The Global Economy (B01.2303.30)

Spring 2007

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Classes: Mondays, 6:00–9:00 in KMC 2–90

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 conclusions and recommendations. Academic research in macroeconomics is now advancing 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 in 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. Just send me an email to schedule an appointment. You can also ask questions by email. I will get back to you by the end of the day. You can also see either of the teaching assistants. Both 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, homework assignments, and practice exams 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.** 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 your performance in the quizzes (see below), your attendance, and on the quality (not quantity) of your contributions to class sessions.

- **Quizzes.** Each quiz consists of three elementary questions. You must write down your answers by hand in the designated space, and hand them in at the beginning of class. The due dates are indicated in the calendar. Notice that quizzes do not count independently towards your final grade. Your performance in the quizzes will affect your participation grade.

- **Homework.** As I am sure you will agree, 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 “Tools” and then “Digital Dropbox”). 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 75–minute in–class midterm, scheduled for Monday, April 2nd, and a 75–minute in–class final exam, scheduled for Monday, May 7th. Both tests will be closed–book and will be based on all the material covered to date. You are allowed to bring a double–sided prepared sheet and a calculator. Devices capable of wireless transmission are not allowed. 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:

- Class Participation 10%
- Homework 30%
- 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\(^T_M\)**

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 Real Player streaming files), 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 “Miscellany,” 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 Ljunqvist 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 Financial Institutions and Markets, which covers the development of financial systems in the US and elsewhere. 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.
Session 1 (Monday, February 5th)

Introduction and Overview.
Presentation of the course. Why should you sit in this class?

Measurement in Macroeconomics/I
National Accounts. What does GDP really measure?
Due: Beginning–of–term quiz, Quiz #1.

Session 2 (Monday, February 12th)

Measurement in Macroeconomics/II
How is inflation measured?

Economic Growth/I
The sources of economic growth: accumulation of physical and human capital.
Total Factor Productivity. Growth Accounting.
Due: Quiz #2.

Session 3 (Monday, February 26th)

Economic Growth/II
Relation between saving, population growth, and economic growth.
Due: Quiz #3, Homework #1.

Session 4 (Monday, March 5th)

Economic Growth/III
The key factors for long-term growth: Education and Total Factor Productivity.
Determinants of TFP: institutions and government policy.
Due: Quiz #4.
Due: Homework #2.

Session 5 (Monday, March 19th)

Labor Markets
Employment, unemployment, labor force participation, job flows, worker flows.
Due: Quiz #5.
Session 6 (Monday, March 26th)
*International trade.*
Comparative advantage. Trade liberalizations: who wins and who loses? How to compensate the losers? Major obstacles to the trade liberalization agenda. Are there any sensible arguments against free trade?
Due: Quiz #6.
Due: Homework #3.

Session 7 (Monday, April 2nd)
*Business Cycle/I*
Statistical properties of business cycles.
Due: Homework #4.

Session 8 (Monday, April 9th)
*Business Cycle/II*
Leading and lagging indicators of economic activity. Forecasting.
Due: Quiz #7.

Session 9 (Monday, April 16th)
*Fiscal Policy*
Macroeconomic effects of tax cuts, deficit spending, and government debt.
Due date: Quiz #8.
Due: Homework #5.

Session 10 (Monday, April 23rd)
*Monetary Policy/I*
Due date: Quiz #9.
Due: Homework #6.

Session 11 (Monday, April 30th)
*Monetary Policy/II*
Monetary policy conduct. Short-run effects of monetary policy.
*International Capital Flows/I*
Due: Quiz #10.

Session 12 (Monday, May 7th)
*International Capital Flows/II*