Boom-Bust Cycles in Emerging Markets

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Boom-Bust Cycles in Emerging Markets.

Key: Sharp sectoral asymmetries

- Endogenous insolvency risk taking
- Credit Market Imperfections → Borrowing Constraints
- Political Imperfections → Systemic Bailout Guarantees

Lending boom:

- Credit-to-GDP increases
- Asset price inflation
- Nontradables-to-Tradables output ration increase

The Bust:

- GDP growth resumes fast
- Protracted credit crunch
- Fire sales
- N-to-T jumps down
Tiping point: shift from risky to safe equilibrium

with no insolvency risk taking

Safe equilibrium → low leverage → fall in N-prices

Policy makers try to avoid the resolution of the crisis (fall in p)
The Boom-Bust Cycle in the US and in Emerging Markets

1. The Boom-Bust Cycle in Emerging Markets

<table>
<thead>
<tr>
<th>Average MEC</th>
<th>Mexico</th>
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<tbody>
<tr>
<td><strong>Credit/GDP</strong></td>
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<td><img src="image1.png" alt="Graph" /></td>
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<td><strong>N-to-T Output Ratio</strong></td>
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<td><img src="image3.png" alt="Graph" /></td>
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<td><strong>Exports Growth</strong></td>
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GDP per Capita Growth

Investment

Consumption

Note: Event windows were constructed from panel regressions of the respective variable in each graph on dummy variables that take
of value of 1 in the period where a joint banking and currency crisis occurred and zero otherwise. The panel regressions are estimated
with fixed effects, using a GLS estimator. The N/T and GDP series where computed as mid-year changes. The graphs are the visual
representations of the point estimates and standard errors from the following pooled regression:

\[ y_{it} = a_i + \sum_{j=-3}^{3} \beta_j Dummy \tau+j + \epsilon_{it}, \]

where \( y \) is the respective variable of interest in the graph, \( i = 1 \ldots 35 \) denotes the country, \( t = 1980 \ldots 1999 \), and \( Dummy \tau+j \) equals
1 at time \( \tau+j \) and zero otherwise, where \( \tau \) is a crisis time.
Credit in Mexico

a) Credit/GDP

b) Real Credit

Source: Banco de Mexico.

Figure 9: Credit to the N sector

Non-tradables and Tradables Production in Mexico
Note: The T-sector includes Manufacturing, Mining and Agriculture. The N-sector includes Construction, Commerce, Restaurants and Hotels, Transporting, Storage and Communications and Communal Services.
Source: INEGI
Share of NPLs in Total Loans

* Restructured loans include the programs of UDIS, IPAB-FOBAPROA, restructured portfolio affecting the flow participation scheme and Special CETES

*The IPAB-FOBAPROA non-performing loans were obtained by applying the ratio of non-performing loans to total IPAB-FOBAPROA portfolio to IPAB-FOBAPROA’s Titles.
2. Boom-Bust Cycle US
Figure 1. Asymmetric Financial Development (I)

Figure 1: Domestic Non Financial Sector: Mortgage Debt/GDP vs. Non Mortgage Debt/GDP
Figure 2. Asymmetric Financial Development (II)

Partition of Financial Assets in US Chartered Banks

- Other Loans / Total Financial Assets
- Cash and Treasury Securities+Federal Reserves Assets / Total Financial Assets
- Other Financial Assets/Total Financial Assets
- Mortgage Loans+ CMOs + MBS /Total Financial Asset

Graph showing the partition of financial assets over time.
Figure 3. Real Home Price

Figure 1.2 Real Home Price (source: Shiller)
Figure 4. New Home Sales
Figure 5. Asymmetric Real Development

Value of New Construction put in pace / GDP
Figure 6. Asymmetric Crash

CDS Spread by Industry
(source JP Morgan)

Basic Industry (ex-Homebuilding) CDS Spread (equal weight)
Homebuilding CDS Spread (equal weight)
Should regulation aim at eliminating risk taking?

Is a safe path preferable to a risky path?

Across emerging countries, those that have higher GDP growth tend to have a greater incidence of crises.

How can we see this in the data?

High mean growth is associated with **negative skewness** of macro variables.

The volatility associated with crises is not identified by **variance**

Crises are **rare** and exhibit **sharp falls in growth**

Over the long-run rare crises are associated with more growth

**WHY?**

Contract enforceability problems → lending is constrained by internal funds

Payoff to divert < Expected debt repayment

With systemic bailout guarantees

Insolvency risk-taking → taxpayers will pay debt in crisis states

→ lenders don’t charge a higher interest rate

→ Expected debt repayment is lower

→ borrowing constraints are relaxed

Higher lending → more investment

→ higher asset prices

→ higher collateral value

→ more lending

→ ........

→ More long-run growth???

Yes if borrowing constraints imply high productivity projects are not undertaken.