

ECON 382
Junior Research Seminar: International Macroeconomics

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Course Web site: In Moodle

Class time: Tuesdays-Thursdays 1-2:30pm – STO 102

Office hours: Chase 217 - Mondays-Tuesdays-Thursdays 3-5pm or by appointment

COURSE DESCRIPTION

This course covers fundamental issues in international money and finance and open economy macroeconomics. We will learn about balance of payments, foreign exchange rates, interest and purchasing power parity. We will also study the effects of fiscal and monetary policy in an open economy. The research component of the course will focus on international financial markets data to understand how crises are transmitted internationally and how banking, debt and currency crises are related to each other. Here we will also draw lessons from past crises in world history including East Asia in the 1990's, Mexico in 1994, Russia in 1998, and Latin America in the early 2000's.

LEARNING OBJECTIVES AND GOALS

Having completed this course, the student should be able to:

- 1) Explain the market mechanism through which the equilibrium interest rate is determined in an open economy.
- 2) Explain the market mechanism through which the equilibrium exchange rate is determined in a flexible exchange rate system.
- 3) Explain how fixed exchange rate regimes work.
- 4) Discuss the effects of fiscal policy in an open economy, including those on interest rates, exchange rates, capital flows, the trade balance and the current account.
- 5) Discuss the effects of monetary policy in an open economy, including those on interest rates, exchange rates, capital flows, the trade balance and the current account.
- 6) Explain how these effects differ across types of exchange rate regime.

REQUIRED TEXTBOOK

Krugman, Obstfeld and Melitz, “International Finance: Theory and Policy”, 10th edition or newer. **(KOM)**

GRADING POLICY AND COURSE RULES

- 1) Your course grade will be computed as follows: Homework assignments (20%), 2 midterm exams (20% each), research component (40% - more details below). Class participation is not specifically graded but of course encouraged and expected.
- 2) There are 4 homework assignments. Homework is due in class at the beginning of the lecture time. Late homework will not be accepted. If an assignment is submitted late, it will take a 50% penalty in the grade. Assignments should be hard copies. Electronic versions by email won't be accepted.
- 3) Homework due dates will be assigned during the term based on the timing of lectures. Tentative dates are now available in the calendar on Moodle.
- 4) The midterm exams might be combinations of multiple choices, short answers and mathematical questions.

COURSE OUTLINE

National income accounting and the Balance of Payments

- National accounts: GNP, GDP and their components
- Savings, investment, the current account and net foreign wealth
- Balance of Payments accounts: the current account, the financial account and the capital account.
- Official reserve assets or international reserve assets.

Textbook chapter: chapter 2 KOM.

Exchange Rates and the Foreign Exchange Market: An Asset Approach

- Definition of exchange rates.
- Appreciation and depreciation.
- Foreign exchange markets: participants.
- Spot and forward rates.
- The demand for foreign currency deposits and uncovered interest parity (UIP).
- Determination of the equilibrium exchange rate according to the asset approach.
- Effects of changes in domestic and foreign rates, and in expected appreciation.
- Covered interest parity (CIP).

Textbook chapter: chapter 3 KOM.

Money, Interest Rates and Exchange Rates

- The money market: supply, demand and equilibrium interest rate.
- Simultaneous equilibrium in the money market and the foreign exchange market.
- Effects of changes in domestic and foreign money supply.
- Short-run and long-run effects: exchange rate overshooting.

Textbook chapter: chapter 4 KOM.

MIDTERM EXAM #1 – February 21st

Price Levels and the Exchange Rate in the Long Run

- Law of One Price.
- Purchasing Power Parity: Absolute PPP and relative PPP.
- Monetary approach to the determination of exchange rates: short-run and long-run.
- The Fisher effect.
- Shortcomings of PPP.

Textbook chapter: chapter 5 KOM.

Output and the Exchange Rate in the Short Run

- Equilibrium in goods markets – derivation of the DD schedule.
- Equilibrium in asset markets – derivation of the AA schedule.
- The short-run equilibrium nominal exchange rate and output: Putting the DD and AA schedules together.
- Effects of temporary changes in monetary policy.
- Effects of temporary changes in fiscal policy.
- Effects of permanent changes in monetary policy.
- Effects of permanent changes in fiscal policy.
- Macroeconomic policies and the current account.
- Pass-through from the exchange rate to import prices.

Textbook chapter: chapter 6 KOM.

Fixed Exchange Rates and Foreign Exchange Intervention

- Foreign exchange market intervention by central banks
- Sterilization
- Response to changes in GDP and business cycle fluctuations
- Devaluations and revaluations
- Effectiveness of monetary and fiscal policy under fixed ER
- Types of fixed exchange rate systems-Currency boards – dollarization.

Textbook chapter: chapter 7 KOM.

MIDTERM EXAM #2 – April 4th

Research Component

The final term paper will be written as a part of a group project. I will divide the class in groups of 2-3 students each. Each group will do research and write a paper on one of the topics listed below.

Papers on all topics should include some empirical work.

