The Global Economy (B01.2303)

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Office Hours: By appointment

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Course Description

This class is about Macroeconomics, the sub–field of Economics that studies the evolution and the determinants of aggregate quantities such as GDP, unemployment, international trade, government debt, ... and of prices such as exchange rates, interest rates, ... Among the cool questions that macroeconomists ask are: (i) why are some countries very rich and others are very poor? (ii) what causes inflation? (iii) is international trade beneficial to everybody? (iv) does a large federal budget deficit today imply high interest rates in the future? (v) why sometimes countries plunge in devastating financial crisis?

Why should MBA students take a full semester of Macroeconomics? There was never an easier question to answer: no matter what career you chose or you are thinking about choosing, you will have to take decisions whose success depend on the future evolution of variables such as exchange rates, inflation rates, interest rates, GDP, employment, .... I have not used the expression “future evolution” by chance. In order to take sound decisions, knowing the status quo is not enough. One needs to forecast how these prices and quantities will evolve in the future. For the sake of illustration, let’s look at a couple of examples, by considering the three most common occupations of Stern graduates: finance industry, corporate job, and consulting.

Finance. Assume you work for a hedge fund investing in emerging markets. The risk–return profile of securities traded in such markets depend to a very large extent
on the growth prospect of the respective countries, both in the short– and in the
long–run. As far as the short–run is concerned, you will have to assess the likelihood
that a country will keep its exchange rate pegged to the dollar, or the chance that
it will fall in a financial crisis. With regard to the long run, you will have to gauge
whether the conditions for economic development will persist in the future.

*Corporate / Consulting.* Assume you work (or consult) for a US–based technology
company that is facing growing demand from Europe. How should the company respond? Should it build new capacity? If yes, should it locate a new plant in
Europe, or expand capacity in the United States? Conditional on choosing Europe,
which country should it invest in? Among the factors that are likely to influence
your decisions are projections about (i) the evolution of demand for your product
in Europe (how much does it depend on the dynamics of GDP?); (ii) the evolution
of exchange rates (if you locate in the US, most of your expenses are going to be
denominated in US dollars, while your revenues will be in a foreign currency); (iii)
the level of tariffs; (iv) labor market conditions; (v) taxes.

To put it differently, this course is designed in such a way that by the end of the
semester, you will be able to:

(i) Comment intelligently on global economic events and trends.

(ii) Assess and critique the opinions of market analysts and journalists. Is their
analysis based on sound theory? Is it supported by the data?

(iii) Understand the different perspectives brought to economic policy by people
around the world.

**The Stern Approach**

Macroeconomics is a “strange” field. A body of ideas that were mainstream thirty
years ago are now dismissed by the research community either because recent data
have shown them to have counterfactual implications, or because they have been
proven to be internally inconsistent. Unfortunately, these ideas still constitute the
framework upon which most journalists, analysts, and commentators base their con-
clusions and recommendations. Academic research in macroeconomics is now ad-
vancing at a very fast pace. At Stern we strive to bring its most recent developments
to the classroom, with the purpose of giving our students a competitive advantage.
We can follow this approach because the faculty itself is engaged on the frontier of
research.
Prerequisites

The class is going to be challenging and will require a substantial amount of work. Your proficiency will depend in part on your knowledge of elementary but important notions of economics, statistics, and mathematics. I encourage you to spend a couple of hours working your way through the “Mathematics Review,” a concise overview of the math tools we’ll be using.

Help

There may be times when you will need a little help. If this happens, I strongly encourage you to come to see me. If you email me, I’ll try my best to get back to you by the end of the day. You can also contact any of the teaching assistants. They are very talented and knowledgeable.

Course Materials

The course materials consist of:

- Lecture notes. There is no actual textbook. We (the Stern faculty) have prepared a comprehensive set of notes. They will be distributed to you in hard copy and posted on Blackboard.

