Financial Crisis Applications

1. 1970s-1980s

a. 1972-1981: Many LDCs significantly increase international borrowing and run large current account deficits.
   Why all the lending?
   i. Heavy foreign borrowing is a normal part of the process of economic development.
   ii. Oil shocks of 73-74 and 79-80 led to “recycling of petro-dollars.”

b. 1982: Lending dries up as banks lose confidence in ability of LDCs to repay.
   Why did loans go bad?
   i. World recession and exports.
   ii. Interest rates.
   iii. Careless lending.

   c. March 1989: Brady Plan - a deal between lenders, international agencies, and LDCs.
   Why no earlier resolution?
   i. Costs of default.
   ii. Costs of concessions.

2. Mexico

   i. Restructuring of foreign debt under Brady Plan.
   ii. Reductions in budget deficit and inflation.

   i. Net financial inflows of 8% of GDP.

c. 1994: Crisis.
   i. Political instability.
   ii. Doubts about continuing reform.
   iii. Financial investors panic.

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1 Material from Abel and Bernanke’s *Macroeconomics.*