FGV | SAO PAULO SCHOOL OF ECONOMICS

Syllabus

[cmcd.economia@fgv.br]

Course: Open Economy Macroeconomics (Minicurso)
Professor: Carlos Eduardo Goncalves, IMF

2020 SECOND SEMESTER

COURSE OUTLINE

This course is for students interested in having a better understanding of the workings of the macroeconomy in an environment where some degree of financial integration amongst countries exists. When agents have access to international capital markets, new possibilities arise, such as the financing of investment through current account deficits, alongside new risks, such as destabilizing capital outflows. A new relative price is born (the exchange rate!), novel tradeoffs (fixed or flexible exchange rate regimes?) emerge, more complex transmission channels have to be taken into account (what if interest rates go up in the US?) and new policy instruments are deployed (should governments impose restrictions on capital flows, throw some sand in the wheels?).

If the last paragraph did not get you excited enough, think of it this way: without a proper understanding of open macroeconomics, you will be at a loss when someone asks you under what circumstances the current account deteriorates in face of a positive output shock. You do not want that to happen…

PROGRAM (TENTATIVE)

- Class I (04/11 – 9h00-10h50): Describe basic facts about the behavior of important macroeconomic variables and how emerging economies differ from advanced ones. Discuss the correlation between trade balance/current account and the economic cycle. Lay the foundations of models to come via a simple endowment economy with access to international capital markets.
- Class II (06/11 – 9h00-10h50): The workhorse open macro model with capital. Here is where we develop the intuition linking both the temporariness of shocks and time to build/capital adjustment costs to the cyclicality of the current account. We will ad nauseum discuss the intuition of the current account as a shock absorber. Finally, we ask ourselves how uncertainty affects the dynamics of the current account and use a simple model to account for the US case: a marked reversal of the current account during the 2000s.
- Class III (09/11 – 9h00-10h50): Derive the SOE-DSGE model; explain and discuss how to render the model stationary (why is it a problem here?), go through the calibration procedure. Discuss Bayesian estimation of DSGE models. Computer hands-on: apply the model to a small open developed economy – NZL, CAN, AUS?
- Class IV (11/11- 9h00-10h50): Emerging economies are not only more volatile than advanced; in addition, consumption in these economies is more volatile than output. Here we discuss two ways of accounting for developing economies business cycles idiosyncrasies: permanent TFP shocks and Interest rate shocks. Hands-on exercise using data from EMs – ARG, MEX?

- Class V (13/11- 9h00-10h50): So far, we have tried to understand the behavior of a small open economy, be it developed or developing. In this class, we tackle the issue of large open economies. In this setting, current accounts are jointly determined and interest rates are not taken as a given anymore. Size becomes a relevant variable for transmission of shocks. Using a simple two large economies model, we shed some light on competing theories vying to explain the increase in the current account deficits in the US in the first decade of the new century: American investment prowess or international savings glut.
- Class VI (16/11 – 9h00-10h50): This is an open macro mini course, so we should say something about the exchange rate, nominal and real, and what capital market integration means in terms of interest rates differentials. In this class, we will start discussing big mac exchange rates (are they useful?) and purchasing power parity theories (do they hold?). Then we analyze strange phenomena, such as home bias in consumption and how it affects PPP, and border effects (how a line drawn on the ground dramatically prevents arbitrage in goods prices). Finally, we discuss capital markets integration and interest rate differentials, UIP and Covered UIP and the Forward puzzle.
- Class VII (18/11 – 9h00-10h50): Paper presentations by students.

MAIN REFERENCES

- Martin Uribe and Schmitt-Grohe, “Open Economy Macroeconomics”, Princeton University Press, 2018.
- Carlos Vegh, “Open Economy Macroeconomics in Developing Countries”, MIT Press, 2013.

ASSESSMENT

Student grades will be based on a one-hour written exam (50%) and a group presentation (no more than 3, preferably 2, papers selected will depend on course coverage and students’ preferences). The exam date and time will be set at the beginning of the course.