

ANDERSON GRADUATE SCHOOL OF
MANAGEMENT
UCLA

MGT 297
Business and Economics in Emerging
Markets

Sebastian Edwards
Henry Ford II Professor of International Business Economics

Winter 2001

During the past few years, business opportunities in the Emerging Markets (EM) have grown dramatically. Investment banks, private equity investors, pension funds and manufacturing firms carefully evaluate prospects in Asia, Latin America, Central Europe and Africa when designing their strategic plans.

The purpose of this course is to analyze the most salient features of the Emerging Economies. Some of the most important issue that will be covered include: (1) The EM prospects for economic growth; (2) How to deal with EM's volatility; (3) Exchange rates and currency crises; (4) Inequality and political instability; (5) Currency, country and political risk.

Many of the readings for this course correspond to material issued by major investment banks – Goldman-Sachs, JP Morgan, Deutsche Bank and others – for their clients.

We will meet once a week – Thursdays from 6 to 9PM.

There is one midterm, several group assignments, one case and a final exam.

LECTURES

In what follows I provide an overview of the course. The session by session description is meant to be indicative. Depending on the way in which our discussion evolves, it is possible that the treatment of a particular topic will more (less) time than what I have indicated here.

READINGS

There is a course reader. I have assigned approximately three readings per session. Try to read ahead of time. The readings are supplementary to the lectures.

Many, but not all, of the Edwards readings can be downloaded from my web site:

<http://www.anderson.ucla.edu/faculty/sebastian.edwards/>

Session 1: Economic Growth and Stability

In this session we will discuss why some countries grow very fast, while others tend to stagnate. We will look at regional experiences, and will discuss the way in which economic policies can help accelerate growth. We will also look at the determinants of economic stability. An understanding of these issues is fundamentally important for business decision process. Companies – new and established – prefer to expand in fast growing and stable counties.

In this session we will discuss Goldman-Sachs renowned model *GS-Watch*.

1.1 The Emerging Economies: Regional Overview

- a. Latin America
- b. Asia
- c. Eastern Europe
- d. Africa

1.2 The Determinants of Economic Growth

- a. Recent Evidence
- b. The Long View
- c. Economic Policies to Accelerate Growth
- d. The role of institutions

1.3 Crisis and Instability

- a. Recent Crises: Mexico, East Asia, Russia, Brazil
- b. Crises Predictors

Readings:

Goldman Sachs, Macroeconomic Outlook for Emerging Economies, 2000

Goldman Sachs, GS-Watch

Krugman, “The Myth of the Asia’s Miracle”

Session 2: Exchange Rates Crises

The exchange rate is arguably one of the most important financial and economic variables. Its behavior affects a company’s ability to compete, its rate of return, and its cost of capita. Additionally, the exchange rate impacts on a country’s business a key determinant of inflation and other interest rates.

Emerging economies have diverse exchange rate systems – ranging from freely floating to super fixed --, and are prone to exchange rate crises. In these sessions we will deal with the most important exchange rate issues in the emerging economies. The analysis will cover the models used by major investment banks to forecast exchange rate movements.

- a. Exchange rate regimes
- b. Exchange rates and inflation: what is the nexus?
- c. Real exchange rates

Readings:

Edwards and Savastano: “Exchange Rates in Emerging Economies: What do we know? What do we need to know? P. 453-469

Edwards, “The Mexican Peso Crisis”

Edwards, “Exchange Rate Misalignment in Developing Countries”

Sessions 3: Exchange Rates Crises (Continuation)

- d. Devaluation crises
- e. Fiscal imbalances and crisis
- f. Fixed vs floating exchange rates: Is that the question?

Readings:

Goldman-Sachs, GSDEEMER and STMPIS

Session 4: Trade Balance, Vulnerability and Instability

The trade balance is often considered a key economic variable. It has been argued, for example, that large trade deficits increase a country's degree of vulnerability. In this session we will discuss how to interpret external sector developments. We will ask whether large trade (and current account) deficits are, indeed, leading indicators for currency crises. Should firms avoid nations that run large deficits? How can firms protect themselves from developments triggered by large external imbalances?

- a. External Sector Accounts
- b. The Goldman-Sachs model
- c. The Deutsche Bank model

Readings:

Goldman Sachs, GS-SCAD

Edwards, "On Crisis Prevention" NBER Working Paper

Session 5: International Capital Markets

The global capital market plays a key role in modern economies. It is a source of funds for emerging economies, and allows global investors to diversify risk and take advantage of higher rates of return. However, some analysts – including George Soros – have argued that capital flows are dominated by speculators, and that they should be regulated.

In this and the next session we will deal with the more important aspects of capital flows in the world economy.

- 1.1 Basic Relationships, bonds and spreads
- 1.2 The Rating Agencies
- 1.3 Capital Flows and Equities

Readings:

Beckaert and Harvey, "Capital Flows and Behavior of Emerging Market Equity Returns"

Dornbusch, "Check the Laws Before you Invest Abroad"

Goldman-Sachs, "GS-Derby and BMPIs"

Session 6: International Capital Markets (Continuation)

- 1.4 Capital Mobility and Cross Country Performance
- 1.5 Speculation, Crises and Controls

Readings:

Edwards, “How Effective Are Capital Controls?”

Edwards, “On Crisis Prevention”

Session 7: Currency Crises and Contagion

In recent years, currency crises that erupt in a particular country have tended to spread to other nations. This phenomenon has come to be known as “contagion.” In this section we will discuss what are the main forces behind this transmission process. We will inquire whether contagion can be predicted.

- a. Recent experiences
- b. Volatility Contagion

Readings,

Edwards, “Contagion”

Session 8: The IMF, the World Bank and Stability in the World Financial Markets

The International Monetary Fund and the World bank have become dominant institutions in the world economy. They are supposed to assure a stable financial environment and assist poorer countries develop. Throughout the years, however, they have been deeply criticized by both conservative and liberal analysts. In this session we will discuss the role of these two institutions, including the way their policies affect global financial markets.

Readings

IMF, “What is the IMF?”

IMF, “IMF at a Glance”

Edwards, “Abolish the IMF”

Session 9: Social Conditions, the Environment and Political Instability

Poverty and an unequal distribution of income are two basic problems in the emerging nations. They affect business opportunities directly and indirectly. In particular, nations with poor social conditions will tend to be politically unstable, and subject to sharp

changes in the rules of the game. In this session we will discuss the existing evidence, alternative ways of measuring poverty and inequality, and possible economic policy solutions to these problems. We will also discuss some important environmental issues.

Edwards, "Crisis and Reform", Ch. 8

Session 10: Final Exam