Crisis, Adjustment and poverty in Developing Countries
IT models of adjustment

ECON 5450 Crisis, Adjustment and Poverty aka Stabilization Policy

Fall 2015 Lecture notes

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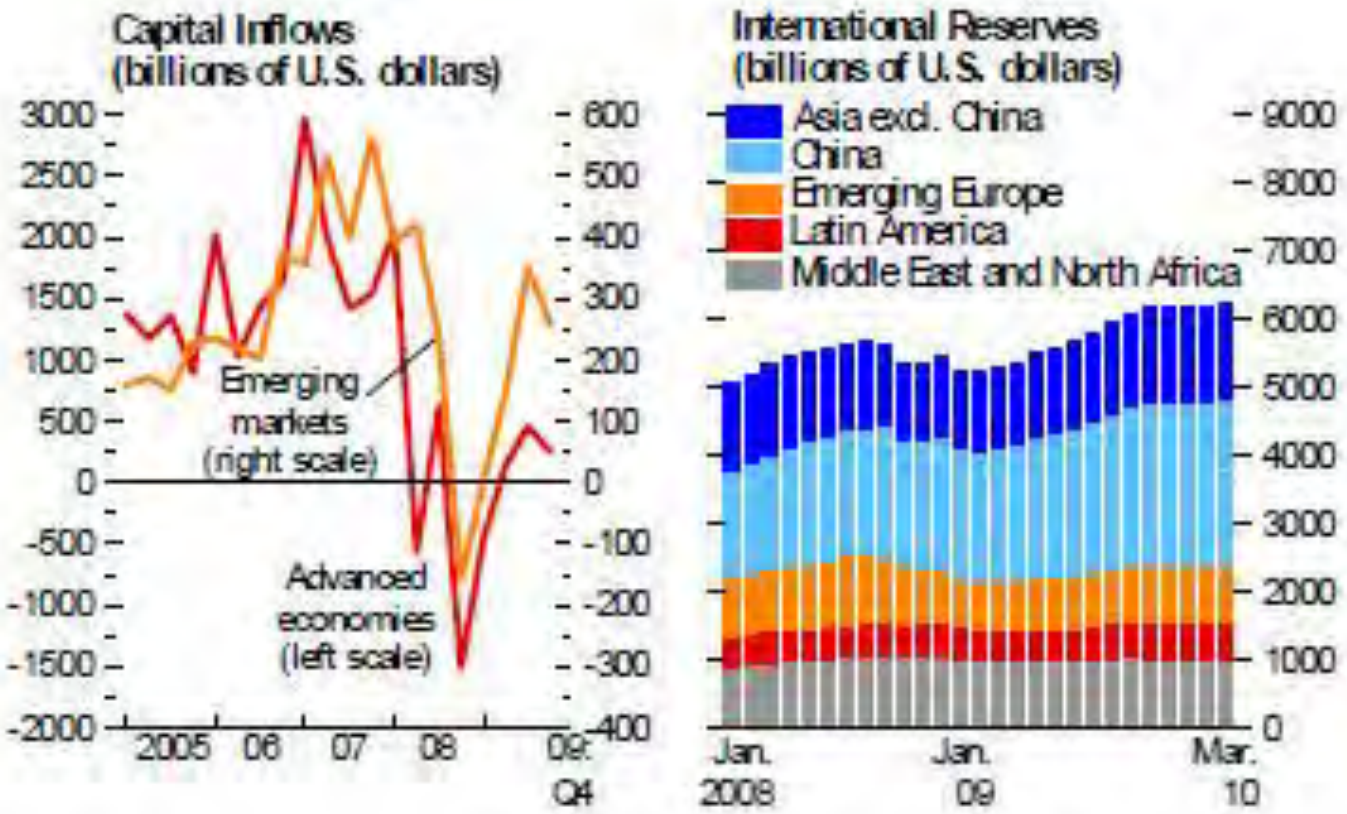
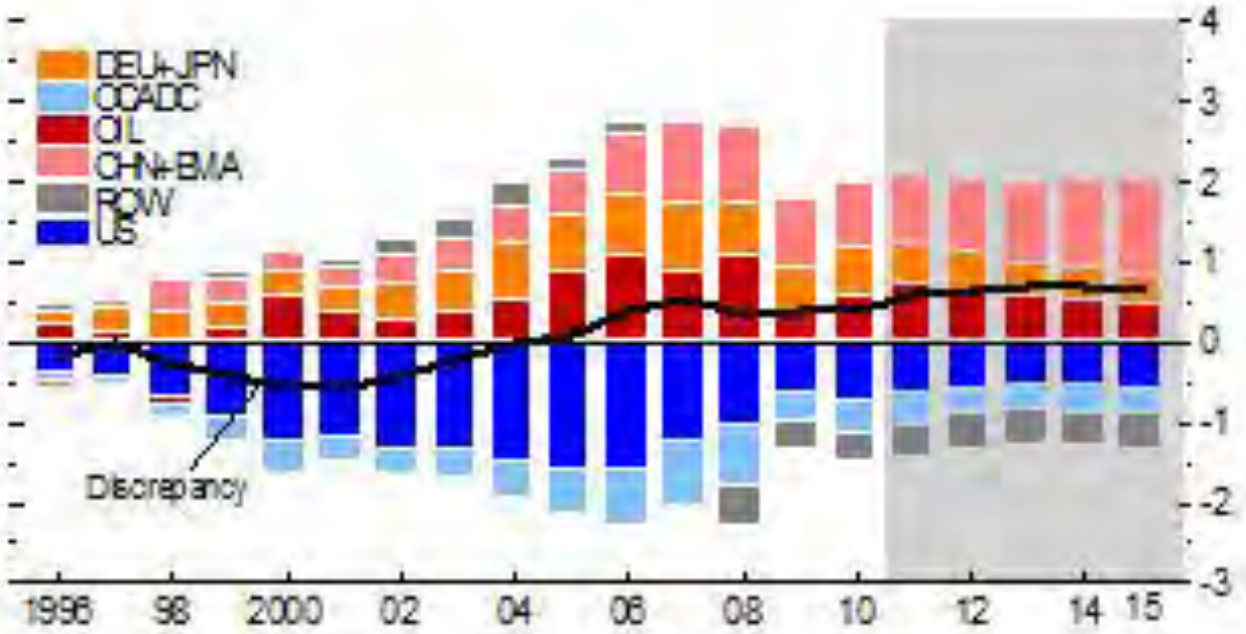
Figure 7. Capital Flows to Emerging Markets



Sources: Bloomberg Financial Markets; Capital Data; IMF, *International Financial Statistics*; and IMF staff calculations.

Figure 6. Global Imbalances[1]

(Percent of world GDP)



Source: IMF staff estimates.

[1]CHN+EMA: China, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan Province of China, and Thailand; DEU+JPN: Germany and Japan; OCADC: Bulgaria, Croatia, Czech Republic, Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Turkey, and United Kingdom; OIL: Oil exporters; ROW: rest of the world; US: United States.

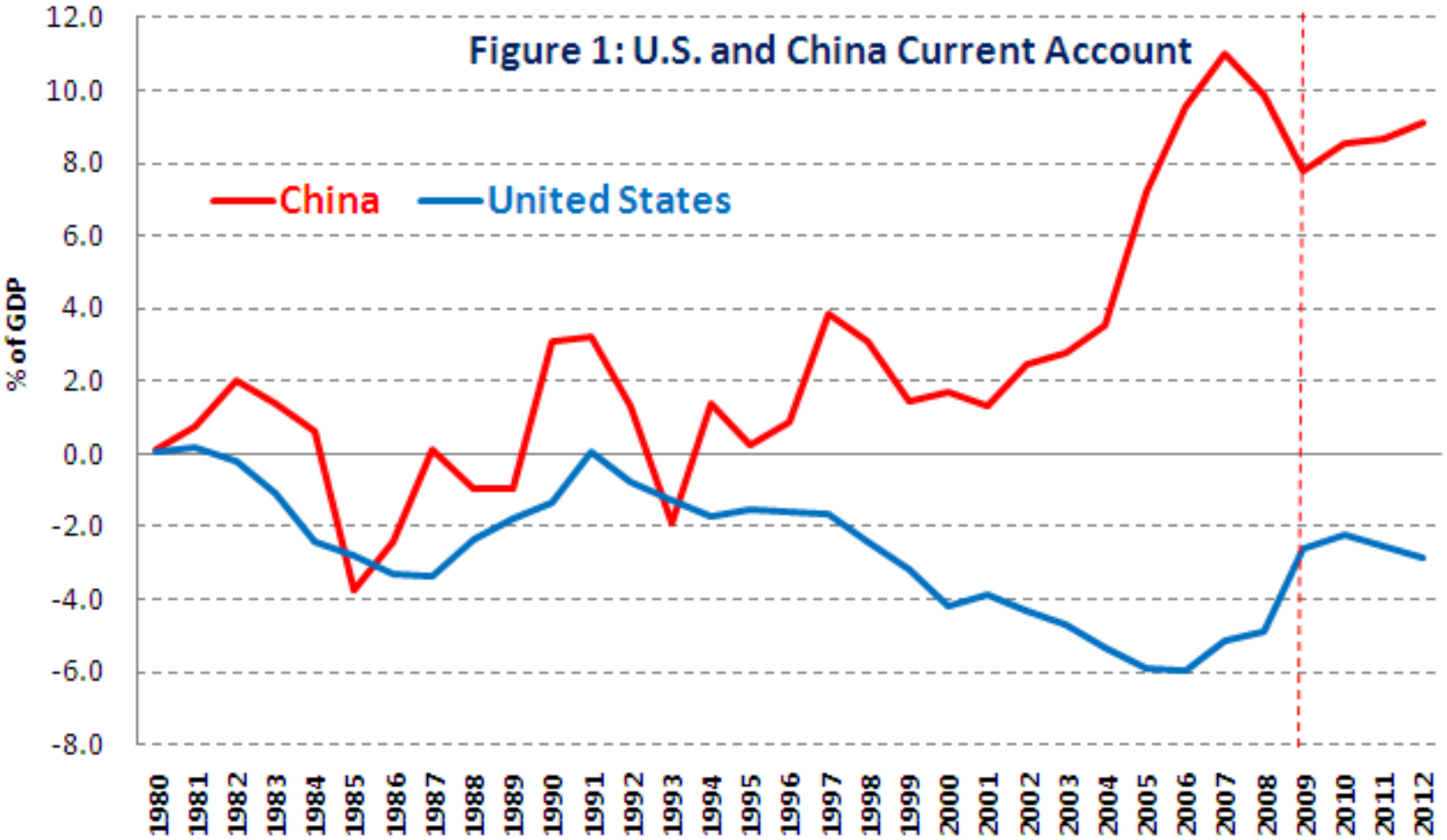


Figure 1: U.S. and China Current Account
China
United States
% of GDP
12.0
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
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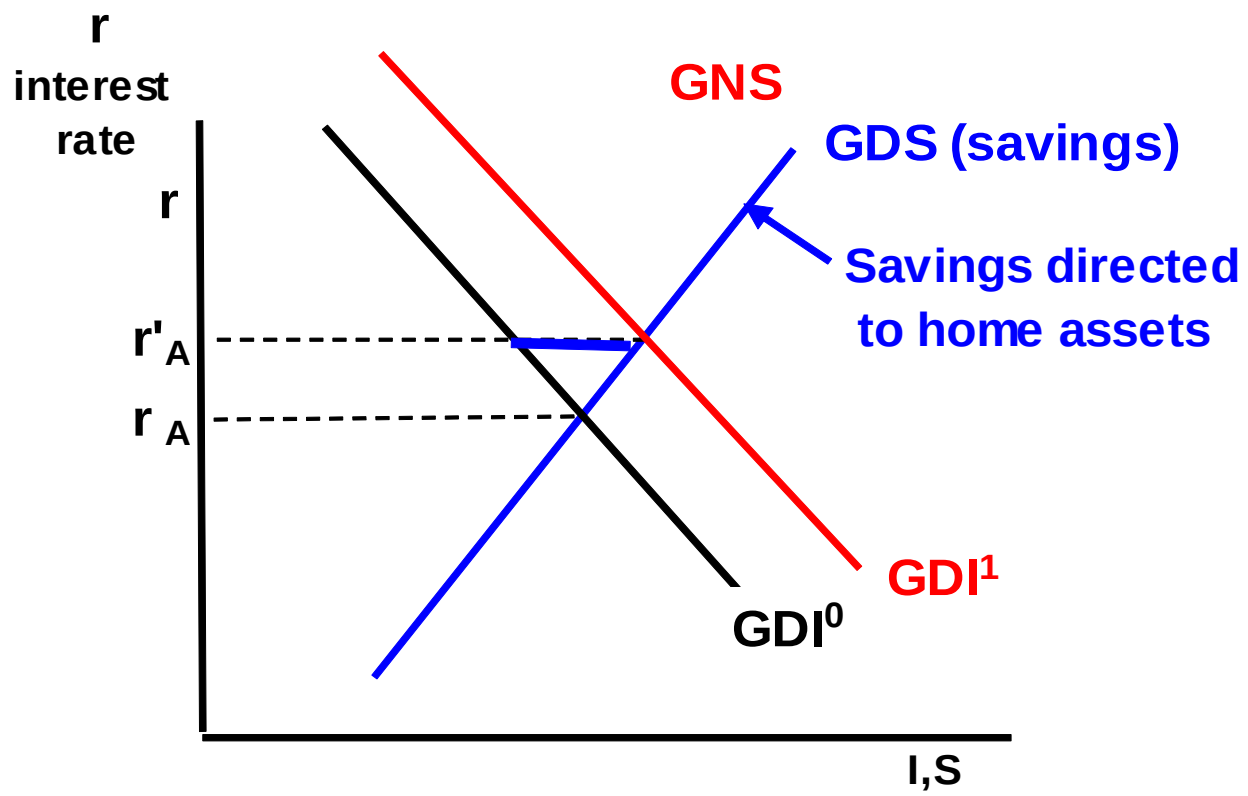
2011
2012

