

Topics in Finance: International Macroeconomics

Class: MF 2015
Management 495 — Spring 2015

April 3, 2015

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DESCRIPTION

This course extends insights from financial economics to examine the macroeconomy in an international setting. The course covers the exchange rate and the current account, and relates their determination to world capital markets and the domestic macroeconomy. The course balances a business cycle perspective on short-term macroeconomic adjustment with a real-side perspective on the long-term evolution of the macroeconomy. The real-side view is bundled in three groups of lectures (lectures 1&2, 8&9 and 17-19) and offers the long-term foundation. On the monetary side (lectures 3-7 and 10-16), the course discusses economic policies and their effects under different exchange rate regimes—ranging from floating rates to fixed rates to monetary unions—and presents implications for the current account and the economy as a whole.

The first part of the course invokes economic principles of finance to develop an asset pricing approach to the nominal exchange in the short run and builds on versions of the principle of no arbitrage in global markets for goods and services (purchasing power parities) to determine the real exchange in the long run. The second part of the course then postulates plausible aggregate relationships to characterize current account and output fluctuations and assesses their dependence on the nominal exchange in the short run and the real exchange in the long run. A final part of the course turns to current policy topics including past and recent global financial crises, the Great Recession of 2008, as well as causes and consequences of prevailing global imbalances.

OBJECTIVES

After completion of this course, you will be able to:

- Understand the identity of a country's net export outflows and its net capital outflows.
- Relate production (investment) and consumption (savings) decisions to net exports and capital flows.
- Assess how global capital markets help economies realize gains from trading resources over time.
- Use parity conditions on financial returns to determine the nominal exchange rate.
- Use parity conditions on the purchasing power of residents to determine the real exchange rate.
- Relate the objectives of internal balance and external balance to monetary regimes in history.
- Explain how household consumption typically responds to transitory changes in disposable income, how business investment typically responds to transitory changes in interest rates and aggregate demand, how the current account responds to transitory changes in disposable income and to the real exchange rate, and how therefore gross domestic product relates to disposable income and the real exchange rate.
- Describe why an appreciated real exchange rate relates to higher gross domestic product in financial markets and why a depreciated real exchange rate relates to higher output of goods and services in real-side markets.
- Analyze temporary and permanent monetary and fiscal policies under alternative exchange-rate regimes.
- Trace financial crises to government policies, speculative attacks, or financial disintermediation.
- Discuss economic rationales for sovereign debt risk, debt management, buybacks and forgiveness.
- Assess financial and macroeconomic conditions for current account sustainability.

MATERIALS

Lecture notes become available online at econ.ucsd.edu/muendler/teach/15s/495 before each lecture.

Textbook (required): Krugman, Obstfeld, and Melitz (2015)

Textbook supplement (required): Muendler (2014)/Ch. 1, 3, 14 and 20

Background Readings (recommended): Ardagna and Caselli (2014); Caballero, Farhi, and Gourinchas (2008); Calvo and Reinhart (2002); Diamond and Dybvig (1983); Duffie (2010); Greenspan (2010); Spolaore (2013); Stiglitz (2000); Zettelmeyer, Trebesch, and Gulati (2013)

The textbook is available for purchase from the bookstore.

The textbook supplements are chapters from my own textbook Muendler (2014)/Ch. 1, 3, 14 and 20, which is under development with Pearson. The chapters will be available for viewing via Ted prior to the respective lectures. Further textbook supplements may or may not become available throughout the quarter.

The readings (articles) help you review the lecture material beyond the textbook. They are available through the course web page (see link above). Web links to copyrighted readings only work from on-campus domains.

