

3543 Fiscal and Financial System in Japan A
/ KC3002 International Finance
Fall 2012

Lecture 1 General Course Discussion

Hideyuki IWAMURA

Faculty of International Studies



Instructor

Hideyuki IWAMURA

Ph.D in International Studies (The University of
Tokyo, 2006)

Research: Political Economy of Monetary Unions

Teaching: International Finance
Introduction to Economics, etc.

Music: Play and sing Bossa Nova

Website: <http://www1.meijigakuin.ac.jp/~iwamura/>

Contact Information

Office: Room #8423, Building #8

Office Hour: 12:30 – 13:20 on Fridays
Any other time by a prior appointment

E-Mail: iwamura@k.meijigakuin.ac.jp

Interdependent Economies

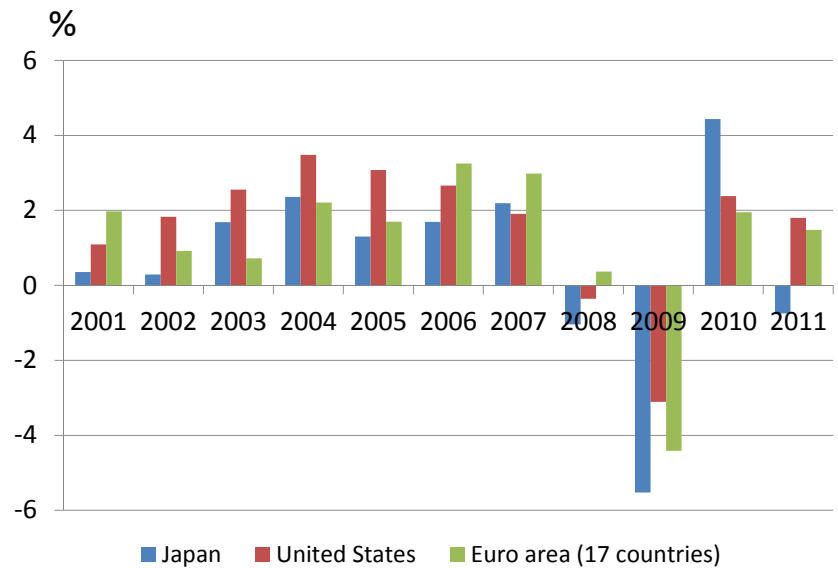
In a globalizing world, national economies are related in a complex manner.



Many channels
Repercussions

Finally, what will be the level of exchange rates, interest rates, and outputs?

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Annual GDP Growth 2001-2011

Source: OECD, *Main Economic Indicators*

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yen / dollar



Yen/dollar exchange rates, monthly average

Source: Bank of Japan

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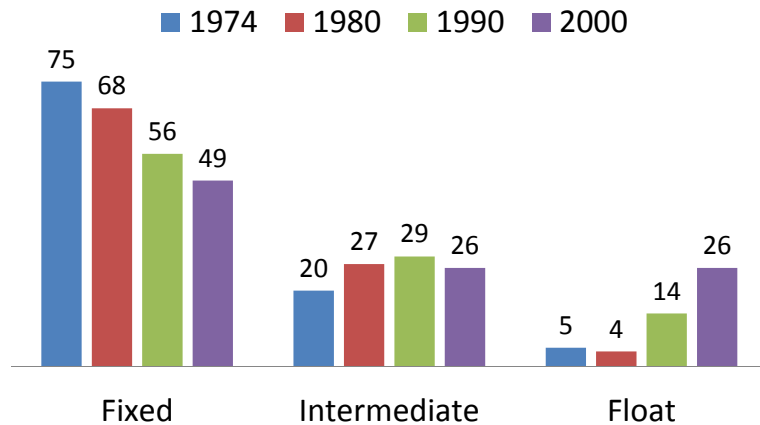
Main Questions: Goal(1)

After the successful completion, the students are expected to give logical answers to these questions:

- How are **exchange rates, interest rates, and outputs** are determined?
- What kind of **shocks or events** affect those variables, and how?
- What measures can **governments** take to alleviate the impacts on those variables?
- Can **institutional arrangements** make any difference to the answers to the questions above?

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Exchange Rate Arrangements



Distribution of Exchange Rate Regimes IMF Classification

Source: Levy-Yeyati and Sturzenegger, "Classifying exchange rate regimes: Deeds and words," *European Economic Review* 2005

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Goals (cont.)

Upon successful completion of the course, you'll also be able to:

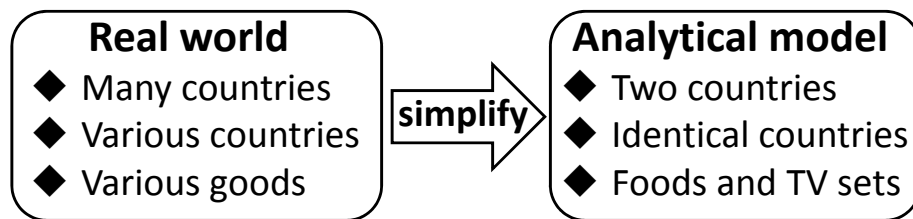
- (2) master an **analytical tool** – a model -- to examine how national economy works in an interdependent world, and apply the tool to examine the effects of various shocks and events,
- (3) **think like an economist.**

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Model – Economist's Analytical Tool