IT approach Metzler diagram with closed capital account

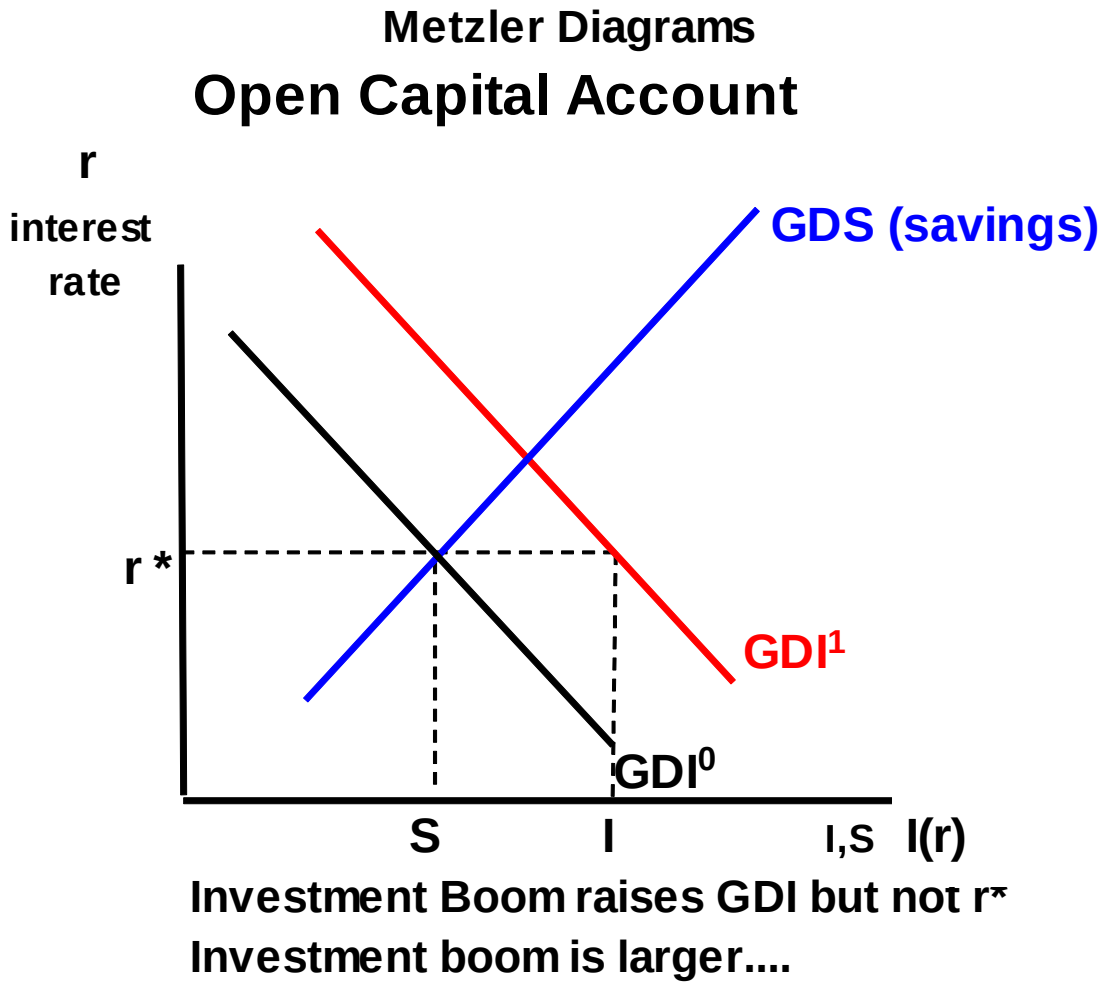
Intertemporal Approach to the CA*

Investment Boom with closed capital account



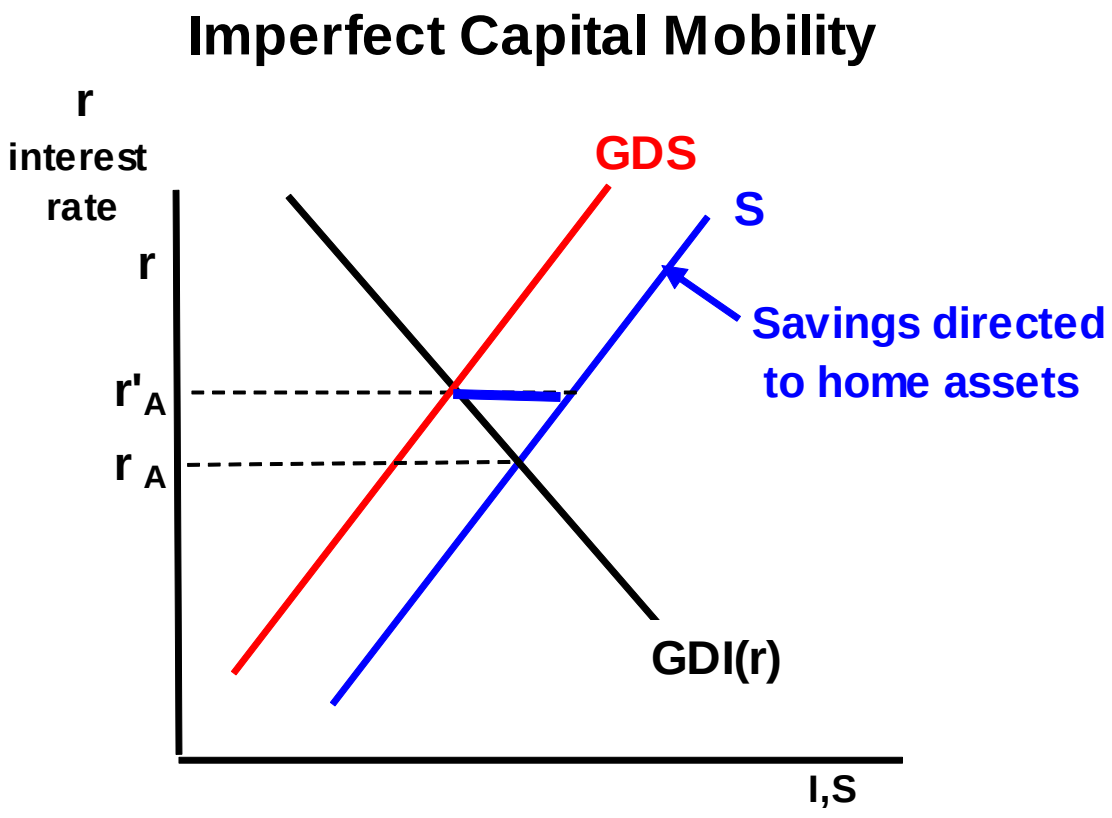
Investment boom raises GDI and r...

IT approach Metzler diagram investment boom with open capital account



*see chapter 6 of Sachs and Larraine (1993)

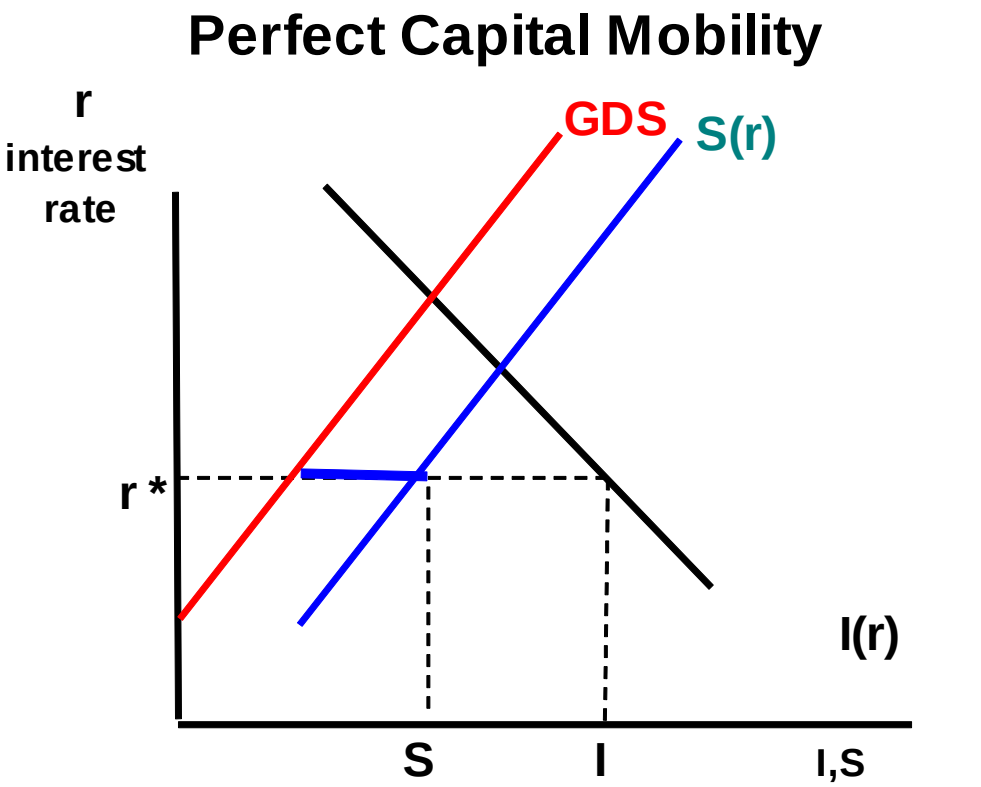
Capital flight (fall in GDS) with closed capital account



Capital Flight raises r and reduces I
Domestic investment is lower

Capital flight (fall in GDS) with open capital account

Metzler Diagrams



Capital Flight increases the CA deficit but Investment remains unchanged

Capital inflows lead to RER appreciation, always (q falls)

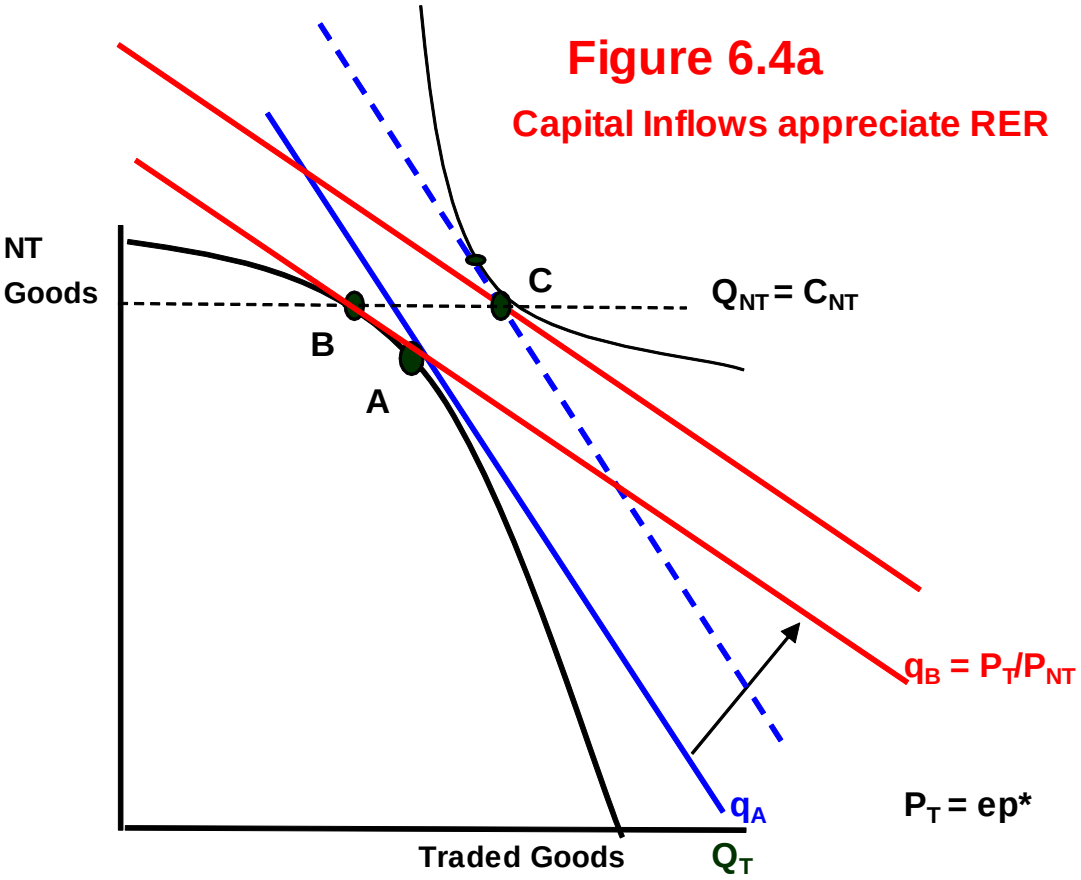


Figure 6.4: Capital Inflows always cause an appreciation of the real exchange rate, RER or $q = P_T/P_{NT}$ where $P_T = ep^*$.

