

# The Impact of the Great Recession and Policy Responses in Latin America

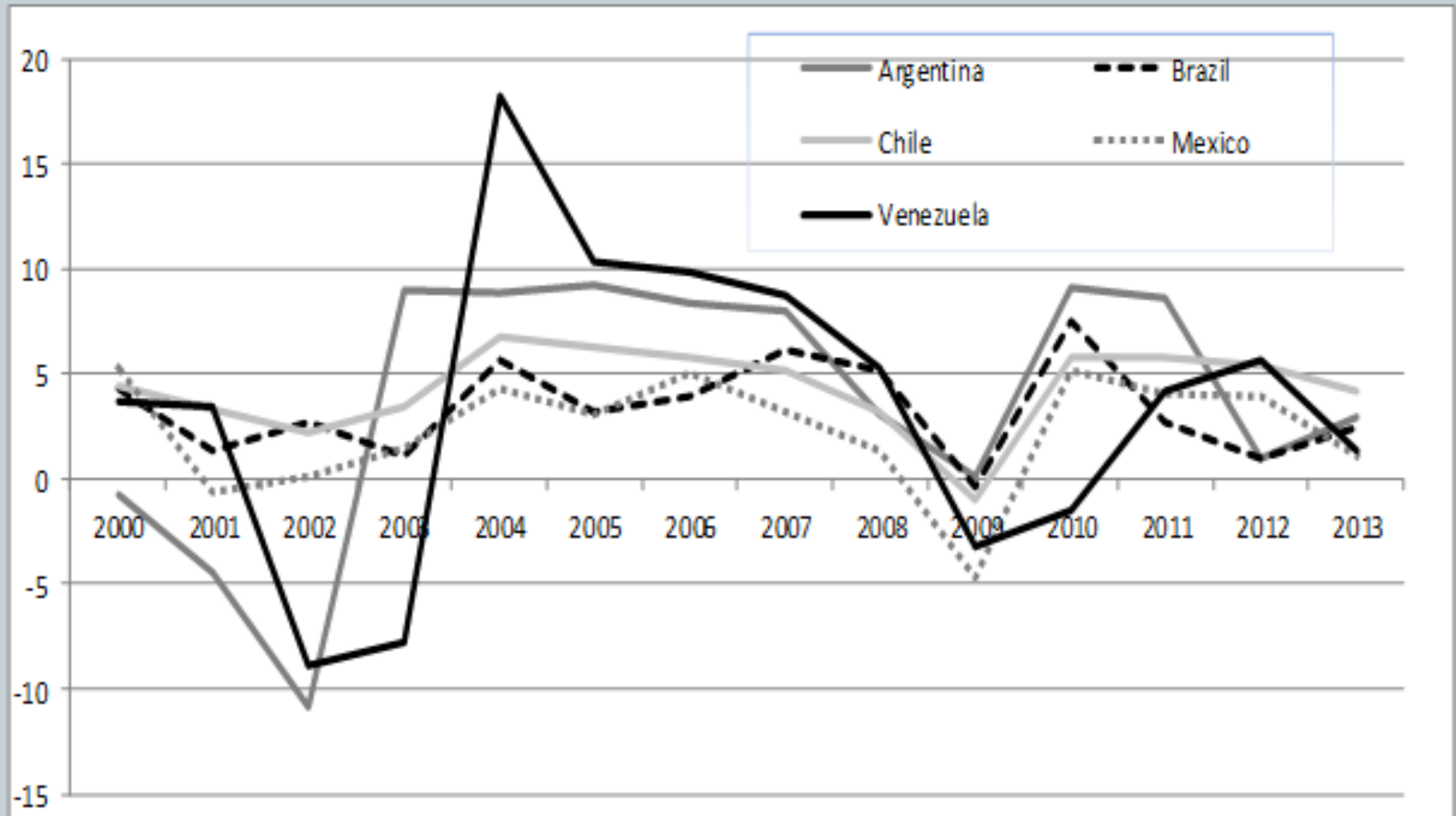


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# GDP growth (%)



