

Anderson Graduate School of Management
UCLA

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MGMT 406
THE GLOBAL ECONOMY
Fall 2006

The purpose of this course is to provide an analytical framework for understanding changing macroeconomic conditions in the world economy. Having this type of knowledge is fundamentally important for decision makers and business leaders.

Issues related to economic growth, inflation, interest rates, Fed actions, exchange rates determination, global competitiveness, unemployment and the trade account will be explored.

At the end of the course it is expected that students will be able to critically assess how possible developments in the world economy -- such as the change in the monetary policy stance by the *European Central Bank* or the *Federal Reserve*, for example -- will affect the business environment relevant to their specific industry.

This course is eminently practical; concepts and models will only be discussed to the extent that they have direct bearing in the understanding of real life situations.

I expect that all students will actively participate in class discussions.

I have assigned one book and several articles for this class. As you will soon find out, the lectures usually **will not** follow the textbook closely. This is absolutely and completely **deliberate**. In fact, one of the strong aspects of this course is that readings are designed to be a complement to the lectures, and not a substitute.

I will distribute investment bank research reports and additional readings in "real time." This will allow us to discuss current global macroeconomic developments as they unfold. Reading these reports and additional articles is required.

Grading Policy

- There will be two exams.
- Several (group) homework assignments.

The final grade will be determined in the following way:

- Midterm 20% (Monday, November 6)
- Final 50% (Monday, December 11)
- Class Participation 10%
- Homework 20%

If you are unable to take the midterm, the final exam will count for 70% of the grade.

I will not “cold call” on you, but I expect everyone to participate actively in class discussions. Class participation will be critical in determining the fate of marginal grades cases.

Homework

There will be four to five homework assignments. Although these are group assignments, I urge all members of the group to participate in these projects.

Office Hours

My office is located in C-508, and my phone number is 206-6797. My E-mail address is sedwards@agsm.ucla.edu.

The TA is Christine Richmond. She can be reached at 825-8207, or through her E mail address: christine.richmond.2010@anderson.ucla.edu.

T.A. Office hours: TBA.

Organization of the Course and Syllabus

The course is organized in several “modules.” Each module covers a specific set of concepts and tools. Modules do not necessarily correspond to specific sessions. Covering some modules may take more than one session, covering other modules may only take part of a session. The time devoted to each module is not pre-determined; it depends on how the class proceeds, on how many questions students have and how many current applications we discuss.

Required readings:

There is one textbook:

David Miles and Andrew Scott, ***Macroeconomics and the Global Business Environment***, Second Edition, John Wiley & Sons, Inc. (M)

There are also a number of readings. All of them can be downloaded from the web.

Students are also responsible for reading the **Financial Times**. We will discuss many of the articles in the FT. If you decide not to subscribe to it, make sure that you read it in the library or that you borrow it from someone.

COURSE OUTLINE

In what follows I provide a detailed outline of the topics that we will cover in this course. There is **no** correspondence between the different topics and the week in the quarter. We will move at our own pace, often covering more than one topic in one week.

MODULE 1: Introduction to global macroeconomics

A. Concepts

Macroeconomics vs. microeconomics
 Macroeconomics and forecasting
 Closed vs. open economy perspectives
 Long vs. short run analyses.
 Partial vs. general equilibrium analysis
 Macroeconomic data, basic relations and concepts
 GNP
 GDP
 Consumption
 Investment
 Government expenditure
 Net exports and trade balance
 Savings

B. Readings:

M, chapters 1, 2, and 3

Federal Reserve Bank of San Francisco, "Schools of Economic Theory," in <http://www.frbsf.org/publications/education/greateconomists/index.html>

Useful Websites:

<http://www.bea.gov/beahome.html> (Bureau of Economics Analysis - data on GDP and other macro data)

<http://minneapolisfed.org/research/data/us/> (Minneapolis Fed data base and commentary).

MODULE 2: ECONOMIC GROWTH

A. Concepts

Aggregate production function
 Sources of Growth
 Capital Accumulation and Growth

Employment creation and growth
 Total factor productivity (TFP) growth
 Determinants of TFP
 - Trade policy.
 - Educational policy.

B. Readings:

M, chapters 3, 4, and 5

Paul Romer "Economic growth" in
<http://www.stanford.edu/%7Epromer/EconomicGrowth.pdf>

MODULE 3: CONSISTENCY AND GROWTH OBJECTIVES

A. Concepts

Savings
 Private savings
 Public savings
 Savings and growth as a consistency check
 Foreign savings and the trade deficit

B. Readings:

M, chapter 6.