Fixed Exchange Rate: P_T is fixed so P_N must increase.
(capital inflows are generally inflationary)

Flexible Exchange rate: $P_T = ep^*$ may fall, or P_N may increase.
(capital flows cause Inflation to rise or fall)

NT sector Productivity Growth attenuates appreciation in q

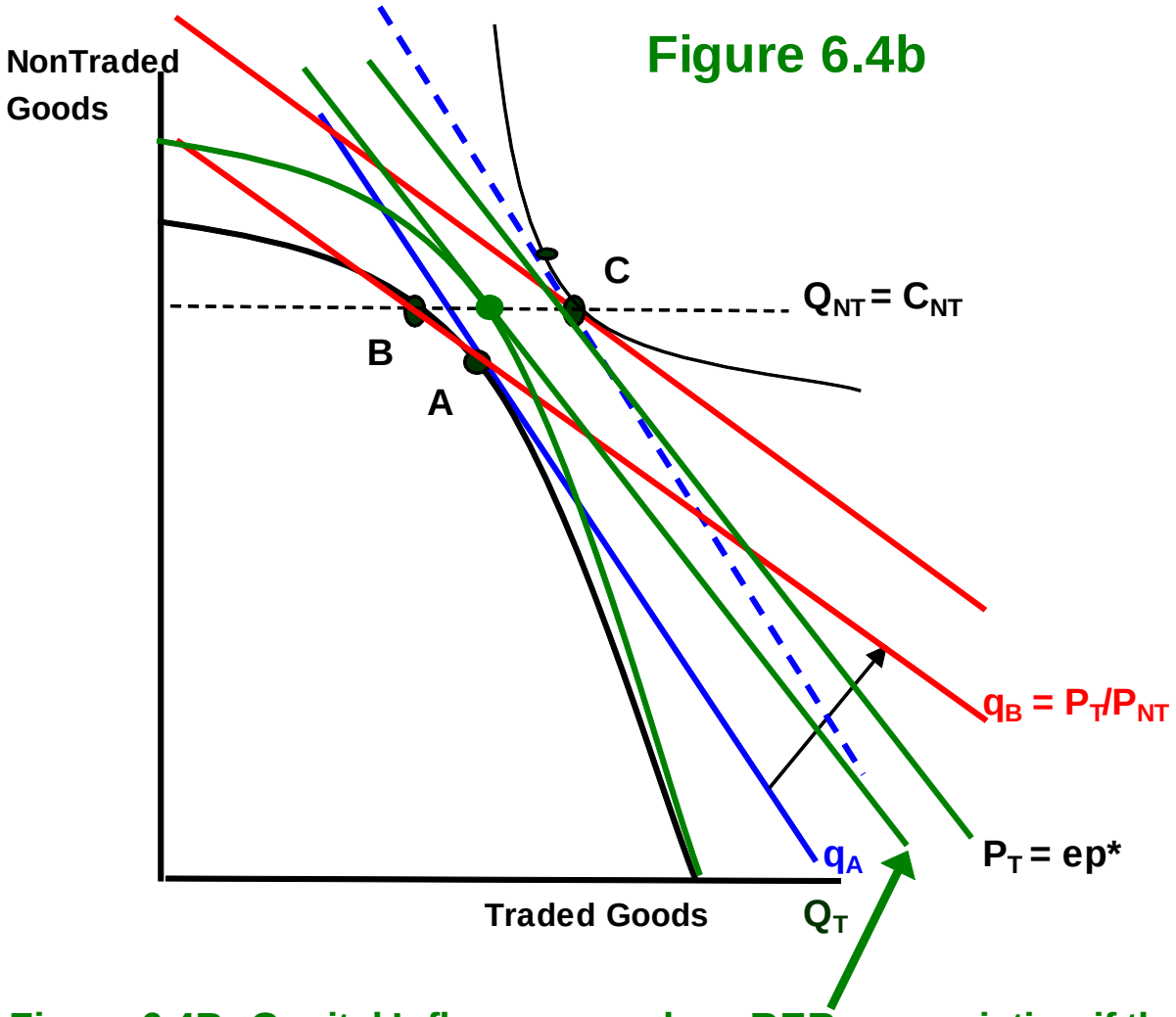


Figure 6.4B: Capital Inflows cause less RER appreciation if the NT sector gets a boost in investment as in TWM (2004) .

(RER or q = PT/PNT where PT = ep*)

IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

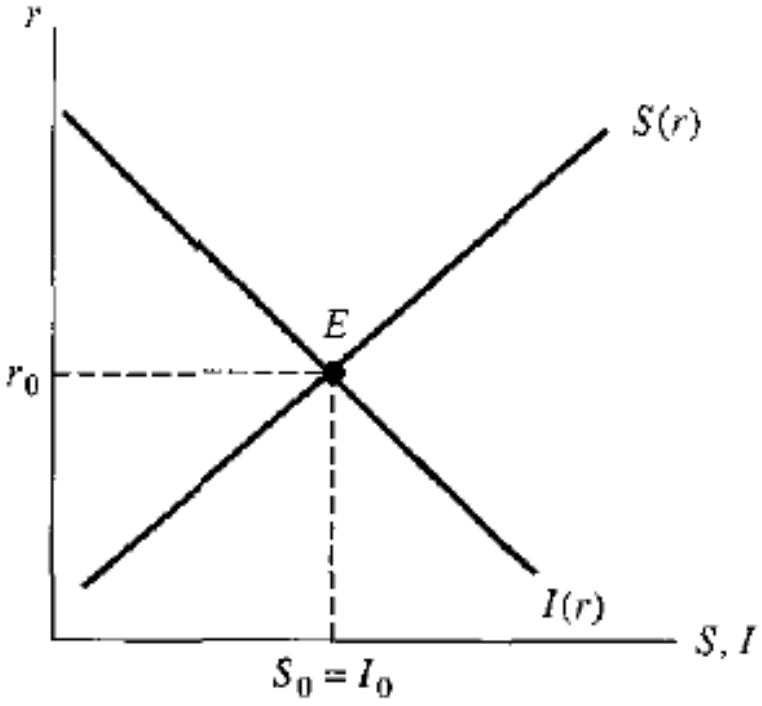
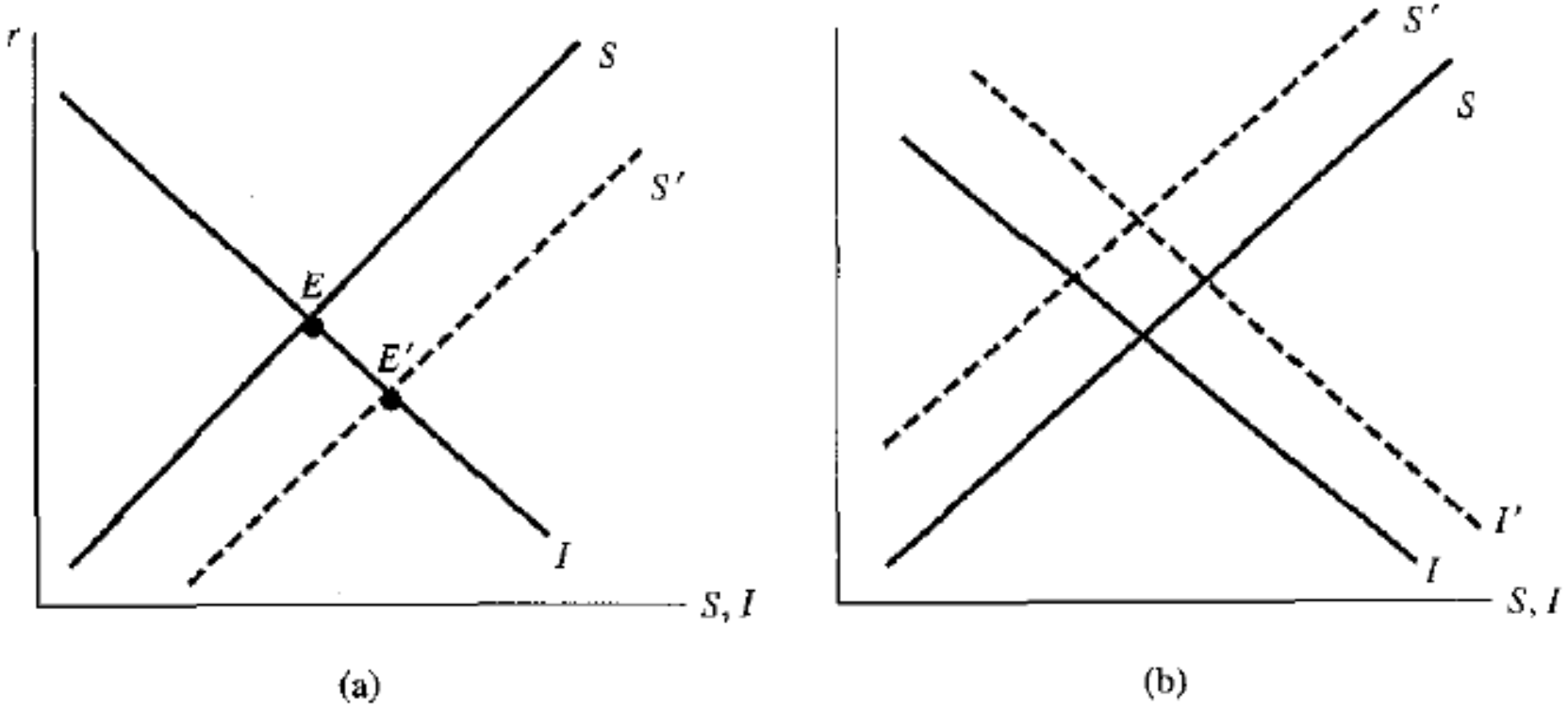


