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Monetary policy in Latin America during the COVID-19 crisis: Was this time different?¹

January, 2022

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Abstract

Emerging economies' central banks generally respond to financial or external crisis by stemming massive capital outflows. The resulting sharp currency depreciation forced central banks in emerging economies to tighten monetary policy (PM) abruptly. The central banks of most Latin American economies reacted somewhat differently this time, however, during the COVID-19 crisis, implementing quantitative easing policy, cutting policy rates and introducing some non-conventional monetary policy measures. This paper examines the conventional and non-conventional monetary policy implemented by some major Latin American economies during the COVID-19 shock, seeking in particular to answer the following questions: Was this time different? Did these central banks apply non-conventional monetary policies? If so, what sort of non-conventional policies were implemented and for what purpose? What were the impacts?

Key-words: monetary policy; non-conventional monetary policy; COVID-19; Latin America

1 Introduction

Emerging economies' central banks generally respond to financial and external crises by stemming massive capital outflows. The resulting sharp currency depreciation forced central banks in emerging economies to tighten monetary policy abruptly. For instance, this situation – that is, central banks' orthodox monetary as a response to financial and external crises – occurred during the Asian, Russian and Brazilian crises at the end of the 1990s. However, during the COVID-19 crisis, in general, the central banks of the main Latin American economies reacted somewhat differently, implementing quantitative easing policy, cutting policy rates and introducing some non-conventional monetary policy measures. Preliminary findings indicate reasons for that behaviour that included (i) the swift qualitative easing by the Fed and other advanced economy central banks calmed global financial conditions, (ii) the cyclic condition of Latin American economies at the time of the COVID-19 shock opened up more space for quantitative easing policy than in other crises, and (iii) the sharp drop in output and inflation that followed the COVID-19 shock compounded depressed business cycle positions and opened up space for quantitative easing policy.

It should be remembered that Latin America was the region of the world most affected economically and socially by the Coronavirus pandemic, largely as a result of its historical structural weakness, its limited fiscal space (as compared to most advanced economies), limited social protection coverage, highly informal labour market and its unequal and heterogeneous productive structure. These factors are fundamental to understanding its countries' difficulties in implementing policies to counter the effects of the pandemic on their economies.

This paper examines the conventional and non-conventional monetary policy implemented by some major Latin American economies, such as Argentina, Brazil, Chile, Colombia, Mexico and Peru, during the COVID-19 shock, seeking in particular to answer the following questions: Was this time different? Did these central banks apply non-conventional monetary policies? If so, what sort of non-conventional policies were implemented and for what purpose? What were the impacts?

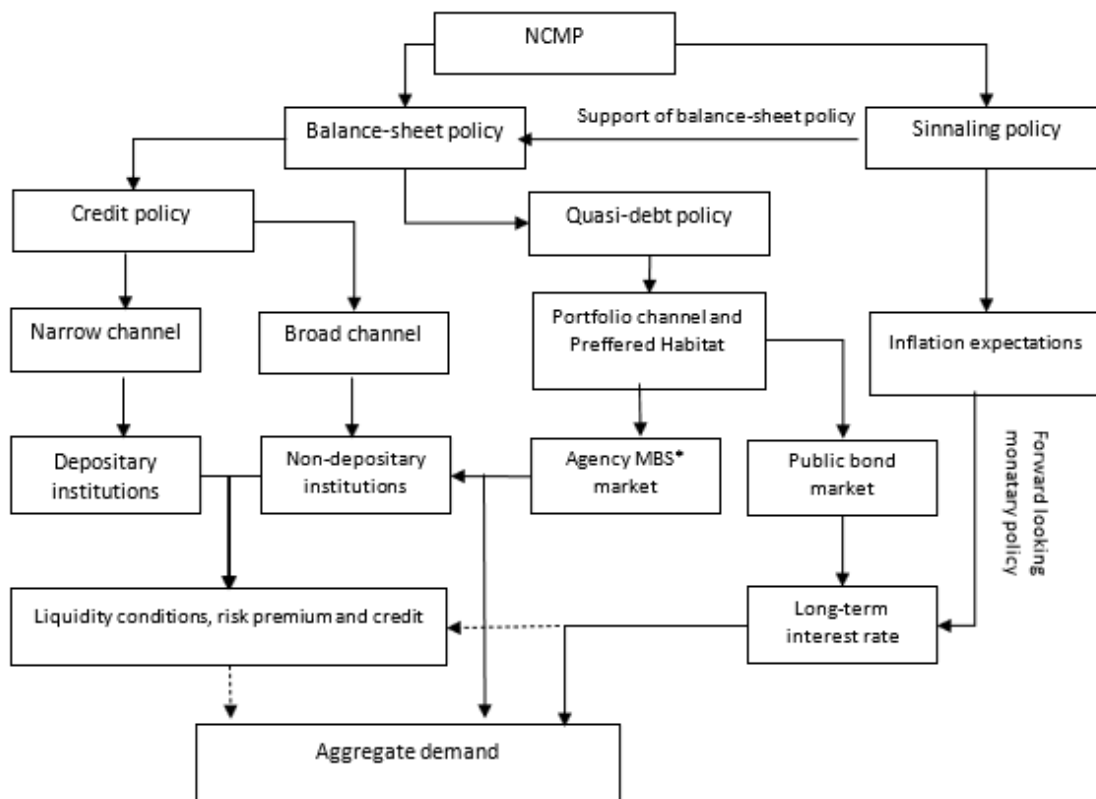
The article is divided into four sections besides this introduction. Section 2 describes the main features of non-monetary monetary policy. Section 3 focuses on the experience of non-conventional monetary policy in the United States (USA) during the COVID-19 shock, as the Federal Reserve Bank (FED)'s monetary management is considered the 'benchmark' for non-conventional policies. Section 4 considers monetary policy in Latin American economies during the COVID-19 crisis. Lastly, section 5 concludes the paper.