COURSE SCHEDULE

I. Open-economy Macroeconomics

- 1. Tue, March 31:** Introduction to Open-economy Macroeconomics
(Krugman, Obstfeld, and Melitz 2015/Ch. 1 and 2; Muendler 2014/Ch. 1 and 14)
- 2. Tue, March 31:** International Capital Market Integration
(Krugman, Obstfeld, and Melitz 2015/Ch. 2; Muendler 2014/Ch. 14)

II. Exchange Rate Determination

- 3. Tue, April 7:** International Monetary Systems, Past and Present
(Krugman, Obstfeld, and Melitz 2015/Ch. 8)
POLICY DISCUSSION ASSIGNMENT 1 OUT
 - 4. Tue, April 7:** Exchange Rates and Foreign Exchange Markets
(Krugman, Obstfeld, and Melitz 2015/Ch. 3)
 - 5. Tue, April 14:** An Asset Approach to the Exchange Rate
(Krugman, Obstfeld, and Melitz 2015/Ch. 3)
 - 6. Tue, April 14:** A Monetary Approach to the Exchange Rate
(Krugman, Obstfeld, and Melitz 2015/Ch. 4)
 - 7. Tue, April 21:** Monetary Policy and Exchange Rate Determination
(Krugman, Obstfeld, and Melitz 2015/Ch. 4)
 - 8. Tue, April 21:** Purchasing Power Parity and the Monetary Approach
(Krugman, Obstfeld, and Melitz 2015/Ch. 5)
- Mon, April 27, 6:00-7.30p:** *Policy Discussion Assignment 1 review section* (room 1E107)
- 9. Tue, April 28:** Purchasing Power Parity and the Real Exchange Rate
(Krugman, Obstfeld, and Melitz 2015/Ch. 5, Muendler 2014/Ch. 3)
POLICY DISCUSSION ASSIGNMENT 1 DUE

III. Exchange Rate and Current Account Determination

- 10. Tue, April 28:** Flexible Exchange Rates and Output in the Short Term
(Krugman, Obstfeld, and Melitz 2015/Ch. 6; Muendler 2014/Ch. 20, sections 1 and 2)
- Mon, May 4, 6:00-8:00p:** *Midterm review section* (room 1E107)
- Tue, May 5, 9:00a - 10:20a:** MIDTERM (80 minutes)
covering lectures 1 through 10,
Krugman, Obstfeld, and Melitz (2015)/Ch. 1 through 5 (ch. 8 will be on the final); Muendler 2014/Ch. 1, 3 and 14 (ch. 20 will be on the final)
- 11. Tue, May 5:** Policy under Floating Exchange Rates
(Krugman, Obstfeld, and Melitz 2015/Ch. 6; Muendler 2014/Ch. 20)
POLICY DISCUSSION ASSIGNMENT 2 OUT

- 12. Tue, May 12:** Managed and Fixed Exchange Rates
(Krugman, Obstfeld, and Melitz 2015/Ch. 7)
- 13. Tue, May 12:** Policy under Managed Exchange Rates
(Krugman, Obstfeld, and Melitz 2015/Ch. 7; Calvo and Reinhart 2002)
- Wed, May 13:** *Online review:* International Monetary Policy (Historic Review with Model and Exercises)
(Krugman, Obstfeld, and Melitz 2015/Ch. 8)

Mon, May 18, 6:00-7:30p: *Policy Discussion Assignment 2 review section* (room 1E107)

- 14. Tue, May 19:** Optimum Currency Areas
(Krugman, Obstfeld, and Melitz 2015/Ch. 10; O'Rourke and Taylor 2013, Spolaore 2013)
POLICY DISCUSSION ASSIGNMENT 2 DUE