Figure 6-1
Saving, Investment, and the Interest Rate in a Closed Economy

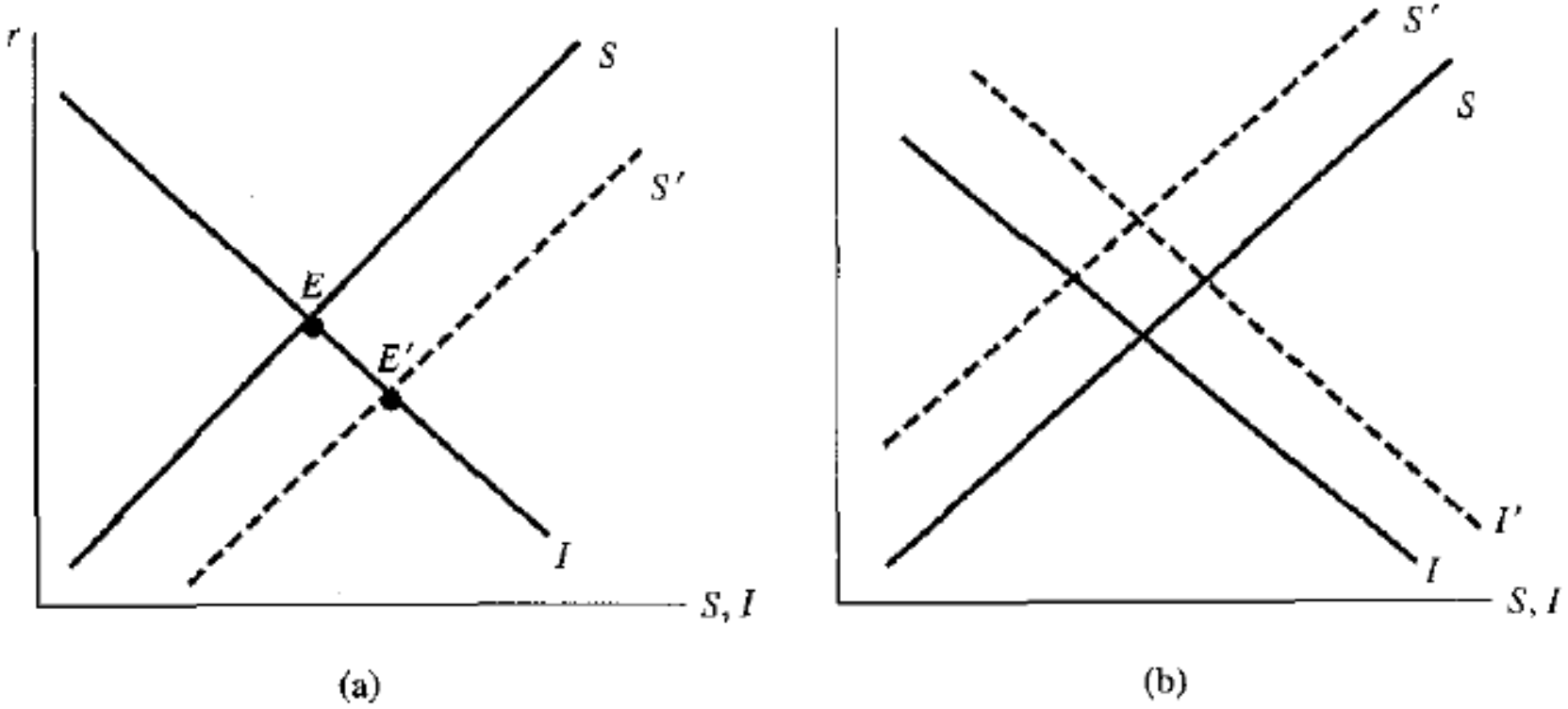
IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

Figure 6-2
Effects of Economic Shocks on Saving and Investment in a Closed Economy



IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

Figure 6-2
Effects of Economic Shocks on Saving and Investment in a Closed Economy



IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

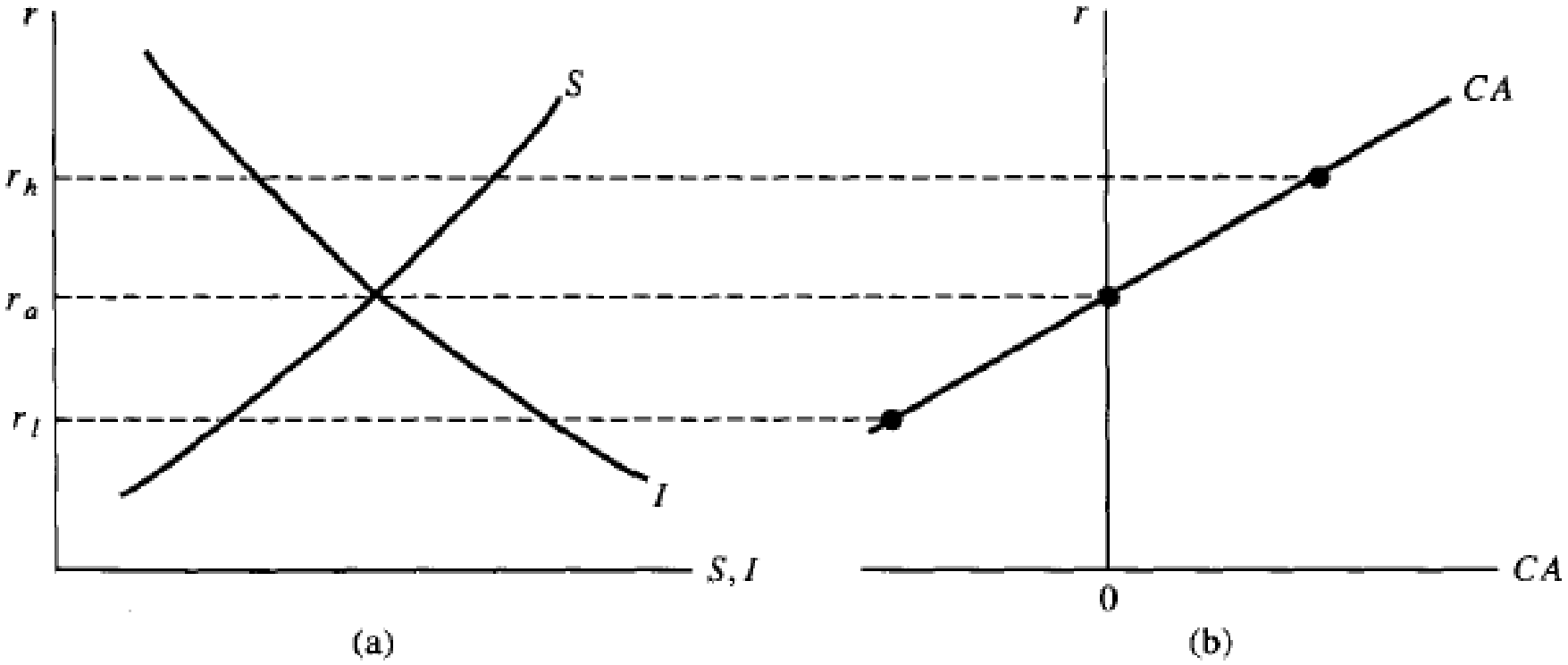


Figure 6-4
Saving, Investment, and the Current Account

IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

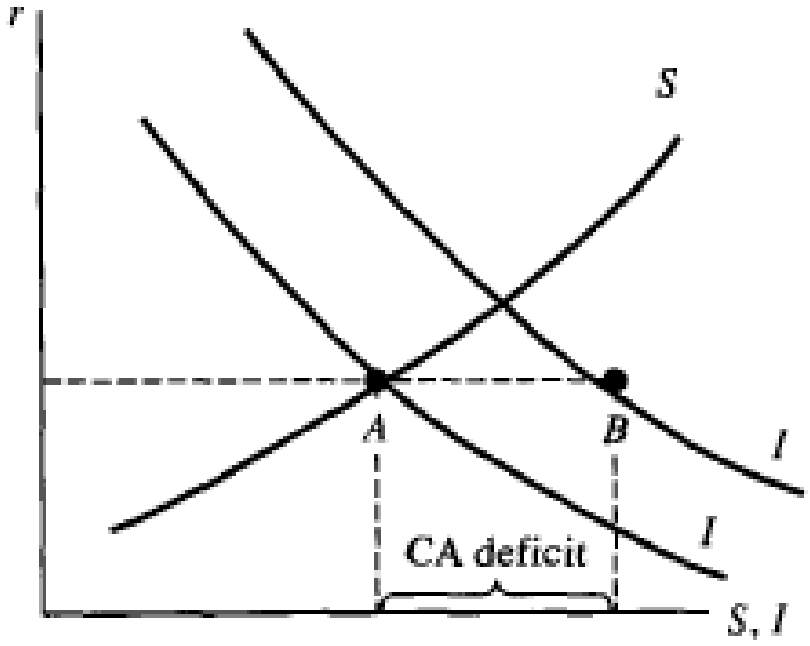


Figure 6-5
The Current Account and Improved Investment Opportunities

IT Model: Sachs and Larraine Chapter 6 page 151
Metzler Diagram

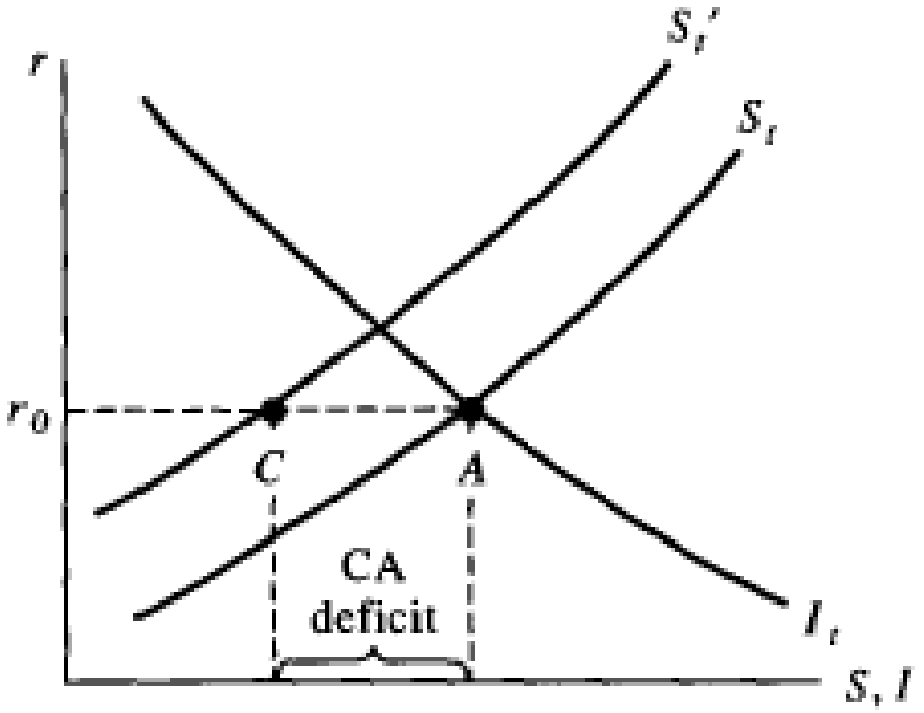


Figure 6-6
The Current Account and a Transitory Output Decline

Aid inflows: to absorb or not to absorb?, donor vs. country prioties

Consider a 10% of GDP increase in Foreign Aid given directly the the government	Scenario 1: Donor View	Scenario 1: Domestic	Mixed
Change in CA deficit	10%	0%	5%
Change in Government Deficit	10%	0	10%
Change in public debt (% of GDP)	0	-10%	0
Change in reserves or reduction in foreign debt (as a % of GDP)	0	10%	5%
Effect on RER	Appreciates	None	Appreciates
Effect on inflation	none	reduced	some