2 Non-conventional monetary policies: an introduction

During financial economic crises, such as those seen in 2007-2008 and during the Coronavirus pandemic, conventional monetary policies (open market, rediscount and reserve requirements) have been less effective. This is because of, among other things, excessively volatile demand for reserves, extreme liquidity preference on the part of agents (households, firms and banks), a reduction in liquidity loans among depository institutions and the interruption of credit in various segments of the financial market, which limit the ability of the central bank to control long-term interest rates and prevent conventional monetary policies from being transmitted along credit, exchange, asset price and relative price channels (Cecioni et al., 2012).

This situation is aggravated when the short-term interest rate approaches the zero lower bound (liquidity trap). In this case, transmission mechanisms via the interest rate channel lose effectiveness and the central bank loses the ability to reduce long-term interest rate spreads, because it cannot flatten the interest rate maturity structure and risk premiums so as to stimulate aggregate demand and output (Blinder, 2010). As an alternative, non-conventional monetary policies are a set of instruments for central banks' to intervene directly in specific financial markets to revert potential recession and asset deflation. These can be subdivided into balance sheet policies and signalling policies. Figure 1 shows the main transmission channels for nonconventional monetary policies.

Figure 1. Non-conventional monetary policies (NCMP) transmission channels



Source: Authors' elaboration.

Note: (*) Agency MBS are mortgage-backed securities issued by the government-sponsored enterprises Freddie Mac and Fannie Mae.

Through the signalling channel, the monetary authority communicates information to the public about what monetary policies intend to introduce, whether directed to the long-term interest rate, financial asset purchases, inflation or other measures. Their effectiveness depends on the central bank's credibility and how market expectations and confidence affect financial and macroeconomic conditions. Note that, until the 2007 crisis, it was a widely accepted hypothesis that, in a situation of interest rates close to zero, the central bank would continue to influence long-term rates by way of expectations for the forward interest rate structure and to manage expectations through forward policy guidance (Eggertsson and Woodford, 2003).

Balance-sheet policies (as detailed in Table 1), can be subdivided into (i) exchange, (ii) quasi-debt management, and (iii) credit policies.

Table1. Typology of balance sheet policies

		Impact on private sector balance sheet structure		
		Change in net foreign exchange exposures	Change in the composition and maturities composition of securities held by the public sector	Change in profile of private sector securities
Target-market	Exchange	Exchange policy		
	Public debt and securities		Quasi-debt management policy	
	Private credit and securities			Credit policy

Source: Borio and Disyatat (2009).

Each of a central bank’s balance sheet policies involves a counterpart for the private sector balance sheet, in which the main characteristics of which are listed below:

(i) *Exchange policy* operates directly on the foreign currency market and constitutes direct intermediation by the central bank between the domestic market and foreign sector. These measures improve domestic liquidity conditions and reduce the risk of private sector exposure to abrupt exchange rate variations. The central bank operates on the exchange market, buying and selling foreign currencies, exchange swap contracts etc., in such a way as to reduce the volatility and influence of foreign exchange prices at any given interest rate level.

(ii) *Quasi-debt management policy* comprises central bank intermediation between the government and the private sector. These measures reduce risk premiums in relation to maturity and liquidity of public securities in private hands, so as to stabilise output. It is operationalised by purchasing public securities. Note that these assets are an important reference point for the market in that they correspond to a benchmark risk-free rate and,

accordingly, affect financing costs and asset prices in general. For such policies to be effective normally requires purchases in substantial volume in order to produce any effect on asset yields.

(iii) *Credit policy* acts on specific segments of the financial market (the interbank and non-bank markets), to alter the composition of the private sector balance sheet and so affect financing conditions. The operations performed by the central bank, which impact private debt and securities and alter balance sheets, are carried out in various manners, such as by alterations to collateral and maturities, counterparty terms on monetary operations, lending or private sector asset purchases. The objective is to relieve tensions on the interbank market, particularly maturities and spreads, and to improving conditions of credit to the non-bank sector. Such policies can produce indirect effects, in that the market on which they act plays an important financial intermediation role. Note also that these measures are applied directly to financial intermediaries, indirectly suggesting overall improvements to the market, by virtue of the role these institutions play. On specific markets, however, the central bank performs direct intermediation operations, without the participation of depository institutions, placing itself between investors and borrowers.

The theory underpinning non-conventional monetary policy can be divided into two groups. The first focuses on the effects of monetary policy on asset prices and imperfect substitutability on the asset side of the private sector balance sheet, and is referred to as the ‘portfolio balance channel’. The central bank’s purchasing of private sector portfolio assets, normally public and government agency securities, alters supply on these markets, leading to a more equitable redistribution of these securities’ relative yields and maturities. For instance, the technical sources of reference here are Tobin (1969), Ando and Modigliani (1963) and Modigliani and Sutch (1966).

The second group emphasises imperfect substitutability on the liability side of the private sector balance sheet and is normally referred to as the ‘credit channel’. In these operations, the central bank meets the need for loans directly, besides offering more attractive conditions (interest rates and maturities), with a view to improving financing conditions on the market, inducing credit expansion and raising asset prices. The main source authors here are Bernanke and Blinder (1989) and Bernanke and Gertler (1995).

