 28](#)

- J. Frankel, 2008, "[Carried Away](#),” *Milken Institute Review Q1*, pp.38-45.
- [“Debt dilemma: Emerging countries seek action to avert crisis](#),” *Financial Times*, Dec. 20, 2020.