IT Model: Sachs and Larraine Chapter 6 page 174
Metzler Diagram

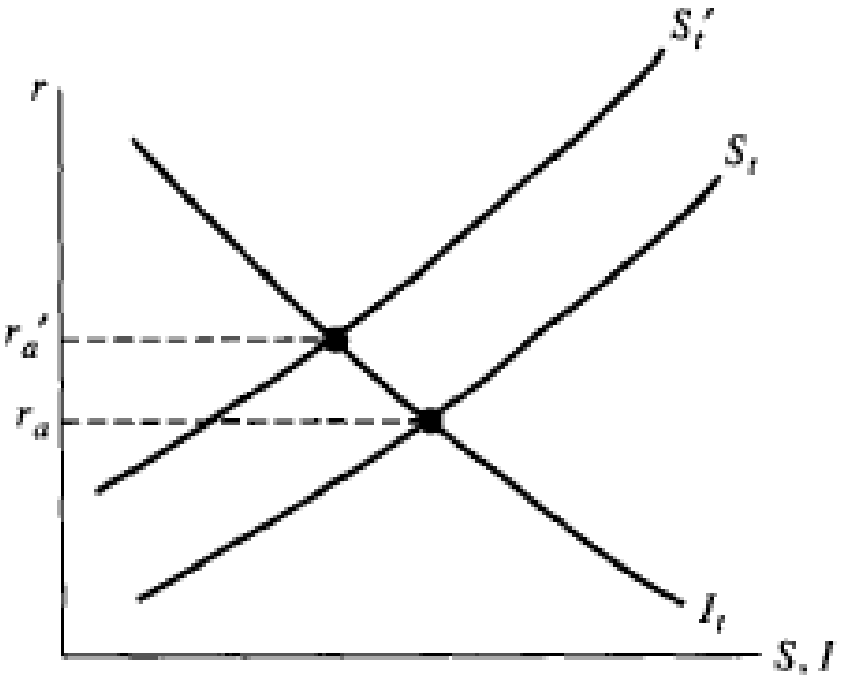


Figure 6-10
A Temporary Output Drop Under Capital Controls

IT Model: Sachs and Larraine Chapter 6 page 176
Metzler Diagram

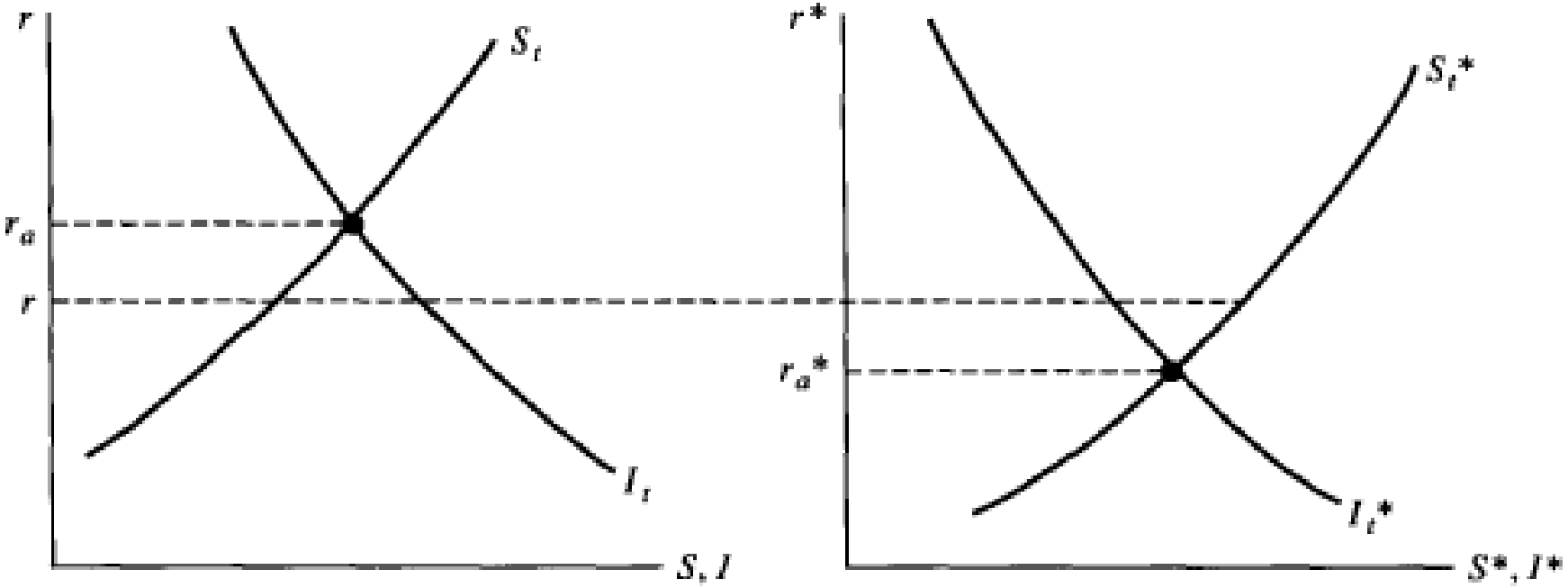


Figure 6-11
Global World Equilibrium of Saving and Investment

IT Model: Sachs and Larraine Chapter 6 page 151
Intertemporal consp diagram Diagram

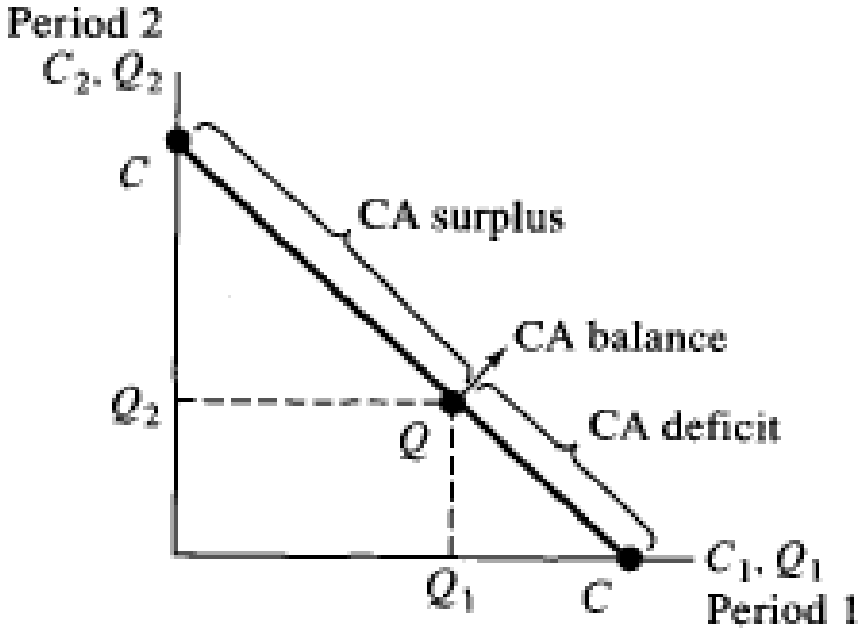


Figure 6-7
The Country's Budget Constraint and the Current Account

IT Model: Sachs and Larraine Chapter 6 page 151
Intertemporal consp diagram Diagram

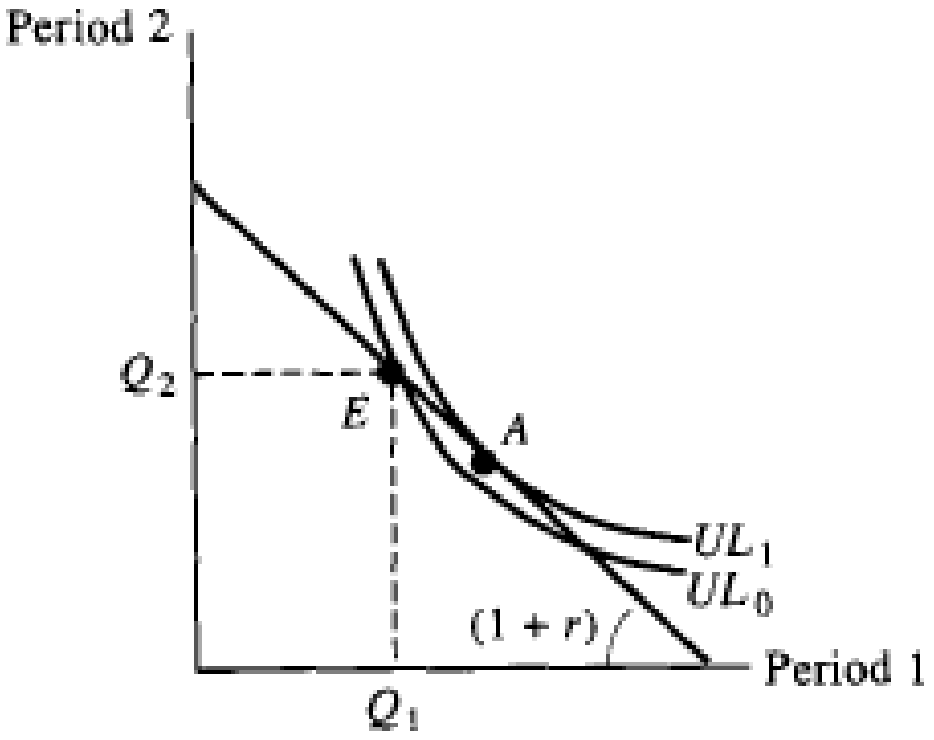
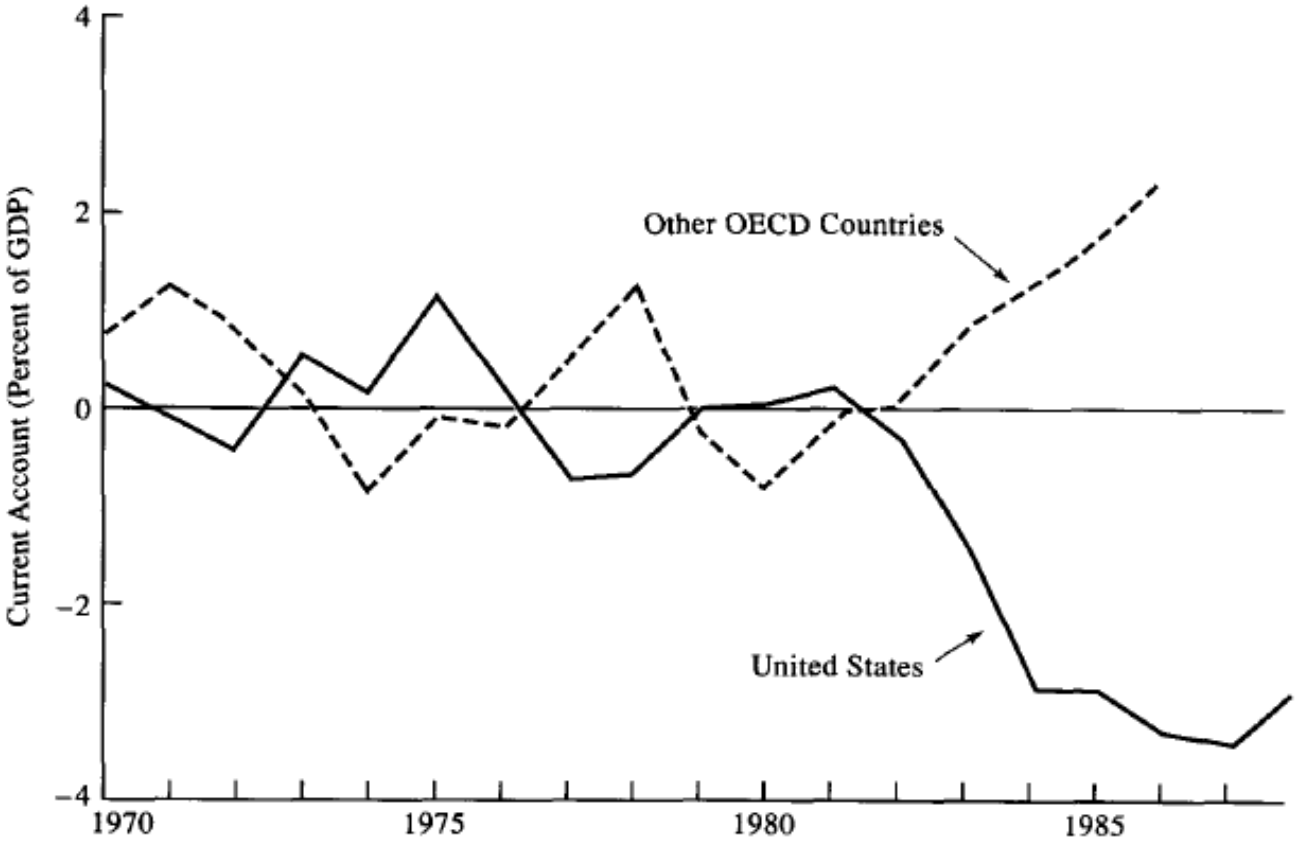


Figure 6-9
Capital Controls and the Economic Well-being of the Country

IT Model: Sachs and Larraine Chapter 6 page 151
Past US CA deficit, $ gov very strong what happened after?



The six major OECD trading partners of the U.S. are Canada, France, Germany, Italy, Japan, and the United Kingdom. The figure shows the sum of their current accounts, measured in dollars, as a percentage of their combined GDP, also measured in dollars.