# Stylized facts



- The 2007-8 international financial crisis and the great recession (GR) affected strongly Latin America => trade and financial channels.
- However, most Latin economies recovered quickly.
- Historical experiences of financial crisis in LA had been a succession of painful crisis (external debt crisis of the 80s, Contagion of Mexican 1994-95 crisis, Contagion of Asian crisis, etc.).
- But this time was somehow different! Why?
- Combination of favorable international environment with implementation of countercyclical policies
- More recently, concerns about the future performance of the economies of the Region due the uncertainties related to the global economy and the reduction of the policy space in bigger Latin American economies.

# Objectives



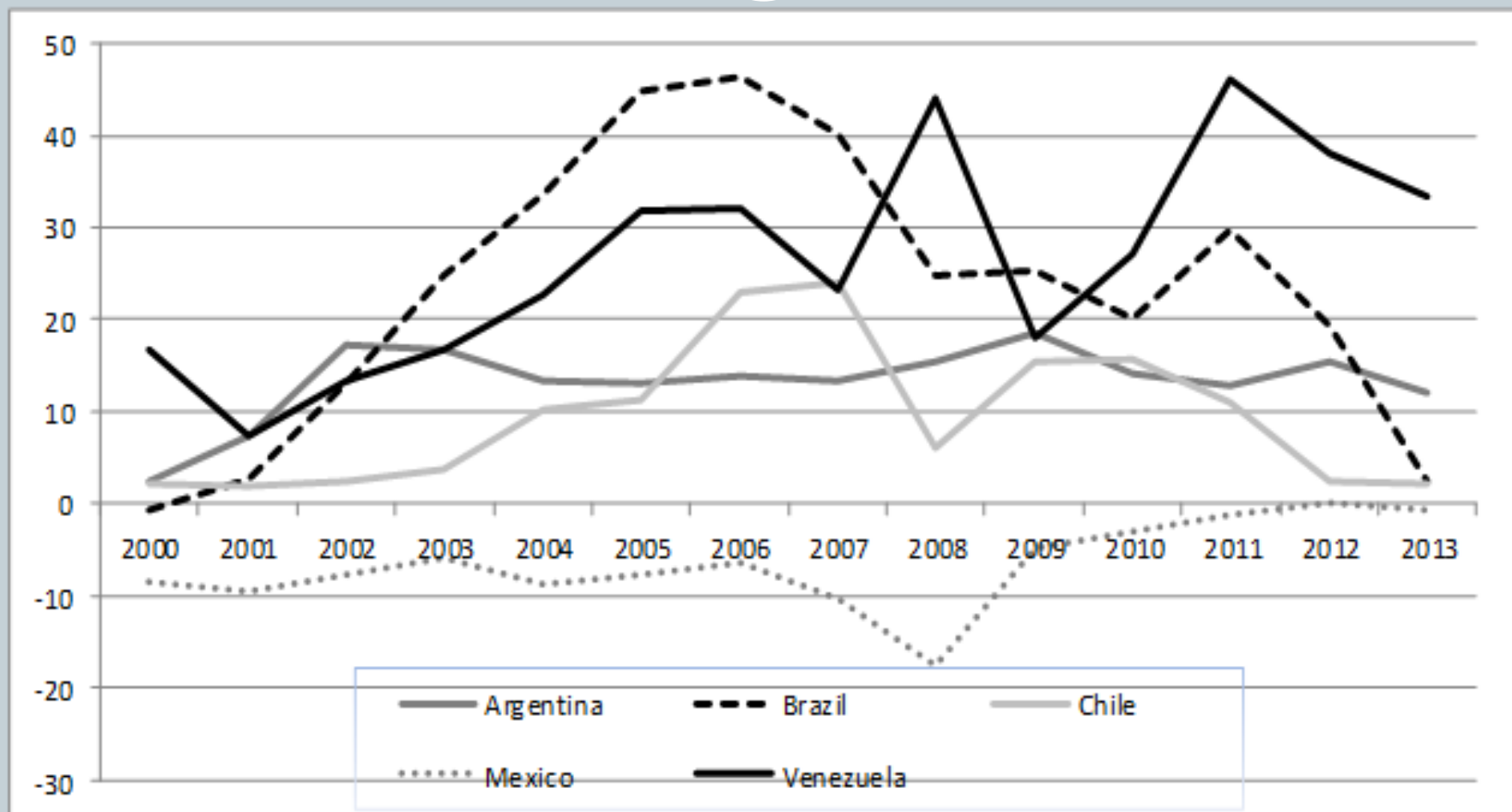
- The purpose of the paper is to examine the consequences of the GR in the main Latin America countries and the implementation of countercyclical policies in these countries.
- The analysis considers Argentina, Brazil, Chile, Mexico and Venezuela, for two reasons: (i) Gross Domestic Product (GDP) of these countries represents almost 80% of Latin America's GDP; and (ii) they are important to the Region, both politically and economically.