3 Non-conventional monetary policy in the USA

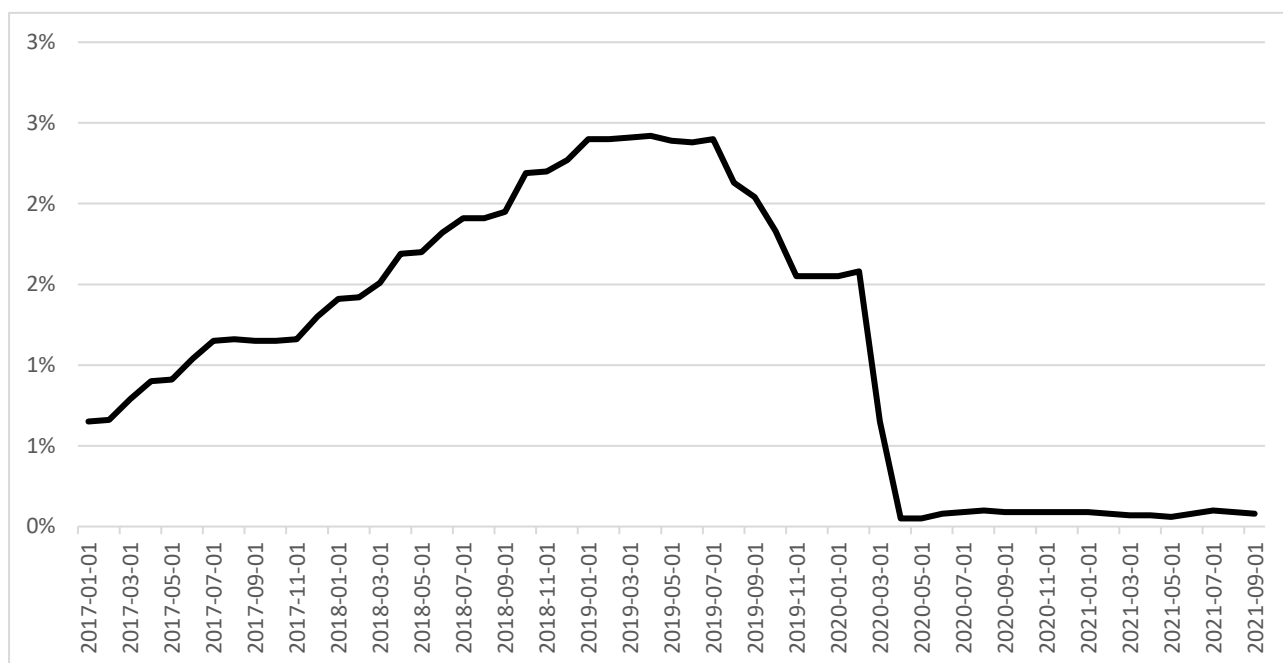
The rapid slowing of the USA economy due to the impact of the pandemic crisis was met by monetary and fiscal policy measures, particularly over the course of 2020, although they continued active in 2021. Quickly recovering part of its arsenal of non-conventional monetary policies deployed during the 2007-2008 crisis, the FED, in cooperation with the Treasury, introduced new facilities to support the flow of credit to households and businesses, at the same time as fiscal measures were raised to new levels. FED Chair Jerome Powell (2020), in his Press Conference on April 29, 2020, makes it clear how the FED intended to meet the COVID-19 crisis: “We are deploying these lending powers to an unprecedented extent [and] ... will continue to use these powers forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery”.

Notwithstanding its powerful non-conventional monetary policy arsenal and its performing better than other advanced economies, the USA saw GDP shrink by 3.5% in 2020. On the labour market, over 20 million were unemployed, and in May 2020, unemployment stood at 14.7%, closing the year at 6.7%. On the financial market, in March 2020, the exchange swap spread of the dollar to other leading currencies (Euro, Yen, etc.) widened, as did spreads of corporate securities to what were considered zero-risk Treasury bonds.

Similarly on the stock market, the S&P 500 dropped abruptly by 35% in just one month after 21 January 2020 and then rose strongly from then on, gaining 75% in just one year. That outcome indicated a certain confidence that the US economy would recover as a result both of the countercyclical measures introduced, including non-conventional monetary policies, and the return to normality of productive activities in the economy. One indicator is the 5.9% GDP growth forecast for 2021 (The Conference Board Economic Forecast, 2021).

The monetary policies introduced can be subdivided into conventional and non-conventional policies. As regards the former, from March 2020 the FED reduced the interest base rate (policy rate) by 50 base points on March 3 and on March 16, by a further 100 base points, to a range between 0.0% to 0.25% p.a. (Figure 2). The rate's return to zero marks the close of the conventional monetary policy management cycle.

Figure 2. Target interest rate for FED Funds – 2017-2021 (%)



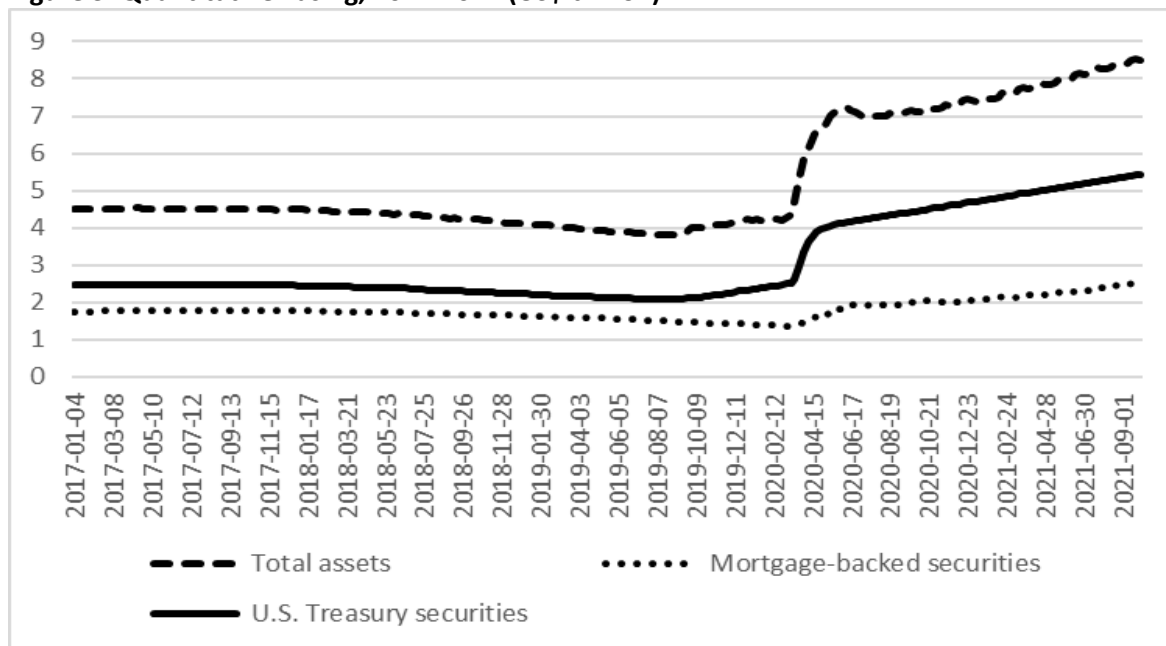
Source: Authors' elaboration, based on data from Board of Governors of the FED (2021).