Figure 6-3
The Current Account in the United States vis-à-vis Other Industrialized Countries

(From International Monetary Fund, International Financial Statistics.*)*

IT Model: Frankel & Razin Chapter 5

typo: discount rate should be the same $\delta = \alpha_1$

see p. 167

Table 5.1

Assumptions generating pure consumption-smoothing, consumption-tilting, and consumption-augmenting effects

	Smoothing	Tilting	Augmenting
Discount	$\delta = x_1$	$\delta \neq \alpha_1$	$\delta = \alpha_1$
Endowments	$\bar{Y}_0 \neq \bar{Y}_1$	$\bar{Y}_0 = \bar{Y}_1$	$\bar{Y}_0 = \bar{Y}_1$
Investment profitability	$F_1'(K_0) \leq r_0$	$F_1'(K_0) \leq r_0$	$F_1'(K_0) > r_0$

IT Approach, intertemporal consuption diagram: Frankel & Razin Ch 5 page 165

The Two-Period Composite-Commodity World

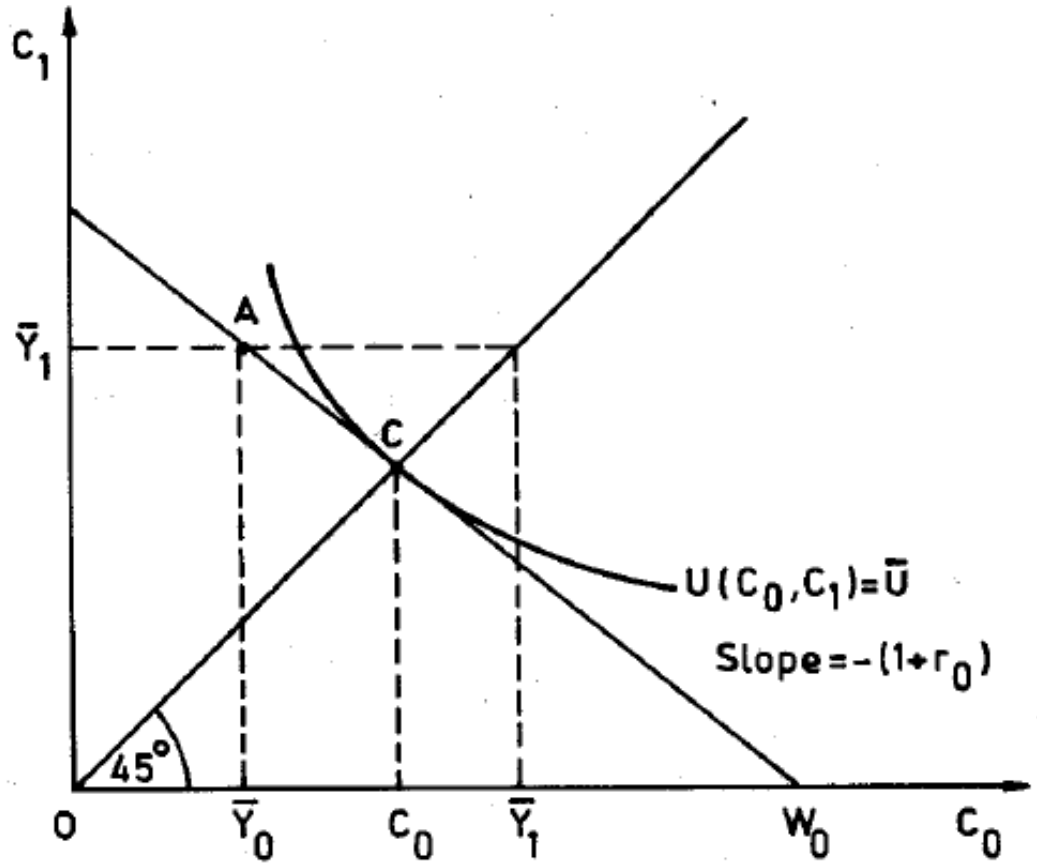


Figure 5.3
The consumption-smoothing effect

IT Approach, intertemporal consuption diagram: Frankel & Razin Ch 5 page 166

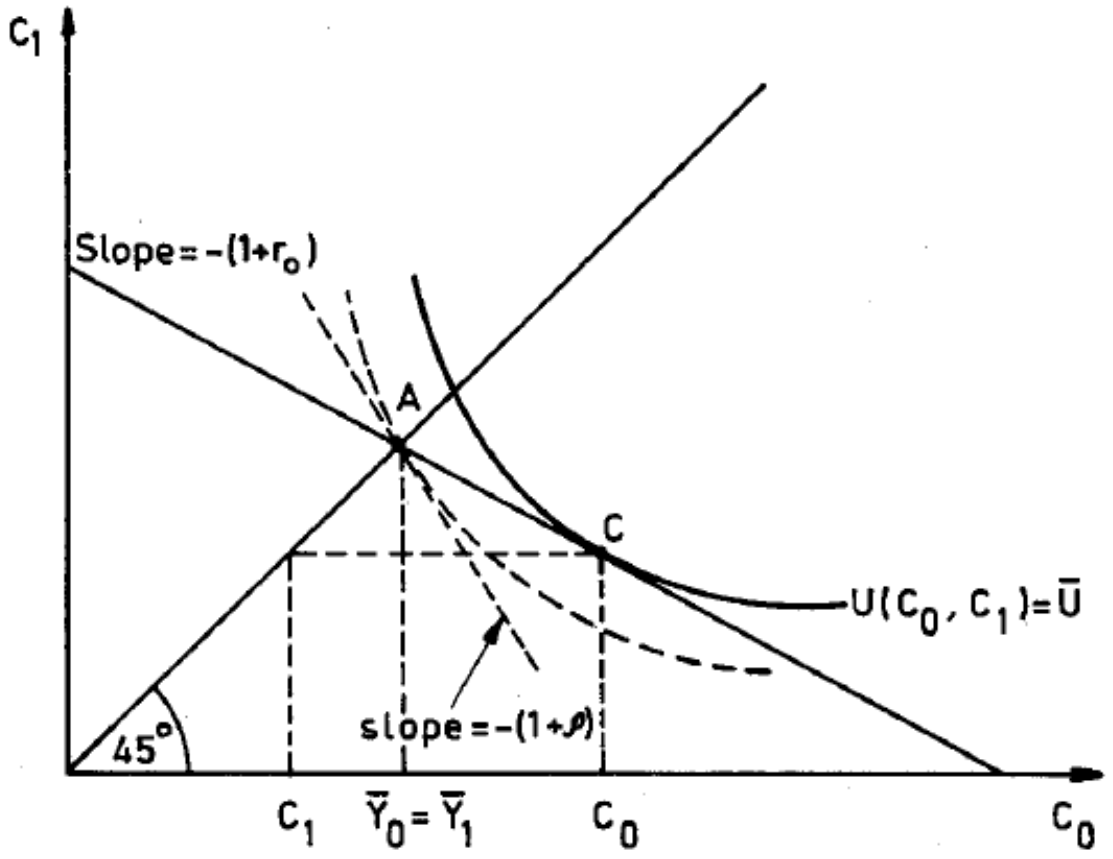


Figure 5.4
The consumption-tilting effect

IT Approach, intertemporal consp: Frankel & Razin Chapter 5

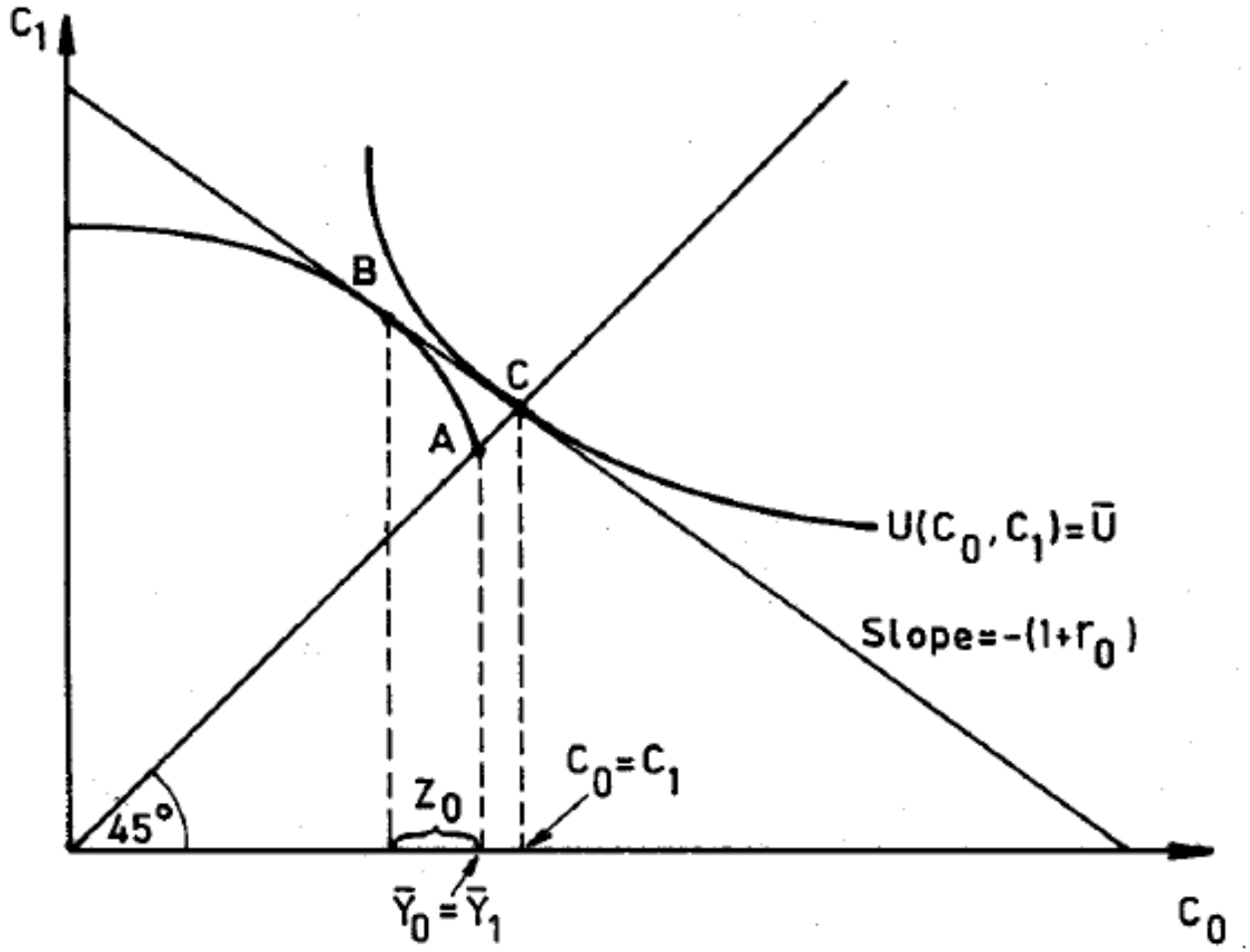


Figure 5.5
The consumption-augmenting effect

IT Approach, intertemporal consumption diagram: Frankel & Razin Ch 5 p. 163

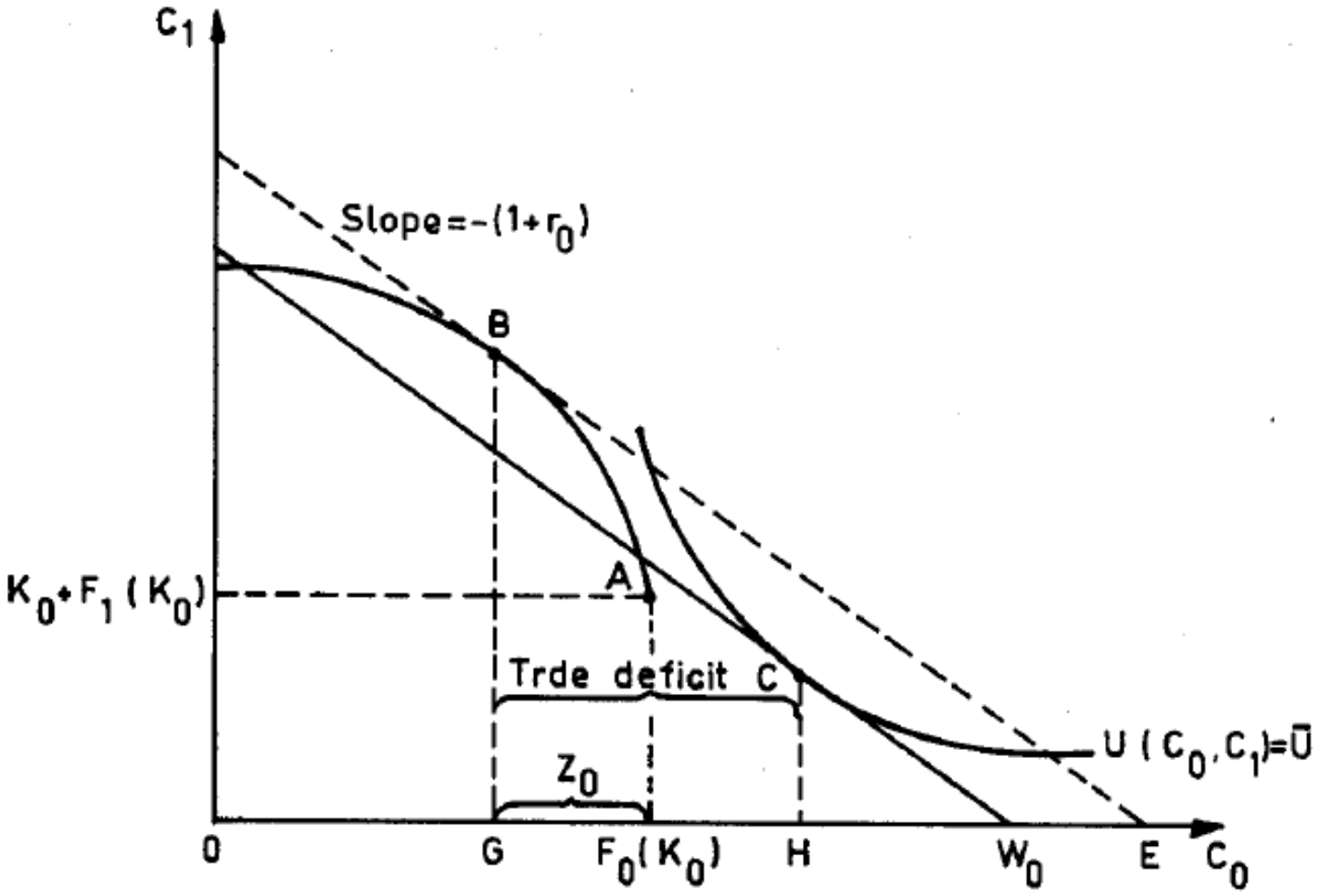
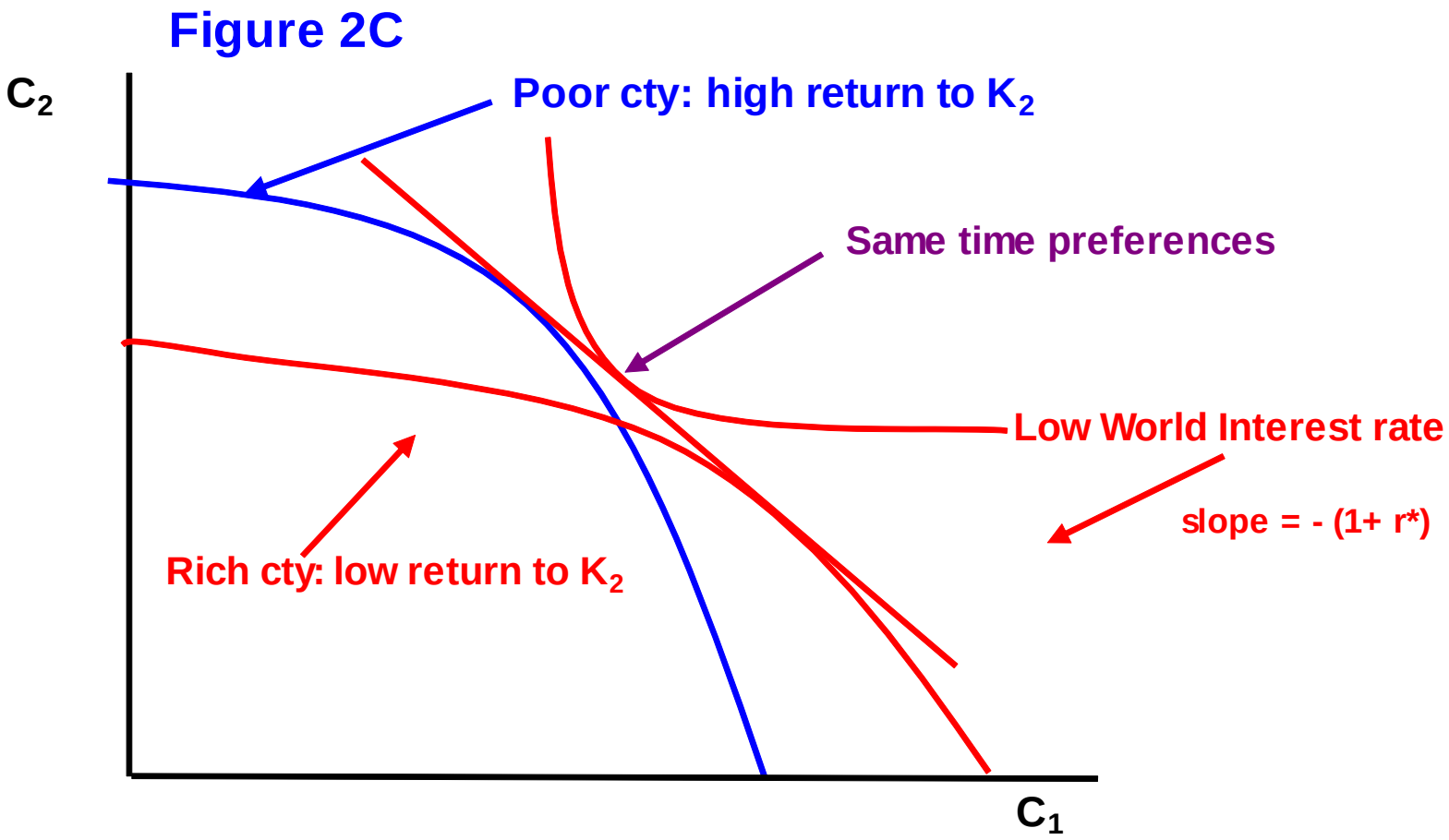


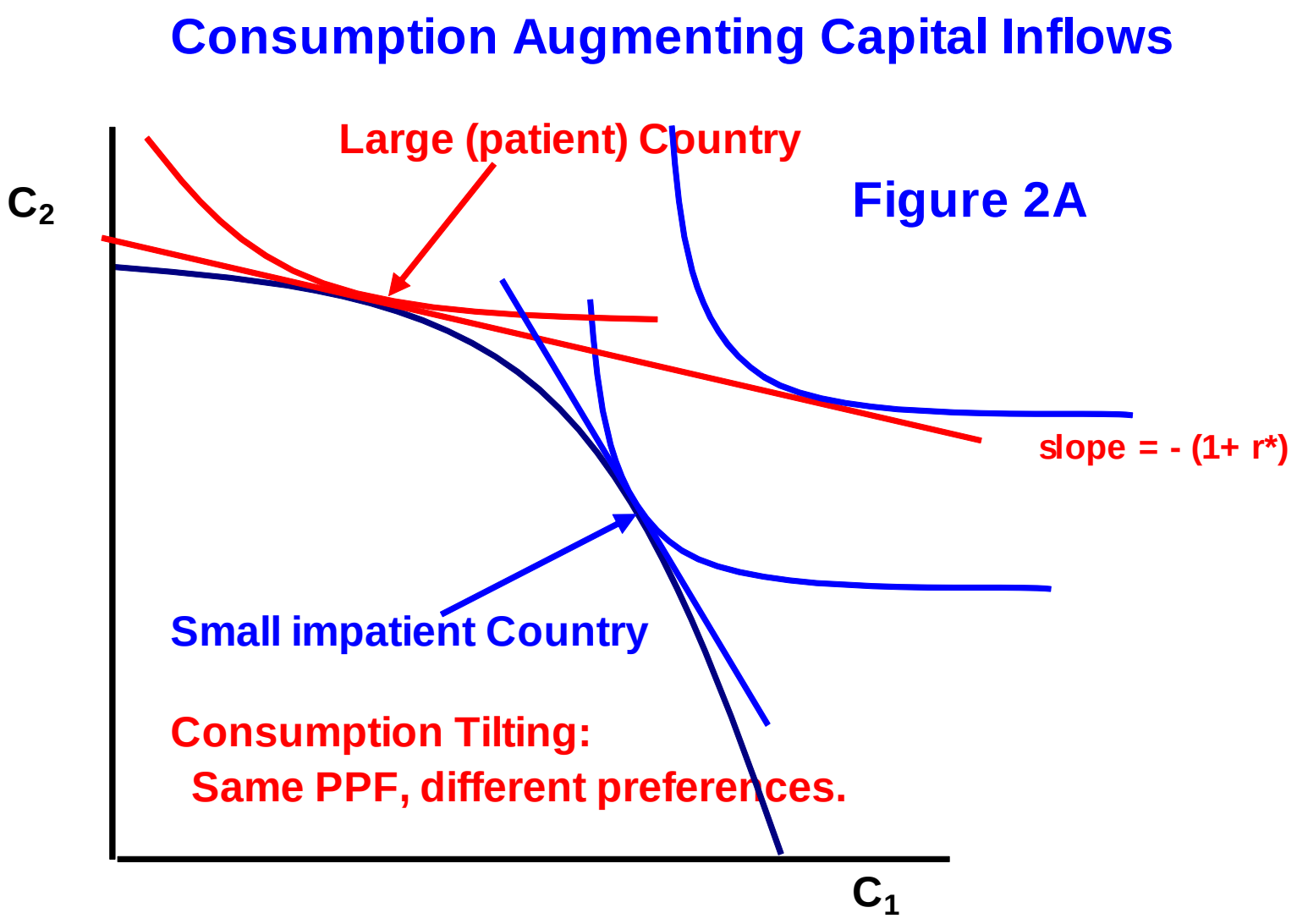
Figure 5.2
The general equilibrium of consumption, investment, and the trade balance

