

International Macroeconomics, Harvard University

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

Syllabus, Spring 2022

Staff: **Professor:** Jeffrey Frankel Jeffrey_Frankel@Harvard.edu
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Times: Live lecture Mondays-Wednesdays, 3:00-4:15 pm in L280

Review session: Fridays, 12:00 – 1:15 pm in L230.

Final exam: Wed., May 4, 2 – 5 pm

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. 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.”

Readings

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

Links to other readings listed below are also available.

- * Asterisk denotes recommended readings.
- ** Double asterisk denotes required readings.

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

Lecture date and Topic	Chapter in Textbook
I. ELASTICITIES & THE TRADE BALANCE	
Lecture 1, Jan. 24, 2022: Balance of payments accounting. Supply & demand for foreign exchange.	<u>WTP Ch.15</u> **
<p><u>"Tourism and the Trade Balance: A Number of Great Import,"</u> <i>The Economist</i>, Feb. 15, 2014.*</p> <p><u>"Beijing hails success in battle against capital flight,"</u> <i>Financial Times</i>, Aug. 8, 2017.*</p> <p>"China Concerns: <u>Tourism deficit leaves current account vulnerable to trade shock,</u>" <i>Financial Times</i>, June 14, 2018.**</p> <p><u>"A milder infection: The Philippine peso is the champion of emerging-market currencies,"</u> <i>The Economist</i>, July 23, 2020. **</p>	
Lecture 2, Jan. 26: Export & import elasticities	<u>WTP Ch.16: 16.1</u> **
<p><u>"The Other Deficit,"</u> <i>The Economist</i>, October 17, 2015 .</p> <p><u>"Pakistan's economy: In need of re-stitching,"</u> <i>The Economist</i>, June 16, 2018. *</p>	
Lecture 3, Jan. 31: Empirical effects of devaluation on the trade balance	16.2 **
<p><u>"Petri-dish economies: Poland – Few woes in Warsaw,"</u> <i>The Economist</i>, April 30, 2011. **</p> <p><u>"Swiss cheesemakers long for a stronger euro,"</u> <i>Financial Times</i>, August 1, 2017. *</p>	
Due Wed., Feb. 2. Problem Set 1: Balance of payments accounting & Trade elasticities	
II. THE KEYNESIAN MODEL	
Lecture 4, Feb.2: National saving identity; Multipliers in an open economy.	<u>WTP 17:</u> 17.1-17.2 ** 17.3-17.4. **
<p>Ethan Ilzetzki, Enrique Mendoza, & Carlos Vegh, 2013, "<u>How Big (Small?) Are Fiscal Multipliers?</u>," <i>JME</i>, 60(2), 239-254. <u>NBER WP 16479</u> or <u>IMF WP 1152</u>. <u>Summarized in NBER Digest</u>, 2011. *</p> <p>Olivier Blanchard and Daniel Leigh, 2014, "<u>Growth Forecasts Errors and Fiscal Multipliers</u>," <i>American Economic Review</i>, 103, no.3, pp. 117-12. Based on <u>IMF WP 13-1</u>. *</p> <p><u>"Chile's Economy: Cashing in the fruits of rigor,"</u> <i>The Economist</i>, Feb. 19, 2009. *</p> <p><u>"Economics focus: Much ado about multipliers,"</u> <i>The Economist</i>, Sept. 26, 2009.</p>	