One of the FED's first non-conventional monetary policy measures was quantitative easing (QE), which became the main facility. Over the course of 2020 and by mid-2021, purchases of Treasury bonds had increased by just over US\$ 2.9 trillion and, of mortgage-backed securities,² by approximately US\$ 1.1 trillion. These measures contributed to a

²Mortgage-backed security is a type of asset-backed security which is secured by a mortgage or collection of mortgages.

surge in central bank assets from US\$ 4.3 trillion in March 2020 to US\$ 8.5 trillion in September 2021, as Figure 3 shows.

Figure 3. Quantitative Easing, 2017-2021 (US\$ trillion)



Source: Authors' elaboration, based on data from Board of Governors of the FED (2021).

The first credit policy measure taken reintroduced the Commercial Paper Funding Facility (CPFF). Just as in 2007-2008, this facility was designed to ensure that companies could obtain funding for their payroll and financial liabilities, given that the credit market was paralysed. Another key purpose of that programme was to guarantee liquidity for papers traded on that market, reinforcing the secondary market. The amount earmarked for this programme was US\$ 12.8 billion, more than 95% of which was Treasury capital managed by the FED. The programme was concluded on 31 March 2021.

A second credit policy, also revived from the previous crisis, was the Primary Dealer Credit Facility (PDCF). This programme was similar to a rediscount, facilitating overnight operations, which indirectly bolster the markets in credit to non-financial companies and households by providing liquidity to lenders. The FED thus offered loans to primary dealers with up to 90 days maturity at the overnight interest rate. The total financed by the FED was US\$ 37.3 billion.

The FED's concern with Money Market Mutual Fund Liquidity Facility (MMLF) has to do with the fact that these money market funds, where the main investors are households and small businesses, feature high liquidity ('near money'). In order to prevent these funds from failing, as they do not have access to the 'discount window' available to depository institutions, the monetary authority launched a programme, jointly with the Treasury, to help meet investor demand for withdrawals and minimise losses, as well as to forestall the paralysis of this important market. The total amount involved was US\$ 54 billion.

With a view to reinforcing consumer and corporate credit, on 23 March the FED and Treasury Secretary re-launched the Term Asset-Backed Securities Loan Facility (TALF). This programme enabled asset-backed securities to be issued, providing they were AAA rated. However, these measures were backed by the following assets: student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets. The total provision for this facility was US\$ 4.1 billion.

The Primary Market Corporate Credit Facility (PMCCF) was a new credit policy, especially developed for the COVID-19 crisis and designed to support issues of bonds and loans on the primary market to investment-grade non-financial companies. Initially developed for a four-year period, it operated jointly with the Secondary Market Corporate Credit Facility (SMCCF), which provided liquidity to the secondary market in corporate bonds, including on the stock exchange. The two programmes were launched on 23 March 2020, jointly representing US\$ 800 billion in FED and Treasury Secretary funds, of which only US\$ 70 billion was disbursed.

The Pay Check Protection Program Liquidity Facility (PPPLF) was put in place to bolster the Pay Check Protection Program (PCPP) by providing liquidity to participating financial institutions. Note that the main facility, the PCPP, is a programme not developed by the FED, but administered by Small Business Administration (SBA), which received US\$ 376 billion from the Treasury under the "CARES Act".³ The main goal of the

³ Coronavirus Aid, Relief, and Economic Security (CARES).

programme was to support small businesses and workers, and was developed particularly to protect employment by way of term loans.

The Municipal Liquidity Facility (MLF) represented support for state governments, counties with resident populations of more than 500,000 and towns with resident populations of more than 250,000. With support from the Treasury, the FED offered funds to support cash flow and also measures for companies and households.

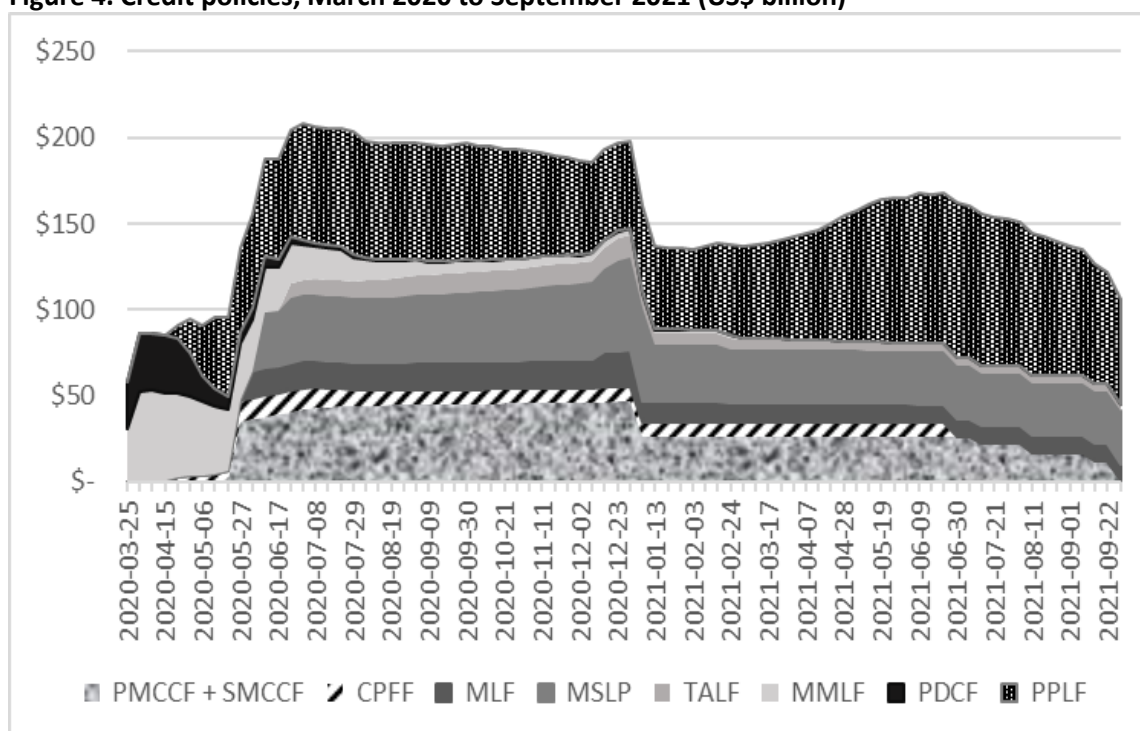
This programme was allocated US\$ 6.4 billion in all, with Eligible Notes⁴ as collateral, and could include anticipation of taxes, revenues and bonds with maturities of no more than 36 months.

The Main Street Lending Program (MSLP) was established to support lending to small and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 crisis. These gained access to loans with maturity of five years, deferral of principal payments for two years, and deferral of interest payments for one year. The programme executed US\$ 16.4 billion. Five facilities were set up: the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), the Main Street Expanded Loan Facility (MSELF), the Non-Profit Organization New Loan Facility (NONLF), and the Non-Profit Organization Expanded Loan Facility (NOELF).

Figure 4 shows the set of credit policies for the period from 2020 to mid-2021. The new facilities (PMCCF/SMCCF, PPLF, MLF and MSLP) stand out, totalling around 50% of the FED's operations. Of those originating with the 2007-2008 crisis, the MMLF and PDCF are of particular note.

⁴ “Eligible Notes are tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), revenue anticipation notes (RANs), and other similar short-term notes issued by Eligible Issuers, provided that such notes mature no later than 36 months from the date of issuance.” (Federal Reserve, 2020).

Figure 4. Credit policies, March 2020 to September 2021 (US\$ billion)



Source: Authors' elaboration, based on data from Board of Governors of the FED (2021).

Lastly, central bank liquidity swaps comprised permanent and temporary agreements between the FED and other central banks to establish US dollar exchange swaps to assure international liquidity. Exchange swap contracts expanded from US\$ 18 billion in late February 2020 to US\$ 448 billion by May.

4 Monetary policy in Latin America during the COVID-19 crisis

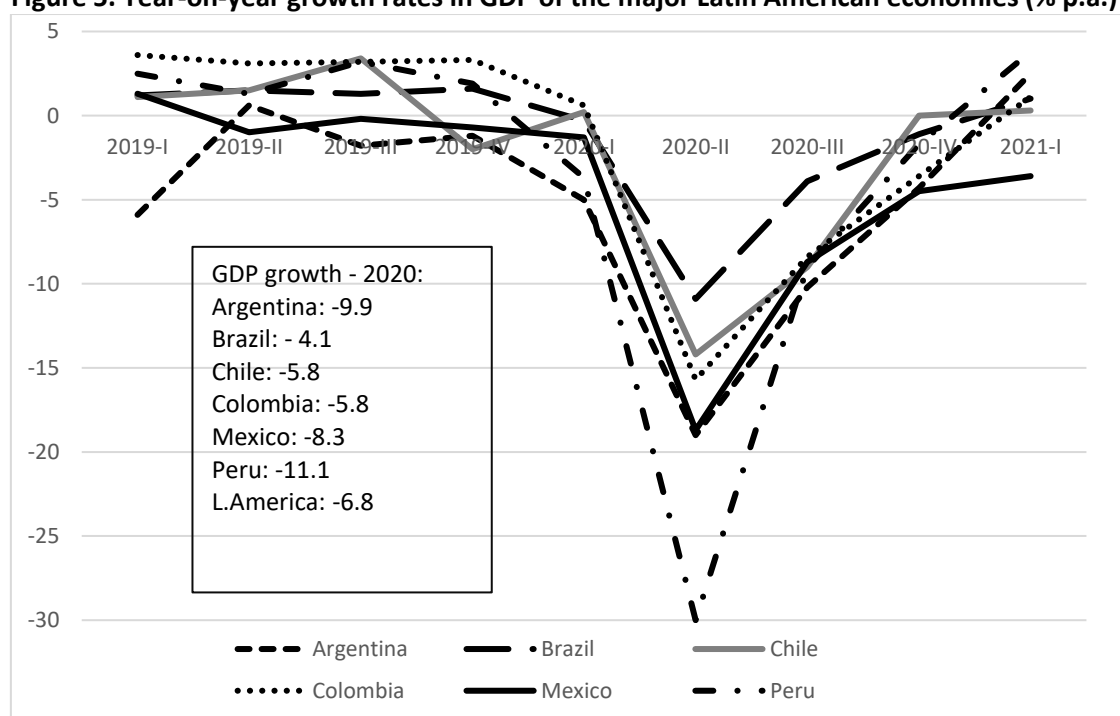
4.1 The COVID-19 crisis in Latin America

The COVID-19 crisis hit the world economy hard, given the high degree of uncertainty as to the dynamics and evolution of the pandemic. International trade was badly shaken and commodity prices and capital flows fluctuated intensely, generating high levels of volatility on financial markets. In that context, the advanced economies implemented monetary and fiscal packages of unprecedented magnitudes, which produced high levels of liquidity at the global level in 2020 and 2021.

Latin America was the region of the world most affected economically and socially by the Coronavirus pandemic, largely as a result of its historical structural weaknesses, limited fiscal space, limited social coverage, highly informal labour, and heterogeneous and unequal productive structure. These factors are fundamental to understanding the region's difficulties in implementing policies to counter the effects of the pandemic on their economies and produce sustainable and socially inclusive economic recovery (ECLAC, 2021a).

As shown in Figure 5, all the major Latin American economies were abruptly shaken by the Coronavirus crisis, the worst affected in 2020 being Peru (-11.1% in real GDP), Argentina (GDP dropped 9.9%) and Mexico (GDP was - 8.3%), with any recovery in 2021 resulting more from the statistical effect of the prior year's acute contraction. Particularly in 2020 negative GDP growth in Latin America overall (-7.0%) was far greater than the average for the advanced economies (- 4.5%) and the emerging economies (- 2.1%) (IMF, 2021).