IV. Management of International Financial Relations

- 15. Tue, May 19:** Currency Crises
(Krugman, Obstfeld, and Melitz 2015/Ch. 9; Stiglitz 2000)
POLICY DISCUSSION ASSIGNMENT 3 OUT
- 16. Tue, May 26:** Banking and Debt Crises
(Diamond and Dybvig 1983; Duffie 2010; Greenspan 2010)
- 17. Tue, May 26:** International Capital Flows and Sovereign Risk
(Krugman, Obstfeld, and Melitz 2015/Ch. 9 and 11; Muendler 2014/Ch. 16 *if ready*)
- 18. Tue, June 2:** Debt Overhang, Debt Buybacks and Debt Forgiveness
(Krugman, Obstfeld, and Melitz 2015/Ch. 9 and 11; Muendler 2014/ch. 17 *if ready*)
(Ardagna and Caselli 2014, Zettelmeyer, Trebesch, and Gulati 2013)
- 19. Tue, June 2:** Current Account Sustainability
(Krugman, Obstfeld, and Melitz 2015/Ch. 11; Muendler 2014/ch. 17 *if ready*; Caballero, Farhi, and Gourinchas 2008)

Wed, June 3, 6:00-7:30p: *Policy Discussion Assignment 3 review section* (room 4N128)

Fri, June 5, 6:00-8:00p: *Final review section* (room 1E107)
POLICY DISCUSSION ASSIGNMENT 3 DUE

Tue, June 9, 9:00a-11:00a: FINAL EXAM (120 minutes)
covering lectures 1 through 19,
Krugman, Obstfeld, and Melitz (2015); Muendler (2014)/Ch. 1, 3, 14 and 20; and Ardagna and Caselli (2014), Caballero, Farhi, and Gourinchas (2008), Calvo and Reinhart (2002), Diamond and Dybvig (1983), Duffie (2010), Greenspan (2010), Spolaore (2013), Stiglitz (2000), Zettelmeyer, Trebesch, and Gulati (2013)

ASSIGNMENTS AND DELIVERABLES

There are two types of assignments and deliverables:

I Independent, individual work only. No collaboration or consultation allowed.

C Collaboration with classmates is allowed. However, each student must submit a deliverable.

(There is no type “G” in this course.)

Policy discussion assignments: C

There will be three policy discussion assignments, due on scheduled dates throughout summer session. The assignments will ask you to provide recommendations to policy makers or businesses facing specific macroeconomic circumstances. You are encouraged to work on the assignments with your classmates. Your teaching assistant will hold sections over the course of the quarter to help you approach the assignments, and you can receive assistance during any of the scheduled office hours.

Your solutions to the policy discussion assignments will be checked by question (check/no check) and your performance on them will be a part of the final grade. The first policy discussion assignment will have eight questions, the latter two will have six questions each. Well crafted and correct answers count five points per question. Collaboration with classmates is allowed. However, each student must submit a personal deliverable.

Your teaching assistant Deborah Watkins will offer three review sections to help you approach the policy assignments. Policy Discussion Assignments 1 and 2 have to be handed in *on paper before 9:00a* on the respective due dates (4/28 and 5/19/2015), Policy Discussion Assignment 3 has to be handed in *on paper before 5:00p* on the due date (6/5/2015). You can hand in the policy discussion assignments prior to the start of lecture.

Exams: I

There will be one midterm exam and a final exam. The midterm exam will take 80 minutes and the final exam will take 120 minutes (no extra time). The final exam is cumulative. The midterm exam contains eight 10-minute questions, the final exam contains twelve 10-minute questions.

There will be review sections to help you prepare for the exams.

During exams, only a pen, a pencil, a ruler and an eraser are permitted for use. No other material is permitted. No collaboration with classmates is allowed. Each student must submit a personal exam. Principles of academic honesty are strictly applied.

GRADING POLICY

Your final raw score will be your total points from the three exams and the three policy discussion assignments:

Policy Discussion Assignments:	100 points (40+30+30 points)	4/28, 5/19, 6/5/2015
Midterm (80 minutes):	80 points	5/5/2015
Final (120 minutes):	120 points	6/9/2015
<i>Total:</i>	300 points	

Your final *letter grade* will be inferred from the typical grade distribution (curve) in *management* classes at UC San Diego’s Rady School of Management. To achieve fairness in grading and uniformity in grading across

courses, the Rady faculty in core courses have agreed to the following grade distribution, which is used for final (course) grades: *A* 15%, *A-* 20%, *B+* 30%, *B* 20%, *B-* (or below) 15%. Under this curve, the difficulty or simplicity of policy discussion assignments and exams will not matter, whereas your relative performance in comparison to your classmates will determine your final letter grade.

