

**Macroeconomía II – International Macroeconomics****Prof. Stephen McKnight****E-mail: [mcknight@colmex.mx](mailto:mcknight@colmex.mx) / Office: 4475**

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**Course Description**

- There is one class scheduled for 16 weeks: Tuesday 10:30 – 14:00.
- In addition to the classes, several tutorials have been scheduled with Alejandro Gurrola Luna ([agurrola@colmex.mx](mailto:agurrola@colmex.mx)). These tutorials will give students the opportunity to discuss and resolve specific difficulties with the course materials.
- This course aims to provide students with up-to-date knowledge of the major topics in international finance and open-economy macroeconomics. The course will cover the most important models (both real and nominal). Emphasis will be given throughout the course on understanding contemporary international macroeconomic policy issues.
- The course is divided into the following 3 sections:
  1. The Dynamics of the Current Account.
  2. Money and Exchange Rates.
  3. International Macroeconomic Policy.
- Lecture notes will be distributed via email before each class.

**Course Evaluation**

- There will be two (in-class) examinations. A mid-term exam and a final-term exam.
- The evaluation of the course will be based on both examinations.
  - Mid-Term Exam 35%
  - Final Exam 65%
- The Mid-Term Exam will take place on Tuesday 5<sup>th</sup> March (week 8) between 10:30 – 13:30.
- The Final Exam will take place on Tuesday 21<sup>st</sup> May between 11:00 – 14:00.

## Textbooks

There are two textbooks for this course.

- Schmitt-Grohe, Uribe, and Woodford (SUM), *International Macroeconomics: A Modern Approach*, Princeton University Press: 2022.
- Krugman, Obstfeld, and Melitz (KOM), *International Economics: Theory and Policy*, 11<sup>th</sup> Edition, Pearson: 2018.

## Course Outline

### Section 1 – The Dynamics of the Current Account

#### **Topic 1: The Balance of Payments, National Income Accounting, and the Current Account**

- The Balance of Payments
- The Trade Balance and the Current Account
- The Current Account and the Net International Investment Position
- National Income Accounting
- Can Countries Run Perpetual Trade and Current Account Deficits?

Reading: SUW (2022), chapters 1 and 2; and KOM (2018), chapter 13.

#### **Topic 2: Intertemporal Trade and the Current Account**

- A Small Two-Period Endowment Economy Model
- The Trade Balance and the Current Account
- Explaining Intertemporal Trade Patterns
- Example: An Economy with Logarithmic Preferences

Reading: SUM (2022), chapter 3.

### **Topic 3: Terms of Trade, World Interest Rate, Tariffs, and the Current Account**

- Terms of Trade Shocks
- World Interest Rate Shocks
- Import Tariffs

Reading: SUM (2022), chapter 4.

### **Topic 4: Current Account Dynamics in Production Economies**

- The Investment Decision of Firms and the Investment Schedule
- The Consumption-Saving Decision of Households and the Saving Schedule
- The Current Account Schedule
- Equilibrium in the Production Economy
- An Algebraic Approach
- The Terms of Trade in Production Economies
- Application: Giant Oil Discoveries

Reading: SUM (2022), chapter 5.

### **Topic 5: Uncertainty and the Current Account**

- The Great Moderation
- A Small Open Economy Model with Uncertainty
- Complete Asset Markets

Reading: SUM (2022), chapter 6.

### **Topic 6: Government Budget Deficits and the Current Account**

- A Small Open-Economy Model with Government
- Government Spending and the Twin Deficits Hypothesis
- Reasons for Ricardian Non-Equivalence
- Optimal Fiscal Policy
- Fiscal Policy in Economies with Imperfect Capital Mobility

Reading: SUM (2022), chapter 8.

## **Section 2 – Money and Exchange Rates**

### **Topic 7: The Foreign Exchange Market**

- The Basics of Exchange Rates
- A Model of the Foreign Exchange Market
- Covered Interest Parity
- Covered Interest Parity and Free Capital Mobility: Empirical Evidence

Reading: KOM (2018), chapter 14; and SUW (2022), chapter 11.1 – 11.5.

### **Topic 8: Money, Interest Rates, and Exchange Rates**

- Money: A Brief Review
- Equilibrium in the Money Market
- The Money Supply and the Exchange Rate in the Short Run
- The Short Run Versus Long Run
- Permanent Money Supply Changes and Exchange Rate Overshooting

Reading: KOM (2018), chapter 15.

### **Topic 9: Long-Run Models of the Exchange Rate**

- The Law of One Price
- Purchasing Power Parity
- Relative Purchasing Power Parity
- A Flexible-Price Exchange Rate Model Based on PPP (or the Monetary Approach to the Exchange Rate)
- Beyond PPP: A Long-Run Real Exchange Rate Model (or the Real Exchange Rate Approach to the Exchange Rate)
- Real Interest Parity

Reading: KOM (2018), chapter 16, and SUM (2022), chapter 9.

## Section 3 – International Macroeconomic Policy

### **Topic 10: Monetary and Fiscal Policies under Flexible Exchange Rates**

- Determinants of Aggregate Demand in an Open Economy
- The DD – AA Model
- Monetary and Fiscal Policy
- The J – Curve
- The Liquidity Trap

Reading: KOM (2018), chapter 17.

### **Topic 11: Fixed Exchange Rates**

- Central Bank Intervention and the Money Supply
- Macroeconomic Policies under Fixed Exchange Rates
- Balance of Payments Crises and Speculative Attacks
- Managed Float and Sterilized Intervention

Reading: KOM (2018), chapter 18.

### **Topic 12: Fixed Vs. Flexible Exchange Rate Regimes**

- Macroeconomic Policy Goals in an Open Economy
- The Open-Economy Monetary Trilemma
- Analyzing Policy Options for Reaching Internal and External Balance
- The Case Against Fixing the Exchange Rate
- The Case for Flexible Exchange Rates

Reading: KOM (2018), chapter 19.

### **Topic 13: The Macroeconomic Problems of Developing Countries**

- The Gap Between Rich and Poor
- Structural Features of Developing Countries
- Borrowing and Debt
- The Macroeconomic Policy Framework of Mexico
- Explaining the Mexican Growth Paradox

Reading: KOM (2018), chapter 22.