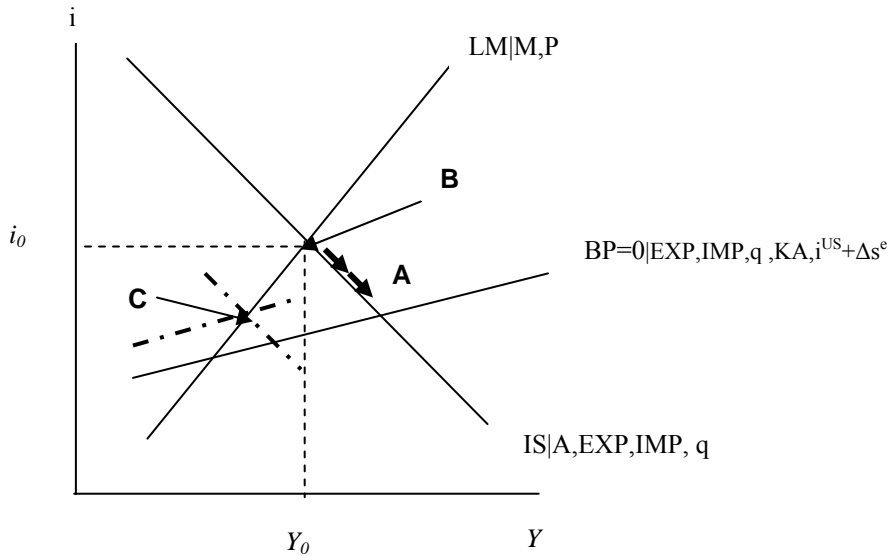
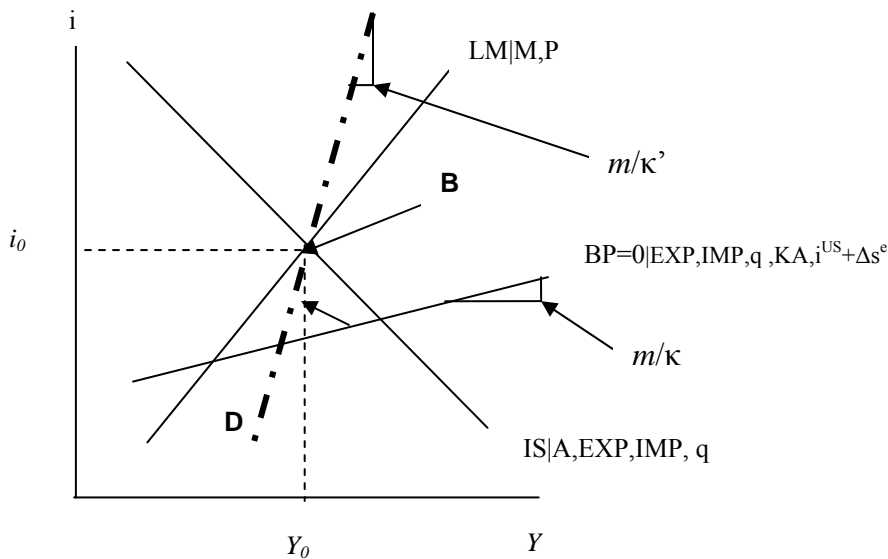


### Emerging Market Crises

To organize one's thoughts about emerging market crises, consider a semi-open economy, and the different situations it encounters. Many stories start with a boom, where capital is flowing in. Returning to IS-LM-BP=0:

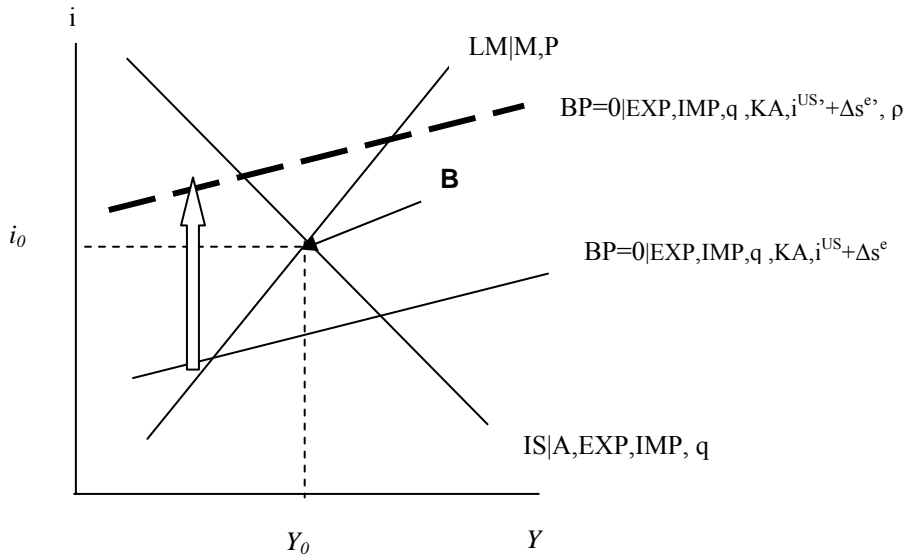


B: Sterilize Inflows, A: No Sterilization, C: Allow Currency appreciation

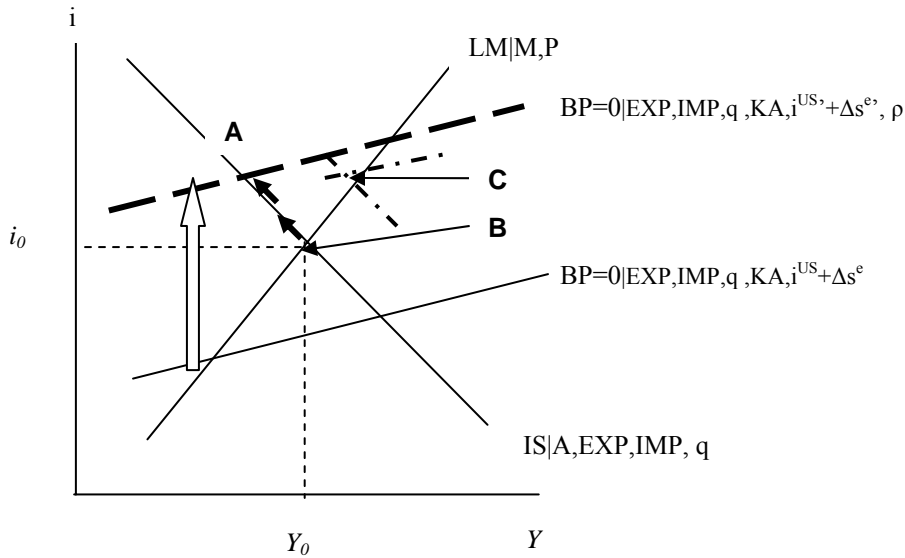


D: Impose capital controls,  $\kappa$  decreases, so  $m/\kappa$  rises to  $m/\kappa^2$

Now consider the bust side of the situation. Suppose international investors expect the home currency to be devalued, or to depreciate in a discrete fashion:



Either US interest rates rise, or expected depreciation rises, or the risk premium rises. In this case, there is a balance of payments deterioration.



A: Allow outflow of money, no sterilization; B: Sterilize outflow; C: Allow depreciation; D: Reimpose capital controls