

Introduction to International Macroeconomics (Ch. 11)

WS 2018

Harris Dellas

- Thinking about Macroeconomics
- The aggregate performance of an economy
- Determination of
- Quantities: total output and its components, consumption, investment, government spending; savings; employment, unemployment,...
- Prices: Inflation, wages, interest rates,...
- How quantities and prices are affected by shocks (technological progress, globalization, war,..) and policy (monetary-fiscal policy, regulations, taxes,..)

.

- Thinking about International Macroeconomics:
- The aggregate performance of an **open** economy
- Determination of
- Quantities: total output and its components, consumption, investment, government spending; savings; employment, unemployment; **balance of payments, trade balance, the current and capital account, Net International Investment Position (NIIP)**
- Prices: Inflation, wages, interest rates; **exchange rates (nominal and real)**

So in an open economy, there are *additional* variables to be determined.

Moreover, the determination of other variables is also affected by degree of openness.

Example: investment in a closed vs an open economy.

Preview of the topics

- 1. Definitions and measurement of the foreign accounts (ch. 12)
- **Balance of Payments (BOP)**
- **BOP**—a record of a country's economic transactions with the rest of the world.
- The BOP's main components are the current account (CA) and the Financial-Capital Account (KFA).
- The CA's main components are the trade balance (TB) (or net exports (NX)) and the income account.

Ch 12

- Interesting questions, ch. 12
- How do BOP variables relate to National Income Accounts variables (Consumption, Investment, Savings,..)?
- Does a country become richer or poorer when it runs a CA surplus?
- Why has VH been running CA surpluses for many years and Greece CA deficits?
- The US has been running trade deficits for the last 40+ years. What does this imply for its relative wealth? Can it continue doing it indefinitely?

2. A description of the foreign exchange market, FEM (ch. 13)

- What is the Exchange Rate (ER)?
- Types of Exchange Rates (spot, forward)
- Activities in the FEM: Arbitrage, Hedging, Speculation
- Instruments for these activities: Swaps, Futures, Options
- Central Bank Intervention in FEM (the recent Swiss –SNB- experience)
- Interesting question: Are risk free profits available in the FEM?

3. Relationship between the key aggregate prices (ch. 14, 15)

- Prices and Exchange Rates (Purchasing Power Parity, PPP)
- Interest Rates and Exchange Rates (Interest Rate Parity, IRP)
- *Interesting questions*
- Why has the CHF been so strong while interest rates in CH have been typically lower than those abroad?
- When is a currency overvalued? Is the CHF overvalued?
- Why have the Turkish Lira and the Argentinian Peso lost so much of their value this year?
- Does it pay to borrow in foreign currency when foreign interest rates are low?

4. Theories of the international quantities (BOP) and prices (FE) (ch. 17,18)

- Interesting questions
- What moves exchange rates?
- Why has the CHF appreciated strongly vs the EUR? Why is the USD worth now $\frac{1}{4}$ of its value in 1950?
- What are the implications of movements in the FE for GDP and unemployment?
- Are more open economies more volatile?

5. International Monetary Arrangements (ch. 19)

- Types of exchange rate regimes (Fixed, Flexible, Currency Union, Dollarization)
- *Interesting questions*
- What are the pros and cons for CH adopting the EUR?
- Have economies fared better under fixed or flexible rates?
- What causes currency crises? Can they be defended? Does the Central Bank have complete control over the FE?

6. International Debt (ch. 20)

- International Financial (Credit) Markets
- *Interesting questions*
- Why do countries borrow internationally?
- What causes defaults?
- What are the consequences of defaults?
- Case studies: Greece, Argentina

Open-Economy Macroeconomic Policy and Adjustment (ch 21)

- How does economic (monetary and fiscal) policy matter for the open macro-economy?
- Is it more or less effective in open economies?

