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Guest editors' introduction

Advances in international macroeconomics: Lessons from the crisis ☆

The worldwide financial crisis that erupted in 2007 has revealed the fragility of major financial institutions, and triggered the sharpest global recession since the 1930s. These dramatic events require a rethinking of the role of global finance for real activity—and will represent a challenge for economic research for years to come. This special section of the European Economic Review consists of eight new papers that address this challenge. All papers were presented at a conference held at the European Commission in Brussels on July 23–24, 2010.

Several of the papers provide novel econometric analyses of the mechanisms through which the turmoil that began in US financial markets in 2007 was so quickly and strongly transmitted to the rest of the world. The first paper, by Andrew Rose and Mark Spiegel, studies macroeconomic performance in a broad cross-section of countries during the crisis. The authors find that countries with higher incomes and looser credit market regulation suffered most during the crises, but overall there are surprisingly few clear reliable pre-crisis predictors of the incidence of the 'Great Recession'. Alexander Chudik and Marcel Fratzscher likewise stress the diversity of the international transmission channels of the crisis. While liquidity shocks have had a more severe impact on advanced economies, the emerging market economies were mainly affected by a decline in global investors' risk appetite. Thomas Helbling, Raju Huidrom, Ayhan Kose and Christopher Otrok establish that credit shocks originating in the United States have had a significant impact on the evolution of world growth during this and previous global recessions. Tobias Adrian, Erkko Etula and Jan Groen show empirically that, during the crisis, financial intermediaries' balance sheet constraints significantly amplified the effect of fundamental shocks on foreign exchange markets.

Before the global crisis, standard macro models largely abstracted from financial intermediaries. The recent events revealed the stark limitations of those models. The remaining papers in this special section address the challenge of developing structural general equilibrium models of open economies that incorporate important financial frictions. The paper by Anton Korinek studies risk premia on foreign debt, in a model of a small emerging market economy. The mutual endogeneity of external debt, risk premia, and macroeconomic volatility is shown to create important feedback effects: small increases in international risk aversion may entail large amplification effects on macroeconomic volatility. The last three papers incorporate financial intermediaries in dynamic stochastic general equilibrium (DSGE) two-country models. Jan in't Veld, Rafal Raciborski, Marco Ratto and Werner Roeger estimate a large-scale macro model with banks, using data for the US and the rest of the world. The paper identifies credit supply shocks and asset bubbles as crucial in the recent boom-bust cycle. The paper by Robert Kollmann, Zeno Enders and Gernot Müller focuses on the role of global banks for the transmission of loan default shocks. It shows that a loan loss originating in one country induces a sizeable decline in the capital of global banks, which may trigger a sharp simultaneous decline in worldwide economic activity. The global financial crisis has undermined many economists' views about the benefits of open financial markets. The paper by Michael Devereux and Alan Sutherland models the effect of international financial liberalization in the presence of credit market distortions within countries. It is shown that the type of financial integration is critical for both macroeconomic

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outcomes and for welfare. In particular, financial integration in bond markets alone may increase aggregate consumption volatility and reduce welfare. Financial integration in both bond and equity markets generates high positive co-movement across countries, but is welfare improving.

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