Global Economies and Markets

FIRST YEAR REQUIRED COURSE PACKET

Quarter III
2009
Global Economies and Markets  
Quarter III 2009

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. Understanding the global business environment is therefore a prerequisite for effective leadership. The Global Economies and Markets course is designed to help students develop frameworks for analyzing both opportunities and risks when operating in the global business environment.

The course applies the ideas and methodologies of economics to the analysis of the business environment in which firms operate and managers make decisions. GEM expands students’ knowledge of global economies and markets in three dimensions. First, it delivers insights and tools for analyzing markets in the global economy and for formulating business strategies by studying topics including competition, market structure, efficiency, industry equilibrium and change. Second, it provides tools and concepts for analyzing the performance of national economies by focusing on the economic and political forces that shape production, trade flows, capital flows, interest rates, exchange rates and other variables that define the global economic landscape. Third, it applies the tools of international trade and finance to broaden students’ perspectives on how globalization affects the performance and strategies of nations and firms.

While we realize that very few of you may become professional economists, we fully expect that all of you will be users of economic data and analyses 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 things and highlight relevant factors and relationships so as to understand the economic impact of substantive global events. To be an informed user, you will need to acquire an executive level of proficiency for thinking like an economist, but not necessarily to become one. Indeed, 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 changing global business environment. The concepts and models you should gain a working knowledge of are no
academic curiosas. They are used by chief economists in the Wall Street investment banks, by strategists in the most successful macro hedge funds, and by policy makers in central banks and finance ministries around the world.

This course is intended to be thought-provoking and managerially relevant; it is not designed as one predominantly focused 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 various business stakeholders. As a part of the course, we will also bring to the discussion current events and emerging trends in the business environment. Upon completion, 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 look forward to working with you and wish you 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. The author of the textbook is a Harvard University professor who served as the Chairman of the Council of Economic Advisors from 2003 to 2005 in the Bush Administration. Mankiw is widely considered one of the best authors in economics textbooks.

B. Companion Web (www.worthpublishers.com/mankiw)

The publisher of our required text maintains a companion website, which 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.** The 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 the range of backgrounds in the class, from time to time you may find it useful to consult some of the supplemental materials listed below. Copies of the supplemental textbooks are available through library reserve.


We will also make regular use of contemporary media reports on the economy. We will work to connect GEM themes and models to closely related writings such as those that appear in popular business sources: *The Wall Street Journal, Financial Times, Business Week, The Economist* and *Bloomberg*. You can access highly relevant articles through the ‘GEM In The Media’ page at the following web address:


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 supplementary readings for GEM include selected chapters from it. The Darden Library will have ten copies on GEM Reserve.

3. Technical Notes and Cases from GEM Pre-matriculation Course – On The GEM Course Web Folder.


One of the authors of this text, Ben S. Bernanke, is a former Princeton University professor and currently the Chairman of the Federal Reserve System—the U.S. central bank. This is another widely used intermediate text on macroeconomics. It is rich in
institutional details and comprehensive in coverage of the topics and issues. We used this textbook in 2005. The Darden Library will have ten copies on GEM Reserve.

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

5. Charles Schultze, *Memos to the President*, Brookings, 1992 (paperback)*

There are a number of copies of this book on GEM Reserve in the Library. While dated, the book offers a highly qualitative and basic approach to a number of the topics we study.


The instructional video series, produced by the Educational Film Center, offers high quality introductory economics lessons using video footages of important historical events and economic commentaries. It is a great learning tool. And best of all, it is FREE (but registration is required). There are 28 half-hour lessons on both microeconomics and macroeconomics.