## Consequences of the GR on the main Latin American countries

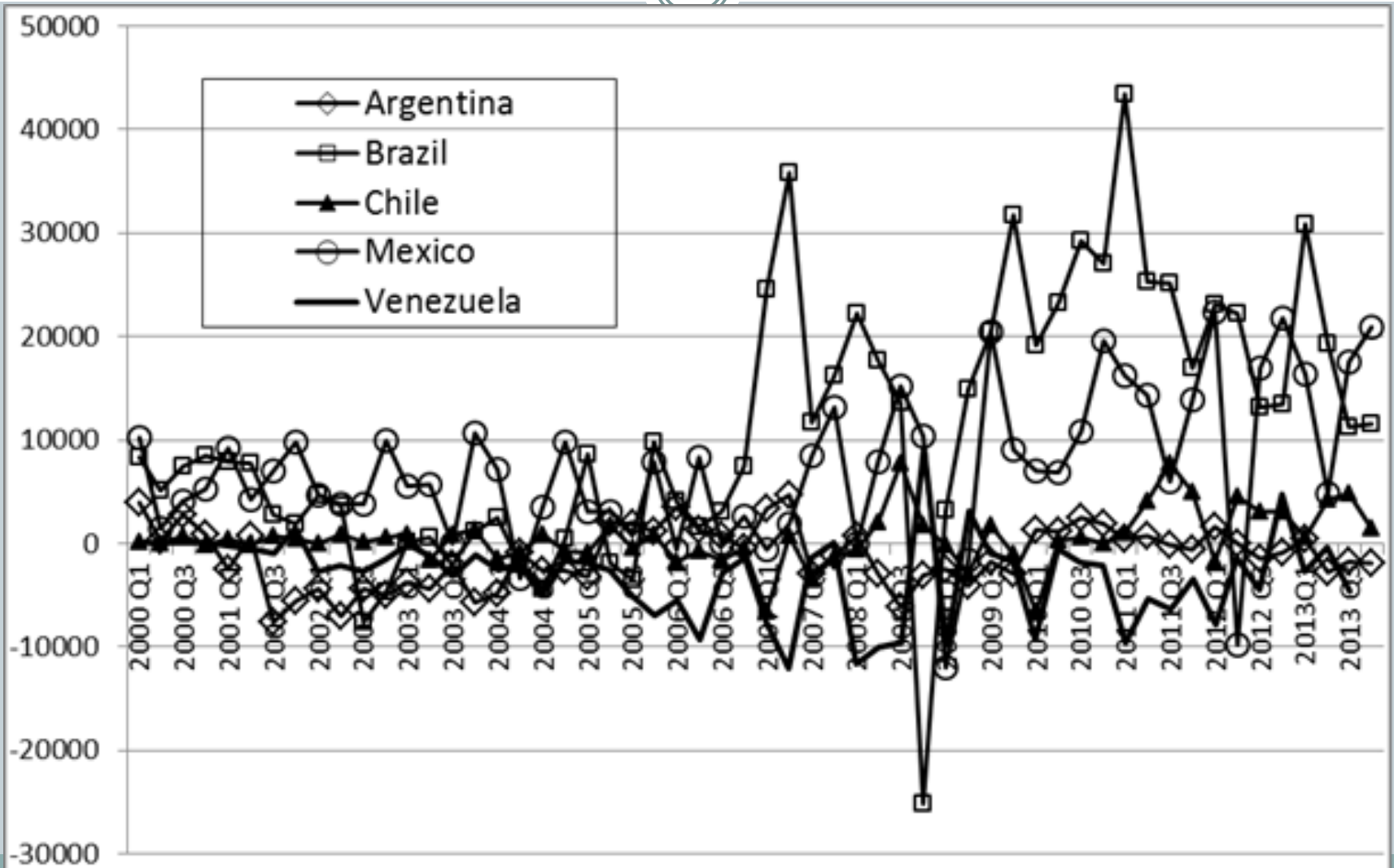


- Deterioration of trade balance (fall in the commodities prices and volume of trade) and of current account balance (profit repatriation by multinational firms)
- Increase of capital outflows in all the modalities (portfolio capitals, loans, foreign direct investment)