"The Unpleasant Arithmetic of Budget and Trade Deficits", Gary H. Stern, President,
 Federal Reserve Bank of Minneapolis in <http://minneapolisfed.org/pubs/ar/ar1986.cfm>

MODULE 4: MONETARY POLICY AND CENTRAL BANKS

A. Concepts

Base money
 M1
 M2
 Money multiplier
 Federal Funds target interest rate
 Open market operations
 Yield curve and the transmission mechanism of monetary policy

B. Readings:

M, chapters 11, 15, 18 (18.1-18.4)

Federal Reserve Board, "Monetary Policy," in <http://www.federalreserve.gov/policy.htm>

Gary H. Stern “The Transition to Low Inflation: Progress and Pressures,” in <http://minneapolisfed.org/pubs/ar/ar1984.cfm>

Arthur J. Rolnick, “An Anti-Inflation Policy is a Pro-Growth Policy” in <http://minneapolisfed.org/pubs/fedgaz/97-04/edi-ajr.cfm>

“U.S. Monetary Policy: An Introduction” in www.frbsf.org/publications/federalreserve/monetary/index.html

MODULE5: TRADITIONAL THEORIES OF INFLATION

A. Concepts

The Quantity Theory of Money

Velocity of circulation

Full employment

The demand for money

- Transactions motive
- Precautionary motive
- Unit of account

Opportunity cost of holding money

Inflation as a Tax

Interest rates, yields and bonds

Readings:

M, chapter 11, 18

Interview with Former Federal Reserve Vice Chairman Roger W. Ferguson, Jr. in <http://www.minneapolisfed.org/pubs/region/00-06/ferguson.cfm?js=0>

MODULE 6: MODERN THEORIES OF INFLATION: THE ROLE OF THE GLOBAL ECONOMY

A. Concepts

The law of one price

Goods arbitrage

Purchasing power parity (PPP)

Absolute version of PPP

Relative version of PPP

B. Readings:

M, chapter 9, 19 (19.2-19.3).

Michael R. Pakko and Patricia S. Pollard, "For Here or To Go? Purchasing Power Parity and the Big Mac" in

<http://research.stlouisfed.org/publications/review/96/01/9601mp.pdf>

Michael R. Pakko and Patricia S. Pollard, "Burgernomics: A Big Mac™ Guide to Purchasing Power Parity", in

<http://research.stlouisfed.org/publications/review/03/11/pakko.pdf>

MODULE 7: ALTERNATIVE EXCHANGE RATE REGIMES AND INFLATION**A. Concepts**

Alternative exchange rate regimes

Pegged exchange rates

Monetary approach to the balance of payments

Pricing to market

Deviations from PPP

Inflation and the exchange rate

Tradable and non-tradable goods

The relative price between tradable and non-tradable goods (the Real Exchange Rate)

B. Readings:

M, chapters 15, 19 (19.1).

"Monetary Policy", by James Tobin, in

<http://www.econlib.org/library/Enc/MonetaryPolicy.html>

MODULE 8: BALANCE OF PAYMENTS ACCOUNTING**A. Concepts**

Imports

Exports

Trade balance

Service account

Transfers

Financing account

International reserves

Balance of payments

B. Readings:

M, chapters 8 and 19 (19.4).

"International Economic Analysis", in
<http://www.bea.gov/beatdi1.htm>

"What Is the Balance of Payments?", Norman S. Fieleke in
<http://www.bos.frb.org/economic/special/balofpay.pdf>

Balance of Payments Statistics Newsletter
<http://www.imf.org/external/pubs/ft/bop/news/pdf/1205.pdf>

MODULE 9: CURRENT ACCOUNT SUSTAINABILITY

A. Concepts

Current account financing
 Net international investment position (NIIP)
 Exorbitant privilege
 International evidence

B. Readings:

M, chapter 19 (19.1-19.4)

"The International Investment Position: Measurement Aspects and Usefulness for Monetary Policy and Financial Stability Issues", Frederic Lambert and Laurent Paul in
<http://www.imf.org/external/pubs/ft/bop/2002/02-74.pdf>

Interview with Gary Becker in
<http://www.minneapolisfed.org/pubs/region/02-06/becker.cfm?js=0>

MODULE 10: EXCHANGE RATE DETERMINATION IN THE LONG RUN AND THE BALANCE OF PAYMENTS

A. Concepts

Real exchange rate (RER)
 RER and exports
 RER and imports
 RER and sustainable current account balance
 From the RER to the NER

