

# ANEMIA, EXUBERANCE AND VULNERABILITY: THE NEW GLOBAL ECONOMIC GEOGRAPHY

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Latin America's Macroeconomic Outlook  
From a Global Perspective

**CERES**  
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# Anemia, Exuberance and Vulnerability: The New Global Economic Geography<sup>1</sup>

By Ernesto Talvi and Ignacio Munyo\*

*This is a summary of CERES's (Center for the Study of Economic and Social Affairs) recent report on Latin America's Macroeconomic Outlook from a Global Perspective. The report is titled: "Anemia, Exuberance and Vulnerability: the New Global Economic Geography" and can be downloaded from [www.ceres-uy.org](http://www.ceres-uy.org).*

It would not be an overstatement to assert that the global financial crisis has created a *New Global Economic Geography* (NGEG), a new reality that responds to the remarkable fact that the crisis that crippled advanced economies has nevertheless left not only losers but also winners around the globe.

This remarkable phenomenon is suggested by the sharp contrast in macroeconomic performance in the US and the EU compared to some key emerging economies such as China, India and Brazil. The aftermath of the financial crisis in the US and the EU came hand in hand with a severe credit crunch, an equally severe and persistent decline in private consumption, investment and output relative to pre-crisis trends, a significant rise in unemployment, disinflationary pressures and a depreciation of the US dollar and the Euro on a trade-weighted basis. In other corners of the world, namely in China, India and Brazil, the picture that emerges is the exact opposite: output currently stands above pre-crisis trends and unemployment rates are low and declining. Both components of domestic demand, consumption and investment, are also above pre-crisis trend levels, fueled by a very rapid acceleration in bank credit flows. As a by-product, these three countries had to face up to inflationary pressures and a significant real appreciation of their currencies against the US dollar and on a trade-weighted basis.

This sharp contrast is not a mere coincidence: it is causally connected. The genesis of the NGEG lies in the financial crisis in advanced economies: depressed consumption

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and investment freed-up capital and financial resources that literally flooded a broad spectrum of emerging markets across every region of the world.

This new economic reality clearly suggests that the global financial crisis that erupted in early 2007 in an obscure corner of the US credit market now infamously known as sub-prime mortgages, has produced winners and losers, i.e., countries that appear to be better off and countries that are significantly worse off relative to the trends prevailing prior in the to the onset of the global financial crisis.

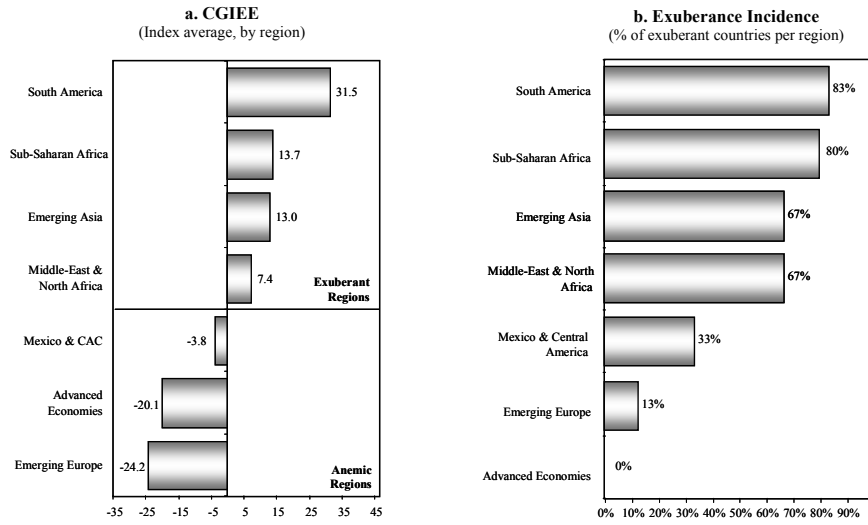
### ***CERES Global Index of Economic Exuberance (CGIEE)***

To identify who are the winners, who are the losers and why, we develop the *CERES Global Index of Economic Exuberance (CGIEE)*. It is designed to measure whether a country's macroeconomic performance is stronger or weaker relative to the prevailing performance prior to the advent of the global financial crisis in 2007.<sup>2</sup>

The CGIEE gauges the behavior of six key macroeconomic variables —output, unemployment, domestic demand, bank credit, inflation and the real exchange rate— for 42 advanced and emerging economies covering every region of the world.