# Trade balance (US\$ billion)



# Balance of financial account



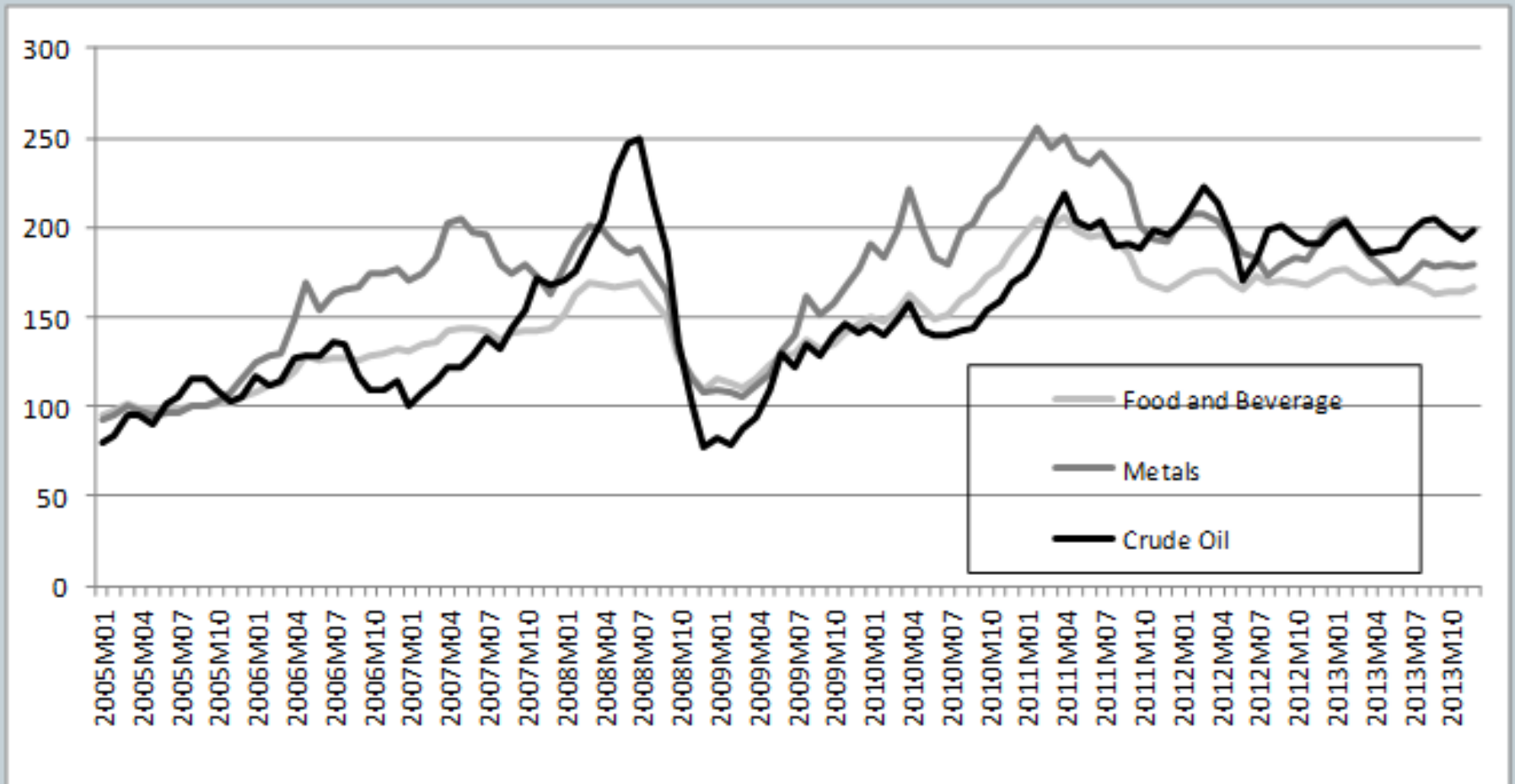
# Recovery of LA economies



- *External factors*: recovery of the international trade by middle of 2009 was favored by the recovery of the Chinese economy, and the new surge of capital inflows to emerging economies.
- *Domestic factors*: well-succeed implementation of countercyclical policies in most cases.
- *Exception*: Venezuela, due to the slowly recovery of prices and demand of oil and the lack of countercyclical policy tools.



# Commodity Prices and Oil Prices (USD)



# Counter-cyclical policies



- Central banks provided foreign currency liquidity to the private sector, to ensure both the continued operation of foreign exchange markets and external financing of exports.
- Central bank of Brazil and Mexico established reciprocal currency arrangements with the FED totaling USD 30 billion each, while IMF created FCL financing facilities, that was used by Mexico (USD 47 billion) and Colombia (USD 10.5 billion).
- Many central banks also relied heavily on lower reserve requirements (Colombia, Brazil and Peru) to increase liquidity of banks.
- However, most central banks delayed lowering rates until late 2008 or early 2009, due concerns related to the impact of the exchange rate depreciation on domestic inflation.
- Some countries made use of countercyclical fiscal policy, by the reduction of the taxes to stimulate consumption (Brazil and Chile) and/or by the increase in the public expenditures (Argentina, Brazil and Colombia).