[Home](#) [News](#) [Sport](#) [Weather](#) [Shop](#) [Earth](#) [Travel](#)[Home](#) [Video](#) [World](#) [UK](#) [Business](#) [Tech](#) [Science](#) [Stories](#) [Entertainment & Arts](#) [Health](#) [More](#)[Business](#) [Market Data](#) [Global Trade](#) [Companies](#) [Entrepreneurship](#) [More ▾](#)

ADVERTISEMENT

Argentina - the crisis in six charts

By Andrew Walker & Daniele Palumbo
BBC World Service economics correspondents

9 September 2018

[f](#) [🗨️](#) [🐦](#) [✉️](#) [Share](#)



AFP

Argentines are angry that the government turned to the IMF (FMI in Spanish)

Argentina is once again looking into the barrel of an economic crisis.

The currency is sliding, inflation rising and there could well be a recession in the making.

The International Monetary Fund (IMF) is providing an emergency loan.

It's all happening under a government that was seen by the international financial markets as offering Argentina new hope, one which, under the leadership of President Mauricio Macri, held out the prospect of stability and sustainable market-oriented economic policy that could begin to reverse a century of poor performance.

We look at six factors which have helped drive the crisis.

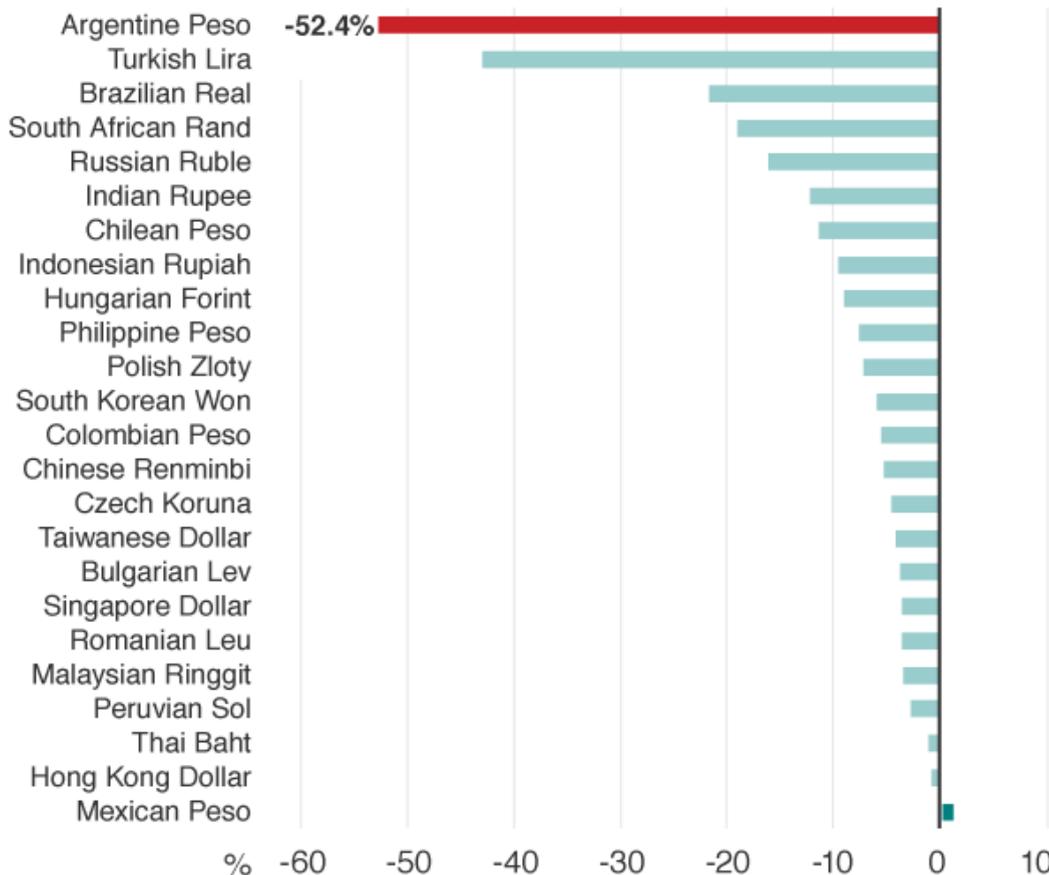
ADVERTISEMENT

Peso plummets

It has been a grim year for the Argentine economy and the national currency, the Peso. Almost all emerging market currencies are down, due to rising interest rates in the United States encouraging investors to move money there.