- Other readings. To maximize your payoff from taking this class, you must read the international business press as we go along. My suggestions? The Economist and the Financial Times. Whenever you spot an article that you feel might be relevant for our class, please point it out to me.

- Slides. I will distribute them on the day I show them in class. After that, they will be available for download from Blackboard. Notice that, by definition, slides are not self–contained. I distribute them with the purpose of reducing the time devoted to note–taking.

- Deliverables. Quizzes and homework assignments will be posted on Blackboard well before they are due.

For every class meeting, you will be assigned a set of readings. It is a requirement of the course that you complete them before coming to class.
Coursework and Evaluation

- **Class attendance and participation.** Attendance is required. Your participation enhances both your and your classmates’ learning experience. You can participate both by asking some questions, and answering others. Your grade will be based on the quality (not quantity) of your contributions to class discussions.

- **Quizzes.** These are very short assignments which you’ll be able to complete on Blackboard and whose main purpose is to give you one more incentive to complete the readings before class. The due dates are indicated in the calendar. Given the the stated goal of these assignments, late submissions will not be accepted for any reason.

- **Homework.** Homework assignments constitute unique opportunities to review and apply the principles and tools developed in class. I strongly encourage you to work in team. However, remember that there are good and bad ways to work with classmates. Tackle all the problems on your own and then discuss them with your colleagues: good. Split the problems in such a way that you do not actually see most of them: bad. You are required to hand in your assignments electronically, through Blackboard (select “Submit Homework”). If you work with others, please hand in only one copy of the solution, noting the names of the authors on the first page. The due dates are indicated in the calendar.

- **Exams.** There will be a midterm and a final exam. Both will last 80 minutes, will be closed–book, and will be based on all the material covered to date. The midterm will be held in class (the dates are specified in the calendar). You are allowed to bring a double–sided prepared sheet and a calculator. The final will be a take–home test, to be taken at a time of your choice during the last week of class (the exact time windows are May 4 - May 7 for section 30 and April 30 - May 3 for section 32). Prior to each exam, you will be assigned a practice exam.

- **Re–grading.** Any request of re–grading must be advanced to me (not to the TAs) no later than one week after the assignment or exam is returned to the class.

Your grade for the course will be based on your performance on all of these deliverables, weighted as follows:

- Quizzes (Best 8 of 11) 5%
- Class Participation 10%
- Homework (Best 4 of 5) 25%
- Midterm Exam 30%
- Final Exam 30%
Final grades will follow the School’s guideline for core courses: no more than 35% of the class will receive an A or A−. This guideline was introduced several years ago at the request of students, who wanted to make sure that different sections of the same course would be graded to the same standard.

Honor Code

At Stern we believe that honesty and integrity are necessary for a rewarding educational experience. These qualities form the basis for the strong trust among members of the community (students, faculty, and administrators) that is essential for educational excellence. The Honor Code requires each student to act with integrity in all academic activities and to hold his or her peers to the same standard.

In this course, you may discuss assignments with anyone – in fact, we encourage it – but any written work submitted for a grade should be your own. On exams, you may bring in and consult one piece of paper with anything on it you like (letter size, both sides), but your answers should be entirely your own work.

We also hold ourselves to a high standard of professional behavior. Accordingly, lateness, using cell phones, holding private conversations, using your laptop for anything but note-taking, and indeed any behavior that disrupts me or your colleagues will be considered inappropriate. Repeated violations of this standard will affect your participation grade.

Blackboard™

By now you are probably familiar with the course management software Blackboard. During the term, you will be able to use it to view all classes (I will post links to the streaming videos), download notes, slides, readings, and homework assignments, deliver your solutions to the problem sets (.pdf, .doc, .xls formats only), email your classmates and me, send me anonymous feedback, and check your grades in a confidential manner. Whenever I post a new item, I will announce it via email. I will also post on Blackboard answers to frequently asked questions about any aspect of the course.

