Global Economies and Markets

FIRST-YEAR REQUIRED COURSE PACKET

Quarter II
2008
Global Economies and Markets  
Quarter II, 2008

FACULTY

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COURSE DESCRIPTION

Today all businesses are global. Events occurring thousands of miles away can move markets at home and in even remote corners of the earth. While the global marketplace offers richer opportunities to managers, it also exposes them to more challenges and risks. Now more than ever, understanding the global business environment is essential for effective leadership. The Global Economies and Markets (GEM) course develops models and frameworks for analyzing the opportunities and risks inherent to the global business environment.

The GEM course applies the ideas and methodologies of economics to the analysis of the global business environment in which firms operate and managers make decisions. The core first year course is designed to expand students’ knowledge of global economies and markets in three dimensions. First, it delivers tools for analyzing markets in the global economy and for formulating suitable business strategies by studying topics including institutions, competition, market structure, and change. Second, it provides tools and explains concepts useful in analyzing the performance of national economies by focusing on the economic and political forces that shape production, trade flows, capital flows, interest rates, and exchange rates. Third, it applies the tools of international trade and finance to broaden students’ perspectives and enable them to better understand how globalization affects the performance and strategies of firms and nations.

Wherever your future takes you, in business you will be a more capable leader if you are adept at using economic data and employing standard tools for the analysis of global economies and markets. Thus, we take an informed user’s perspective throughout the course. This is not to say that we will ignore the importance of understanding economic principles and models. Given the complexity of the real world, professional analysts must make use of models to simplify highly complex systems and highlight relevant relationships so as to understand the economic impact of substantive global events. To be an informed user, you must acquire a reasonable level of proficiency for thinking like an economist, but not necessarily to become one. We will learn some basic models and frameworks and we will apply them to analyze historical and current events, national economic policies, and managerial decisions in the context of the changing global business environment. Be assured that the concepts and models you will learn in
the core GEM course are no academic curiosities. They are the core concepts and workhorse models used by chief economists in Wall Street investment banks, by strategists in the most successful macro hedge funds, and by policymakers in central banks and finance ministries around the world.

The core GEM course is intended to be thought-provoking and managerially relevant; it is not designed so as to focus on modeling mechanics or the memorization of economic principles. We will challenge you, as future managers, to think about the implications of alternative national economic policies and their impact on business decisions and stakeholders. As a part of the course, we will discuss current events and emerging trends in the business environment. Upon completion of the course, you should have a working knowledge of essential economic concepts and models and be able to apply that knowledge to understand the complex global business environment.

We are very enthusiastic about the value of the core GEM course and look forward to sharing many valuable learning experiences with you. We wish you great success in Darden’s first-year program and in your future career.

REQUIRED MATERIALS

The cases, notes, and reports included in this case packet are part of the required course materials. In addition, students are required to have access to the Mankiw textbook referenced below. The Mankiw textbook is the text of choice in many of our competitors’ MBA programs and serves as the basic reference book for most of the second-year GEM electives and some finance electives. Required readings will be assigned from Mankiw as well as from several cases, notes and reports.

A. Required Textbook:


This is an intermediate-level macroeconomics textbook. Author Greg Mankiw is a Harvard University professor who served as the chairman of the Council of Economic Advisors from 2003 to 2005 in the Bush Administration. He is widely considered one of the best authors of economics textbooks.

B. Companion Web Site (http://www.worthpublishers.com/mankiw)

The publisher of our required text maintains a companion Web site that provides a range of resources and activities to aid and motivate the student throughout the course.

- **Self-assessment tests.** Students can test their knowledge of the material in the book by taking multiple-choice tests on any chapter or combination of chapters. After the student responds, the program explains the answer and
directs the student to specific sections in the book for additional study. Students may also test their knowledge of key terms using the flashcards.

- **Data Plotter.** Students can explore macroeconomic data with time-series graphs and scatterplots. The plotter contains 34 data series on the U.S. economy.

- **Macro Models.** These modules provide simulations of the models presented in the book. Students can change the exogenous variables and see the outcome in terms of shifting curves and recalculated numerical values of the endogenous variables. The following models are relevant to our course in Q2:
  - Equilibrium Interest Rate
  - Deriving the IS and LM
  - IS-LM Model (a baseline IS and LM model)

- **Presidential Game.** This game allows students to become president of the United States in the year 2012 and to make macroeconomic policy decisions based on news events, economic data, and approval ratings. It gives students a sense of the complex interconnections that influence the economy. It is also fun to play.

### C. Supplemental Textbooks and Materials

Given that the students in this class come from a range of backgrounds, we offer the following list of supplemental materials that you may find useful. Copies of the supplemental textbooks are available through library reserve.


   This is an introductory economics textbook by the same author of our required text. It is well suited for students who have never had an economics class to acquire basic skills and intuitions. The suggested summer readings for GEM include selected chapters.

   2. Pre-matriculation cases and technical notes in the course folder.

   Many of you attended the pre-matriculation GEM course in which many materials and technical notes were discussed and studied. We highly recommend that everyone, particularly those who did not attend the pre-matriculation course, review all of these materials.


   One of the authors of this text, Ben S. Bernanke, is chairman of the Federal Reserve—the U.S. central bank—and a former Princeton University professor. It is another widely used intermediate text on macroeconomics, and we ourselves used it in 2005. It is rich in institutional details and comprehensive in coverage of the topics and issues.

   Another book that students—especially novices to the subject—find useful is:

Though dated, *Memos to the President* offers a highly qualitative and basic approach to a number of the topics we study.

5. **Streaming Video: Economics USA**, Educational Film Center, 2002.  
   [http://www.learner.org/resources/series79.html](http://www.learner.org/resources/series79.html)

   This instructional video series offers 28 high-quality introductory economics lessons using video footage of important historical events and economic commentaries. The videos were made in the 1980s and may seem dated, but they are great learning tools. And, best of all, it is FREE (registration is required; simply click on the VoD icon, and the site will take you through a simple registration process that gives you access to the series).

6. Newspapers and magazines

   The following newspapers and magazines offer good coverage and analysis of events that affect global economies and markets:


   The Darden library subscribes to these and other newspapers and magazines.

**GRADING**

Class participation and exams will be weighted as follows:

**Q2 (Fall)**

- Participation in Q2 (Fall) section discussions  
  35%
- Q2 exam (open book, open notes)  
  65%

**Q3 (Spring)**

- Participation in Q3 (Spring) section discussions  
  35%
- Q3 exam (open book, open notes)  
  65%

You will receive an interim grade at the end of the Q2 (fall) term based solely on Q2 performance, and a final grade at the end of the Q3 (spring) term that incorporates both the Q2 and Q3 grades. Generally, the final grade will be based equally on the Q2 and Q3 terms; however, the GEM faculty reserves the right to recognize major trends in performance across the two terms and adjust grades accordingly. **The Q3 exam is**
directed principally towards spring material, yet it will utilize comprehensive skills and understanding acquired in the topics of the entire course, fall included.

The Darden faculty believes that people learn best through active engagement. Therefore, participation in class is an essential part of your learning experience. There are many effective ways to participate in class discussions, regardless of your comfort-level with economics, ranging from asking good questions to articulating ideas and insights that will help foster the learning and understanding of the entire section. Our belief in everyone’s ability to contribute to our shared learning experience is reflected in both the way we conduct class and how we assess class participation grades. It is not sufficient to master the material for oneself: true mastery requires developing the ability to articulate ideas in ways that help enlighten others. We believe that without the ability to explain your analysis and use it to persuade others to adopt your recommended course of action, even the best analysis can have little substantive impact.
# Global Economies and Markets
## Course Outline
### Quarter II, 2008

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<td>1. Readings and related Media on the Financial Crisis (In order to focus on the most current events, readings, media sources and any relevant data on this topic will be distributed electronically at least one week prior to this class session).</td>
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Assignment

Class #: GEM1

Topic: Macroeconomics and Managerial Decisions

Materials:
1. Mankiw, *Macroeconomics*, Chapters/Sections 1.1, 2 and 6.1
2. Case: “What Went Wrong at CISCO?” *CIO Magazine*

Case Data: Business_Cycle_CISCO.xls

Assignment:
1. Why was the impact of the 2001 recession particularly strong on CISCO? What could CISCO have done to lessen the impact?
2. What would you recommend that CEO John Chambers do beginning in mid-2001?
3. What were the important causes of the 2001 global economic slowdown? Identify one and be prepared to explain?
4. Can managers proactively respond to the business cycle? How?
Assignment

Class #: GEM2

Topic: The Global Economy

Materials:
1. Mankiw, *Macroeconomics*, Chapters 5.1 and 5.3 (pp. 131-34 only)

Case Data:
1. Bernanke_Saving_Glut.xls
2. Interest_Rates_GEM.xls
3. EconPI-MBA.xls

Assignment:
1. Answer Question 9 on page 148 of Mankiw.
2. Read Chairman Bernanke’s remarks on the U.S. current account deficit and analyze the causes of the U.S. current account deficit. Discuss Bernanke’s arguments in your study team and compare the predictions of his analysis with the data that we have provided you in GEM. Be prepared by defend your position.

Notes:
The current account measures the net flow of current transactions, including goods, services, interest payments, transfer payments (e.g., foreign aid) between countries. It is the sum of the balance of trade (net exports or exports less imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid).

A current account surplus signifies a country that is a net exporter of capital, which means the country is a net buyer of foreign assets. Conversely, a current account deficit signifies a country that is a net importer of capital, which means that the country is a net seller of assets to foreign residents.

The balance of trade is typically the largest part of the current account. Changes in the patterns and the values of traded goods and services are key drivers of the current account.

We may write the economy-wide saving-investment relationship as

\[ S - I = CA \]

where \( S \) is national savings, \( I \) is investment and \( CA \) is the current account balance.
Assignment

Class #: GEM3

Topic: Money, Interest Rates and Inflation

Materials:
1. Case: Zimbabwe: Grappling with Hyperinflation  (UVA-G-0599)

Case Data: Refer to case charts and graphs

Assignment:
1. How does hyperinflation change the behavior of consumers?
2. With 10,000% annual inflation, what should be the price one year from now of a good that costs 1 Zimbabwean dollar today?
3. How are buyers and sellers likely to respond to Mugabe’s decree? Who wins and who loses from the decree?
4. Why did the current Zimbabwean government and the German government in the early 1920s print so much money?

Notes:
Assignment

Class #: GEM4

Topic: Analyzing the Financial Crisis I

Materials:
1. Mankiw, *Macroeconomics*, Chapters 4.1, 4.2, 4.3 and 4.5
4. Data & Readings on the US/World economy in 2008, (In order to focus on the most current events, additional materials will be distributed electronically at least one week prior to this class session).

Case Data: Data to be disseminated electronically prior to class

Assignment:
1. What are the fundamental determinants of the current financial crisis that began as the sub-prime crisis in the summer of 2007?

2. How has the financial crisis affected inflation, interest rates, gdp and unemployment in 2008? How do you expect the crisis to affect the US economy in 2009?

3. How have actions of the Federal Reserve and the US Treasury affected the U.S. economy in 2008?

4. How should the US government, the Federal Reserve and the US Treasury respond at this stage of the financial crisis? What will be the effects on the economy of the actions that you recommend?

Notes:
Assignment

Class #: GEM5

Topic: Modeling and the Business Cycle

2. A Technical Note on the IS/LM Model (UVA-F-1541)

Case Data:

Assignment:  
1. What key macroeconomic and industry variables are central to managerial decisions during times of economic expansion or contraction?

2. What are the primary uses of macroeconomic models like the IS/LM and AS/AD models?

3. What are the key relationships that macroeconomists study? How are these represented in the IS/LM and AS/AD models?

Notes:
Assignment

Class #: GEM6

Topic: Modeling Aggregate Demand and Aggregate Supply

Materials:

Case Data: Refer to tables and charts in the case.

Assignment:
1. What caused the inflation and rising unemployment, particularly in the US, in the 1970s? Use the AS/AD framework to analyze this question.
2. What seems to be the cause of rising inflation around the world in early 2008?
3. How would the inflationary pressures of 2008 affect GDP, unemployment and interest rates?
4. What should the Fed or the US government do about inflation in 2008? Use the IS/LM and AS/AD models as appropriate to determine the effects of your policy recommendations.

Notes:
Assignment

Class #: GEM7

Topic: Modeling Fiscal Policy

3. Technical Note: “Measures of the Budget and Fiscal Policy”

Case Data: Taxcut64.xls

Assignment:

1. What were the objectives of the tax cut proposal?
2. What was President Kennedy’s advisor’s estimate of the income multiplier?
3. How well did President Kennedy manage the legislation?
4. Use the data in the worksheet (“Taxcut64”) to analyze the state of the economy before and during Kennedy’s consideration of tax reform. Did the tax cut achieve its objectives?
5. Answer Question 4 on page 302 of Mankiw.

Notes: Glossary:

*Potential Output* (also referred to as *Full Employment Output*) is the real GDP that an economy produces when the economy is running at full employment (i.e., when the unemployment rate is at the natural rate of unemployment). The natural rate of unemployment is the rate to which the economy gravitates in the long run, given all the labor-market imperfections that impede workers and employers from finding instant matches.

*Output Gap* is the difference between actual real GDP and potential output. An economy is producing below its potential output level when its unemployment rate is above the natural rate.
Assignment

Class #: GEM8

Topic: Modeling Monetary and Fiscal Policy

Materials:
2. Case: Bernanke in 2005 (UVA-Draft)

Case Data: Bernanke-2005.XLS

Assignment:

2. How will the sharp rise in oil prices in 2005 affect the US economy?

3. How might a sudden rise in the Fed Funds rate affect the housing market? How would the resulting changes in the housing market affect the macroeconomy?

4. What should Chairman Bernanke recommend the Fed do heading into 2006?

Notes:
Assignment

Class #: GEM9

Topic: The Money Multiplier and Modeling Monetary Policy

Materials:
1. Mankiw, *Macroeconomics*, Chapters 11.1 and 18.1
2. Problem Set—Paul Volcker
   http://www.learner.org/resources/series79.html

Case Data: USA1971-1982.xls

Assignment: Answer the questions in the Problem Set.

Notes: Glossary

*Reaganomics* (a portmanteau of “Reagan” and “economics,” coined by radio broadcaster Paul Harvey) is a term that has been used to both describe and decry the economic policies of U.S. President Ronald Reagan, who was President from 1981 to 1989.

Reaganomics had its roots in two of Reagan's campaign promises: lower taxes and a smaller government. Reagan reduced income tax rates, with the largest rate reductions on the highest incomes; the top tax bracket rate dropped from 70% to 50% in his first tax legislation, and would fall to 28% by the end of his presidency. He proposed reduction in federal civilian programs, although political forces prevented him from obtaining the large reductions he sought. He scaled back federal regulation, starting with the elimination of federal oil price control, and left more discretion to the private sector. However, Reagan had also promised a military buildup to counter the Soviet Union, and this included a dramatic increase in government contracts. This buildup, combined with the continuing growth of civilian programs, raised deficit spending to its highest level (relative to GDP) since World War II. As a result, there has been endless debate on whether the economic trends of the Reagan years actually came from increased productive capacity in response to tax cut and deregulation (the supply side), or from increased aggregate demand caused by large deficit spending.
Assignment

Class #: GEM10

Topic: Financial Markets, Panic and Regulation

Materials:
1. Case: The Panic of 1907 (UVA-G-0619)

Case Data: All relevant data is contained in the case

Assignment:
1. What triggered the banking crisis? Do you see parallels with the credit crunch of 2007-8?
2. What tools were available to address a liquidity crisis at the turn of the century?
3. What improvements would you propose to the financial structure of the United States in the aftermath of the 1907 crisis?
4. Using the data in the case, what would be the effect on the money stock due to a change in the reserve-deposit and the currency-deposit ratios in the wake of the banking crisis?
5. How would you analyze the impact of the 1907 crisis in a macroeconomic framework such as IS/LM?

Notes:
Assignment

Class #: GEM11

Topic: The Great Depression

Materials: 

Case Data: Great_Depression.xls

Assignment:

1. What caused the Great Depression? Use the IS/LM model to demonstrate your answer.

1. What might the Fed have done to stop the downward spiral of the economy? When should the Fed have acted?

2. Why is it important that the Fed has been the primary regulator of banks operating in the United States?

3. What, if any, lessons from the Great Depressions are applicable in today’s economy?

Notes:
Assignment

Class #: GEM12

Topic: Applying the IS/LM Model

Materials: Case: “Germany in the 1990s: Managing Reunification” (9-793-043)

Case Data: Refer to data and tables in the case.

Assignment:

1. What is Kohl’s Reunification strategy?

2. How will reunification likely affect the macroeconomy (i.e. interest rates, inflation, unemployment, gdp)? Prepare to share your IS/LM analysis.

3. What fiscal and monetary policy options are available to manage the macroeconomic challenges that are resulting from reunification?

4. How will macroeconomic policy responses to reunification affect ‘West’ German firms and organized labor?

Notes: Focus: The examination of the Germany economies in the early1990s raises many issues that will be of interest to us in the second half of GEM (i.e. Q3). Bear in mind that issues surrounding the value of the German Mark and the effort to more deeply integrate Western European markets are important, but will not be the focus of this class. We will return to these ‘other’ issues later in the course.
Assignment

Class #: GEM13

Topic: Analyzing the Financial Crisis II

Materials: Contemporary Readings and Media (Pending)

Case Data: Data to be provide electronically in advance of class.

Assignment: The assignment for this class will be based on contemporary data and will be disseminated electronically.
Assignment

Class #: GEM14

Topic: Exam Review

Materials: 1. “Eurozone Rate Cuts in 2008: Oui or Nein?”
2. GEM 2007 Q2 Exam Questions

Case Data: Eurozone2008.XLS

Assignment: Answers the exam questions and prepare to share them with the class.

Notes:
Assignment

Class #: GEM15

Topic: Exam Review

Materials: 1. “Eurozone Rate Cuts in 2008: Oui or Nein?”
            2. GEM 2007 Q2 Exam Questions

Case Data: Eurozone2008.XLS

Assignment: Answers the exam questions and prepare to share them with the class.

Notes: