The Growth of Emerging Economies and Global Macroeconomic Stability

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Paper's Contribution

- Novel modeling elements
  1. Entrepreneurs as net lenders to banks
  2. Banks default because of non-fundamental shocks (sun spots)
  3. Impact of emerging economies on a large economy
- Finds that high leverage comes with more aggregate volatility

Role of Rising External Demand

With Simple Worker Debt Constraint

- No default regime (low leverage)

$$\widetilde{B_t} = B_t \leq \bar{\xi}\eta$$

- Multiple equilibria regime (high leverage)

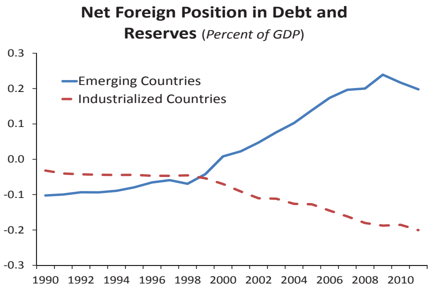
$$\widetilde{B_t} \geq \bar{\xi}\eta$$

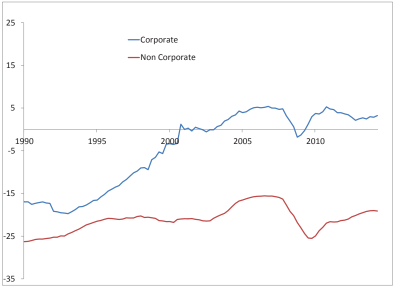
- Output is linear in $\widetilde{B_t}$: Not the typical mean-variance tradeoff.
- Model may not generate enough movement in leverage as it is.

Role of Rising External Demand

- Bank liability $B_t = B_t^D + B_t^F$
- With a (deterministically) rising B_t^F series, on average, B_t increases but B_t^D decreases.
- Higher volatility (left skewed)
- Suggestion: Isolating the impact coming from the B_t^F series?

Two Motivating Facts





Net Financial Asset Position and Credit Constraint

Non-financial Corporate Sector

A1 Financial asset

1. Misc. (0.46 to 0.50)
2. Trade receivables (0.24 to 0.18)
3. FDI (0.14 to 0.20)

A2 Real asset

L Financial liability

1. Credit market inst. (0.50 to 0.48)[a]
2. Misc. (0.26 to 0.23)
3. Trade payable (0.13 to 0.14)
4. FDI (0.11 to 0.14)

E Equity

[a] All changes between 1993 and 2005

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- Change in A1-L seems to reflect what firms do, rather than the severity of credit constraints

Firms as Net Lenders

- Not essential for the theory—one could use the Evans-Jovanovic (1989) or Quadrini (2000) constraint:

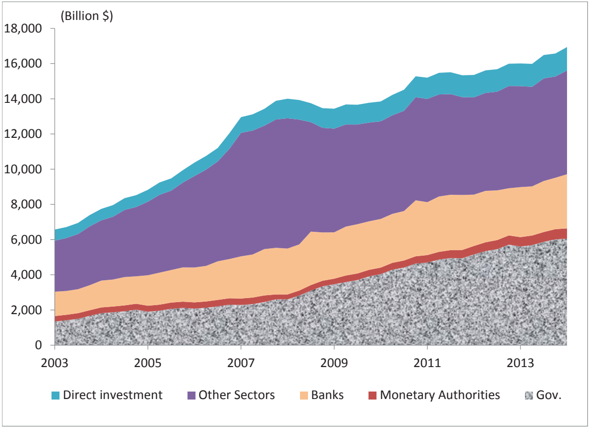
$$k_i \leq \lambda b_i$$

- Would be interesting to consider entrepreneurial portfolio choice—some assets are more collateralizable.

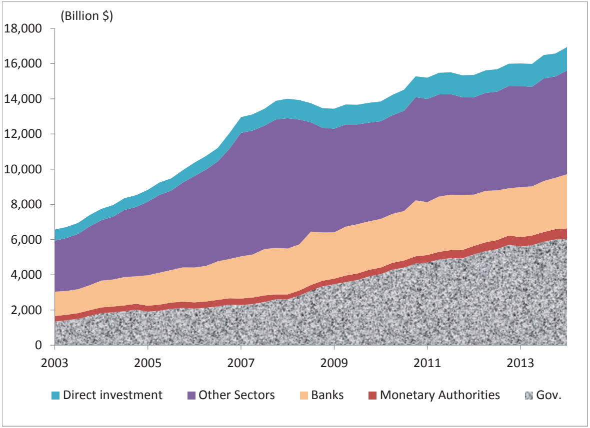
External Demand

- One compelling explanation for foreign demand for US debt securities: Safe asset (Mendoza, Quadrini and Rios-Rull, JPE 2009)

External Demand



External Demand



(Not necessarily a problem, if one can generate spillover across asset classes.)

Concluding Remark

- Very interesting, thought-provoking paper!
- Much needed new modeling elements (i.e., banks)
- Incorporating capital flows into US-centric models.
  - Difficult choices: why net debt only?

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- Much needed new modeling elements (i.e., banks)
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  - Difficult choices: why net debt only?
- Maybe limited quantitative mileage?
  1. Very elastic labor supply
  2. $\frac{B^F}{Y}$ targeted, but unclear what is the right $\frac{B}{Y}$ counterpart in the data (B^D is negative in the data).