7. 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 GEM faculty believes that active engagement in classroom discussions promotes comprehension of economic concepts. Therefore, participation in class is an essential part of your learning experience. Among the many effective ways of participating in class discussions are asking good questions, articulating ideas and insights that will help foster the learning and understanding of the entire section and constructively challenging an ongoing analysis or recommended course of action. We view personal mastery of GEM concepts as only one part of excellence performance in our course: true mastery also requires developing the ability to articulate ideas in ways that help enlighten others. Without the ability to explain your analysis and use it to persuade and enlighten others, even the best analysis may not succeed in affecting the decisions of leaders and the performance of firms and societies.
<table>
<thead>
<tr>
<th>Class</th>
<th>Materials</th>
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| 1     | 1. Jaguar plc. 1984 9-290-005  
3. Jaguar DCF Valuation Model and Assignment | Introduction to Exchange Rates |
| 2     | 1. Mankiw, *Macroeconomics*, Chapter 5.3 (pp. 131-145)  
| 3     | 1. Fishy Issues: The U.S. Shrimp Anti-Dumping Case UVA-G-0600 | Trade and Protectionism |
| 4     | 1. Mankiw, *Macroeconomics*, Chapter 12 appendix and 12.1, 12.2, and 12.3 (Carefully read the appendix to chapter 12 and Skim 12.1 – 12.3)  
2. A Technical Note on the Open Economy IS/LM Model (UVA-Draft) | Open-Economy IS/LM Model |
| 5     | 1. Germany in the 1990s: Managing Reunification 9-793-033  
| 6     | 1. Brazil: Dealing with International Shocks UVA-BP-0509  
| 7     | 1. Chile: A Changed Jungle for the Latin American Tiger (Abridged), UVA-BP-0458  
| 8     | 1. Inflation Targeting in South Africa UVA-BP-0507  
| 9     | 1. A Note On Long-Run Models of Economic Growth UVA-Draft  
2. GEM Growth Model (File Posted to Course Folder) | Economic Growth |
| 10    | 1. Foreign Direct Investment in Ireland’s Tiger Economy 9-706-007  
2. Multinationals and Foreign Direct Investment, UVA-G-0613 | Foreign Direct Investment and Economic Growth |
   Multinationals and FDI

   China’s Economy and Growth

13 1. India on the Move 9-703-050  
   India’s Economy and Growth

14 1. Examining the economic future for China and India  
   (Assignment, Data and Readings to be distributed electronically)  
   China and India

   Exam Review
2. GEM Spring 2008 Exam Questions

Exam
Class #1: January 19, 2009

Topic: Exchange Rate and Currency Risk Exposure

3. Jaguar DCF Valuation Model and Assignment (case data file)

Case Data: DCF Valuation Model for Jaguar – posted to course folder

Assignment:
Read the case and review the section on exchange rates in the Mankiw text. Use the Jaguar DCF Valuation Model to answer the questions given below:

**Case 1: No inflation, Constant Exchange Rate**
A. Estimate the value of Jaguar equity at year end 1983 assuming:
   - No inflation in the US or the UK
   - No change in the nominal exchange rate

**Case 2: General Inflation in UK and US**
A. Estimate the value of Jaguar equity at year end 1983 assuming:
   - 5% annual inflation in the US and the UK
   - No change in the nominal exchange rate
   B. What effect does general inflation have on the value of Jaguar equity?

**Case 3: US Inflation**
A. Estimate the value of Jaguar equity at year end 1983 assuming
   - 5% annual inflation in the US and no inflation in the UK
   - No change in the nominal exchange rate.
   B. Why does the value of Jaguar equity change relative to Case 1

**Case 4: UK Inflation**
A. Estimate the value of Jaguar equity at year end 1983 assuming
   - No inflation in the US and 5% annual inflation in the UK
   - No change in the nominal exchange rate.
   B. Why does the value of Jaguar equity change relative to Case 1

**Case 5: US Inflation, Constant Real Exchange Rate**
Estimate the value of Jaguar equity at year end 1983 assuming:
   - 5% inflation per year in the US and no inflation in the UK
   A nominal exchange rate that changes as follows:
   \[ S(t) = S(t-1) \left(1 + \frac{I_{US}}{1 + I_{UK}}\right) \]
   where \( S(t) \) is the current period nominal exchange rate in dollars per pound,
   \( S(t-1) \) is the exchange rate last period, \( I_{US} \) and \( I_{UK} \) are the current period inflation rates in the US and UK. (To calculate \( S(t) \) for 1984, set \( S(t-1) = 1.35 \).

What happens to the value of Jaguar’s equity under these assumptions?
How does the real exchange rate change over time in this case?

Notes:
Class #2: January 21, 2009

Topic: Exchange Rate Determination

Materials:

Assignment:

1. The law of one price and purchasing power parity (PPP) are often referred to as practical measures for what “the right exchange rate should be.” What is the intuition that justifies such a view? Discuss the impact that net capital flows will have on the exchange rate when purchasing power parity holds?

2. How well does “the law of one price” hold, when you study the Hamburger standard from the *Economist*? How would you explain differences in $ prices of the Hamburgers across countries?

3. How well does PPP hold over time? Compare the time series in the data file (PPP.xls) for the nominal dollar ($) – pound (£) exchange rate and the CPIs in both countries. [You can take 1948 as base year for your calculations].

