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Emerging Capital Markets

# Introduction

# This Journal intends to discuss the emerging capital markets and the matters related with international financial and economic issues faced by the developed as well as developing economies. Three main articles are discussed that covers different areas under the global capital markets. The first article was written in 2013 by Xavier exploring the undocumented and unmeasured data on capital formation before the 1950’s and the fluctuations in net investment of Latin American economies. Second article was focused on the international recessions and the globalized impact they make on the other countries that ultimately leads to global recession. Third article quantitatively testes the asset pricing model on stock price booms and expected capital gains for investors. Collectively these articles form the basis for the impact capital markets are making on the growth of the economies (Ahmed et al., 2017).

**Analysis of literature**

Capital formation in Latin America: one and a half century of macroeconomic dynamics

This article studies the capital formation in the form of net investment and GFCF in Latin America (Tafunell, 2013). There is no doubt that physical asset formation has always played a critical role in boosting the economic growth in long run. Many studies are conducted on this account but they have some limitations due to data constraint. When it comes to analyze the macroeconomic dynamics, it becomes different to view complete time frame with maximum geographical area captured. This is the reason why there was a need to conduct a research which is extended to different time periods and covers most geographical area. This study was intended to specifically view capital formation in changing the dynamics of macro economy. Investment trends in Latin America were instable till 1950. After 1950, more significant growth in investment was witnessed that ultimately overtook the growth that was experienced in Golden age from the time frame of 1950 to 1980. Investment is a variable which can never be separated from the economic model of growth as it gives direct robust to economic growth. The relation of long term capital formation on economic growth is stronger in developing countries as it gives a big push to the country. The article also kept in consideration the time period when there was no proper measure available to assess the economic trends of GDP and GFCF in the Latin American economies (Tafunell, 2013). As the main objective of the research article was to find the annual estimation of GFCF in all the Latin American economies before the time period of official data reservation.

*Methodology*

Therefore, for this purpose, the article was simply structured by suggesting a method to assess to the GFCF in the pre-statistics era in which the time before official records of economic variables were reserved i.e. from 1856 till 1950-time period[[1]](#footnote-1). An approach was undertaken with the help of the support assisted by the regional agency of UN, Economic Commission for Latin America and the Caribbean (ECLAC). This proved to be a great help in the way of quantification of capital formation for the period before 1950. The data was compiled and standardized according to the requirements of the national accounts of economic database. Once the data was made available, trends were seen in the long effects of GFCF between 1856 to 1950 and 1950 to 2008. It was seen that drastic positive fluctuations occurred after 1950’s in these countries along with globalization. Furthermore, it was also revealed that that the countries that lagged behind in development showed more potential for a greater investment per capita than the developed countries. This raised more questions in regard to the convergence concept as the disparities in per capita is still very high in the present world.

International Recessions

The second article talks about the international recessions with reference to the 2008 global financial crisis. Financial crisis in one country spills over to other countries economic and financial performance. This is what happened when the 2008 hit the U.S with Lehman brother’s bankruptcy and the effect ultimately passed on to the G7 countries through internationalization synchronization. It was seen that before taking under control of the 2008 recession, G7 countries witnessed high levels of credit growth and also faced huge contractions in both real and financial activities.

*Methodology*

This research paper is based a quantitative analysis performed with the help of a simpler model of two countries analysis. Financial frictions were studies in that model and the firms’ usage of credit in in terms of financing and investment was seen. The reasons were diagnosed related to the 2008 crisis with the help of the two countries s model. It was noted that the global liquidity that are induced by negative self-fulling anticipation can generate measurable trends like those similar to 2008 crisis data (Perri and Quadrini, 2018). Model suggested the less frequency of crisis with regard to financial integration but when they occur, the impact is globally spread. It was also seen during the 2008 crisis that the employment rate falls significantly in the United States of America but the same trend was not visible in the other G7 countries[[2]](#footnote-2). Moreover, the productivity of labor didn’t change significantly in U.S. but it was reduced in the other G7 economies. This paper is closely related to the abundant literature available on international comovement. To incorporate the theory of endogenous financial booms and busts, model was extended in some directions by relaxing some assumptions and incorporating changes. To support the evidence, the theory of financial crisis was used in open economies to help in achieving two inputs in the existing literature. The first one was the justification of 2008 crisis that said that the crisis occurred because of shortage of liquidity globally in relation to the negative likelihood of occurrences. The second input made by the paper was the impact international financial integrations makes on the expectancy and the size of crisis.

Stock Price Booms and Expected Capital Gains

The third research paper addresses the aspects of Stock Price Booms in relation to the expected capital gains (Adam, Albert & Beutel, 2017). Subjective capital gains expectations are very crucial to explaining the reasons behind stock price fluctuations. Survey data was used to determine the rise in sustained stock price booms and busts and also the behaviors of the investors associated with capital gains expectations. The survey results showed that these expectations show excessive optimism (pessimism) at stock exchange market peaks. The null hypothesis was formed claiming that the survey results were consistent with rational expectations.

*Methodology*

Assets pricing model was used to incorporate the endogenous belief of dynamics about the capital gains [[3]](#footnote-3)(Adam, Albert & Beutel, 2017). The model also included the subjective price beliefs with these properties in a more standardized asset pricing model keeping into account the internal rationality through rational agents. Many asset pricing moments were quantified by the detaching the stock prices from fundamentals from the rise in boom bust cycles. After the econometric testing being performed on the survey results, the null hypothesis was rejected. It was interpreted that the evidence of survey is not in line with the rational expectations. The empirical testing also stated that the significant doubt on the more prevalent view that stock price fluctuations were efficiently effective. More specifically, the examined significant positive correlation between the price dividend ratio and survey return expectations that were hard to have any coordination with rational expectations.

**Conclusion**

After analyzing in detail the above empirical literature on different aspects of the emerging markets, some questions are explored. Tafunell (2013) in his research questioned the occurrence of convergence in the developing countries which have greater desire to net investment and capital formation than the advanced economies. Similarly, Perri and Quadrini (2018) talked about the international impact the financial recession of one country can made over the world but they showed limited scope of assessing these crises in prediction. Adam, Albert & Beutel (2017) in their study talked about the stock prices boom and the expected capital gains but the question the role rational expectations in determining investor’s behavior. These studies effectively explained the importance of capital investment, net per capita income, financial stability, stock exchange expectations and probability for investors for the underdeveloped countries.

Works Cited

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1. Tafunell, Xavier. "Capital formation in Latin America: one and a half century of macroeconomic dynamics." CEPAL Review (2013). [↑](#footnote-ref-1)
2. Perri, Fabrizio, and Vincenzo Quadrini. "International recessions." American Economic Review 108.4-5 (2018): 935-84. [↑](#footnote-ref-2)
3. Adam, Klaus, Albert Marcet, and Johannes Beutel. "Stock price booms and expected capital gains." American Economic Review 107.8 (2017): 2352-2408. [↑](#footnote-ref-3)