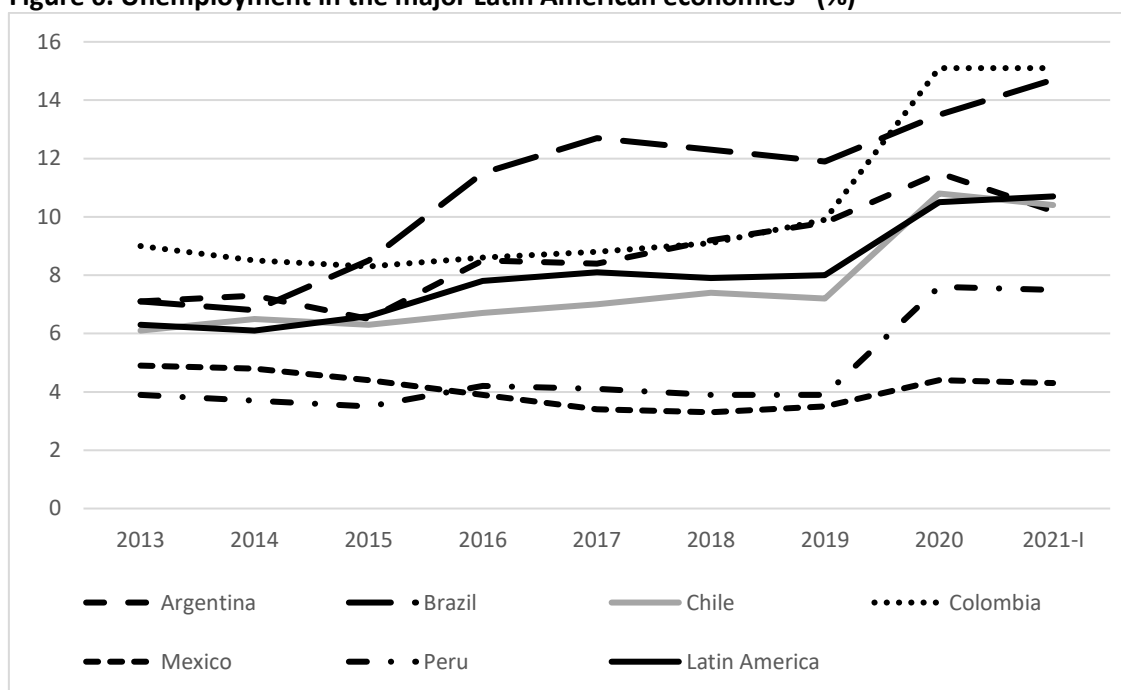
Figure 5. Year-on-year growth rates in GDP of the major Latin American economies (% p.a.)



Source: ECLAC (2021a).

This downturn in economic activity caused a strong rise in unemployment rates across Latin America in 2020 (averaging 10.5%) – most markedly in Colombia (15.1%), Brazil (13.5%) and Argentina (11.5%) – a marked drop in labour force participation and considerable increases in poverty and inequality, worsening the region’s structural problems (Figure 6). Vulnerable groups, particularly informal workers, young people, workers with little education, women and immigrants, were the worst harmed by loss of work (ECLAC, 2021a).

Figure 6. Unemployment in the major Latin American economies* (%)



Source: ECLAC (2021a).

Note: (*) Unemployed as a percentage of total workforce.

It is important to emphasise that the instability of the international financial market resulting from the pandemic, combined with uncertainty on commodities markets, led first to strong exchange devaluation in response to capital flight. This has now been followed ever since by intense exchange rate volatility. The central banks of Brazil, Chile, Colombia and Mexico expanded the scope of their interventions in the exchange market, using a series of instruments, including futures contracts and exchange swaps, to provide liquidity to this market. Many Latin American countries also used monetary agreements

with the International Monetary Fund (IMF) and FED to open up contingent credit lines with a view to reinforcing their exchange reserves.

Despite strong exchange devaluation at the onset of the Coronavirus pandemic, inflation in 2020 remained at its historically low levels as a result of the acute contraction of aggregate domestic demand, which reached an average accumulated rate of 3.0% in the 12 months to December 2020. In 2021, however, inflationary pressures on the cost side, particularly prices of food, energy and other production inputs, in addition to greater exchange volatility, led to an overall tendency for inflation rates to rise, most adversely in Brazil (8.3%) and Mexico (5.9%), to an accumulated average of 5.4% in the region in June 2021 (ECLAC, 2021a).

It was in this context of economic downturn and falling inflation in 2020 that many Latin American central banks deployed their conventional and non-conventional monetary policies so as to avert a liquidity crisis in the banking sector, any sharp fall in financial asset prices and contraction of credit supply, with a view to stimulating economic activity overall. Particularly, many central banks used non-conventional instruments, which included purchasing securities held by banks, setting up financing programmes (jointly with the Treasury) for households and firms and even, in some cases, financing governments directly (ECLAC, 2021b). This subject will be discussed in the next subsection.

4.2 Non-conventional monetary policy in Latin America during the COVID-19 crisis

In the recent literature (Aguilar and Cantú, 2020; Arslan et al. 2020; ECLAC, 2020; Server et al., 2020), the monetary and fiscal policy responses by emerging countries (including Latin America) to the COVID-19 crisis in early 2020 are being regarded as an advance over the implementation of countercyclical macroeconomic policies in the Great Recession of 2008, particularly as regards preserving levels of income and employment in a global crisis. This shift in economic policy postures was crucial in support of measures to restrict population mobility, such as lockdown and social distancing, which

were necessary to contain the advance of the Coronavirus and assure health system capacity to meet demand for beds to provide care for those infected. These measures paralysed various sectors of the economy, except those considered essential. The scenario caused by the pandemic called for an effective fiscal and monetary policy response in order to prevent a more precipitous fall in incomes. There was a consensus that these policies were necessary to avert a probable financial crisis due to erosion of company cash flows and mounting default on the part of households as a result of the economic crisis triggered by the Coronavirus pandemic.

In fiscal policy, the measures introduced in Latin America consisted mainly in deferring payment of income and value added taxes (in some cases, reaching 1% of GDP) and in increasing the share of direct cash transfers to households, sub-national units and also to companies to enable them to maintain their employees for specific periods. ECLAC (2021a, p.84) reported:

“primary expenditure – which excludes interest payments – has grown significantly, with real increases above 10% in several countries (and more than 20% in some cases) in January–September 2020 relative to the same period in the 2019. This growth is largely explained by higher spending on current transfers (subsidies, retirement and other pensions, and social benefits, among other items), which influence the level of disposable income and thus consumption by families and businesses”.