The research component of the course includes the following elements:

a. First literature presentation (5%):

Students will be required to present a summary of their literature review on the papers selected by the instructor for each topic. Students are required to use slides in their presentation. EVERYBODY in the class is expected to contribute to the discussion.

b. Second literature presentation (5%):

See above.

c. Paper presentation (10%):

During the last two class meetings, students will present their research papers. Presentations should represent original research and be accessible and understandable to the audience of the class. Presentations should be 25 minutes long (longer time may be allowed depending on class enrollment). ATTENDANCE AT ALL RESEARCH PROJECT PRESENTATIONS IS REQUIRED.

d. Post-presentation reflection piece (5%):

Students will be required to write a one-page reflection piece related to what they learned through the research process, what the main challenges were, what strengths and weaknesses of their own that they discovered while working on the paper, what the paper encouraged them to think about as they take more classes in the future or as they prepare to write their theses.

e. Research paper (15%):

The paper will be due during final exams week. It must contain independent work. The research project as a whole, and the research paper in particular, is a semester-long process which students should begin working as soon as the semester starts. Papers should be 13-15 pages long in total including references, figures, tables and one title-abstract page (size 12 font, 1.5 line spacing, standard margins).

GROUP 1: Arguments in favor and against fixed and flexible exchange rates regimes. Fixed exchange rate regimes, financial crises and capital flight. How do these result in countries running out of international reserves? What happens afterwards? Are fixed exchange rate regimes sustainable?

First literature presentation:

Chapters 7 and 8 in KOM.

Second literature presentation:

Obstfeld and Rogoff (1995), “The Mirage of Fixed Exchange Rates”, *Journal of Economic Perspectives*, Vol. 9(4), pp. 73-96.

Additional materials:

Based on students’ own research.

Empirical component: Compare macro and financial sector indicators across fixed and flexible exchange rate countries.

GROUP 2: The Euro Zone. What is it? History. Pros and cons for a country of joining the EZ. The recent European sovereign debt crisis.

First literature presentation:

ABOUT THE EU

https://europa.eu/european-union/about-eu_en

THE HISTORY OF THE EURO ZONE

https://ec.europa.eu/info/about-european-commission/euro/history-euro/history-euro_en

Second literature presentation:

Mc Callum, B. (1999), “Theoretical Issues Pertaining to Monetary Unions”, NBER working paper #7393.

Additional materials:

Based on students’ own research.

Empirical component: Analyze macro and financial sector indicators for countries in the EZ before and after the adoption of the common currency.

GROUP 3: Liability dollarization and the problem of the “original sin”.

First literature presentation:

Chapters 9-11 in KOM.

Calvo and Reinhart, “Reflections on Dollarization” (chapter 5), **Currency Unions**, Hoover Press, Alberto Alesina and Robert Barro eds.

Second literature presentation:

Eichengreen, Hausmann and Panizza, “The Pain of Original Sin”, manuscript August 2003.

Additional materials:

Based on students’ own research.

Empirical component: Look for data on currency composition of private sector liabilities and sovereign debt. Compare these data across countries.

GROUP 4: Link between banking/financial crises and sovereign debt crises: which drives which?

First literature presentation:

Reinhart and Rogoff (2011), “From Financial Crash to Debt Crisis”, *American Economic Review*.

Reinhart and Rogoff (2009), “The Aftermath of Financial Crises”, *American Economic Review* Papers and Proceedings.

Second literature presentation:

Sosa-Padilla (2018), “Sovereign Defaults and Banking Crises”, *Journal of Monetary Economics*, forthcoming.

Gennaioli, Martin and Rossi (2018), “Banks, Government Bonds and Default: What do the Data Say?”, *Journal of Monetary Economics*, forthcoming.

Additional materials:

Based on students’ own research.

Empirical component: Analyze macro and financial sector indicators during episodes of banking and debt crises.

GROUP 5: International contagion of financial crises: How are they transmitted across countries to result potentially in a global financial crisis?

First literature presentation:

Chapters 9-11 in KOM.

Second literature presentation:

Kaminsky and Reinhart (2000), “On Crises, Contagion and Confusion”, *Journal of International Economics*, Vol. 51, pp 145-168.

Additional materials:

Based on students’ own research.

Empirical component: Analyze macro and financial sector indicators for a group of countries going through a crisis and also for their main trading partners.

GROUP 6: Lessons from past crises: East Asia in the 1990's, Mexico in 1994, Russia in 1998, Latin America in the early 2000's.

First literature presentation:

Chapters 9-11 in KOM. Crises in East Asia, Russia, Mexico and Latin America.

Second literature presentation:

Burkart and Coudert (2002), "Leading Indicators of Currency Crises for Emerging Countries", *Emerging Markets Review*, Vol. 3, pp. 107-133.

Goldfajn and Valdes (1998), "Are Currency Crises Predictable?", *European Economic Review*, Vol. 42, pp. 873-885.

Additional materials:

Based on students' own research.

Empirical component: Study macro and financial sector indicators for these countries during these crises.