Emerging Financial Markets

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“What is an emerging market? A market that will never be developed.”
-Anonymous Trader at an Investment Bank in London, September 2007

What separates an emerging market from a developed one? Are “emerging markets” destined to develop or will their path be unsteady and peripheral? The answer to these questions is more convoluted, contentious, and relevant than ever. With more than 50% of the global GDP and almost two thirds of its growth now produced by the emerging world, global investors will likely continue allocating an increasing fraction of their portfolios to EM. A nuanced understanding of institutional differences, risks, and specificities of the emerging world are key to untap the potential of these markets.

This course dives into the institutional, economic, and financial fundamentals of emerging market economics. We will explore the main risk factors in EM financial systems over the past three decades and build on country characteristics to predict corporate and government asset performance. The first goal is to challenge you to think critically about the place EM countries occupy in the international financial system. The second goal is to equip you with analytical tools to prepare you for successful development of investment strategies in emerging markets. To that end, we will draw on historical examples, economic theory and empirical techniques to analyze how emerging markets have performed, what underlying fundamentals drive development and how current political turmoil influences opportunities for investment and business development.

Readings: The main textbook is Emerging Financial Markets, by David Beim and Charles Calomiris, 2001 (EFM). Other readings (including EFM) and the case studies are found in the electronic course packet.

Students are expected to prepare for class by reviewing the assigned readings and preparing case-debate presentations and written case solutions as a group. Groups consist of a team of three or four students. Students are responsible for forming groups immediately after the first class. Team lists must be submitted in hard copy form to the instructor at the beginning of the second class.

Grading is based on 4 cases- team written case solutions (50%), 4 team presentations of mini-cases (30%) and a take-home final exam consisting of longer-answer questions (20%). The take-home final exam will be distributed on the second to last class and will be due by the end of the last class of the term. The final exam will test comprehension of the material in the required readings, class discussions and guest speakers’ presentations. The final exam should take no more than 3 hours to complete. Case solutions should be no more than four pages of text (double-spaced, Times Roman 12 font with normal margins), which follow a one-page executive summary. Up to five pages of charts and tables may be attached. Finally, there is a bonus (optative) individual Essay, representing 10% of the total class grading.
The following is a list of readings and assignments for each class meeting. Additional readings with contemporaneous information will be added in a timely fashion.

**COURSE SCHEDULE AND READINGS**

Readings with asterisks (*) are required. All required readings are available in the readings packet.

**Theme 1**: How do *institutions* affect development in Emerging Markets? Is economic convergence a reality or a dream? How do institutional risks impact strategies for investment in EM?

- *EFM, Chapters 1-3.*
- *Patel, D., Sandefur, J.and Subramanian, A., 2018. Everything you know about cross country convergence is (now) wrong. PIIE Real Time Economic Issues.*

**Theme 2**: What are the economic and social benefits of *financial development*? Why do countries rely on *financial repression*? Which kind of investment opportunities are created by this government intervention?


**Theme 3:** How should you assess Sovereign and Corporate Risk in Emerging Markets? What happens with domestic financial assets when a country opens its capital market?


**Theme 4:** How do the legal foundations of finance and corporate governance shape innovation and private equity investment in Emerging Markets?

- *EFM, Chapters 4-5.*
Theme 5: How has the emergence of China changed the Emerging Markets landscape and its opportunity set? Which are the Chinese engines of growth and how are they evolving? What are the financial market and macroeconomic impacts of Chinese spillovers to the rest of EMs?

Theme 6: How do inflation and exchange rate policies affect investment strategies for Emerging Markets? How should you analyze inflation and exchange rate risks?

- Romer, David., 2013. Short run fluctuations.
- *EFM, Chapters 6.
- *Mishkin, F., Schmidt-Hebbel, K., 2001. One decade of inflation targeting in the world: what do we know and what do we need to know. NBER WP.


Theme 7: What are the macroeconomic and financial indicators most useful in identifying sovereigns at risk of default? What are the factors that determine the size of “haircuts” or a forced reduction in the value of a bond— in a sovereign restructuring? Taxonomy, Causes and Social Costs of EM financial crises, historically and in the present era.

- *EFM, Chapters 7 and 8.
- *Reinhart, C., Rogoff, K., 2008a. This Time is Different: A Panoramic View of 8 Centuries of Financial Crisis. NBER wp 13882.

Charles Calomiris and Stephen Haber, Fragile By Design, Chapters 10-11, 14-15.
• Serkan Arslanalp and Peter Henry, "Debt Relief: What Do the Markets Think?" NBER, December 2002.

Theme 8: What is macro-prudential regulation and how does it affect international capital flows to EMs? Why could too much capital inflows be a bad thing?


Theme 9: Does factor investing work in Emerging Markets? How do portfolio construction, liquidity and transaction costs affect the way we invest in EM?

Assignments

22-May: Mini Case 1
5-Jun: Case 1
12-June: Mini Case 2
26-Jun: Case 2

10-Jul: Mini Case 3
17-Jul: Case 3
31-Jul: Mini Case 4
14-Aug: Case 4