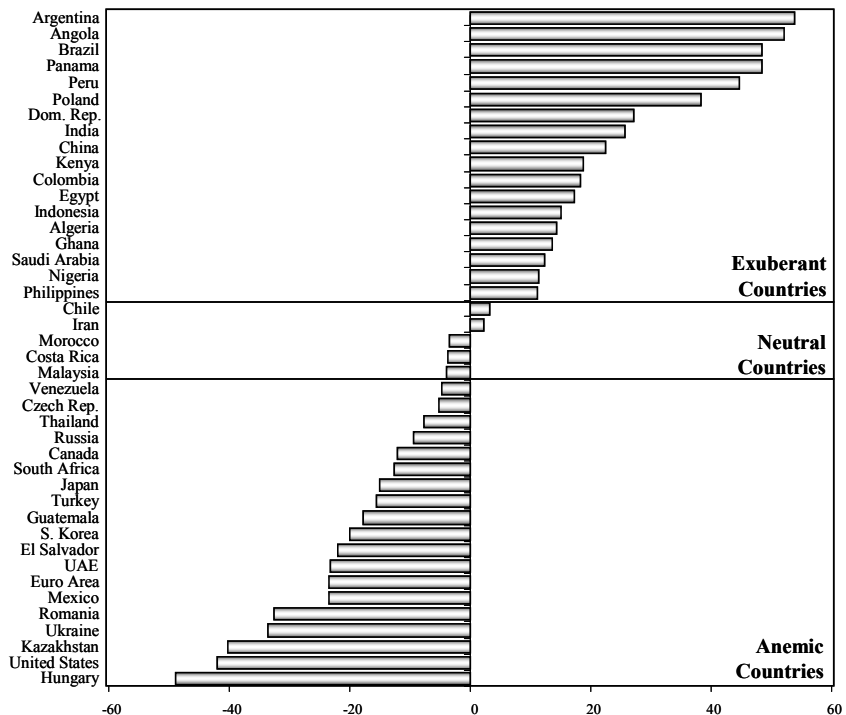
According to the CGIEE the post-global financial crisis world is divided into two groups: countries with a positive CGIEE that we define as *Exuberant Economies*, and countries with a negative CGIEE that we define as *Anemic Economies*. *Anemic Economies* are dominated by advanced economies and those emerging regions that are closely connected to them: Emerging Europe and Mexico & Central America. On the other hand, *Exuberant Economies* are largely dominated by emerging economies of South America, Emerging Asia, Sub-Saharan Africa and Middle East & North Africa (see Figure 1).

**Figure 1. CERES Global Index of Economic Exuberance (CGIEE):  
Results by Region**



Surprisingly, for *Exuberant Economies* with large positive CGIEE values, the first positions are dominated by Latin American countries (Argentina, Brazil, Panama, Peru, and the Dominican Republic) and African countries such as Angola, rather than Emerging Asian countries. India and China rank high but appear in the 8<sup>th</sup> and 9<sup>th</sup> position of the CGIEE, respectively (see Figure 2).

**Figure 2. CERES Global Index of Economic Exuberance (CGIEE):  
Results by Country**



Exuberance and anemia are a rather generalized phenomenon that spreads across the whole set of macro variables composing the CGIEE. The average exuberant economy not only displays a positive value of the CGIEE but also displays positive values in each and every one of the variables of the index. Something similar occurs with the average anemic economy: it displays an overall negative value of the CGIEE and negative values in every one of the components of the index.