Considered against historical patterns, this level of public spending was significant, even though much lower than in the advanced countries (ECLAC, 2021b). Note that the scenario of slow economic growth prior to the pandemic and Latin American countries’ having higher public debt/GDP ratios than those of other emerging countries did not significantly hamper fiscal expansion in the period. The public debt/GDP ratio rose an average of 7.4% in the region between year-end 2019 and September 2020, to higher levels in Brazil (14.8%), Colombia (12.5%) and Paraguay (8.0%) (ECLAC, 2021a, p. 90). As a result, greater coordination with monetary policy was required in order to reduce this fiscal cost to the Treasury, as well as to prevent higher exchange risk from public debt denominated in foreign currency, especially for countries such as Argentina,

Paraguay, Uruguay and Venezuela, where this represented around 80% of their total public debt.

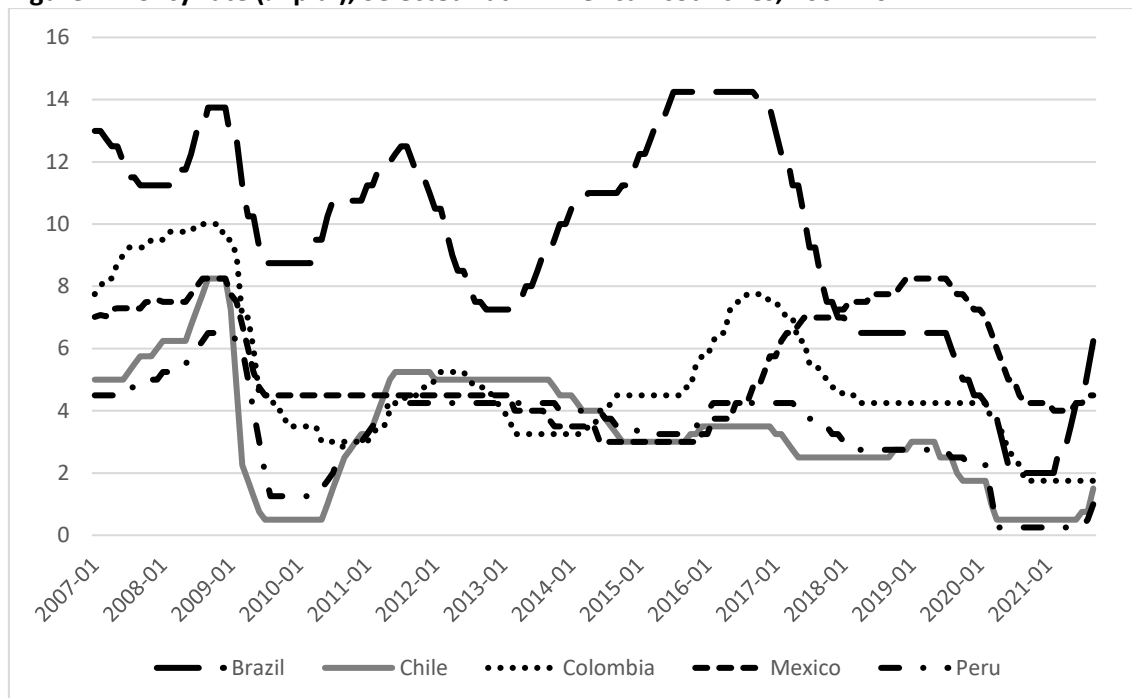
The monetary policy response to the COVID-19 crisis was to introduce greater flexibility to traditional interest rate-based monetary policy, despite a movement towards capital flight: “In the first ten months of 2020, the domestic currencies of 17 of the region’s economies lost value against the dollar relative to their end-2019 exchange rate, recording an average depreciation of 16.3%” (ECLAC, 2021a, p. 98). Most Latin American countries reduced interest rates during the period, even to levels close to the zero lower bound. In Brazil, for instance, the interest rate was brought down to levels around 2% at year-end 2020, while Peru set even lower levels (0.25%) (ECLAC, 2021a, p. 93). The average reduction for the region was considerable against historical patterns: 2.05% in 2020, with Mexico and Paraguay introducing cumulative reductions of 3.0% and 3.25%, respectively, over the course of the year (ECLAC, 2021a, p. 94). Venezuela was the only country in the region to apply a restrictive policy during 2020, but there the scenario prioritised combating hyperinflation (ECLAC, 2020).

During the Great Recession, the overall trend in the emerging economies, including Latin America, was for the base interest rate to be raised to offset the movement towards capital outflows and its adverse effects on the economy caused by exchange devaluation (Aguilar and Cantú, 2020). In that period, the region’s central bank aimed to avoid raising inflationary expectations and missing inflation targets as a result of a supply shock under the pass-through effect of import prices on production costs. Another key concern was to avoid increasing systemic risk to economic agents’ balance sheets denominated in foreign currency. Arslan et al. (2020) explained that this response to the COVID-19 crisis constituted a paradigm shift for emerging country central banks in that it made it possible to address what is known as the ‘fear of floating’⁵ (Calvo and Reinhart, 2002).

⁵ Fear of floating is said to exist when country officially adopts a floating exchange rate regime, but in practice the central bank intervenes in foreign exchange markets to avoid currency volatility.

Figure 7 lists the monetary policy interest rates of Latin American countries that set inflation targets between 2007 and 2021.

Figure 7. Policy rate (% p.a.), Selected Latin American countries, 2007-2021



Source: Bank for International Settlements (2021).