The fall of emerging markets currencies

Argentine peso is the worst performing currency against the US dollar in 2018



Source: Bloomberg. Last update 06/09/2018

BBC

But the Peso has declined further than any other.

Argentina has IMF history

Once again, Argentina has turned to the IMF for financial help in a crisis.

It has agreed to lend Argentina a total of \$50bn. Going to the IMF is a controversial move, especially so in Argentina.

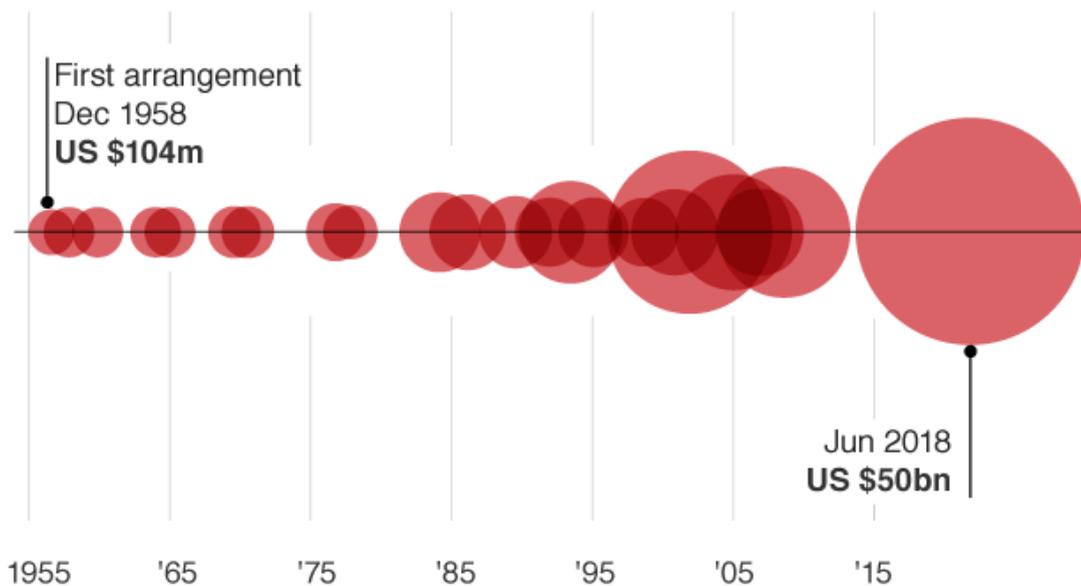
ADVERTISEMENT



IMF support generally comes with conditions that include unpopular austerity. Many Argentines blamed the IMF for the previous crisis in 2001. And there's a history. Argentina had its first IMF programme sixty years ago.

IMF and Argentina: A long history of lending

Lending arrangements since 1958



Note: Values in US Dollars as converted from Special Drawing Rights (SDR).
1 SDR = 1.39 USD as per 03/09/2018