# Reduced external vulnerability before-crisis



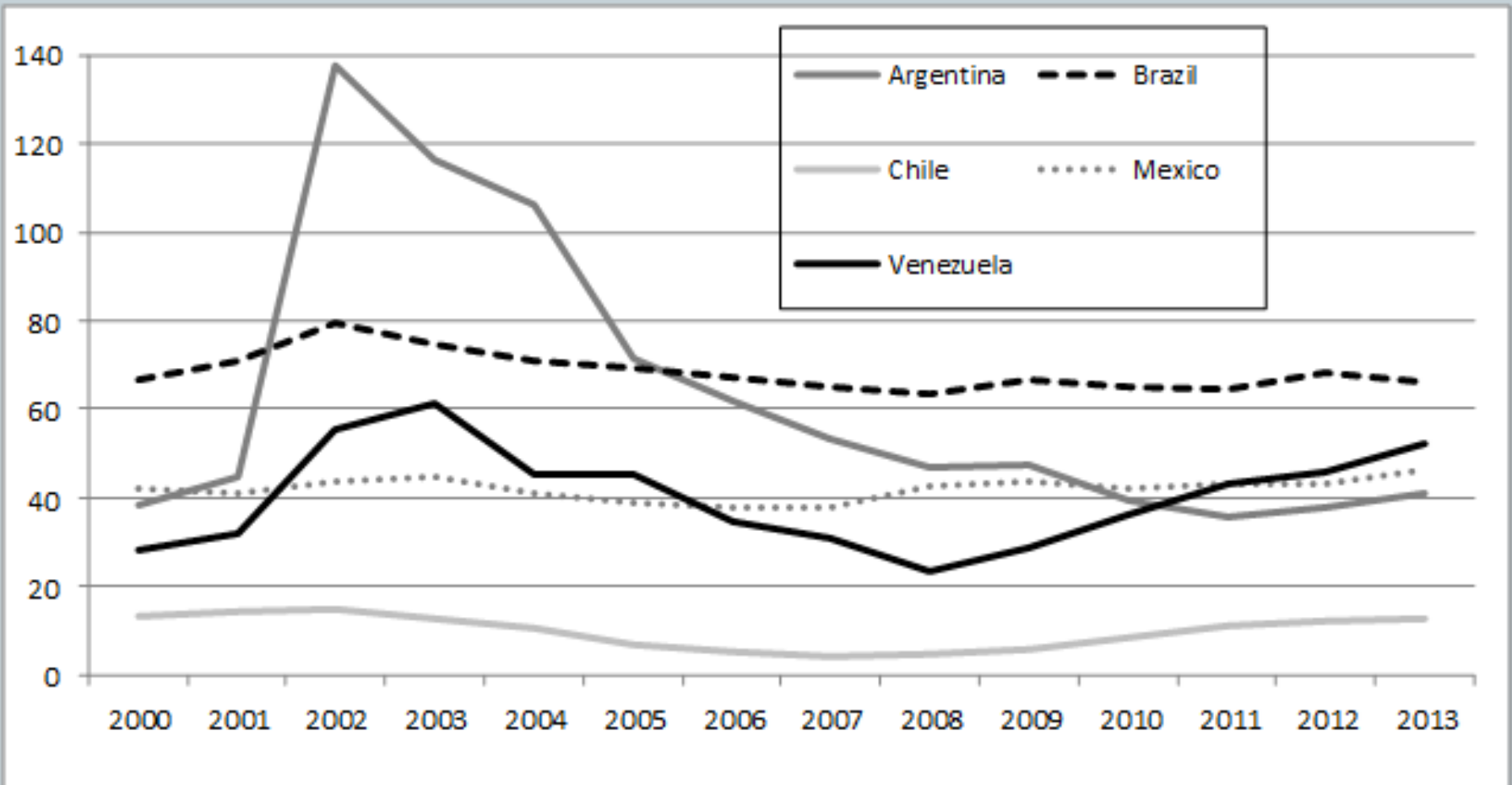
- Previous reduction and improvement in the composition of public debt.
- Low current account deficits or even surplus (commodities boom);
- Flexibility in the management of exchange rate;
- High level of foreign exchange reserves;
- Fall in the external indebtedness of public sector;
- Result: ↑ reserves ↓ external liabilities
- positive net balance in foreign currencies!