B. Readings:

M, chapter 19, 20

"The Real Exchange Rate: Definitions and Calculations", Ahmet N. Kipici and Mehtap Kesriyeli in
<http://www.tcmb.gov.tr/yeni/evds/teblig/97/reel.pdf>

Long-run Determinants of East Asian Real Exchange Rates
<http://www.frbsf.org/econsrch/wklyltr/wklyltr98/el98-11.html>

MODULE 11: NOMINAL EXCHANGE RATE DETERMINATION, ASSET MARKETS AND INTEREST RATES

A. Concepts

Nominal interest rate
 Real interest rate
 Fisher equation
 Risk neutrality
 Risk aversion
 Currency risk
 Uncovered interest rate differentials
 Carry trade
 Exchange rate volatility and “news”

B. Readings:

M, chapter 20

“Testimony of Chairman Ben S. Bernanke”,
<http://www.federalreserve.gov/boarddocs/hh/2006/february/testimony.htm>
<http://www.federalreserve.gov/boarddoc/hh/2006/july/testimony.htm>

Interest Rates and the Economy in
<http://www.newyorkfed.org/education/economy.html>

MODULE 12: EXCHANGE RATE CRISES IN EMERGING MARKETS

A. Concepts

Crisis
 Devaluation
 Overvaluation
 Undervaluation
 Fiscal sustainability
 IMF and World Bank

B. Readings:

M, chapter 21

Sebastian Edwards, "The Mexican Peso Crisis: What did we know? When did we know it?" *The World Economy*, 1998.

"To Float or Not to Float? Exchange Rate Regimes and Shocks" in <http://www.frbsf.org/publications/economics/letter/2005/el2005-01.html>

MODULE 13: UNEMPLOYMENT

A. Concepts

Labor force
 Rate of participation
 Discouraged worker
 Additional worker
 Natural unemployment rate
 Labor market distortions and unemployment

B. Readings:

M, chapter 7

U.S. Department of Labor, Bureau of Labor Statistics Home Page, <http://www.bls.gov/>

Bureau of Labor Statistics, "Latest News Release. The Employment Situation" in <http://www.bls.gov/news.release/pdf/empsit.pdf>

MODULE 14: INFLATION, UNEMPLOYMENT AND MONETARY POLICY: THE "TAYLOR RULE"

A. Concepts

Taylor rule
 Monetary accommodation

B. Readings:

M, chapter 15

Uncertainty and Monetary Policy in <http://www.frbsf.org/publications/economics/letter/2005/el2005-33.html>

Inflation Expectations: How the Market Speaks <http://www.frbsf.org/publications/economics/letter/2005/el2005-25.html>

MODULE 15: SHORT RUN MACROECONOMIC FLUCTUATIONS AND BUSINESS CYCLES: AN INTRODUCTION

A. Concepts

Business cycle
Aggregate demand
Automatic stabilizers

B. Readings:

M, chapter 14

Olivier Blanchard, "Commentary on Automatic Stabilizers", in
http://econ-www.mit.edu/faculty/download_pdf.php?id=792

Emerging Markets and Macroeconomic Volatility: Conference Summary in
<http://www.frbsf.org/publications/economics/letter/2005/el2005-03.html>

MODULE 16: AGGREGATE DEMAND AND GOODS MARKET EQUILIBRIUM

A. Concepts

Consumption
Investment
Government expenditure net exports
Keynesian multiplier
IS curve
IS and government expenditure
IS and net exports
IS and exchange rate depreciation

B. Readings:

M, chapter 12

"Fiscal Policy" by David N. Weil, in
<http://www.econlib.org/library/Enc/FiscalPolicy.html>

MODULE 17: AGGREGATE DEMAND AND MONEY MARKET EQUILIBRIUM

A. Concepts

Demand for money
Supply for money
LM curve
LM and monetary policy

B. Readings:

M, chapter 12

MODULE 18: AGGREGATE DEMAND AND EXTERNAL EQUILIBRIUM)

A. Concepts

Net exports

FF schedule

FF schedule and capital mobility

FF schedule and exchange rate fluctuations

B. Readings:

M, chapter 16

**MODULE 19: PUTTING EVERYTHING TOGETHER: THE EFFECTIVENESS OF
MONETARY AND FISCAL POLICIES UNDER ALTERNATIVE EXCHANGE RATE
REGIMES**

A. Concepts

Monetary policy

Fiscal policy

Policy effectiveness

“Impossibility of the Holy Trinity”

B. Readings:

M, chapter 10