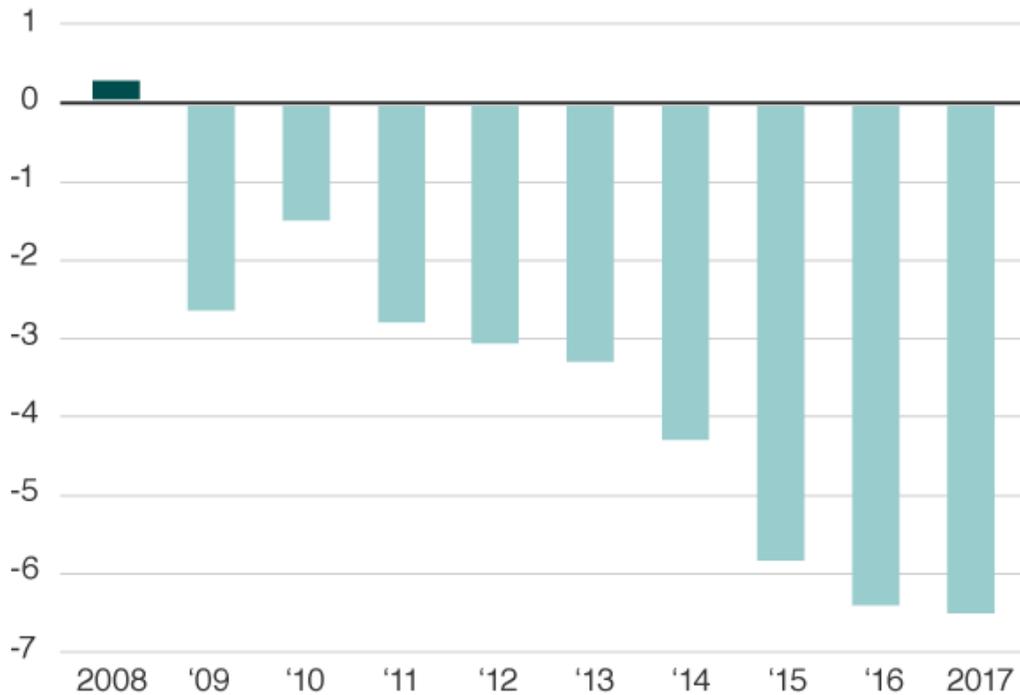
Source: International Monetary Fund

BBC

Messy finances

The loss of confidence among international investors reflects concerns about whether the government can meet all its debt repayments and borrow the new money it needs to finance its spending.

General government net lending/borrowing As % of GDP



Source: International Monetary Fund

BBC

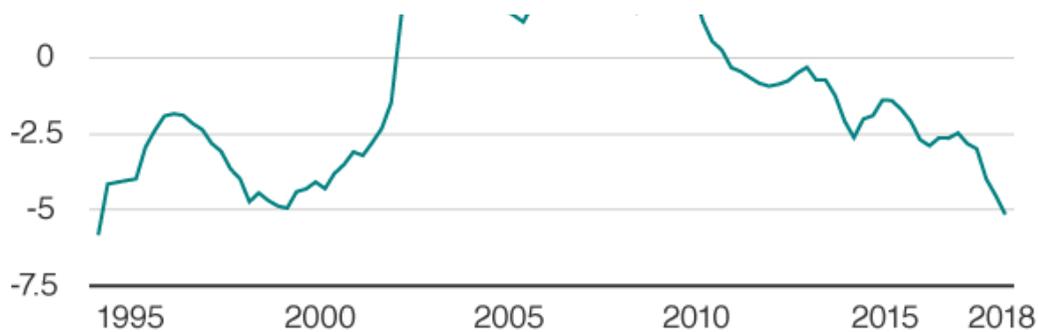
When President Macri took office at the end of 2015 the deficit in the government's finances - how much more it spends than it takes in taxes - was large. He wanted to bring it down but adopted a gradual approach to economic reform.

There is also a growing deficit in the country's international trade (or strictly speaking its current account). That has to be financed by foreign borrowing or investment, which is increasingly challenging at a time when US interest rates are rising.

Current account balance

As % of GDP





Source: International Monetary Fund

BBC

In fact the deficit got slightly larger leaving Argentina at risk from anything that might make investors more inclined to pull their money out.