# Structural characteristics

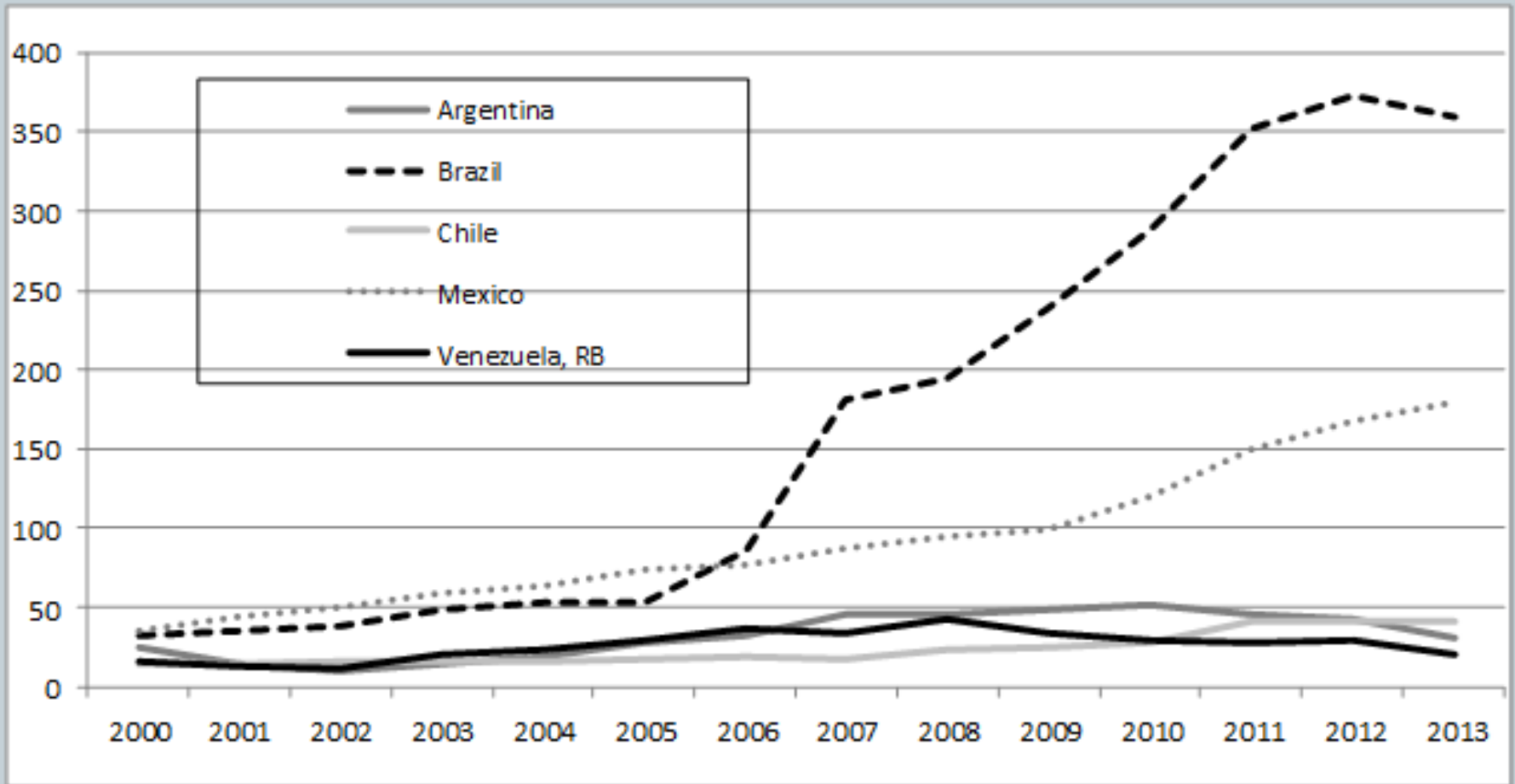


- Argentina: “agro-industrial exporter” (soya, cereals, wheat)
- Brazil: more diversified economy; “primarization” of exports
- Chile: exporter of metals and minerals
- Mexico: integration with U.S. economy (“maquiladoras”)
- Venezuela: oil exporter and low productive diversification

# Public debt/GDP (%)



# International reserves (US\$ billion)



# Some recent problems....



- Emergence of inflationary pressures in some economies (mainly in Argentina, Brazil and Venezuela) has put some pressure on monetary policy;
- Gradual but imminent change in the monetary policy of FED (“tapering”) and consequent increasing in the interest rates of external financing for emerging economies and pressure on exchange rates (devaluation);
- Increasing current account deficits (fall in commodities prices);
- Some deterioration in the fiscal balance (in some economies tax revenues depends on exports performance).

