

# International Macroeconomics

Semester 2, 2006

## Course Outline

### Course Description

This course introduces advanced international macroeconomics to students enrolled in the graduate program in economics. We will study basic workhorse models as well as empirical methods to analyse various issues arising in modern international macroeconomics and finance. Wherever appropriate, the interplay between theory and empirics will be emphasised. The following topics will be considered: two-period and infinite-horizon models, stochastic models of the current, international financial markets, international business cycles, theories of exchange rate determination, the stochastic Mundell-Fleming model, and new open economy macro models.<sup>1</sup>

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**Classes:** Thursdays 2-6pm.

### Aims and Expected Learning Outcomes:

Upon a successful completion of this course, students should be able to:

- Understand the theoretical models that macroeconomists typically use and also form the basis of current research in international macroeconomics;
- Understand some of the main techniques used by macroeconomic researchers to create knowledge;
- Explain and understand the associated empirical implications and policy issues;
- Evaluate the contribution of some recently created knowledge in international macroeconomics;
- Synthesize some of the recently created knowledge in international macroeconomics;
- Be ready to identify a research topic and undertake an independent research.

### Assumed Knowledge

This course assumes a good intermediate knowledge of macroeconomics and microeconomics. It will also be assumed that students are reasonably familiar with mathematical tools such as elementary calculus, matrix algebra, difference and differential equations and intermediate econometrics or statistics. No other prior knowledge will be assumed.

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<sup>1</sup> Note that some topics may be skipped due to the time constraints.

## Assessment

The mark from this course is determined as follows:

|                                    |            |
|------------------------------------|------------|
| 1 discussion report + presentation | 20%        |
| 2 Midterms                         | 40%        |
| <u>Final exam</u>                  | <u>40%</u> |
| Total                              | 100%       |

The final exam will be held for the duration of 2 hours. The exam will be entirely based on lecture material, required readings and tutorial questions. Further information will be provided in lectures.

## Textbook and Readings

The primary reference for this course is:

Obstfeld, M. and Rogoff, K. (1996), *Foundations of International Macroeconomics*, MIT Press. [hereafter *OR*]

We will try to understand the basic workhorse models presented in core sections of this book. This will provide the basic grounds for possible future research.

In addition, some sections of the following books may be useful for the course. See for details the 'Lecture Outline' in this handout.

Romer, D. (2001), *Advanced Macroeconomics*, 2<sup>nd</sup> Edition, New York: McGraw Hill, 2001.

Krugman, P. and Obstfeld, M. (2003), *International Economics: Theory and Policy*, 6<sup>th</sup> Edition, Addison-Wesley.

Blanchard, O. and Fischer, S. (1989), *Lectures on Macroeconomics*, MIT Press.

Mark, N. (2003), *International Macroeconomics and Finance*, Blackwell.

If your econometric preparation is weak or needs a refresher, the following references would be useful and may be referred.

Green, W. (2003), *Econometric Analysis*, Fifth edition, Prentice Hall.

Enders, W. (1995), *Applied Econometric Time Series*, John Wiley.

## Online Access to Journal Articles

Most of the journal articles will be made available on the university library. Some important articles will be directly available from the course website.

## Lecture Outline

### Notes:

The lecture material is quite standard and can usually be found in the texts. Nevertheless, the readings provided in the outline will serve the following purposes.

- a. Tracing down the original sources of the relevant ideas/material, usually published in scholarly journals, for those who are interested in a particular topic and wish to dig deeper. These readings are unmarked.
- b. Sources which were used directly or indirectly. These readings are marked with a single asterisk.
- c. There are readings available for presentation and discussion by students in class. These readings are marked with double asterisks.
- d. It is not expected that you read all of the papers listed here. The reading list will constitute a bibliography should you wish to pursue work in these research areas.

### **Topic 1: Intertemporal Trade and the Current Account**

Lecture Notes  
OR: Chapter 1.

### **Topic 2: Dynamics of Small Open Economies**

Lecture Notes  
OR: Chapter 2.

\*Obstfeld, Maurice and Kenneth Rogoff (1995), "The Intertemporal Approach to the Current Account", in Gene Grossman and Kenneth Rogoff, (eds.): *Handbook of International Economics*, Vol 3, North-Holland.