Rocketing inflation

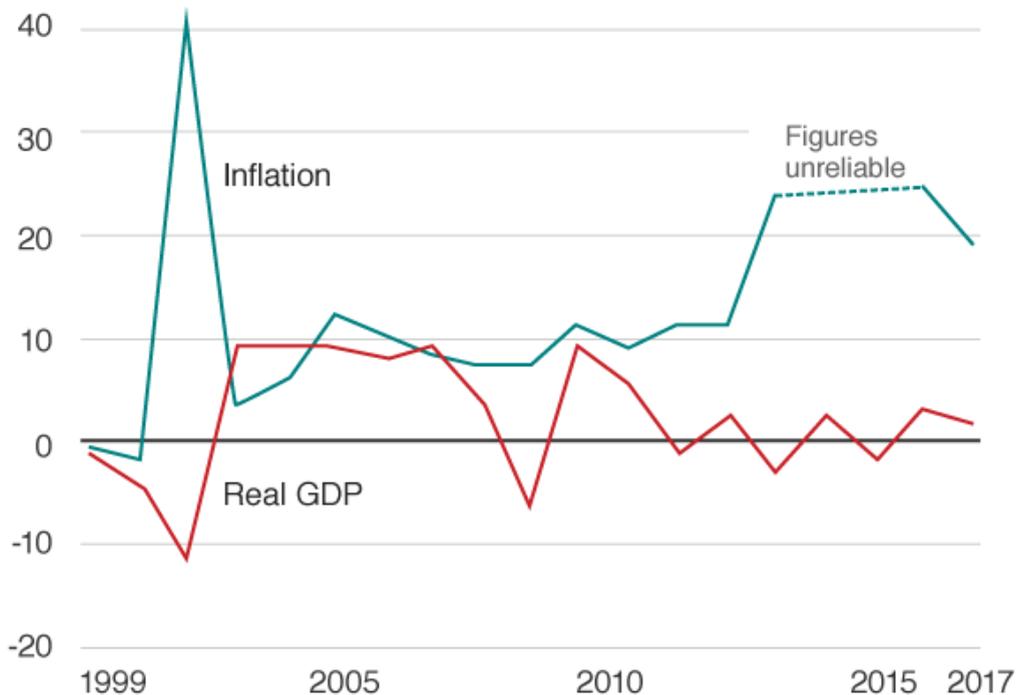
Argentina's long standing inflation problem is another element in the crisis. The most recent figure is around 30%. That is one of the highest in the world, although not exceptional in Argentina's history.

There was a period of relatively moderate inflation in the 2000s, but it didn't last. (There is a gap in the graph, where the IMF thought the official inflation figures unreliable).

The economy (GDP in the graph) grew strongly in the years after the previous crisis in 2001-2. But its recent performance has been more uneven. Over the long term, Argentina's performance has been dismal.