Grades that may be awarded to the bottom 15% include *B-*, *C+*, *C*, *C-* and *F*. A student who does not achieve minimum mastery of the material will be given an *F*. For this course, minimum mastery will lie at a threshold of around 140 points in the final raw score. It is not my, or any instructor's, desire to fail a student. Note that 100 points out of the minimum 140 threshold can be earned on the policy discussion assignments alone; and you can pre-check your policy discussion draft in the according review section prior to the due date. However, you will be in danger of failing if you do not put sufficient time and effort into your studies.

Questions about the grading of any exam or assignment, including (but not limited to) requests for regrading, must be made within one week of when the graded exam or graded assignment is returned. All questions must be in writing.

COURSE POLICIES

Participation in exams is mandatory and excused only under the conditions that also permit an incomplete grade: course work must be of non-failing quality and absence must be for a cause beyond the student's control. In particular, the incidence of other exams on the same day is no reason for an excuse from the exam. Under its current rules, Student Health Services offers access to medical excuses that document illness only under extreme circumstances (severe, prolonged illness that necessitates dropping a class or obtaining specific accommodations for class/lab participation, test taking or make-up). To be excused from the midterm because of illness, the student must inform the instructor *before* the midterm exam. To be excused from the final exam, however, the illness must be sufficiently severe so that Student Health Services or another health-care provider does document the illness.

Appeals of scores on exams or policy discussion assignments must be submitted in writing, along with all prior exams and policy discussion assignments. Following the appeal, all questions on all exams and assignments will be reconsidered. An appeal may be denied if the exam was written with a pencil.

ACADEMIC INTEGRITY

Integrity of scholarship is essential for an academic community. As members of the Rady School, we pledge ourselves to uphold the highest ethical standards. The University expects that both faculty and students will honor this principle and in so doing protect the validity of university intellectual work. For students, this means that all academic work will be done by the individual to whom it is assigned, without unauthorized aid of any kind.

The complete UC San Diego Policy on Integrity of Scholarship can be viewed at: senate.ucsd.edu/manual/appendices/appendix2.pdf.

STUDENTS WITH DISABILITIES

A student who has a disability or special need and requires an accommodation in order to have equal access to the classroom must register with the Office for Students with Disabilities (OSD). The OSD will determine what accommodations may be made and provide the necessary documentation to present to the faculty member.

The student must present the OSD letter of certification and OSD accommodation recommendation to the appropriate faculty member in order to initiate the request for accommodation in classes, examinations, or other academic program activities. No accommodations can be implemented retroactively.

Please visit the OSD website for further information or contact the Office for Students with Disabilities at (858) 534-4382 or fosorio@ucsd.edu.

References

- ARDAGNA, S., AND F. CASELLI (2014): "The Political Economy of the Greek Debt Crisis: A Tale of Two Bailouts," *American Economic Journal: Macroeconomics*, 6(4), 291–323.
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- KRUGMAN, P. R., M. OBSTFELD, AND M. J. MELITZ (2015): *International Finance: Theory and Policy*. Pearson, Boston, 10th edn.
- MUENDLER, M.-A. (2014): "The Economics of Globalization," University of California, San Diego, unpublished textbook manuscript.
- O'ROURKE, K. H., AND A. M. TAYLOR (2013): "Cross of Euros," *Journal of Economic Perspectives*, 27(3), 167–92.
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- ZETTELMEYER, J., C. TREBESCH, AND M. GULATI (2013): "The Greek Debt Restructuring: An Autopsy," *Economic Policy*, 2013(75), 513–55.