# Countercyclical policies: Argentina



- Contagion of crises: deterioration of terms of trade and drop in the external demand.
- Active countercyclical policy:
  - a) Fiscal policy: increase in public spending (subsidies to private sector – energy, transport, food industries), lower tax rates on wages, adjustment of retirement contributions, programs to reduce poverty.
  - b) Monetary policy: more gradualist approach
  - c) Exchange rate policy: managed floating -> stable and competitive real exchange rate
- Strong recovery in 2010-2011, lower growth in 2012-13
- Inflation rate of more than 10% p.y. (official); reduction of trade surplus -> measures to contain the erosion of foreign reserves



# Brazil



- Contagion of the crisis: capital flight (portfolio and loans); trade balance
- Countercyclical policies
  - a) Liquidity enhancing measures: reserve requirements, incentives to purchase loan portfolios of small/medium banks.
  - b) Interventions in foreign exchange market (selling US\$ 23 billion of reserves)
  - c) Fiscal measures to stimulate consumption (reduction of tax on consume durable goods, program of housing)
  - d) Active role of state-owned banks.
  - e) Policy of minimum wage.
- Recovery since mid 2009, high growth in 2010; recovery of capital inflows; deceleration in 2011-2013; since 2011 lack of well coordinated macroeconomic policy (tax exemption to firms, more stimulus to consumption, etc.)

# Chile



- Contagion of the crisis: fall in both price and volume of exports
- Countercyclical policies:
  - a) Expansionary fiscal policy with the use of fiscal fund (use of cooper revenues during the boom): temporary tax reductions, income transfers to poorest people, etc. (fiscal spending of 2.8% of GDP).
  - b) Sharp reduction in interest rates as inflation dropped.
  - c) Exchange rate policy: dirty floating
- Economic recovery in 2010-2012: recovery of commodities prices + increase domestic demand
- China is a important importer of cooper.

# Mexico



- Contagion of the crisis: fall in the exports of manufacturing to U.S., and oil exports; strong recession in 2009 (-4.7%)
- Countercyclical policies (less active than Brazil and Chile):
  - a) Monetary policy: gradual reduction of interest rates
  - b) Fiscal policy: primary fiscal deficit of 1% in 2009-2013
  - c) Exchange rate policy: increase of liquidity in the foreign currency market and recovery of international reserves
- GDP recovery in 2010-2012 due some recovery in the U.S. economy; in 2013 GDP dropped to 1.1% (slow growth of both exports and domestic demand)

# Venezuela



- Contagion of the crisis: fall in the exports of oil (that also affect tax revenues); recession in 2009-2010
- Countercyclical policies:
  - a) Expansionary monetary and fiscal policies (primary fiscal deficits of 1.8% on average in 2009-2013); currency devaluation in 2010,
  - b) Implementation of two exchange rates (one for priority goods, and other one for other goods). Due to high inflation, REER appreciated.

GDP growth has oscillated a lot: big recession in 2009-2010, recovery in 2011-2012, and drop in 2013; Inflation is a real concern (inflation rate of 56% in 2013)!

# Conclusion



- Good governance of the macroeconomic policy – in most countries the reduction of public external debt, the previous policy of international reserves accumulation and the reduction and improvement in the public debt provided some policy space for countercyclical policies.
- Such conditions were only possible due to exceptional external conditions before the global crisis of 2008.
- Economic performance also depends on structural characteristics of each economy and its insertion in the international economy: Mexico' dependence on U.S.; Venezuela's dependence on oil exports.
- Policy framework can also contribute the implementation of countercyclical policies, as it is the case of fiscal fund in Chile, and the strong presence of state-owned banks in the case of Brazil.

# Some recommendations to assure robust growth



- Monetary policies must explicitly consider the goal of employment stability, together with price stability,
- Fiscal policy must prioritize public investment and social programs
- Exchange rate policy must be designed to maintain balance of payments equilibrium.
- At the same time it is proposed the creation of a Regional Market Maker in the Latin America