Lecture 5, Feb.7: Large-country repercussions; Transmission of disturbances	17.5-17.6. ** WTP 18: 18.1 **
"Fiscal Multipliers: Where does the buck stop?" <i>The Economist</i> , Aug. 13, 2016. * "US stimulus and strong remittances give boost to Mexico," <i>Financial Times</i> , June 17, 2021.	
Due Wed., Feb. 9. Problem Set 2: Keynesian model	
Lecture 6, Feb. 9: Internal & external balance	WTP 18: 18.2 **
III. MONEY & THE BALANCE OF PAYMENTS	
Lecture 7, Feb. 14: Monetary policy, including at the Zero Lower Bound	WTP 18: 18.3 **
Due Wed., Feb. 16. Problem Set 3: Internal & external balance	
Lecture 8, Feb. 16: Reserve flows	19.1 **
"The global monetary system: Not floating, but flailing," <i>The Economist</i> , July 5, 2014. "What comes after Bretton Woods II? The world's monetary system is breaking down," <i>The Economist</i> , Aug. 15, 2019.*	
IV. Globalization of Goods & Financial Markets	
Lecture 9, Feb.23: Goods market integration & PPP	WTP 19: 19.2-19.4 **
The Big Mac index: Interactive Currency Comparison Tool [updated twice a year] ** Michael Pakko and Patricia Pollard, 2003, " Burgernomics: A Big Mac Guide to Purchasing Power Parity, " Federal Reserve Bank of St. Louis <i>Review</i> , Nov/Dec., 9-28.	
Due Mon., Feb. 28. Problem Set 4: Purchasing Power Parity	
Lecture 10, Feb.28: Financial integration. The forward market	WTP 21: 21.1-21.4 **
"Finance: Trick or Treat?" <i>The Economist</i> , Oct. 23, 1999. "Future Perfect," <i>The Economist</i> , Nov. 27, 1999. * Carmen Reinhart & Kenneth Rogoff, 2004, " Serial Default And The 'Paradox' Of Rich-To-Poor Capital Flows, " <i>American Economic Review</i> , May, 53-58.	

Lecture 11, March 2: Pros & cons of financial opening	WTP 21 : 21.5 & Appendix **
<p>“Policing the frontiers of finance – Is foreign capital a luxury that poor countries can live without?” [Summary of Rodrik & Subramanian], <i>The Economist</i>, Apr. 12, 2008.</p> <p>“Capital Bonanzas,” [Summary of Reinhart & Reinhart] <i>The Economist</i>, Sept.27, 2008. **</p> <p>“Capital controversy,” <i>The Economist</i>, April 14, 2012.</p> <p>“An on-off relationship,” <i>The Economist</i>, Dec. 13, 2014. *</p>	
V. Fiscal & Monetary Policy under International Capital Mobility Lecture 12, March 7: The Mundell-Fleming model -- with exchange rate fixed	WTP 22 : 22.1-22.3, 22.4-22.7 **
13, March 9: Midterm exam	
Lecture 14, March 21: Mundell-Fleming model with floating	WTP 23 : 23.1-23.2 **
<p>“Hot money flows into Argentine peso spook President Macri,” <i>Financial Times</i>, May 27, 2016.</p> <p>“Swiss central bank blames strong franc as eurozone pulls away,” <i>FT</i>, June 16, 2017. *</p> <p>“Argentine businesses battle to survive 40% interest rates,” <i>Financial Times</i>, June 11, 2018. *</p> <p>“Japan’s economic troubles offer a glimpse of a sobering future,” <i>The Economist</i>, Dec.7, 2019. **</p> <p>“Emerging markets’ experiments with QE have not turned out too badly,” <i>Economist</i>, Oct.31, 2020. **</p> <p>“Erdogan’s zany monetary experiment is impoverishing Turkey,” <i>The Economist</i>, Nov.24, 2021. **</p>	
Lecture 15, March 23: Mundell-Fleming with perfect capital mobility & the Impossible Trinity	23.3-23.4 **
<p>Paul Krugman, “The Mundell Difference,” <i>VoxEU</i>, April 2021. **</p> <p>“China’s ‘trilemma’ makes it vulnerable to more shocks,” <i>Financial Times</i>, Feb. 22, 2016.</p> <p>Maurice Obstfeld and Alan Taylor, 2017 “International Monetary Relations: Taking Finance Seriously,” <i>Journal of Economic Perspectives</i>, 31, no. 3 Summer, pp. 3-28.</p>	
Lecture 16, March 28: Emerging Markets	WTP 24 : 24.1-24.5; 24.7-24.9 ** [Optional: WTP 20]
<p>G.Calvo, L.Leiderman & C.Reinhart, 1996, “Inflows of Capital to Developing Countries in the 1990s,” <i>J.Ec.Persp.</i>, Spring, 123-39.</p> <p>“Emerging-market debt: A run for your money,” <i>The Economist</i>, Aug.28, 2010.</p> <p>“Brazil’s economy: Wild horses – A soaring currency...” <i>The Economist</i>, Apr. 23, 2011. *</p> <p>“Economic epidemiology,” <i>The Economist</i>, June 16, 2012.</p> <p>“Asia’s great moderation,” <i>The Economist</i>, Nov. 10, 2012.</p>	

<p>"Financial indulgence," <i>The Economist</i>, April 5, 2014. *</p> <p>"Emerging markets face a dollar double whammy," Urjit Patel, <i>Financial Times</i>, June 4, 2018.*</p> <p>"Lira plunges as rates freeze raises fears over Erdogan's economic role," <i>Financial Times</i>, July 25, 2018.*</p> <p>"Investors Are in Retreat, and the Poorest Countries Are Paying for It" <i>NY Times</i>, Dec. 20, 2018. **</p>	
<p>Due Wed., March 30. Problem Set 5: The Mundell-Fleming model</p>	
<p>VI. Interdependence and Coordination</p> <p>Lecture 17, March 30: Effects of fiscal expansion in a large country; Estimates of transmission, International policy coordination.</p>	<p>WTP 25 **</p> <p>25.1</p> <p>25.2</p> <p>25.3</p>
<p>J. Frankel, 2016, "International Coordination," for <i>Policy Challenges in a Diverging Global Economy</i>, R.Glick & M.Spiegel, eds. (Federal Reserve Bank of San Francisco). HKS RWP 16-002. NBER WP 21878. Summary in <i>VoxEU</i>, Dec 2015. **</p> <p>"Brown and Sarkozy seek fiscal boost," <i>Financial Times</i>, December 8, 2008.*</p> <p>"Fingers in the dyke," <i>The Economist</i>, March 21, 2009. *</p> <p>"What a carry-on" Buttonwood, <i>Economist</i> Nov.21, 2015. *</p>	
<p>VII. Supply and Inflation</p> <p>Lecture 18, April 4: Aggregate Supply, wages & inflation</p>	<p>WTP 26:</p> <p>26.1 **</p>
<p>"Some like it hot: Which emerging economies are at greatest risk of overheating?" <i>The Economist</i>, July 2, 2011. **</p> <p>"Argentina's inflation problem: The price of cooking the books," <i>The Economist</i>, Feb.25, 2012.</p> <p>"China drains cash to curb inflation," <i>Financial Times</i>, Feb. 22, 2013.</p> <p>"South Korea raises rates amid inflation fears," <i>Financial Times</i>, Dec. 1, 2017.*</p>	
<p>Due Wed., April 6. Problem Set 6: International coordination</p>	
<p>Lecture 19, April 6: Rational expectations & nominal anchors</p>	<p>WTP 26:</p> <p>26.3-26.4 **</p>
<p>"Nigeria's central bank chief warns on Independence," <i>Financial Times</i>, June 7, 2012.</p> <p>"The desperation of independents: Stubbornly low interest rates may mean the end of central- bank autonomy," <i>The Economist</i>, August 6, 2016.</p> <p>"India's central bank faces a major test of its independence," <i>The Economist</i>, Nov 3rd 2018. *</p>	

Lecture 20, April 11: Exchange rate regimes	WTP 26: 26.5-26.6 **
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 ," <i>Financial Times</i> , Feb.11, 2015.* " Making sense of West Africa's new currency ," <i>The Economist</i> , January 4, 2020. *	
Lecture 21, April 13: Case study -- macroeconomics in China	
J. Frankel, 2015, " Misinterpreting Chinese Intervention in Financial Markets ," <i>China-US Focus</i> , Sept.10.	
Due Mon., April 18. Problem Set 7: The supply relationship	
VIII. Expectations and Exchange Rate Models	
Lecture 22, April 18: Interest parity; the monetary model with flexible goods prices	WTP 27: 27.1, 27.2- 27.3 **
Schools Brief: " Monopoly Power Over Money ," <i>The Economist</i> , Nov.18, 1999. * "Venezuela -- The half life of a currency : Hyperinflation is hard to grasp," <i>The Economist</i> , 9/13/2018.	
Lecture 23, April 20: Dornbusch's overshooting model	WTP 27: 27.4-27.6 **
" Rudiger Dornbusch ," <i>The Economist</i> , Aug. 10, 2002, p. 72.	
Lecture 24, April 25: Forecasting	WTP 28: 28.1 **
J. Frankel, 2008, " Carried Away ," <i>Milken Institute Review Q1</i> , pp.38-45. " One-way baht: For 15 years two currencies have outperformed all others ," <i>Economist</i> , Dec.7, 2019. **	
Lecture 25, April 27: Risk & portfolio diversification	WTP 28: 28.2-28.4 **
" Debt dilemma: Emerging countries seek action to avert crisis ," <i>Financial Times</i> , Dec. 20, 2020. *	

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** Double asterisk denotes required readings.