International Macroeconomics
Chapter 1: The Global Macroeconomy

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Outline

1. Introduction

2. Foreign Exchange: Currencies and Crises
   - How exchange rate behave
   - Why exchange rate matter
   - When exchange rate misbehave

3. Globalization of Finance: Debts and Deficits
   - Deficits and Surpluses: The Balance of Payments
   - Debtors and Creditors: External Wealth

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International Macroeconomics is devoted to the study of large-scale economic problems in interdependent economics.

- It is macroeconomic because it focuses on key economy-wide variables such as exchange rates, prices, interest rates, income, wealth, and the current account.

- It is international because a deeper understanding of the global economy emerges only when the interconnections among nations are fully considered.
Three key elements define and distinguish the field of international macroeconomics

- The world has many monies
- Countries are financially integrated
- In this context, economic policy choices are made
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How exchange rate behave
Why exchange rate matter
When exchange rate misbehave

(a) China–U.S. Exchange Rate
(b) U.S.–Eurozone Exchange Rate
Key Topics:

- How are exchange rates determined?
- In the short run, why do some exchange rates fluctuate sharply while others are almost constant?
- In the long run, what explains why exchange rates rise, fall, or stay flat in the long run?
Changes in exchange rates affect an economy in two ways:

- Changes in exchange rates cause a change in the international relative prices of goods.
- Changes in exchange rates cause a change in the international relative prices of assets.
Key Topics:

- How do changes in exchange rates affect international prices, the demand for goods from different countries, and hence the levels of national output?
- How do changes in exchange rates affect the values of foreign assets, and hence change national wealth?
In an exchange rate crisis, a currency experiences a sudden and pronounced loss of value against another currency, following a period in which the exchange rate had been fixed or relatively stable.
Introduction
Foreign Exchange: Currencies and Crises
Globalization of Finance: Debts and Deficits
Government and Institutions: Policies and Performance

How exchange rate behave
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Country (currency) and year of crisis

Percent change in the U.S. dollar value of one unit of domestic currency

Average change in previous two years
Change in the year of the crisis
Key Topics:

- Why do exchange rate crises occur? Are they an inevitable consequence of deeper fundamental problems in an economy?
- Why are these crises so economically costly?
- What steps might be taken to prevent crises?
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Financial Globalization has taken hold across world, from developed countries to emerging markets.

Current Account Imbalance has dramatically increases.

Current Account Measure how much a country is spending relative to its income.
Surpluses (+) & Deficits (-) (billions of U.S. dollars)

- China
- Major oil exporters
- Japan
- Hong Kong, Singapore, Taiwan, Korea, Indonesia, Malaysia
- Russia
- Other surplus countries
- Other deficit countries
  - Australia
  - Italy
  - United Kingdom
  - Spain
  - United States

Size of current account surplus by country/group
Size of current account deficit by country/group

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Key Topics:

- How do different international economic transactions contribute to current account imbalance?
- How are these imbalances financed?
- Why are some countries in surplus and others in deficit?
Current Account deficits must be financed by borrowing from the rest of the world, which lowers the country’s external wealth.
Key Topics:

- What explains the level of a nation’s external wealth and how does it change over time?
- How does it relate to a country’s present and future economic welfare?
- Why do countries default? What happens when they do?
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Government actions affect economic outcomes by making decisions about exchange rates, macroeconomic policies, whether to pay debts, etc. Some policy questions:

- Choice of exchange rate regime: fixed to another currency, flexible, currency union, adopting another currency.
- Whether to restrict financial capital flows from abroad: capital control?
- How macroeconomic policies like fiscal and monetary policies are changed by international interdependence?