A simplified *miniature* of an actual economy

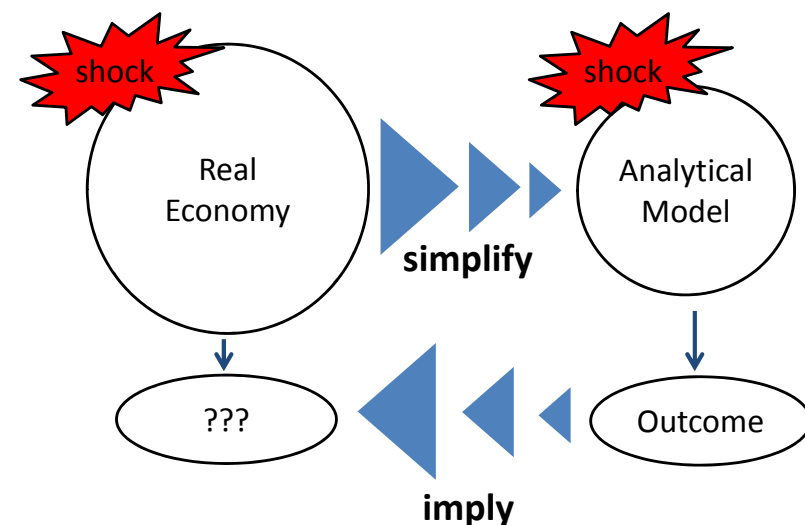
Drop all that is not essential to your question, and construct a world of essential factors alone.



We'll learn a model of international macroeconomics, developed in Krugman, Obstfeld, and Melitz's textbook, "DD-AA model".

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Applying the Model - Experiment



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Think like an Economist

How you think is important, rather than what you know.

Economists always set up models, experiment, and try to find any relationship between variables.

Deriving a result is far more valuable than memorizing many of such results.

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Grading

Grades will be based on two in-class exams, several in-class quizzes, and class participation.

Midterm (Nov 6) : 30%, multiple-choice questions, 2-3 essay questions

Final (Dec 18) : 70%, multiple-choice questions, 4-5 essay questions, covers *all* the materials in the course

Quizzes and class participation : extra points

No make-up tests unless there are compelling medical reasons supported by a doctor's note.

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Prerequisite

- ◆ No formal prerequisite.
- ◆ **Basic algebra skills** are assumed. No differentiation, or matrix algebra.
- ◆ An understanding of **basic macroeconomics** would be of great help. Especially, **an ability to use graphs** to represent links between variables.

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Textbook / References

No particular textbook is used. Every PPT slide and sometimes other handouts are distributed.

- [1] Paul Krugman, Maurice Obstfeld, and Marc Melitz, *International Economics: Theory and Policy*, 9th Edition, Pearson, 2011.

80% of Part 3 and some of Part 4 of the book will be covered.

- [2] Frederic Mishkin, *The Economics of Money, Banking, and Financial Institutions*, 10th Edition, Pearson, 2012.

Chapters 4 and 5 will be covered for the detailed explanation on the determination of interest rates.

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Textbook / References (cont.)

- [3] Charles Jones, *Macroeconomics*, 2nd Edition, Norton, 2011.

- [4] N. Gregory Mankiw, *Macroeconomics*, 7th Edition, Worth Publishers, 2009.

For those interested in details of macroeconomics.

- [5] Richard Caves, Jefferey Frankel, and Ronald Jones, *World Trade and Payments: An Introduction*, 10th Edition, Pearson, 2007.

Focuses on the Mundell-Fleming Model, the most well-known model of international macroeconomics, which this course does not deal with.

All these books will soon be available in the library.

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Schedule (Tentative)

Lecture	Date	
1	Sep 25	General Course Discussion
2	Oct 2	National Income Accounting / Balance of Payments
3	Oct 9	Exchange Rates: Equilibrium in the FX Market
4	Oct 16	Interest Rates: Equilibrium in the Asset Market
5	Oct 23	Interest Rates: Equilibrium in the Asset Market (cont.)
6	Oct 30	Purchasing Power parity
7	Nov 6	Midterm

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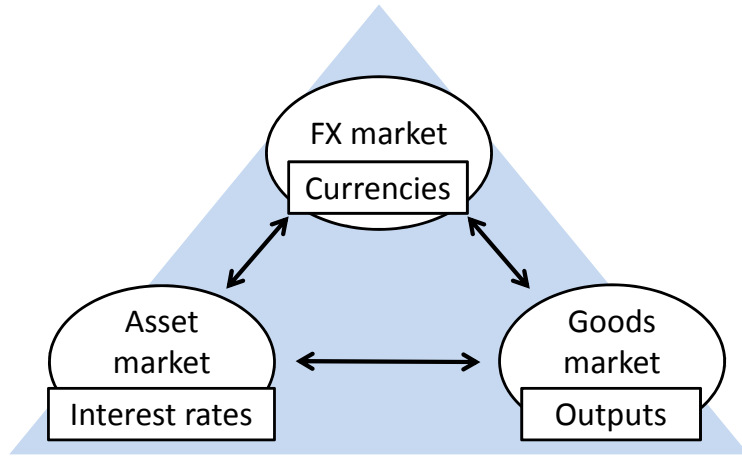
Schedule (Tentative)

Lecture	Date	
8	Nov 13	Output : Equilibrium in Goods Market
9	Nov 20	Output : Equilibrium in Goods Market (cont.)
10	Nov 27	DD-AA Model (1) : General Equilibrium Approach to Exchange Rates and Output
11	Dec 4	DD-AA Model (2) : Applications
12	Dec 11	Fixed Exchange Rates
13	Dec 18	Final
14	Jan 8	(optional) Euro in Crisis: Economics of Monetary Union

Have a great semester!

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Three Models into One Larger Model



The large model describes the **joint determination** of exchange rates, interest rates, and outputs.