

Characterizing the Business Cycles of Emerging Economies

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Discussion by Gian Luca Clementi – NYU Stern

Big fan of this Literature

- Makes non-specialists instant experts on emerging markets (very useful when for a living you **try to** teach macro to MBAs)

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Main point of this discussion

- Empiricists can get some ideas by reading theory papers

Business Cycle Facts

Developing Vs. Developed countries

Variables:	Developed	Developing
Output Volatility	lower	higher
Consumption Vol./Output Vol.	≤ 1	$\gg 1$
Correlation Output/Trade Balance	< 0	$\ll 0$
Correlation Output/Real Interest Rates	?	$\ll 0$
Real Interest Rates	lagging?	leading

Sources: Backus & Kehoe (1995), Mendoza (1995), Agénor, McDermott, Prasad (2000), Neumeyer & Perri (2005), Calderón & Fuentes (2006).

Business Cycle Theory

Recent Application to Developing Economies

- Mark Aguiar & Gita Gopinath (2005)
- Andy Neumeyer & Fabrizio Perri (JME, 2005)

Aguiar & Gopinath

Assumptions

- Production: $y_t = e^{z_t} k_t^\alpha (e^{\gamma_t} l_t)^{1-\alpha}$
 - Standard technology shocks: $z_t = \rho z_{t-1} + \varepsilon_t$
 - Growth rate shocks: $\gamma_t = \gamma_{t-1} + g_t$,
 $g_t = (1 - \rho_g)\mu_g + \rho_g g_{t-1} + \zeta_t$

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- Preferences: $U(c_t, l_t) = \frac{[c_t - \varphi e^{\gamma_t} (1-l_t)^\nu]^{1-\sigma}}{1-\sigma}$ (known as GHH)
 - Bottom line: no wealth effect on labor choice

Aguiar & Gopinath

Mechanics

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 - Consumption increases, but by less than output
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 - Trade balance deteriorates a lot more on impact, and stays in deficit for much longer

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- **Problem:** with wealth effect on labor choice, it does not work. Employment becomes counter-cyclical.

Aguiar & Gopinath

Insight for empirical work

- What really are these permanent TFP shocks that hit developing economies but not the developed ones?

Neumeyer & Perri

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 - Labor demand drops
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Insight for empirical work

- What shocks to fundamentals drive the innovations in the default premium?
- What's the impact of interest rate shocks on firm dynamics? More in general: what's the nature of the propagation mechanism of these interest rate shocks?