**API-119: Advanced Macroeconomics for the Open Economy II, Spring 2019**

**Harvard Kennedy School**

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- Course Assistants: Maria Florez, Daisuke Fukuzawa and Thomas Moatti,

**Times:**
- Lectures: Tuesday & Thursday, 1:15-2:30 pm, in L140  
  Plus Wednesday lectures, 3/27-4/17, 8:45-10:00 am, in L140
- Review Sessions: Friday, 1:15 or 2:45 pm, in Land Hall
- Final exam: Monday, May 13, 9:00 am -12:00 noon.

**Course Description:** This course is the second in the two-course sequence on Macroeconomic Policy in the MPA/ID program. Topics covered in the first half of the course include international financial integration, exchange rate models, speculative attacks, the carry trade, portfolio choice, currency risk, and default risk. The second half of the course uses tools of dynamic optimization; topics covered include, among others, the Solow and Ramsey models of long-term growth, a primer on Dynamic Stochastic General Equilibrium models, and monetary and fiscal policies in financially integrated economies.

**Nature of the approach:** The course is largely built around analytical models. Although real-world examples will appear throughout, the course will rely heavily on theoretical and econometric analysis, as is customary in economics classes.

**Who is expected to take the course:** This course, like Advanced Macroeconomics for the Open Economy I (API 120), is a required component of the MPA / International Development sequence. In addition to MPA/ID students, a student who has successfully taken API 120 in the fall is sometimes admitted by permission of instructor.

**Grading:** 25% on Mid-term exam; 55% on final exam; 20% on problem sets & class participation. Problem sets are due by 10:10 a.m. on the due dates specified below, in the MPA/ID drop box. Please check the dates of the midterm and final exams before you make any travel plans. Students are responsible for knowing what is in the [Academic Code](#) and abiding by it.
I. INTEGRATION OF FINANCIAL MARKETS
1. (1/29/2019) The theory of gains from intertemporal trade
2. (1/31) Imperfections in financial markets
3. (2/5) Interest Rate Parity & other tests of financial integration

II. EXPECTATIONS, MONEY, AND EXCHANGE RATES
4. (2/7) With flexible goods prices
5. (2/12) With sticky prices: the overshooting model
6. (2/14) Speculative attack models

III. THE CARRY TRADE, RISK, & PORTFOLIO DIVERSIFICATION
7. (2/19) Exchange rate forecasting, forward bias & risk premium
8. (2/21) Optimal portfolio diversification
9. (2/26) Exchange rate risk and home bias

IV. DEBT CRISSES & OTHER EM CRISIES
10. (2/28) Sovereign risk and debt dynamics
11. (3/5) Fiscal failures
12. (3/7) EM crises
13. (3/12) MIDTERM EXAM
14. (3/14) No lecture scheduled
15. (3/15 – 3/24) SPRING BREAK

Lectures, second half of semester: Professor E. Levy-Yeyati

V. GROWTH & BUSINESS CYCLES
14. (3/26) Neoclassical growth (Ramsey) model
15. (3/27) Neoclassical growth (Ramsey) model
16. (3/28) Endogenous growth models: Human capital and technology
17. (4/2) Growth theory in the data
18. (4/3) RBC, New Keynesian and DSGE models
19. (4/4) Consumption & investment
20. (4/9) Labor & Unemployment

VI. POLICY
21. (4/10) Effectiveness of fiscal policy
22. (4/11) Monetary and exchange rate policy: an introduction

VII. MACRO FINANCE
23. (4/16) Banks, credit markets & financial dollarization
24. (4/17) Global financial cycles: the risk channel & the benchmark effect
   (4/18) No lecture scheduled
25. (4/23) Finance & the open economy I: International financial architecture and macro
   prudential policies
26. (4/25) Rethinking macroeconomic policy

VIII. 2 CASE STUDIES
27. (4/30) Case I: The Great Recession
   (5/1) No lecture scheduled
28. (5/2) Case II: Two Argentine crises (2001, 2018)

Final exam: May 13, 2019, 9:00 am -12:00 noon

Readings, first half of semester (Prof. Frankel)