Argentina GDP and inflation

Annual % change



Source: International Monetary Fund

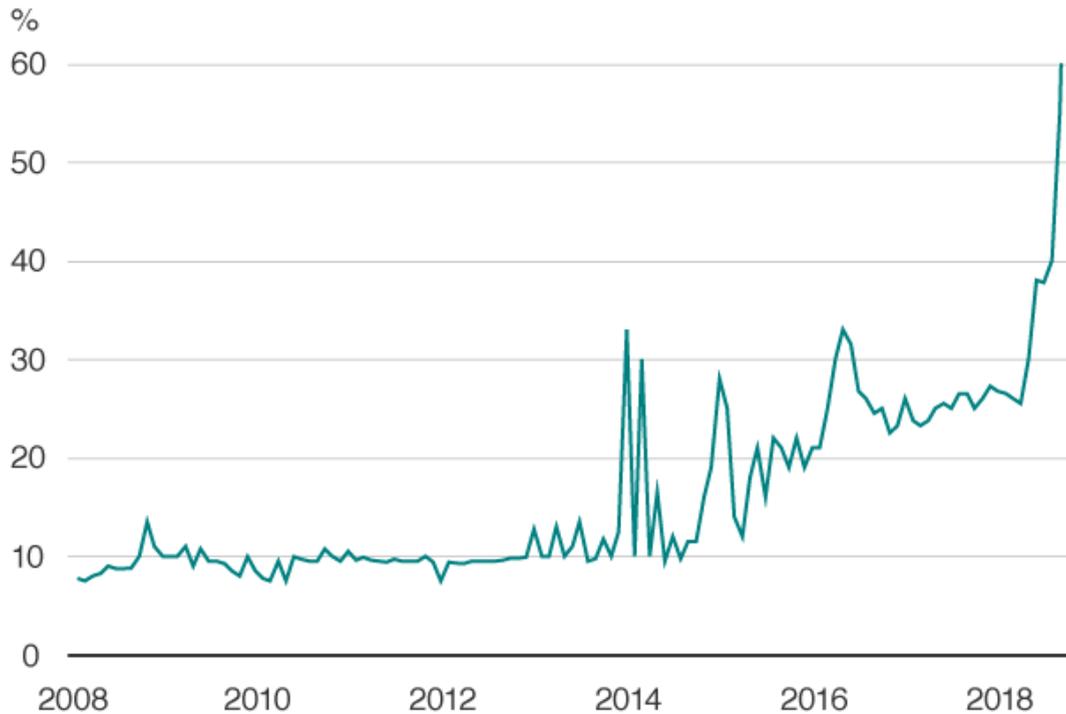
BBC

A hundred years ago, it was richer than many countries in Western Europe, in terms of economic activity (GDP) per person. Now it's less than half the levels of France Germany and the UK. The intervening century has been described as **"one of the most puzzling stories in the annals of modern economic history."**

Interest rates soar

Interest rates have been increased sharply by the central bank in an effort to stabilise the Peso and bring inflation under control.

Argentina's interest rate



Source: Bloomberg

BBC

That is painfully high for consumers and businesses that want or need to borrow.

Even if the IMF bailout and the government's reforms do work, it looks like Argentina is, again, in for a torrid time as it seeks to chart its way through yet another economic crisis.

Related Topics

Argentina

Share this story About sharing

More on this story

DJIA 26154.67 0.03% ▲

S&P 500 2904.98 0.03% ▲

U.S. 10 Yr -7/32 Yield 2.997% ▼

Euro 1.1622 -0.59% ▼

THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.

<https://www.wsj.com/articles/argentina-needs-to-dollarize-1536524297>

OPINION | THE AMERICAS

Argentina Needs to Dollarize

Another crisis for the peso, as the central bank proves it is not to be trusted.



By Mary
Anastasia
O'Grady

Sept. 9, 2018 4:18 p.m. ET



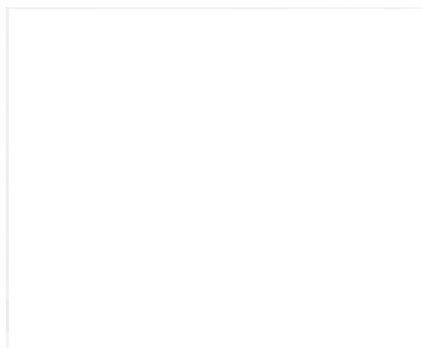
A sign in Buenos Aires showing exchange rates, Sept. 3. PHOTO: NATACHA PISARENKO/ASSOCIATED PRESS

Another currency crisis is roiling Argentina, and a year ahead of an election President Mauricio Macri is struggling to right the ship. The peso has lost half its value against the U.S. dollar since January. Inflation expectations are soaring.

The central bank has boosted its overnight lending rate to an annual 60% to try to stop capital flight. But Argentines are bracing for spiraling prices and recession. According to Alberto Ramos, head of Latin American economics at Goldman Sachs, markets now expect the economy to contract more than 2% this year and inflation to top 40%.

The question that seems to be on everyone's lips: Why is this happening again, under a president who is supposed to embody change? The answer: Because Argentina still has a central bank. To fix the problem once and for all, it should dollarize.

Advertisement



It is worth pointing out that the troubles have been brewing for some time. On a trip to Buenos Aires in February, I got an earful from worried economists who said Mr. Macri

DJIA 26154.67 0.03% ▲

S&P 500 2904.98 0.03% ▲

U.S. 10 Yr -7/32 Yield 2.997% ▼

Euro 1.1622 -0.59% ▼

In 2016 and 2017 the government continued spending beyond its means and borrowing dollars in the international capital markets to finance the shortfall. That put pressure on the central bank to print money so as not to starve the economy of low-priced credit ahead of midterm elections in 2017. It was a risky strategy since it was obvious that the sun would inevitably set on the U.S. Federal Reserve's easy money policy.

A sharp selloff of the peso in May was followed by a new \$50 billion standby loan from the International Monetary Fund in June. With a monetary base that is up over 30% since last year, in a nation that knows something about IMF intervention, that was like waving a red cape in front of a bull.

The peso was thus vulnerable when currency speculators launched an attack on the Turkish lira last month and the flight to the dollar spilled over into other emerging markets, including Argentina. After decades of repeated currency crises, Argentines can smell monetary mischief. A peso rout ensued.

There were strings attached to the standby loan. The fund told the central bank to reduce the stock of its short-term, high-yield domestic debt—known as Lebac's—because it is expensive to service. Not rolling over that debt meant unleashing more pesos into circulation, which would be inflationary. But the IMF limited Argentina's capacity to use the dollars from the loan to sop up those reserves.

The Argentine treasury was instead supposed to issue new debt. It did so, but not to the extent necessary in the midst of a crisis. Plus, markets understand that putting more pesos into government coffers is not the same as extinguishing them.

The bank raised reserve requirements and interest rates, but the panic was on. The demand to hold pesos has collapsed.

Mr. Macri rattled markets in late August when he said he would ask the IMF for the next disbursement of the standby loan early. The peso swooned again.

Argentine Finance Minister Nicolás Dujovne spent two days at the fund in Washington last week, and on Wednesday he expressed optimism about his boss's request. The deal to release the funds early, Mr. Dujovne said, could be voted on this month.

The peso rallied a bit on the news. Yet as any Argentine understands, an IMF package can't cure what ails the peso.

This is a long-term political problem that has manifested itself in repeated economic crises since the mid-20th century. The government lives beyond its means while taxes and regulations, particularly on labor, make many businesses uncompetitive. The net effect is always the same: ballooning debt and a lethargic economy followed by devaluation or default or both.

Mr. Macri has sought to heal the country from the polarization that flourished during the left-wing populism of his predecessor, Cristina Kirchner. In the early years of Mr. Macri's presidency, he emphasized reconciliation and shied away from telling the nation how big a mess he'd inherited. He also wanted to avoid a clash with the organized special interests that have a history of going to the streets and using violence to protect their privileges.

Mr. Macri has managed to cut back on electricity, water, gas and transportation subsidies, but the fiscal deficit—including provinces and municipalities—will still be around 5.5% this year and 3.5% in 2019, according to Aldo Abram, a director at the Buenos Aires think tank Libertad y Progreso. More reforms are needed, and the risk of a political and social upheaval is real.

DJIA **26154.67** 0.03% ▲S&P 500 **2904.98** 0.03% ▲U.S. 10 Yr **-7/32 Yield** 2.997% ▼Euro **1.1622** -0.59% ▼

the peso and to adopt the dollar. Argentines could then get on with the business of saving and investing in their beautiful country. Mr. Macri has tried gradualism. Now is the time to be bold.

Write to O'Grady@wsj.com.

Copyright © 2017 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djreprints.com>.