Disability

If you have a qualified disability and will require academic accommodation during this course, please contact the Moses Center for Students with Disabilities (CSD, 998–4980) and provide me with a letter from them verifying your registration and
outlining the accommodations they recommend. If you will need to take an exam at the CSD, you must submit a completed Exam Accommodations Form to them at least one week prior to the scheduled exam time to be guaranteed accommodation.

Feedback

Your feedback is very important to me. Your comments, suggestions, and critiques, on every aspect of the class, are welcome at any time during the term. You can address them to me in the form you prefer: on person, via the block leaders, by email, or by snail mail. Finally, by clicking on Blackboard’s button “Feedback,” you will be directed to a feedback form that allows you to send me your comments and suggestions in an anonymous fashion.

If you find out you like macroeconomics

Don’t worry, many have had the same problem and gone on to lead productive and financially rewarding lives. Even better, you can pursue your interest in electives that build on the material in this course. Professor Nouriel Roubini teaches the enormously popular International Macroeconomic Policy, which includes a terrific review of emerging market crises. Professors Lars Ljungqvist and Thomas Sargent teach Advanced Macroeconomics, which shows how recent theoretical advances in macroeconomics give us a deeper understanding of hyperinflation, social security systems, capital taxation, and unemployment. Student reaction last year was extraordinary. Professors Richard Sylla and George Smith teach popular economic history courses, including The Development of Financial Institutions and Markets. Professor Paul Wachtel teaches Monetary Policy, Banks and Central Banks, which focuses on central bank policy worldwide. It’s great background for anyone working in capital markets.
Topics

Measurement in Macroeconomics

1. What really is the Gross Domestic Product?
2. How does GDP relate to people’s income?
3. What is the Current Account?
4. How accurate is GDP as measure of a country’s well-being?
5. What is inflation?
6. How do we measure inflation?
7. What is the Purchasing Power Parity adjustment?

Economic Development

1. How different is economic development across countries?
2. What are the ingredients in the process of economic growth?
3. How do we measure the contribution of the various ingredients?
4. What is the role of saving and investment in the process of economic growth?
5. What is the role of population growth in the process of economic growth?
6. Is growth in total factor productivity a necessary condition for perpetual economic growth?
7. What are the main determinants of Total Factor Productivity?

Labor Markets

1. Which are the main indicators of labor market performance?
2. Are labor market outcomes very different around the world?
3. What are the main determinants of labor market performance?
4. What is Employment Protection Legislation?
5. What are workfare programs?
6. What is flexicurity?

International Trade

1. What are the determinants of trade patterns?
2. Is trade beneficial for all countries?
3. Are gains uniformly distributed across countries?
4. In each country, does everybody gain?
5. How do governments hinder international trade?
6. Is there any rationale at all for limiting trade?

Business Cycles

1. What is the Business Cycle?
2. How do major aggregate variables comove with the Business Cycle?
3. Are Business Cycles predictable?
4. How can we forecast growth in GDP and other aggregate quantities?

Fiscal Policy

1. What are the effects of an increase in government expenditures?
2. What are the effects of a deficit–financed tax cut?
3. Do large budget deficits imply high real interest rates in the future?

Monetary Policy

1. What is the difference between commodity money and fiat money?
2. What’s the long-run relationship between money and inflation? Does monetary policy have any long-run effect on real quantities (read: GDP)?

3. What do we mean by deficit monetization?

4. What is seignorage?

5. Why do hyperinflations occur?

6. How do central banks (try to) control the quantity of money in circulation? That is: how do they implement monetary policy?

7. What are the objectives of monetary policy?

8. How does the Fed try to accomplish those objectives?


**International Capital Flows**

1. What is the Balance of Payments?

2. What is the Current Account?

3. What is the relation between Current Account, Foreign Debt, and Budget Deficit?

4. Is a Current Account deficit necessarily harmful?

5. What are currency exchange rates?

6. What are the defining characteristics of the various exchange rate regimes?

7. What drives exchange rates in the long-run?

8. Can we forecast short-run movements in exchange rates?