To dig further into the causes of why some emerging countries turned out to be winners and others turned out to be losers, we perform formal statistical cluster analysis. This analysis unveils that emerging countries that share some key structural characteristics turned out to be winners in the NGE: (i) net commodity exporters, who benefited from historically high commodity prices; (ii) countries that export a significant share of their goods and services to *Exuberant Economies*; (iii) countries with low dependence on remittances flowing from advanced *Anemic Economies*; (iv) countries with relatively ample opportunities for investment in capital intensive and interest rate sensitive sectors in the economy (and a relatively favorable domestic investment climate), that benefited from cheap and abundant capital and financial resources.<sup>3</sup>

To summarize, the CGIEE projects an image of a NGE that splits the world into *Exuberant* and *Anemic Economies*. This divide escapes any easy classification, cutting across economic development categories, geographical regions or the East-West dimension. First, although *Exuberant Economies* are largely dominated by emerging markets and *Anemic Economies* by advanced countries, many emerging markets still fall into the anemic category. Second, there is diversity within geographical regions, each of them displaying their fair share of both exuberant and anemic economies. Third, although Western economic powerhouses, the US and the EU, are classified by the CGIEE as *Anemic Economies*, and China and many countries in Asia are classified as *Exuberant Economies*, it is a far cry from being an East-West phenomenon. For starters Japan is also in the anemic group, while countries in South America and Africa are of the exuberant type. This new configuration of the world economy implies a more complex redistribution of economic power and a new web of economic relations (and maybe also of geopolitical interests) than a simple minded East-West dichotomy might suggest.

### ***External Vulnerability in Emerging Markets***

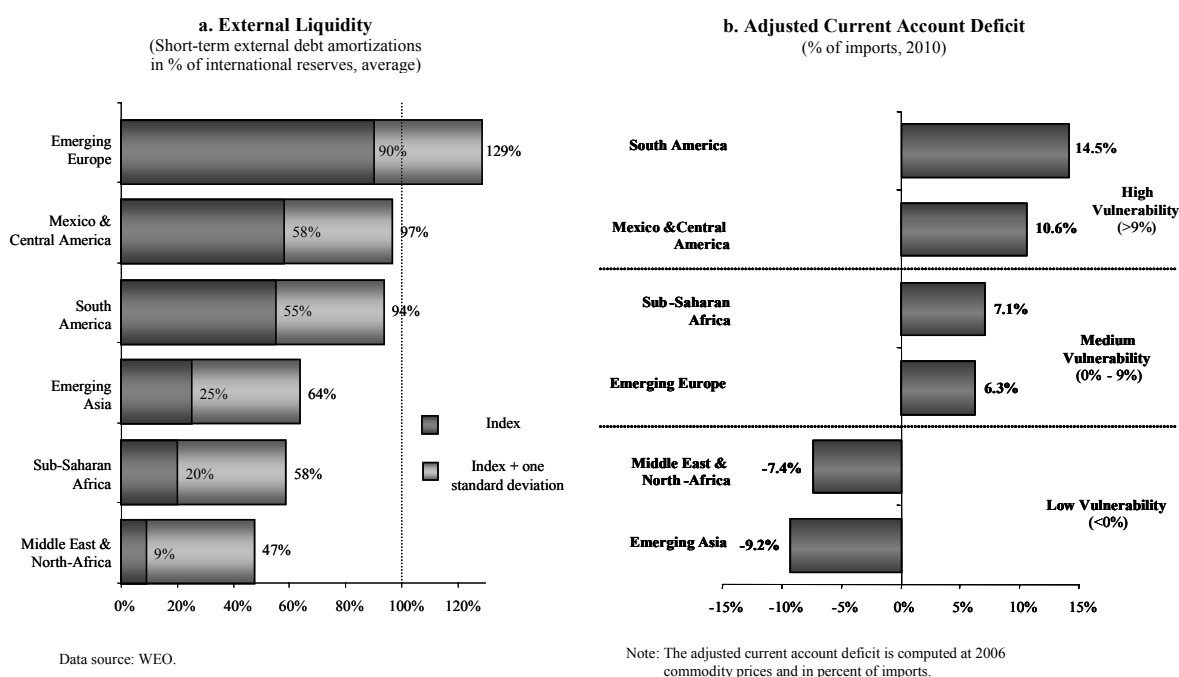
Although the NGEF has been largely beneficial for emerging countries it has come at a price. As we stated before, the genesis of the NGEF lies in the financial crisis in advanced economies that freed-up capital and financial resources to be reallocated to emerging markets. However, the financial crisis and its collateral damages are far from being resolved, and subject the world capital markets to recurrent episodes of financial turmoil.

