Emerging Market Business Cycles: The Cycle is the Trend

Aguiar & Gopinath, 2007

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Objectives

- Model emerging markets considering it's volatilty
- Identify permanent shocks from transitory shocks
- In permanent shocks savings decrease , and trade experiment a large deficit.
- In transitory schocks, savings increase and deficit in trade is small

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Emerging Market business cycle

- BCF in emerging markets are characterized by large volatily and dramatic current account reversals, the so -called sudden stops
- Emerging markets have high volatitily in their moments due to frequent Regime Switches
- Those distinct regimes have different policies that change over time : Fiscal,Monetary and Trade
- On average business cycle in emerging economies is twice as volatile as their developed counterparts.

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Modelling

- Author proposes a production function affected by 2 parameters e_t and Γ_t
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$$Y_t = e^{z_t} K_t^{1-\alpha} (\Gamma_t L_t)^{\alpha} \quad (1)$$
- Transitory Shock z_t
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$$z_t = \rho_z z_{t-1} + \epsilon_t^z \quad (2)$$
- Cumulative product de "growth" shocks Γ_t (Trended shock)
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$$\Gamma_t = e^{g_t} \Gamma_{t-1} = \prod_{s=0}^{t} e^{g_s} \quad (3)$$
$$g_t = (1 - \rho_g)\mu_g + \rho_g g_{t-1} + \epsilon_t^g \quad (4)$$

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