\*Campbell, J. (1987), "Does Saving Anticipate Declining Labor Income?: An Alternative Test of the Permanent Income Hypothesis", *Econometrica*, 55, 1249-1273.

\*\*Bergin, P. and Sheffrin, S. (2000), "Interest rates, exchange rates and present value models of the current account", *Economic Journal*, 110, 535-558.

\*\*Nason, J. and Rogers, J. (2006), "The Present-Value Model of the Current Account Has Been Rejected: Round Up the Usual Suspects", *Journal of International Economics*, 68, 159-187.

Kraay, A. and Ventura, J. (2002), "The Current Account in the Long and the Short Run", *NBER Macroeconomics Annual*, April.

Hall, R. (1978), "Stochastic Implications of the Life Cycle-Permanent Income Hypothesis: Theory and Evidence," *Journal of Political Economy*, 86(6), 971-987

### **Topic 3: The Life Cycle, Budget Deficits and the Current Account**

Lecture Notes

OR Chapter 3.  
Romer Chapter 2.

Feldstein, M. and Horioka, C. (1980), "Domestic Saving and International Capital Flows", *Economic Journal*, 90, 314-329.

\*\*Baxter, M. and Crucini, M. (1993), "Explaining Saving-Investment Correlations", *American Economic Review*, 83, 416-436.

\*\*Kim, S. (2001), "The Saving-Investment Correlation Puzzle is Still a Puzzle", *Journal of International Money and Finance*, 20, 1017-1034.

#### **Topic 4: The Real Exchange Rate and the Terms of Trade**

Lecture Notes  
OR Chapter 4.

Balassa, B. (1964), "The Purchasing Power Parity Doctrine: A Reappraisal", *Journal of Political Economy*, 72, 584-96.

Samuelson, P. (1964), "Technical Notes on Trade Problems", *Review of Economics and Statistics*, 51, 239-46.

\*\*Engel, C. (2000), "PPP May Not Hold After All", *Journal of International Economics*, 51, 243-73.

Rogoff, K. (1996). "The Purchasing Power Parity Puzzle", *Journal of Economic Literature*, June, 647-668.

\*\*Chen, Yu-Chin and Rogoff, K. (2003), "Commodity Currencies", *Journal of Monetary Economics*, 60, 133-160.

#### **Topic 5: International Financial Markets and Asset Pricing**

Lecture Notes  
OR Chapter 5.  
Romer Chapter .5.

Mehra. R. and Prescott, E. (1985), "The Equity Premium: A Puzzle", *Journal of Monetary Economics*, 15, 145-61.

Campbell, J. and Cochrane, J. (1999), "By Force of Habit: A Consumption Based Explanation of Aggregate Stock Market Behaviour", *Journal of Political Economy*, 107, 205-291.

\*Campbell, J. (1996), "Consumption and the Stock Market: Interpreting International Experience", *Swedish Economic Policy Review*, 3, 251-299.

\*\*Lewis, K. (1996), "What Can Explain the Apparent Lack of International Consumption Risk Sharing?", *Journal of Political Economy*, 104, 267-97.

#### **Topic 6: Neoclassical Growth, Optimal Growth and Competitive Equilibrium**

Lecture Notes

OR Chapter 7.

Romer Chapters 1, 2, 3.

\*Mankiw, N.G., Romer, D. and D. Weil. (1992), "A Contribution to the Empirics of Economic Growth", *Quarterly Journal of Economics*, 107, 407-437.

\*\*Bernanke, B. and Gurkaynak, R. (2001), "Is Growth Exogenous? Taking Mankiw, Romer, and Weil Seriously", NBER Working Paper No. 8365, also in *NBER Macroeconomics Annual*, MIT Press.

Romer, P. (1994), "Origins of Endogenous Growth", *Journal of Economic Perspectives*, 8, 3-22.

Lucas, R.E. (1988), "On the Mechanics of Economic Development", *Journal of Monetary Economics*, 22, 3-42.

