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:

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.
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


**Useful Websites:**

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


**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  

**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,

**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)

MODULE 5: 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


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).


**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)


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

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”,

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

MODULE 12: EXCHANGE RATE CRISIS IN EMERGING MARKETS

A. Concepts
Crisis
Devaluation
Overvaluation
Undervaluation
Fiscal sustainability
IMF and World Bank

B. Readings:
M, chapter 21


**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

**MODULE 14: INFLATION, UNEMPLOYMENT AND MONETARY POLICY: THE “TAYLOR RULE”**

**A. Concepts**
- Taylor rule
- Monetary accommodation

**B. Readings:**
- M, chapter 15
MODULE 15: SHORT RUN MACROECONOMIC FLUCTUATIONS AND BUSINESS CYCLES: AN INTRODUCTION

A. Concepts
Business cycle
Aggregate demand
Automatic stabilizers

B. Readings:
M, chapter 14


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