Moreover, current instability in global markets occurs in a context where huge fiscal deficits and explosive paths of public debt have weakened the advanced economies' ability to respond as effectively as they did in the initial stages of the crisis, to a new wave of severe financial turbulence. This fact makes a new crisis episode potentially more severe and prolonged than the Lehman episode.

This begs the question of how resilient or vulnerable emerging markets are to such an event. To address this question we analyze two sets of indicators for emerging countries: (i) external liquidity indicators and, (ii) external macroeconomic vulnerability indicators. Liquidity indicators measure the ratio of short-term external and domestic debt amortizations to international reserves.<sup>4</sup> External macroeconomic vulnerability indicators measure the adjusted current account balance in percent of imports.<sup>5</sup> Intuitively, this indicator measures the required adjustment in imports necessary to close any given current account deficit in a context of a potential drought in capital flows—should the adjustment occur only through the reduction in imports.<sup>6</sup>

As illustrated in Figure 3 (panel a), with the exception of Emerging Europe and a note of caution for Latin America—where the external liquidity indicator is above or close to the 100 percent critical threshold, respectively— emerging markets appear to be strong from an international liquidity perspective to sustain a new episode of financial turmoil, even if access to credit markets is shut-off for a considerable period of time. Therefore, according to this assessment, external liquidity issues are not at the current juncture the main source of concern for most emerging markets. Not a minor accomplishment, to say the least.

**Figure 3. Vulnerability to a “Lehman-type Virus”**

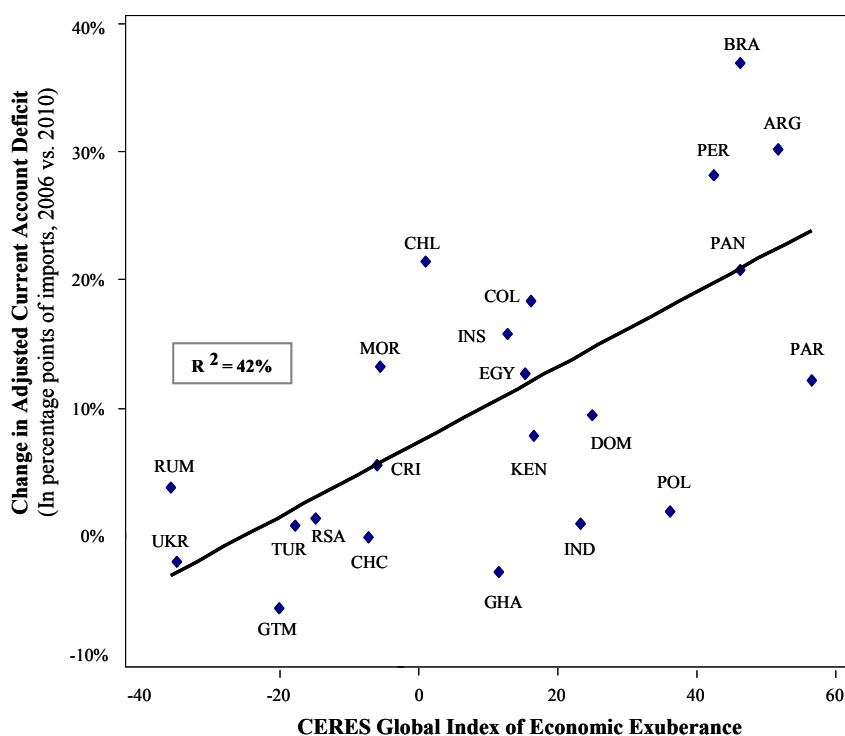


Although the majority of emerging countries are highly shielded regarding external liquidity risk, this is not the case when the vulnerability to macroeconomic risks is factored into the analysis. In spite of a strong external liquidity position, an outbreak of a more resistant strain of the “Lehman-type Virus” would require many emerging countries to undergo severe macroeconomic adjustments: output contraction, rise in unemployment, deterioration in fiscal balances, potentially non-convergent debt dynamics, weakening of banks’ balance sheets, credit crunch. In other words, emerging economies could be mired with problems associated with a sharp deterioration of economic fundamentals.<sup>7</sup>

In this respect, Figure 3 (panel b) depicts a situation in which Latin American countries display the highest levels of macroeconomic vulnerability, with the exuberant South American region leading the pack and Mexico & Central American region a close second. Surplus regions, i.e., Emerging Asia and Middle East & North Africa, display the lowest levels of vulnerability, while Emerging Europe and Sub-Saharan Africa are located in between. These regional patterns are also displayed by the majority of the individual countries within these regions.

