Abstract (summary):

This dissertation consists of three essays that examine empirical questions focusing on the economic cost of financial crises. Currency crises, sudden stops, and banking crises are commonly identified in the theoretical literature as being interrelated events, yet rarely have empirical researchers considered all of these crisis varieties in their analysis of their impacts on the real economy. The first essay investigates how the economic costs differ across the crisis varieties and finds that for 37 emerging countries during 1980-2005, the impact of currency crises, sudden stops and banking crises on output loss are about 3.4%, 1.8% and 0.8% in short run (5.0%, 2.7% and 1.3% in long run), respectively. The simultaneous occurrences of currency crisis and sudden stops with banking crisis cost 3.1% and 2.9% of output loss in one year, respectively.

Despite the important interactions among these crises, most researchers in this literature have used dummy variables to indicate financial crises, which is tantamount to assuming all crises are of equal magnitude. The second essay1 contributes to the literature by systematically analyzing the magnitudes of external crises for 37 emerging markets since 1980 and estimating their effects on real GDP growth. I show substantial variation has characterized the intensities of both currency crises and sudden stops, although much of the variation for the latter is explained by particularly severe crises in 1997 and 2001. Real GDP growth loss estimates in the year of a currency crisis are about 2.8%, but can range from 0% to 5.5%. The typical sudden stop, on the other hand, is associated with very little output loss (about 0.5%), but can range up to 4% for the most severe episodes.

Lastly, recent empirical literature on sudden stops and banking crises has suggested the interaction of these crises is particularly harmful to the real economy. The third essay contributes to this literature by applying a panel vector autoregression to examine how these crises interact via domestic credit. This paper finds that evidence supporting the view that sudden stops occurring with banking crises are more harmful than sudden stops occurring by themselves. I also find that during the joint occurrences of these crises, domestic credit increases during the onset of a sudden stop, but this expansion in credit results in an adverse impact on real GDP growth. This finding is consistent with the hypothesis that the financial intermediaries are unable to allocate credit efficiently. Alternately, the interpretation of this relationship might be the temporal association of real output growth and domestic credit. An increase in the demand of domestic credit occurs to ease the recession.

1 This essay is from a working paper of the same title co-authored with Sam Schreyer.