4. Is the view that Martin Feldstein presented in his remarks plausible if PPP holds at every moment in time? Why, why not? What does it imply for the role of capital flows in determining the exchange rate?

Notes:

1. Martin Feldstein is a Harvard professor, president and CEO of the National Bureau of Economic Research, and former chairman of the Council of Economic Advisors under President Reagan.

2. Big Mac Index. Burgernomics is based on the theory of purchasing-power parity, the notion that a dollar should buy the same amount in all countries. Thus in the long run, the exchange rate between two countries should move towards the rate that equalizes the prices of an identical basket of goods and services in each country. The “basket” used to construct the Big Mac Index is a McDonald's Big Mac, which is produced in about 120 countries. The Big Mac PPP is the exchange rate that would imply that hamburgers cost the same in America as abroad. Comparing actual exchange rates with PPPs indicates whether a currency is under- or overvalued. (Source: [www.economist.com](http://www.economist.com))

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Assignments
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Class #3: January 26, 2009

Topic: International Trade

Materials:
1. Fishy Issues: The U.S. Shrimp Anti-Dumping Case UVA-G 0600
2. The Effects of Tariffs and Quotas UVA-G-0595

Case Data: Refer to graphs and tables in the case

Assignment:
1. You may want to quantify the potential impact of antidumping tariffs on the welfare of the U. S. consumers, producers, the government and exporters. You assume that shrimp tariffs increase from 0% to 10%. You approximate domestics supply and demand with lines based on the prices and quantities for the last two years from Exhibit 4. For the purpose of the exercise, you can ignore any differences between different types of domestic shrimp. (Domestic demand corresponds to $P=6768.824 – 0.005294Q$ and Domestic Supply to $P = -2790 + 0.04Q$, where $P$ is the price per ton of shrimp and $Q$ is the number of tons of shrimp). 2003 is the starting point for the analysis. In that year, there was no import tariff and the United States imported 565,000 tons of shrimp. The domestic price was $3.01 per kilo or $3010 per ton. In a first scenario, you assume that the world price of shrimp, which equals the U.S. nominal price for 2003, does not change when anti-dumping tariffs are levied. It helps to also draw supply and demand.

2. How would the imposition of the tariff affect the world price of shrimp? Would this tariff improve or worsen the welfare situation for consumers, producers, the government, and the foreign exporters?

3. Some would argue that the tariffs on the six countries would not necessarily guarantee much higher prices. Can you come up with arguments about why that could be the case? It may also help to think of any strategies that shrimp producers from the six countries that were targeted by the anti-dumping case might pursue to circumvent the tariffs.

Notes:
Global Economies and Markets  
Assignments  
Quarter III, 2009

Class #4: January 27, 2009

Topic: The Open-Economy IS/LM

Materials:  
1. Mankiw, *Macroeconomics*  
   a. Carefully read the appendix to chapter 12  
   b. Skim Chapter 12.1 – 12.3  
2. A Technical Note on the Open-Economy IS/LM

Case Data:

Assignment:

1. For (i) a large open economy with a flexible exchange rate, (ii) a small open economy with a flexible exchange rate, and (iii) a small open economy with a fixed exchange rate, use graphs similar to Fig. 12-15 (a), (b) and (c) to predict what would happen to aggregate income, the exchange rate and the trade balance in response to the following shocks:  
   a. An increase in government spending  
   b. A fall in consumer confidence about the future induces consumers to consume less and save more.  
   c. A tightening of monetary policy (through a reduction in the money supply).  
   d. An increase in the foreign interest rate $r^*$

2. For a small open economy, the IS and CF curves are much flatter than for a large open economy. Why?

Notes:
Class #5: February 2, 2009

Topic: Macro-Policy and International Arrangements in an Open Economy

Materials:
1. Germany in the 1990s: Managing Reunification 9-793-033
2. Mankiw, Macroeconomics, Chapter 12.5

Case Data: Refer to the tables and graphs in the case

Assignment:
1. How does the ERM work?
2. What could other EMS nations do when faced with German interest rate increases? Evaluate the costs and benefits of the possible responses you identify.
3. In the fall of 1992 George Soros, who headed Quantum Funds, made a large bet in financial markets against the BOE. Why did he do so?
4. What are the benefits and costs of joining the EMU?

Notes:
Class #6: February 3, 2009

Topic: Managing External Shocks


Case Data: Refer to tables and graphs in the cases.

