The Impact of the Great Recession and Policy Responses in Latin America: Was This Time Different?[*]

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Abstract: The 2007-8 international financial crisis and the 'Great Recession' (GR) affected the different regions of the world, including emerging economies. In the case of most major economies of Latin America, the reduction of public external debt, the previous policy of international reserves accumulation and the reduction and improvement in the composition of public debt provided some policy space for countercyclical policies. Consequently, governments could make use of countercyclical fiscal policy to face to effects of the IFC and GR, when in other occasions they made use of tightened policies. The countries' reaction to the crisis has varied with the use of different tools of economic policy. For instance, between 2011 and 2013, despite the countercyclical policies, the economic growth showed great volatility in the economies of the Region. In addition, there are a lot of concerns about the future performance of the economies of the Region due mainly to the uncertainties related to the global economy.

Keywords: Great Recession; Latin America; countercyclical policies

JEL Classification: F63; O23; O54

1. Introduction[1]

The 2007-8 international financial crisis (IFC) was a crisis of globalized finance, meaning that a crisis in one specific segment of the financial system – specifically the United States subprime mortgage market – eventually spread worldwide. The effects of such a crisis are not economically and socially neutral, especially because since 2009 the 'Great Recession' (GR) has affected the different regions of the world, including emerging economies.

As is well known, historical recent experiences of financial crisis in Latin America have been a succession of painful crises: external debt crisis of the 1980s, contagion of

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Mexican 1994-95 crisis and contagion of Asian crisis, among others. However, at this time, the Latin American governments' policy responses to the contagion of global financial crisis and the GR were somehow different. Why? In most large countries of Latin America the reduction of public external debt, the previous policy of international reserves accumulation and the reduction and improvement in the composition of public debt, provided some policy space for countercyclical policies. Consequently, governments could make use of countercyclical fiscal policy to face the effects of the IFC, when in other occasions they made use of tightened policies. The countries' reaction to the IFC and the GR has varied with the use of different tools of economic policy. Between 2011 and 2013, despite the countercyclical policies adopted by the main Latin American countries, economic growth showed great volatility in the economies of the Region. In addition, there are a lot of concerns about the future performance of the economies of the Region due mainly to the uncertainties related to the global economy and the reduction of the policy space in greater Latin American economies.

The purpose of this chapter is to examine the consequences of the IFC and the GR in the main Latin America countries – Argentina, Brazil, Chile, Mexico and Venezuela[2] – and the implementation of countercyclical policies in these countries.

The chapter is divided into three sections following this introduction. Section 2 shows that the IFC and the GR affected substantially the economic dynamism of these countries, as well as shows the reaction of the main Latin American economies to the environment of the IFC and the GR. Section 3 analyses the main countercyclical policies and their results implemented by the main Latin American's Economic Authorities (EA) to mitigate the impacts of the IFC and the GR. Finally, section 4 summarizes and presents some economic policy recommendations to assure macroeconomic stability – that is, sustainable economic growth, inflation under control and long-term fiscal and balance of payments equilibria – and to promote a consistent economic integration in the Latin America.

[2] The analysis considers Argentina, Brazil, Chile, Mexico and Venezuela, as overall proxies for the countries of Latin America, for two reasons: (i) these countries' Gross Domestic Product (GDP) represents almost 80% of Latin America's GDP; and (ii) they are important to the Region, both politically and economically.

2. The consequences of the IFC and GR in the main Latin American countries and the reaction of their EA

The IFC crisis affected economic activity dramatically, both in the developed countries and in the emerging economies, casting doubt on the very notion of the decoupling of emerging economies from developed countries. The developments from the crisis were observed not just in the financial system, but most importantly in the real realm of the economy. After a long period of prosperity in the world economy running from 2003 to 2008, the United States, the countries of the Euro Area, Japan and some of the leading emerging countries, including the Latin American countries (Figure 1) went into recession in 2009. The scenario of economic downturn, shrinking trade flows and asset deflation that unfolded from September 2008 onwards caused the world economy to go into collapse.[3]

Figure 1

It should be stressed that the world recession in 2009 might have been much worse had it not been for the actions of the EA of both the G-7 countries and the emerging countries taking an active part in mitigating the impacts of the IFC on the productive sphere of the economy. To that end, they implemented countercyclical fiscal policies and expansionist monetary policies, mainly through the activities of their central banks as lenders of last resort, in order to reverse the steadily deteriorating state of expectations among economic agents. Indeed, governments of developed and emerging economies have responded to the 2007-08 IFC and the GR with massive fiscal and monetary stimulus. In that regard, injections of liquidity and substantial interest rate reductions by central banks, along with fiscal incentives along 'Keynesian' lines, were important in reducing the impact of the crisis on the 'real economy' and seeking to restore agents' confidence in the workings of the markets.

[3] According to the IMF (2014), the growth rates in 2009 of the United States, the Euro Area and Japan were, respectively, -2.4%, -4% and -5.1%. Moreover, according to the World Trade Organization (2014) the volume of world trade shrank 12% in 2009.

The fact that the IFC was restricted to the developed countries, and the most emerging countries' fiscal and external situation was comfortable, led a number of analysts and policymakers to give credence to the hypothesis of a 'decoupling' of some emerging countries; that is, the notion that these economies would be able to sustain their dynamic performance and prove immune to contagion from the crisis. In 2008, moreover, the main concern among central banks, market analysts and multilateral organizations was with the inflationary pressures that emerging countries might suffer as a result of strongly rising food and oil prices.

However, particularly after Lehman Brothers went bankrupt in September 2008, economic agents' expectations as to the magnitude and development of the IFC changed radically. The crisis spread to the whole world economy by contagion effects, affecting credit and capital markets, as well as international trade, especially by countries dependent on commodity exports, whose prices fell abruptly. In that context, some emerging countries experienced not just macroeconomic instabilities (in terms of economic activity or price volatility), but also situations of fiscal and external fragility, regardless of whether or not they had displayed, prior to the crisis, what were regarded as sound macroeconomic fundamentals.

The outcome was no different in Latin America: after a period of mini-boom of growth[4] (2003-2008) due mainly to the commodities boom, by the end of 2008, most countries in the Region fell into recession (from the last quarter of 2008 until the first quarter of 2009). The contagious crisis effect of the global financial crisis on the performance of Latin American economies was deep, short and synchronized, as can be seen in Figure 1. Indeed, in 2009 GDP growth in the Region's main emerging countries was negative in Brazil, Mexico and Venezuela, while in Argentina and Chile the economic activity dropped considerably as compared with 2008. Moreover, as Figures 2 and 4 show, the trade balance and current account/GDP of the main Latin American countries was substantially deteriorated between 2008-09 due to the fact that their most important trade partners, such as United States and the countries of the Euro Area, entered into recession:

[4] According to OCampo (2011) in this period Latin America combined the highest economic growth since the post-war boom (until the 1970s) with positive social results in terms of reduction of poverty and inequality, favored unusually by: quick growth of trade, increase in the commodities prices and ample access to international financing at historically low costs.

the trade balance of Argentina, Brazil and Chile dropped, while the trade balance of Mexico and Venezuela improved; the current account deficits of Argentina, Brazil, Chile and Mexico worsened, while the current account surplus of Venezuela presented some volatility, but, at the end of the period, it raised due to the increase in the price of oil. According to Figure 3, in general, commodity prices fell sharply by the end of 2008 – compared to the prices of the 2004-2008 period – due to the GR that followed the financial crisis.

Figure 2

Figure 3

Figure 4

Another immediate channel of the contagion of global crisis was through the capital outflows in portfolio capitals, loans, Foreign Direct Investment (FDI) and profit repatriation by transnational corporations.[5] Figure 4 shows that the balance of financial account was reduced sharply in the aftermath of Lehman Brothers bankruptcy, but recovered quickly and strongly in Brazil and Mexico, the major economies of the Region and also ones of the most financially integrated countries. As for Argentina, one should consider the case after the renegotiation of the external debt in 2004-2005, when its external indebtedness was reduced dramatically, and it did not obtain access to international financial market.

The IFC and the GR in principle could cause inflationary pressures to the main Latin American countries, due to the sharp currency devaluation (against the dollar) during the contagion of the global financial crisis after the Lehman Brothers bankruptcy that would result in exchange pass-through effects. However, the recession that followed the financial crisis and the drop in the food and oil prices neutralized the inflationary effects of the devaluation and allowed the monetary authorities to implement expansionary monetary

[5] It should be pointed out that there was not any financial/banking crisis within Latin American countries through, for example, bank purchases of ‘toxic assets’ or through inter-bank links with those of other countries.

policy (expansion of monetary aggregates and/or reduction in interest rates). The behavior of the inflation rate (consumer price index) before and after the crisis has been uneven among the economies: Argentina and Venezuela have much higher level of inflation compared to Brazil, Chile and Mexico. In Venezuela, in particular, inflation rate reached more than 40% per year in 2013, and there is some concern about the likelihood of a future hyperinflation process (Figure 1). After the financial crisis, inflation increased in Argentina and Brazil and reduced in Chile, while there was a more or less stable trend in Mexico. Brazil, Chile and Mexico adopted an inflation target regime with a floating exchange regime, while Argentina operates a managed exchange rate with monetary targets and Venezuela, since January 2002, has implemented a dual exchange rate system.

Summing up, the IFC generated mechanisms by which it was transmitted to Latin American economies included: (i) withdrawal of portfolio capital (with, incidentally, capital flight eventually affecting stock markets) and FDI; (ii) interruption of credit, particularly for foreign trade; (iii) falling commodities prices; (iv) declining exports to developed countries; (v) volatile exchange rates; and (vi) rising levels of profit repatriation by transnational corporations.

Prates and Cintra (2009) argue that in previous crises, more precisely the external crises of the 1990s (Mexico, 1994-5, East Asia, 1997, Russia, 1998, and Brazil, 1998-9), most emerging countries took pro-cyclical (restrictive) measures. This was in line with the International Monetary Fund (IMF) principles and approval, aiming to regain the confidence of the financial markets as a necessary condition for foreign capital to flow back to those emerging economies. However, in view of the systemic nature of the present crisis emerging countries' EA decided such policies would be completely ineffective. Rather they would contribute to aggravating the developments from the crisis by setting off a vicious circle of exchange depreciation, credit squeeze, asset deflation, and crises of effective demand and unemployment. In that light, these countries met the contagion effect by putting in place countercyclical measures to render their currencies less volatile, prevent balance of payment deterioration, assure liquidity for their domestic financial systems, stabilize prices and bring growth back on track.

Indeed, all the major Latin American economies, with the exception of Venezuela, recovered sharply in 2010 (Figure 1). Such recovery was the consequence of a combination

of external factors with domestic factors. The *external factors* are related to the recovery of the international trade by the middle of 2009 favored by the recovery of the Chinese economy with the use of expansionary policies that once more increased the demand for basic goods; and the retake of the capital inflows to emerging economies (including some Latin American countries) thanks to the expansionary monetary policy adopted by developed economies. The surge of capital flows, mainly in the modality of portfolio, contributed to the strong recovery of the capital markets in some important economies of Region, such as Brazil and Mexico.

The *domestic factors* are related to the well-succeeded implementation of countercyclical policies in Latin America. According to Paula *et al* (2013, p.235) economic policy responses included a large range of tools (see also Jará *et al*, 2009):

(i) Central banks provided foreign currency liquidity to the private sector, to ensure both the continued operation of foreign exchange markets and the continued availability of external financing.

(ii) External resources provided significant additional support to Latin American countries during the global financial crisis: central bank of Brazil and Mexico established reciprocal currency arrangements with the FED totaling USD 30 billion each, while IMF created Flexible Credit Line (FCL) financing facilities, that was used by Mexico (USD 47 billion) and Colombia (USD 10.5 billion).

(iii) Some central banks increased the range of assets accepted as collateral to improve access to short-term funding, such as Argentina, Brazil, Mexico and Peru. Many central banks also relied heavily on lower banks' reserve ratio requirements (Colombia, Brazil and Peru).

(iv) However, central banks delayed lowering interest rates until late 2008 or early 2009, due to concerns about inflationary pressures and the potential impact of the exchange rate depreciation; such behavior contributed negatively to the economic growth in 2009.

(v) Some countries made use of countercyclical fiscal policy, by reducing taxes to stimulate consumption (Brazil and Chile) and/or by the increase in public expenditures (Argentina, Brazil and Colombia).

One further countercyclical tool was the increase in the minimum wage that contributed to avoiding the fall in the real wage in a lot of countries and to moderate the reduction of consumption due to recession in the aftermath of the contagion of the crisis.

Reduced external vulnerability was the principal reason for the fair performance of emerging economies during the recent global financial crises; and it is associated with a set of factors, that includes: (i) lower current account deficits; (ii) floating exchange rates; (iii) high level of foreign exchange reserves; (iv) reduced short-term external liabilities; and (v) capital account regulations in place (OCampo, 2012). The combination of stronger external accounts, the accumulation of international reserves and flexibility of the exchange rate showed that most emerging economies were prepared to face the contagion of the global crisis. According to IMF (2012, p.132), “improvements in policymaking and the buildup of policy space in many of these economies account for the bulk of the increased resilience since 1990”.[6]

In the case of the major economies of Latin America, in most countries the reduction of public external debt, the previous policy of international reserves accumulation (Figure 5), that was possible due to the period of bonanza of commodities exports, and the reduction and improvement in the composition of public debt, with the increase of domestically-denominated debt, provided some policy space for countercyclical stabilization policies. The combination of the reduction of public external debt (external liabilities) with the increase in the foreign reserves (external assets) meant that most countries had a positive net balance in foreign currencies. So that the immediate and direct impact of the exchange rate devaluation on the public finance was positive, instead of negative, as it was the case in other previous occasions. Consequently, governments could make use of some countercyclical fiscal policy to face to effects of the financial crisis, when in other occasions they made use of tightened policies. Therefore, in contrast to former crises in Latin America, there were no financial crises in the Region.

Figure 5

[6] Resilience is defined as the ability of the emerging economies “to sustain longer and stronger expansions and to experience shorter and shallower downturn and more rapid recovery” (IMF, 2012, p.130).

Figure 6 shows that the ratio of the primary fiscal surplus over GDP, in all the economies analyzed in this chapter, with the exception of Venezuela, decreased in 2009 and recovered in 2010, which followed the economic recovery. According to CEPAL (2012, p. 17), fiscal policy in most Latin American economies had the following guidelines: (i) the 2003-2008 period of economic growth was marked by generating fiscal primary surplus and the reduction of public debt, that is before the external adversities of 2008-09 (Figure 6); (ii) in 2009, stabilization of domestic demand through the increase of public expenditures (social programs, housing programs, financing of small and middle firms, infrastructure, etc.) and reduction of the taxes to stimulate consumption were active; and (iii) since 2010, implementation of tax reform (either revenues and expenditures sides) in some countries has been important to consolidate public finance. Fiscal deficits in Latin America (simple average) changed from -0.5% of GDP in 2008 to -2.9% in 2009, falling down again to -1.8% in 2010 (CEPAL, 2012, p.17).

Figure 6

As for monetary policy, although most economies (Brazil, Chile and Mexico) reduced interest rates during 2009, the management of the interest rate policy varied somewhat among the countries, with Chile adopting a more aggressive expansionary policy, and Brazil and Mexico implementing a more gradual policy. Venezuela had to deal with increasingly higher inflation, but even so a more expansionary monetary policy was adopted. Argentina was the only economy of the selected countries that increased the central bank interest rate in 2009 (Figure 7). Other tools of monetary policy included reduction of reserve requirements on banking deposits and the implementation of some special credit lines by central banks (for instance, to finance exports). In some countries, like Brazil, where public banks have a high portion of the market share, such banks operated a countercyclical credit policy that contributed to reduce the slowdown in the credit market. Indeed, thanks to the active role of public banks in some economies, the central banks' efforts to expand liquidity and the quick recovery of capital flows to emerging economics (including Latin America), domestic credit recovered rapidly and the temporary problems of liquidity in the banking sector had limited effect on economic

activity in the Region (CEPAL, 2014, p.102). Figure 7 shows the behavior of the domestic credit/GDP ratio in Argentina,[7] Chile, Brazil, Mexico and Venezuela. In 2011-2012, due to the slowdown of the world economy and greater uncertainty about the future, most economies adopted a more cautious and flexible monetary policy, with less variations and some reduction in the basic interest rate, combined with the implementation of macro-prudential policies.

Figure 7

Finally, as for the exchange rate policy, although different strategies were adopted among the countries, no economy implemented a pure floating exchange rate management, but some combination of a flexible exchange rate with active intervention in the foreign exchange market, including a policy of foreign reserve accumulation. Venezuela was an exception in that ita dual and later multiple exchange rate regime was implemented. Figure 8 (increase of the rate means appreciation with decrease means depreciation) shows that Chile and mainly Brazil had appreciation of the real effective exchange rate (REER[8]) before the global financial crisis – in the case of Brazil this trend followed until 2011, and since then REER has depreciated – while Chile has had a more or less stable REER since 2006. Real exchange rate depreciated in Mexico before the crisis; and since 2010 Mexico has maintained a more or less stable trend. Argentina, after the big devaluation of 2001, under the context of a Convertibility Plan crisis, has adopted the target of a competitive exchange rate as one of the cornerstone of the economic policy – indeed, since 2004 REER has had a gradual trend for depreciation.[9] After the second quarter of 2009, the surge of capital inflows in various economies of Latin America resulted in a currency appreciation trend in most countries. Due to the continuous pressure on the exchange rate, Brazil implemented in 2010-2011 some controls on capital inflows (with the use of a financial transactions tax) in order to reduce such pressure and to allow some currency devaluation.

[7] It is important to mention that the monetary and financial systems of Argentina and Chile are the most deregulated compared to those systems of the other big economies of the Region.
[8] REER is the weighted average of a country's currency relative to an index or basket of other major currencies adjusted for the effects of inflation.
[9] Venezuela was excluded from this analysis as the country implemented a complex multiple exchange rate system.

However, since 2013 capital flows in the Region has shown more volatile due to withdrawal of monetary stimulus measures in the United States and possible increase in the interest rate. Consequently, some monetary authorities have drawn on foreign reserves and with some changes in the macro-prudential regulations in order to mitigate exchange rate volatility.

Figure 8

OCampo (2011) points out that the strengthening of Latin America to face the contagion of the global financial crisis was only possible due to the better performance of the balance of payments thanks to the exceptional external conditions that allowed some reduction in the external public debt and an increase in the foreign reserves along with the benign international environment. However, the uncertainty about the recovery of the global economy and the slowdown in the rate of growth of the Chinese economy plus some domestic economic deterioration in some Latin American economies (high inflation, low GDP growth, increase of current account, deceleration of credit supply, etc.) seems to show that the policy space for implementation of countercyclical policies is reduced in the Region.

According to CEPAL (2014, p.102-103), the economic environment in 2014 for the implementation of financial policies is different somehow compared to 2008-2009: (i) the emergence of inflationary pressures in some economies (mainly in Argentina, Brazil and Venezuela) has put some pressure on monetary policy; (ii) the gradual but imminent change in the FED monetary policy ('tapering') and consequent increase in the interest rates of emerging economies are resulting in a currency depreciation trend in Latin America, that can eventually increase domestic prices; and (iii) in some cases, the quick growth of credit supply can eventually put pressure on inflation and external balance. However, the fiscal situations in Latin America are diverse and heterogeneous, and despite of wider deficit and slowing economy, public debt has not risen in general (Figure 6).

Indeed, between 2012 and 2013, despite the countercyclical policies adopted by the main Latin American countries, economic growth showed great volatility in the economies of the Region and an overall trend of some economic slowdown (Figure 1). Economic

growth has been uneven among the major economies of Latin America: the average GDP growth in 2012-2013 was, in the 3 major economies of the Region, 1.9% in Argentina, 1.8% in Brazil and 2.7% in Mexico, while it was 3.5% in Venezuela and 4.8% in Chile. Latin American economies continued to show some resilience to external shocks although economic growth has shown clear signals of deceleration.[10] Since the 2008-2009 crisis, domestic demand has been the main driver of growth in Latin America, while net exports made a negative contribution between 2010 and 2013. Indeed, weak growth in the developed economies and modest expansion in the emerging economies (especially China) can suggest that "boosting the region's external demand will be a slow and difficult process, which will limit the contribution of exports to growth" (ECLAC, 2014, p.11).

With external demand weakening, most countries adopted policies of stimulus to domestic demand fuelled partly by monetary or fiscal policy measures that avoided a greater slowdown of the economic activity, but at the same time contributed to deteriorating the current account deficits – as it was the case of Argentina, Chile, Brazil and Mexico (Figure 2). The current account deficit of Latin America widened from 1.8% of GDP in 2012 to 2.5% in 2013 as imports of goods grew more rapidly than exports and deficit on the services balances widened slightly due to tourism and transport (ECLAC, 2013, p.8). The tendency of high current account deficits has weaken more recently the stronger position of the major Latin American economies due to the reduction of external debt and foreign reserves accumulation.

In the next section we analyze the effects of the IFC and the GR on the economies of Argentina, Brazil, Chile, Mexico and Venezuela and the economic policy responses with the focus on the countercyclical policies.

3. Economic performance and countercyclical policies of the main Latin America countries after the global crisis

[10] According to ECLAC (2015) data, the average GDP growth in Latin America in 2004-2008 was 5.1% per year, while it was 2.1% in 2011-2013. Preliminary data on 2014 indicates a GDP growth of only 0.1% on average in the Region.

3.1. Some structural characteristics[11]

It is useful to point out some structural features of the Latin American economies analyzed in this chapter. Brazil, Mexico and Argentina are the biggest economies of the Region,[12] with a more diversified economy compared to Chile and Venezuela, as they combine a productive structure with manufacturing, agriculture, mining and oil, while Chile and Venezuela are much more specialized exports.

Argentina belongs to the group of the economies 'agro industrial exports' (agricultural products were responsible by 36% of total exports in 2010-2012) that also includes Paraguay and Uruguay, with the special feature of having a more diversified productive structure among these economies. The main destination of exports is the intraregional trade (41%). Argentina had a long period of current account surplus due to the increase of exports (soya, cereals, wheat and manufacturing goods) caused by the improvement of the terms of trade and only in the recent years has underwent deficits. In particular, the Argentinean economy is subject to the external financing restriction since the Convertibility Plan crisis and renegotiation of external debt,[13] and more recently with the problems related to 'vulture funds'. Another problem has been the increase of inflation – the official annual inflation rate has been around 10% in 2010-2013.

Brazil is together with Mexico the most diversified economy of the Region. Differently from Mexico, however, its manufacturing sector is mainly focused on the domestic market, while in Mexico '*maquiladoras*', the industries located next to United States, export consumer goods mainly to this latter country. Brazil, due to a set of features that include a medium-term trend for currency appreciation (2003-2011), is suffering a problem of deindustrialization that has resulted in the reduction of manufacturing exports and stagnation of the industrial sector. Consequently, the share of primary goods has increased in this country (21% are agro industrial goods and 16% is iron). Mexico shows

[11] Most data and relevant details of this section were extracted from CEPAL (2014, Chapter II).
[12] The three countries – Brazil (41.7%), Mexico (21.0%) and Argentina (9.6%) – represented together 72.0% of the total GDP of Latin America in 2013.
[13] From 2003 to 2005, after several proposals from the government of Argentina, payments of public debt (particularly external debt) to creditors was made at considerable discounts from nominal values. More specifically, in January 2005 it was proposed to swap old unpaid debt with a face value of USD 81.8 billion for new bonds with a maximum value of USD 41.8 billion.

the bigger concentration degree of exports in Latin America (78.7% of exports to United States in 2010-2012), and became very 'American dependent', while Brazil presents one of the most diversified exports structure by destination. Both economies have exhibited moderate current account deficits for consecutive years that have been compensated by FDI net flows, mainly in the case of Brazil. Indeed, Brazil and Mexico are among the most financially integrated economies of the Region. Finally, Mexico has a high dependence of fiscal revenues from the basic goods income: the relative share earnings of non-renewable natural resources over public revenue was 33.4% on average in 2009-2012, while in Brazil was only 6.3%. Public finance has gradually deteriorated in Brazil and Mexico with some increase in the public debt (42% of GDP in Mexico and 66% of GDP in Brazil in 2013). The combination of high interest expenditures with low GDP growth have contributed to some deterioration in the public debt.

Chile can be seen as part of the group of 'exporters of metals and minerals' that also includes Peru. This group has the main common feature of the high concentration in some export products (exports of cooper encompass 57% of total exports of Chile), with some destination diversification, although Chile has the highest trade dependence on China in Latin America (23.5% of total exports). Current account (percentage of GDP) was very high in Chile during the commodities boom (3.2% on average in 2004-2007), and has shown more recently a moderate trend to deficit (-2.3% in 2012-2013), due to the combination of fall in the price of cooper with the increase of imports as a result of the increase of domestic demand. Due to the FDI inflows, the external financial needs have been low and eventually negative. The dependence of fiscal revenues from the basic goods income is high in Chile (16.5% in 2009-2012), although much lesser than the hydrocarbons export economies. Public debt, either domestic or external, has been maintained in low levels, respectively, 16.1% and 2.8% of GDP. As public indebtedness is low in Chile,[14] the main external vulnerability of the economy is related to the concentration of exports in a limited set of goods and some dependence to China.