Grossman, G. E. Helpman (1990), "Trade, Innovation, and Growth", *American Economic Review*, 80(2), 86-91,

### **Topic 7: Open Economy Extensions of Business Cycle Models**

Lecture Notes

Romer: Chapter 4.

OR: Chapters 5 and 7.

#### **Basic Facts and Closed Economy Models**

\*Fisher, L, Otto, G. and G. Voss (1996), "Australian Business Cycle Facts", *Australian Economic Papers*, 35, 202-222.

Pagan, A. (1997), "Towards an Understanding of Some Business Cycle Characteristics", *Australian Economic Review*, 30, 1-15.

Prescott, E. (1986), "Theory Ahead of Business Cycle Measurement", *Carnegie-Rochester Conference Series on Public Policy*, 24, 11-44. Reprinted in *Federal Reserve Bank of Minneapolis Quarterly Review*, 10, 9-22.

\*Crosby, M and Otto, G. (1995), "Real Business Cycle Models: An Introduction", *Australian Economic Review*, 3<sup>rd</sup> quarter, 55-70.

King, R. and Rebelo, S. (1999), "Resuscitating Real Business Cycles" in M. Woodford and J. Tayloer (eds.) *Handbook of Macroeconomics*, North-Holland.

King, R., Plosser, C. and S. Rebelo (1988), "Production, Growth and Business Cycles I: The Basic Neoclassical Model", *Journal of Monetary Economics*, 21, 195-232.

\*King, R., Plosser, R., and S. Rebelo (2002), "Production, Growth, and Business Cycles: Technical Appendix", *Computational Economics*, 20, 87-116.

\*Campbell, J. (1994), "Inspecting the Mechanism: An Analytical Approach to the Stochastic Growth Model", *Journal of Monetary Economics*, 33, 463-506.

#### **Open Economy and International Business Cycles**

- \*Backus, D. and Kehoe, P. (1992), "International Evidence on the Historical Properties of Business Cycles", *American Economic Review*, 82, 864-888.
- \*Backus, D, Kehoe, P., and F. Kydland (1992), "International Real Business Cycles", *Journal of Political Economy*, 101, 744-775.
- \*Backus, D, Kehoe, P., and F. Kydland (1994), "Dynamics of the Trade Balance and the Terms of Trade: The J-Curve", *American Economic Review*, 84, 84-110.
- \*Baxter, M. and Crucini, M. (1995), "Business cycles and the asset structure of foreign trade", *International Economic Review*, 36, 821-854.
- \*\*Baxter, M. and Farr, D. (2005), "Variable capacity utilization and international business cycles", *Journal of International Economics*, 65, 335-347.
- \*Correia, I., Neves, J. and Rebelo, S. (1995), "Business cycles in a small open economy", *European Economic Review*, 39, 1089-1113.
- \*\*Neumeyer, P. and Perri, F. (2005), "Business cycles in emerging economies: the role of interest rates", *Journal of Monetary Economics*, 52, 345-380.
- Schmitt-Grohe, S. and Uribe, M. (2003), "Closing Small Open Economy Models", *Journal of International Economics*, 61, 163-185.

**Topic 8: Keynesian Approaches to the Exchange Rate: the Monetary Approach and the Dornbusch 'Overshooting' Model.**

Lecture Notes  
OR Chapters 8, 9.

Frenkel, J. (1976), "A Monetary Approach to the Exchange Rate: Doctrinal Aspects and Empirical Evidence", *Scandinavian Journal of Economics*, 78, 200-24.

Frenkel, J and Johnson, H. (1976), *The Monetary Approach to the Balance of Payments*, Toronto University Press.

\*Dornbusch, R. (1976), "Expectations and Exchange Rate Dynamics", *Journal of Political Economy*, 84, 1161-76.

Rogoff, K. (2002), "Dornbusch's Overshooting Model After Twenty Five Years", International Monetary Fund's Second Annual Research Conference Mundell-Fleming Lecture, *IMF Staff Papers*, 49.

\*Eichenbaum, M. and Evans, C. (1995), "Some Empirical Evidence on the Effects of Shocks to Monetary Policy on Exchange Rates", *Quarterly Journal of Economics*, 110, 975-1009.