Assignment:
Read the case, review the User’s Guide and prepare to discuss the following questions in class


2. In August 1998, the Russian government defaulted on its debt and global investors began to sell emerging market securities. In this context, suppose that the Brazilian government adopted the policy stance of flexible exchange rate, free capital flows, and independent monetary policy. What would be the expected impact of this event on the exchange rate and the economy.

3. How do your predictions in question #2 fit with the data?

4. In January 1999, what policy would you recommend to the Brazilian government?

Notes:
Class #7: February 4, 2009

Topic: Managing External Shocks

Materials:
1. Chile: A Changed Jungle for the Latin American Tiger (Abridged), UVA-BP-0458

Case Data: Refer to tables and graphs in the case. These will also be posted to the course folder.

Assignment:
In this assignment, frame your analysis in terms of our open-economy IS/LM model.

1. What key economic problems did Chile face in the mid-1990s?

2. What were the principal causes of these problems?

3. What policy options for dealing with key economic shocks and risks were available to Chile in mid-1998?

4. What actions or specific policies would you recommend to Carlos Massad?

Notes:
Inflation targeting (IT) is the monetary policy regime of choice for many developed and emerging market countries around the world. Today’s case highlights the difficult tradeoffs in emerging market economies.

1. Assume that inflation is projected to surge in 2002. Under an IT regime, what kind of monetary policy must the SARB implement in their first policy meeting in 2002? What are the predicted effects on the economy (long-term interest rates, real activity, the exchange rate, etc.)?

2. Assume again that inflation is projected to surge in 2002. If the SARB were to discontinue its IT policy, what monetary policy measures would you recommend? With these alternative measures, what are the predicted effects on the economy (long-term interest rates, real activity, the exchange rate, etc.)?

3. What do you recommend the SARB to do in early 2002?
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Class #9: February 12, 2009

Topic: Economic Growth

Materials: A Note On Long-Run Models of Economic Growth UVA-Draft

Case Data:

Assignment:

1. What questions addressed by the Solow model are not addressed in the IS\LM model?
2. What are the fundamental sources of long-run economic growth? How do they interact in the Solow growth model?
3. What does the model imply about national savings?
4. What does the model imply about an economy’s growth rate over time?
5. What does the model imply about the relative levels of per capita income across countries over time?

Notes:
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Class #10: February 13, 2009

Topic: Foreign Direct Investment (FDI)

Materials: 1. Foreign Direct Investment in Ireland’s Tiger Economy 9-706-007
2. Multinationals and Foreign Direct Investment, UVA-G-0613

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

Assignment:
1. What accounts for the Irish economic success?
2. What role did FDI play in the growth of the Irish economy? Should countries subsidize FDI?
3. How does the growth of the Irish economy fit with the predictions of the Solow model?
4. Can the Irish model be replicated?

Notes:
Class #11: February 16, 2009

Topic: Economic Growth

Materials: Gerber Products Company: Investing in the New Poland 9-793-069

Case Data:

Assignment:
1. How attractive is the Alima deal? What parts of the deal concern you?
2. What would you advise Schomer and Clark to do in December 1991?
3. Are the assumptions of the capital budgeting model reasonable?
4. How might deals like this one influence the course of the Polish economy over time?

Notes:
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Class #12: February 17, 2009

Topic: China

Materials: China: Building “Capitalism with Socialist Characteristics” 9-706-041

Case Data:

Assignment:
1. Examine the performance of the Chinese economy since 1980. What reforms and policies were central to the performance over this period?
2. How have external policies (i.e. those that deal with the exchange rate and trade) influenced the performance of the economy?
3. What issues do you see regarding the continuation of these policies?
4. What lessons can be learned or generalized from the Chinese reform and economic performance since 1980?

Notes:
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Class #13: February 18, 2009

Topic: India

Materials: India on the Move 9-703-050

Case Data:

Assignment:
1. What are the strategic issues facing India in 2003?
2. What is unique about the Indian development challenges?
3. How successful have previous policies been during the period 1991-2003? What worked and what did not work?
4. How might the Planning Commission’s recommendations affect India from a macroeconomic perspective? From a competitiveness perspective?

Notes:
Global Economies and Markets
Assignments
Quarter III, 2009

Class #14: February 23, 2009

Topic: China and India

Materials: Data, reading and assignments to be distributed electronically.

Case Data: Data and readings posted to the course folder

Assignment: To be distributed electronically.

Notes:
Class #15: February 24, 2009

Topic: Exam Review

            2. GEM Spring 2008 Exam Questions

Case Data: Case data in Excel posted to the course folder

Assignment: Answer the exam questions.

Notes: