

International Monetary Economics

Main Issues

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What are the main subjects of international macroeconomics?

- ▶ As in the standard, closed economy macro, the main preoccupation is with the determination of macroeconomic activity
 1. quantities: national income, employment, consumption,..
 2. prices: inflation, interest rates,..
- ▶ The difference is that we deal with an internationally open rather than a closed economy

How does openness matter?

A. It provides **additional channels**: Openness, **modifies** the properties of macroeconomic relationships.

Examples:

- ▶ Smaller dependence of a country's current consumption on its current income due to international asset trade
 - ▶ In a closed economy: A decrease in income leads to lower domestic consumption
 - ▶ In an open economy: It may leave consumption mostly or completely unaffected if there is international consumption insurance over time or across states of nature

- ▶ The effects of shocks to domestic investment and/or savings on domestic real interest rates. Interest rates will change in a closed but may remain unaffected in an open economy
- ▶ Production and welfare An increase in the output of an important sector always increases welfare in a closed economy. But it may decrease it in an open economy (immiserizing growth)

B. It gives rise to **additional variables** and additional relationships

- ▶ The foreign accounts (current account, trade balance,..)
- ▶ International prices (nominal and real exchange rates, world interest rates..)
- ▶ The relationship between interest rates and exchange rates. The effects of changes in the exchange rate on employment and output

What are the key questions of interest in international macroeconomics?

- ▶ The determinants of the current account (CA). The sustainability and implications of large, persistent CA imbalances (for exchange rates, interest rates, output,...).
- ▶ The determinants of nominal and real exchange rates in the short and the long run. The implications of movements in these rates for a country's macroeconomic performance (foreign accounts, income,...). The role of economic policies.

- ▶ The properties and implications of alternative international monetary arrangements (fixed, flexible exchange rates, monetary union) for macroeconomic volatility and welfare.
- ▶ What do they imply for the conduct of feasible and optimal monetary policy?
- ▶ Currency crises
- ▶ The role of international financial markets: What do they do and how they do it?
- ▶ International portfolios. Asset pricing.
- ▶ International capital flows. Sovereign debt crises.