Aguilar and Cantú (2020, p. 1) offer some reasons why this space opened up for countercyclical policies during the COVID-19 crisis. As most emerging countries posted GDP growth below potential, there thus existed a negative gap, which enabled aggregate demand to expand without causing immediate inflationary pressures. They had also introduced structural changes that expanded anchorage of inflationary expectations and helped them administer inflation target regimes, also reducing their exchange risks by maintaining larger portions of their long-term debt denominated in local currency, combined with significant build-up of international reserves. Another point was the support derived from the speed with which advanced economies' central banks implemented their non-conventional monetary policies, leaving ample leeway for maintaining liquidity available to emerging countries at the outset of the COVID-19 crisis and reducing the pressure expected from non-resident outflows from their financial markets. Another reason were the complementary measures implemented by central banks and governments, such as lowering of reserve requirements, more active

intervention in the exchange market, capital controls, specific policies on credit for the private sector and strengthening of macro-prudential regulatory measures (ECLAC, 2021b). Aguilar and Cantú (2020, p. 4) argue that:

“In addition to cutting rates, EME central banks implemented domestic lending operations and funding facilities to reduce illiquidity risks. They established direct lending to private sector to ease financing conditions and intervened in FX markets to reduce currency volatility. Together with supervisory authorities, they eased prudential regulations to increase banks’ capacity to lend”.

As already highlighted, the FED once again opened up its exchange swap line broadly for Latin American countries at the start of the COVID-19 crisis.⁶ Thus,

“These two factors made a coordinated policy response between fiscal and monetary authorities in most EMEs possible – even with limited fiscal space. So far, monetary and fiscal policy easing have complemented each other in supporting the flow of credit and aggregate demand” (Aguilar and Cantú, 2020, p.1).

However, the most significant change in monetary policy in emerging countries was the introduction of non-conventional monetary policies during the COVID-19 crisis – an avenue not explored in response to the previous global crisis. Arslan et al. (2020) explain that most of these measures were carried out by way of asset purchases by central banks on the long-term public and private securities markets, either by ‘Operation Twist’ methods or by quantitative easing. Some countries, Brazil among them, had to modify their legislation in order to purchase securities on the secondary market. The Central Bank of Colombia announced bank and public securities purchases of around 0.8% of GDP, while in Chile, the amount was 2.8% of GDP in private bank securities alone (Arslan et

⁶ECLAC (2021a, p. 101) reported: “The capacity of the region’s monetary authorities to protect their currencies in 2020 has been strengthened by the agreements reached by a number of Latin American central banks with the International Monetary Fund (IMF) and the United States Federal Reserve System”.

al. 2020, p.2). The monetary base of countries operating inflation target regimes expanded by an average of 7.4% in the first three quarters of 2019, but by 19.7% in the same three quarters of 2020 (ECLAC, 2021a, p.95). To a lesser extent, other non-conventional monetary policies were used, such as forward guidance, consisting in the central banks' announcing that, for a certain period, it would hold monetary policy at a constant interest rate or to some specific condition, so as to affect market expectations for the long-term interest rate curve (Campbell et al., 2012). The Central Bank of Brazil (BCB) opted for a policy of this type between August 2020 and March 2021 (BCB, 2021).

At the time of writing, there appear to be no broad empirical studies of non-conventional monetary policies outcome in Latin America. However, empirical study findings in the literature do show non-conventional monetary policies to have had significant positive impact in affording emerging countries greater economic policy space, if less so than to the advanced countries. Sever et al. (2020), using an impulse response and local projections method on high-frequency daily data for purchases of long-term public and private securities, demonstrated that, close to the dates of the central banks' announcements, these measures led to reductions of up to 25 base points in these securities' yields. Arslan et al. (2020) reported similar findings, noting that this impact may vary among emerging countries, depending on the starting conditions. Neither of these studies found any significant or persistent effect on exchange rates. Accordingly, Arslan et al. (2020, p.6) wrote:

“The absence of such effects probably reflects the clearly defined scope of the programmes, which explicitly aimed at restoring confidence in markets rather than at providing monetary stimulus, let alone the monetary financing of fiscal deficits. That said, by serving to contain the rise in bond yields, the measures also provided useful support to EME economies during the pandemic shock”.

Lastly, BCB (2021) identified a significant negative effect of the forward guidance announcement on yields from public securities with two-year maturities. Table 2 summarises the distribution of non-conventional monetary policies introduced in some Latin American countries, such as purchase of public and private securities from financial institutions, public sector credit co-financing programmes and direct financing by central banks of public sector expenditure.

Table2. Non-conventional monetary policies in Latin America during the COVID-19 crisis

	Economies with inflation targeting	Economies controlling monetary aggregates		Economies with other arrangements
Exchange type	Flexible	Flexible	Intermediate	
Central banks that announced purchases of public and private securities from financial institutions	Brazil; Chile; Colombia; Paraguay; Mexico; Peru	Argentina; Uruguay	Bolivia	
Central banks co-financing public sector credit programmes	Brazil; Chile; Colombia; Paraguay; Mexico; Peru		Bolivia	
Central banks financing the public sector directly	Paraguay	Bolivia		Venezuela

Source: Adapted from ECLAC (2020, p. 137).

5 Conclusion

The rationale offered by emerging countries, including Latin America, for applying non-conventional monetary policy was that such policies were necessary to correct any possible dysfunctions and assure liquidity on the public and private securities market, so as to restore international investor confidence by their central banks' acting as buyers and sellers of last resort (Aguilar and Cantú, 2020; Arslan et al., 2020). It is to be emphasised that this pattern of rationale was expressed by most Latin American countries (CEPAL, 2020). Thus, these countries' non-conventional monetary policies were considered quantitatively more modest and temporary and designed not to interfere in price formation by the private market. In Latin America, the region most affected economically and socially by the Coronavirus pandemic, the productive and social heterogeneity typical of the region, plus its structural weaknesses, hindered the implementation of more robust countercyclical policies, among them non-conventional monetary policies.

In any case, over and beyond these significant differences in how non-conventional monetary policies were conducted, emerging countries can be seen to have shifted from their conventional policy posture when the economy reopened and after the persistent external shocks on the exchange market, with some countries – contrasting with the resilience of advanced countries – rapidly raising their interest rate levels over the course of 2021 in order to respond to rising inflationary expectations. The most emblematic case in Latin America was Brazil’s central bank, which started 2021 with a short-term interest rate (policy rate) at its historical minimum of 2%, but raised the rate to pre-pandemic levels over the course of the year. That abrupt change may undermine economic recovery after the pandemic and seems to indicate that, despite the advances during the COVID-19 crisis, Latin American countries have a long way to go in conducting economic policy in such a way as support sustainable economic growth with greater social equity.

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