Moreover, exuberant regions such as South America and Sub-Saharan Africa, with positive values of the CGIEE, display the largest increases in macroeconomic vulnerability to adverse global conditions. In fact, these two regions are now much more vulnerable than they were at the beginning of the global financial crisis. In contrast, anemic regions, such as Emerging Europe and Mexico & Central America, display similar levels of macroeconomic vulnerability as they did in 2006. More generally, Figure 4 illustrates the positive relationship between the degree of macroeconomic exuberance (as measured by the CGIEE), and the increase in external macroeconomic vulnerability to adverse global conditions.

**Figure 4. The Exuberance-Vulnerability Paradox**



Note: The change in adjusted current account deficit is computed at 2006 commodity prices and in percent of total imports.

### ***The Exuberance-Vulnerability Paradox: a Policy Touch***

Ironically, exuberance breeds vulnerability. Most of the emerging world turned out to be a winner in the post-financial crisis NGE, in several cases displaying an extraordinary degree of economic exuberance. However, many emerging markets are at the same time highly vulnerable to severe macroeconomic adjustments, should disarray in global capital markets —brought about by a NGE in which advanced

economies are plagued with financial and sovereign debt problems— hit the world economy.

In other words, the economic forces that in the post-financial crisis world created the conditions for a NGEF in which many emerging countries could flourish —cheap and abundant capital and financial resources to be invested in emerging markets— are inherently the same as those capable of creating havoc in global capital markets and stripping emerging economies off their bonanza in the blink of an eye.

In this reality exuberance and vulnerability in emerging markets are connected in a very peculiar way. Thus, three final policy thoughts based on this peculiar connection.

First, governments running exuberant emerging economies should take due notice of this *Exuberance-Vulnerability Paradox* and act accordingly when setting their monetary, fiscal and macro-prudential policies, in such a way that mitigates the build-up of future fiscal and financial risks, rather than buying into the exuberance wave.

Second, the international community that in early 2009 acted in a very swift way to increase the firepower of the IMF and other multilateral institutions to avoid a fallout of fundamentally sound but vulnerable emerging economies, should ensure that these institutions are adequately capitalized and able to perform the same role in the event of a new episode of global financial turmoil. This is a particularly relevant consideration at a time when the resources of the IMF might be strained by the crisis in peripheral Europe.

Finally, exuberant-type-cash-rich global emerging market players who were the key beneficiaries of the NGEF, have high stakes in ensuring that the current global order is not disrupted by a new and perhaps more virulent strain of the “Lehman-type Virus”.

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## Notes

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<sup>2</sup> The Economist (2011) recently published an Overheating Index. The CGIEE has three key differences with The Economist’s Overheating Index. First, the rationale. The CGIEE attempts to identify winners and losers in the aftermath of the global financial crisis and thus, to measure the current situation relative to pre-crisis trends, independently of any notion of overheating. Second, the CGIEE index includes a different set of variables (and in some cases a similar variable computed in a different way). Third, the country coverage of CGIEE is significantly larger and also includes advanced economies.

<sup>3</sup> Cluster analysis is performed along the lines of Izquierdo and Talvi (2011).

<sup>4</sup> See Greenspan (1999), Guidotti (2000), Rodrik and Velasco (1999).

<sup>5</sup> The adjusted current account balance is measured as follows. First, it is computed at 2006 export and import prices to allow for a potential decline in commodity prices in the event of a Lehman-type episode. Second, it is measured in terms of imports, to obtain a more accurate gauge of the decline in domestic demand necessary to close any given current account deficit.

<sup>6</sup> See Calvo, Izquierdo and Talvi (2003).

<sup>7</sup> See for example Calvo, Izquierdo and Talvi (2006) and Reinhart and Rogoff (2009).



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