\*\*Clarida, R. and Gali, J. (1994), "Sources of Real Exchange Rate Fluctuations: How Important Are Nominal Shocks?", *Carnegie-Rochester Conference Series on Public Policy*, vol. 41, pp. 1-56.

\*Enders, W. and Lee, B. (1997), "Accounting for Real and Nominal Exchange Rate Movements in the Post-Bretton Woods Period", *Journal of International Money and Finance*, 16, 233-254.

\*\*Kim, S. and Roubini, N. (2000), "Exchange rate anomalies in the industrial countries: A solution with a structural VAR approach", *Journal of Monetary Economics*, 45, 561-586.

\*\*Engel, C and West, K. (2005), "Exchange Rates and Fundamentals", *Journal of Political Economy*, 3, 485-517.

### **Topic 9: New Open Economy Macroeconomics**

Lecture Notes  
OR Chapter 10.

\*Lane, Philip (2001), "The New Open Economy Macroeconomics: A Survey," *Journal of International Economics*, 54, 235-266.

\*Obstfeld, Maurice and Kenneth Rogoff (1995), "Exchange Rate Dynamics Redux," *Journal of Political Economy*, 103, 624-660.

\*\*Obstfeld, Maurice and Kenneth Rogoff (2000), "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?," *NBER Macroeconomics Annual*, MIT Press, Cambridge, MA.

\*Betts, C. and Devereux, M. (2000), "Exchange Rate Dynamics in a Model of Pricing-to-Market", *Journal of International Economics*, 50, 215-244.

\*\*Bergin, Paul (2003), "Putting the 'New Open Economy Macroeconomics' to a Test," *Journal of International Economics*, 60, 3-34.

\*\*Bergin, P. (2004), "How well can the new open economy macroeconomics explain the exchange rate and current account?", *NBER Working Paper* No. 10356.

\*\*Devereux, M. (2004), "Should the exchange rate be a shock absorber?", *Journal of International Economics*, 62, 359-377.

\*\*Ganelli, G. (2005), "New Open Economy Macroeconomics of Government Debt", *Journal of International Economics* (forthcoming).

### **Topic 10: Introduction to Macroeconometrics**

**- ARMA models, Unit-root, VAR, VEC, Co-integration, and Structural VAR.**

Lecture Notes  
Enders, W. (1995), *Applied Econometric Time Series*, John Wiley, New-York.  
Mark: Chapter 2.  
Blanchard and Fischer: Chapter 1.

Granger, C. and Newbold, P. (1974), "Spurious Regressions in Econometrics", *Journal of Econometrics*, 2, 111-120.

Nelson, C, and Plosser, C. (1982), "Trends and Random Walks in Macroeconomic Time Series: Some Evidence and Implications", *Journal of Monetary Economics*, 10, 139-162.

- Campbell, J. and Mankiw, N.G. (1987), "Are Output Fluctuations Transitory?", *Quarterly Journal of Economics*, 102, 857-880.
- Campbell, J. and Perron, P. (1991), "Pitfalls and Opportunities: What Macroeconomists Should Know About Unit Roots", *NBER Macroeconomics Annual*, 6, 141-201.
- Engle, R. and Granger, C. (1987), "Co-integration and Error Correction: Representation, Estimation and Testing", *Econometrica*, 55, 251-267.
- Johansen, S. and Juselius, K. (1990), "Maximum Likelihood Estimation and Inference on Co-integration", *Oxford Bulletin of Economics and Statistics*, 169-210.
- Sims, C. (1980), "Macroeconomics and Reality", *Econometrica*, 48, 1-48.
- Stock, J. and Watson, M. (2001), "Vector Autoregressions", *Journal of Economic Perspectives*, Fall.
- \*Cooley, T. and LeRoy, S. (1985), "Atheoretical Macroeconometrics: A Critique", *Journal of Monetary Economics*, 16, 283-308.
- Blanchard, O. and Quah, D. (1989), "The Dynamic Effects of Aggregate Demand and Supply Disturbances", *American Economic Review*, 79, 655-673.
- \*\*Pagan, A. and Robertson, J. (1996), "Structural Models of the Liquidity Effect", *Review of Economics and Statistics*, 80, 202-217.

***Enjoy the course!***