Consumption Augmenting Capital inflows

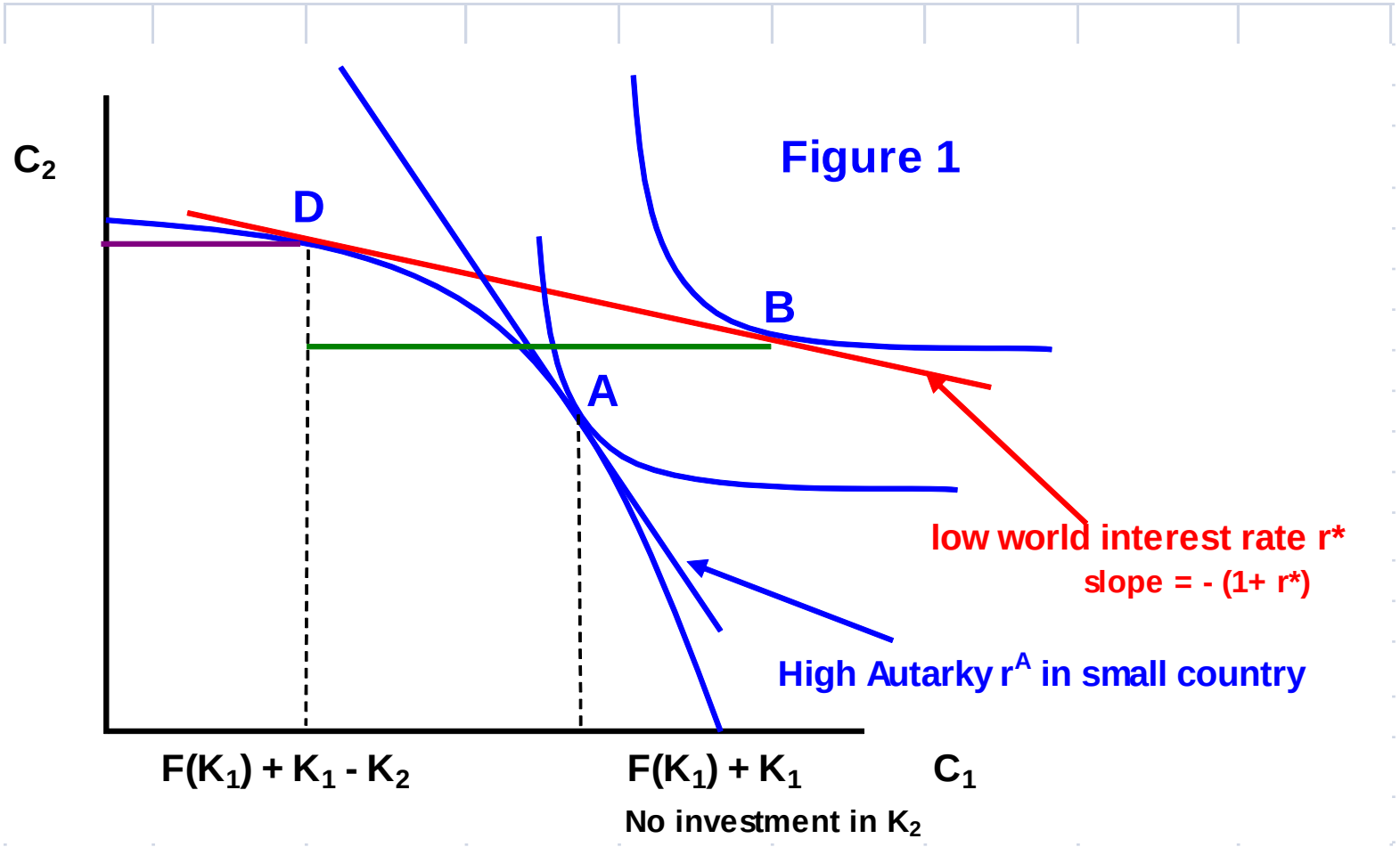


Consumption Augmenting Case:
Return to investment higher in the small country

Consumption tilting capital inflows

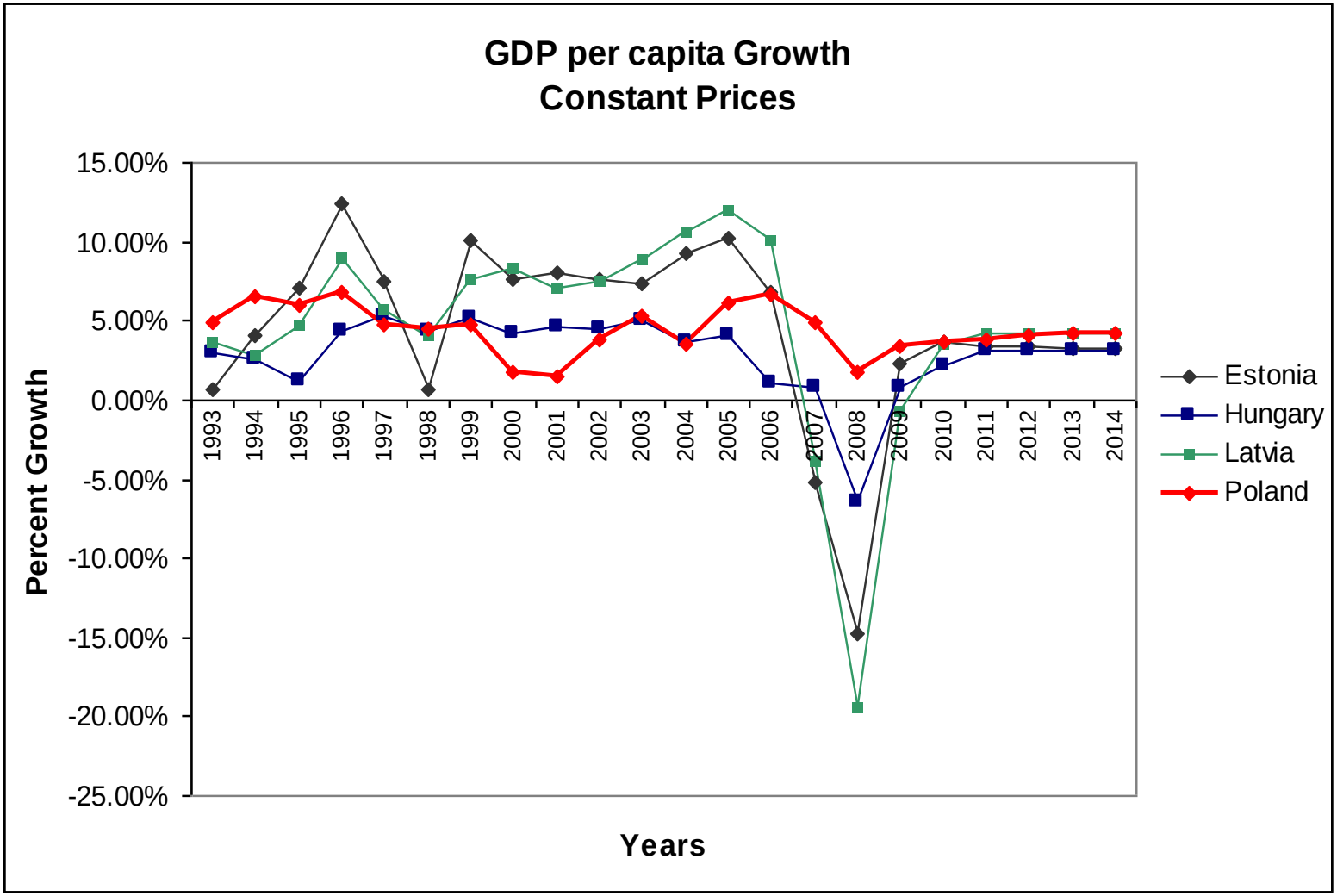


Consumption Augmenting Capital inflows



Case study Poland (thank you Helena)

Figure 1: GDP per capita Growth in Constant Prices (source?)

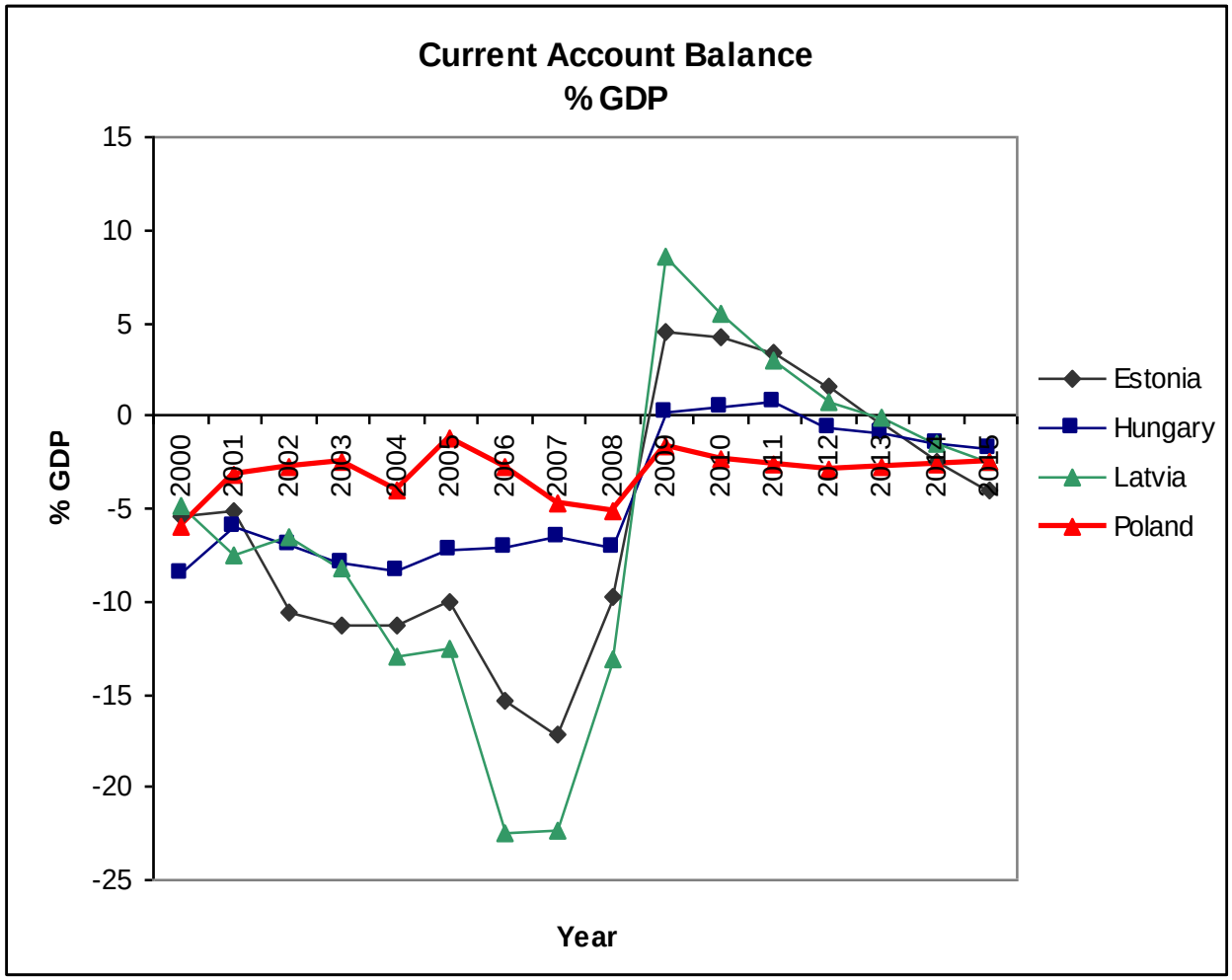


Case study Poland (thanks Helena)

Figure 2: Nominal Exchange Rates: USD/FX (source?)

Case study Poland (thanks Helena)

Figure 3: Current Account Balance as % of GDP (source?)



Case study Poland

Figure 5: Inflation Rate- % change from previous year

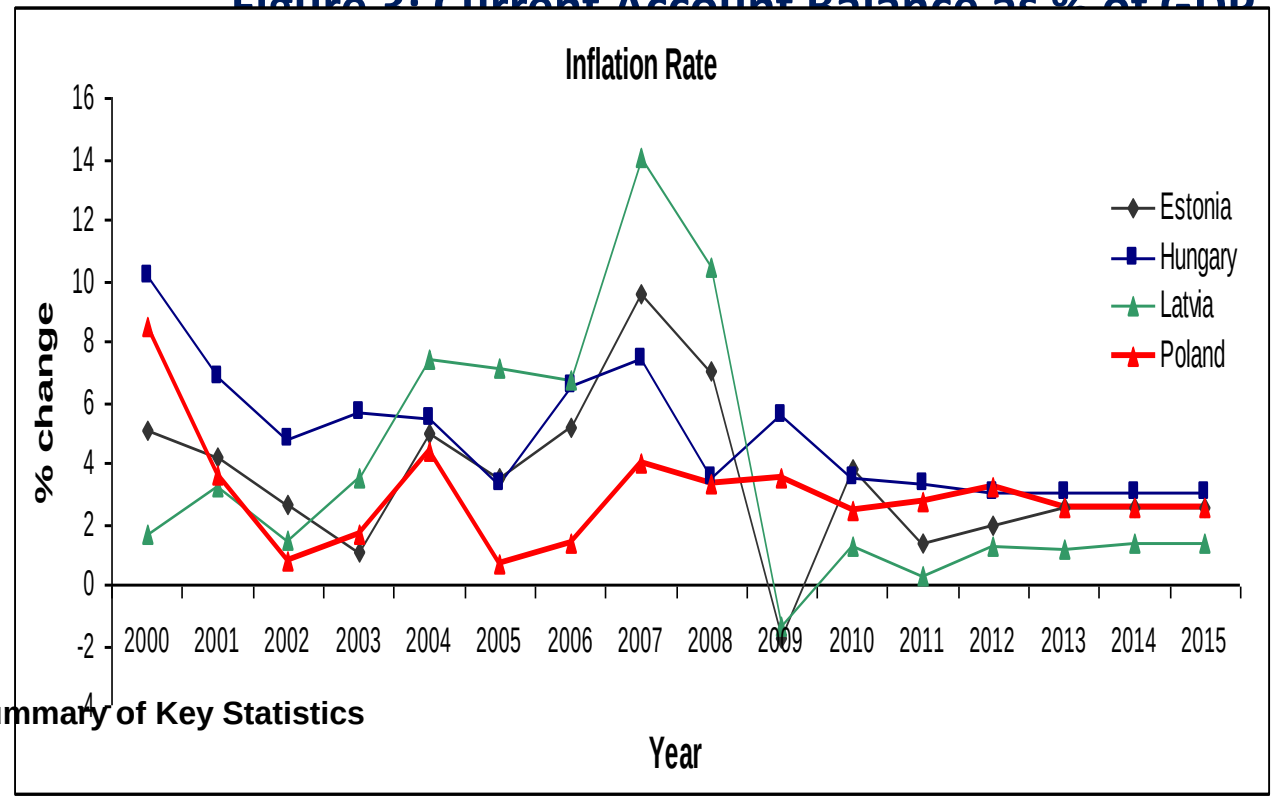


Table 1: Summary of Key Statistics

		Estonia	Hungary	Latvia	Poland
GDP per capita Growth	2008	-5.2%	0.8%	-3.9%	4.9%
	2010	2.3%	0.8%	-0.6%	3.4%
	2015	3.2%	3.1%	4.2%	4.2%
Current Account (% of GDP)	2008	-9.7%	-7.1%	-13.1%	-5.1%
	2010	4.2%	0.5%	5.5%	-2.4%
	2015	-4.0%	-1.8%	-2.5%	-2.4%
Inflation Rate	2008	7.0%	3.5%	10.4%	3.3%
	2010	3.8%	3.5%	1.3%	2.4%
	2015	2.5%	3.0%	1.4%	2.5%