I. INTEGRATION OF FINANCIAL MARKETS

1. (1/29) The theory of gains from intertemporal trade

   World Trade and Payments, 10th edition, Chapter 21.5. ***

2. (1/31) The Lucas Paradox

   Robert Lucas, 1990, "Why Doesn't Capital Flow from Rich to Poor Countries?" American
   Economic Review 80, no. 2: 92–96. *
   Carmen Reinhart and Kenneth Rogoff, 2004, "Serial Default And The 'Paradox' Of Rich-To-
   Development, (IMF), March, 44, no.1, 10-13. *
   Laura Alfaro, Sebnem Kalemli-Ozcan and Vadym Volosovych, 2008, "Why Doesn't Capital Flow from
   Journal of Political Economy 115, 1, February.
   Pierre-Olivier Gourinchas and Olivier Jeanne, 2013, “Capital Flows to Developing Countries: The

3. (2/5) Interest Rate Parity

   WTP, Chapters 21.4, 27.1. ***

II. MONEY & MODELS OF EXCHANGE RATE DETERMINATION

4. (2/7) With flexible prices

*WTP*, 10th edition,  *Chapter 27.2-27.3* and  *Supplement to Ch. 27, S51-S55* ***


5. (2/12) With sticky prices: the overshooting model

*WTP*,  *Chapter 27.4-27.6*. ***

Rudiger Dornbusch, 1976, "*Expectations and Exchange Rate Dynamics*" *JPE*, 84, 1161-76.

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6. (2/14) Speculative attack models

*WTP*, 10th edition,  *Ch. 24.3* ***


III. THE CARRY TRADE, RISK, PORTFOLIO DIVERSIFICATION

7. (2/19) Exchange rate forecasting, forward bias, and the risk premium


8. (2/21) Optimal portfolio diversification

*World Trade and Payments*,  *Chapter 28.2* &  *Supplement to Ch.28, pp. S55-S58*. ***


9. (2/26) Exchange rate risk, equity risk, and home bias

World Trade and Payments, Chapter 28.3 ***


IV. DEBT CRISSES & OTHER EM CRISSES

10. (2/28) Default risk and debt dynamics

World Trade and Payments, Supplement to Ch.24, pp. S47-S48. ***


"Brazil warned of 'explosive' build-up of public debt," Financial Times, 24 May 2016.


11. (3/5) Fiscal failures


Summary: "Fiscal Policy in Developing Countries: Escape from Procyclicality," Vox.EU, June 23, 2011. **

12. (3/7) EM crises

Lessons from past crises and early warning indicators

WTP, Ch. 24.1-24.2 **


Emerging markets debt: The well runs dry,” The Economist, March 5, 2016. p.65-67. *

“Hot and Sour: What Asia learned from its financial crisis 20 years ago,” The Economist, July 1, 2017.
Contagion and the IMF

*WTP, Ch. 24.4-24.5 & 24.8* **

**Readings, second half of semester (Prof. Levy-Yeyati)**

**V. GROWTH & BUSINESS CYCLES**


* Romer, David, Advance Macroeconomics (DR), Chapter 1, sections 2 to 6; chapter 2, sections 1 to 6.

“Economists understand little about the causes of growth”, *The Economist*, April 2018


* DR, Chapter 3, sections 1 to 5.

Romer, Paul (2015) “*Human Capital and Knowledge*”.

17. (4/2) Growth theory in the data

(1:15pm Land – no API-119 review this week)

* DR, Chapter 1, sections 7-8; Chapter 3, section 6


18. (4/4) Keynesian theories of fluctuations and the DSGE approach

* DR Chapter 5, sections 3-5, Chapter 6, section 9, Chapter 7, sections 1, 4, 8.

“The DSGE quarrel (again)”, Bruegel post, December 2017

“The DSGE quarrel (again)”, Bruegel post, December 2017

19. (4/3) Consumption & investment

* DR Chapter 8, sections 1-6, Chapter 9, sections 1-7.

20. (4/9) Labor & Unemployment

* DR Chapter 11.


VI. POLICY


* DR Chapter 13


22. (4/11) Monetary and exchange rate policy: an introduction

* DR Chapter 12


VII. MACRO FINANCE

23. (4/16) Banks, credit markets & financial dollarization


24. (4/17) Global financial cycles: risk and benchmark channels & macroprudential policies


*Cerutti, E., S. Claessens and L. Laeven, “The increasing faith in macroprudential policies”, VoxEU, September 18, 2018


25. (4/23) Finance & the open economy I: International financial architecture


26. (4/25) Rethinking macroeconomic policy


**VIII. CASE STUDIES**

27. (4/30) Case I: The Great Recession