[14] Since 2001 Chile has adopted a counter-cyclical fiscal policy, based on the commitment to an announced goal of a medium-term structural balance as a percentage of GDP. The structural balance nets out the effect of the economic cycle (including copper price volatility) on fiscal revenues and constrains expenditures to a correspondingly consistent level. In practice, this means that expenditures rise when activity is low and decrease in economic booms.

Finally, Venezuela can be seen as part of the group of 'hydrocarbons exporter economies' that also include Bolivia, Colombia, and Ecuador. The main feature of this group of economies is the very high concentration of exports in hydrocarbons and the high participation of these goods in the public revenues (39.8% in 2009-2012 in Venezuela). Oil exports represent 95% of total exports of Venezuela and the main destination of the exports is the United States (36% in 2010-2012). Current account (percentage of GDP) has been very high due to the oil export performance: 13.1% in 2002-2008 and 5.0% in 2010-2013. Venezuela, a big exporter of oil, suffers typically what is called in the literature as 'Dutch disease', that is, the chronic overvaluation of the exchange rate caused by the abundance of cheap natural resources compatible with a lower exchange rate than the one that would pave the way for the other tradable industries. The main problem of Venezuela is the lack of diversification of productive structure and high dependence on oil exports. Venezuela has also had the increasing problem to stabilize the economy: inflation rate (CPI) has been higher than 20% per year since 2008 and jumped to 56% in 2013, raising some concern about the likelihood of a hyperinflation process to be in course in the next future.

3.2. Assessment of the economic performance and countercyclical policies

3.2.1. Argentina

Since the collapse of the 2001-2002 Convertibility Plan,[15] Argentina has applied heterodox types of economic policies, which, in a context of international economic prosperity, high commodity prices, and domestic idle capacity, contributed to a vigorous recovery in Argentina's GDP in 2003-2007 (8.6% on average). According to Damill and Frenkel (2009) the macroeconomic regime based on the preservation of a stable and competitive real exchange rate (SCRER) was the main reason explaining the rapid growth experienced in Argentina, besides the commodities boom.

[15] In April 1991 Argentina implemented a stabilization plan called the Convertibility Plan, which consisted mainly of adopting a currency board-type exchange rate regime, which essentially anchored the Argentinean *peso* to the United States dollar.

In 2008 and 2009, economic growth fell down to 1.5% per year on average, and once again recovered in 2010 and 2011 (8.8% on average) (Figure 1). However, GDP growth reduced substantially in 2012 and 2013 (1.9%), a trend that has continued in 2014. As for the inflation behavior (Figure 1), inflation rate exploded in 2002 (41.0%), due to the huge exchange rate devaluation, and then reduced to 3.7% in 2003, increasing since then (except in 2008), and has been maintained in high levels since 2010 (average of 10.6% in 2010-2013[16]).

Commodities boom combined with the currency depreciation resulted in a sustained current account surplus (percentage of GDP) of 3.1% on average in 2002-2009. Since then, deficit in current account has been low (no more than -1.0% of GDP), but as the economy does not have access to external financing, EA had to make use of international reserves and some measures to limit the access of domestic residents to U.S. dollar.

With the onset of the IFC, the Argentinean economy suffered especially by the deterioration of terms of trade and drop in the external demand. Under such conditions, the Argentinian' EA implemented fiscal and monetary stimulus packages designed to stabilize aggregate demand and temporarily assisting more vulnerable social groups.

In terms of fiscal policy, the following measures were taken: (i) increased government spending, particularly in subsidies to the private sector and especially to the energy, transport and food industries; (ii) lower income tax rates on wage earnings; (iii) increased infrastructure expenditures and funding for programs to combat poverty; (iv) adjustment of retirement contributions and benefit payments; and (v) reduction of taxes on agricultural exports, either to increase public sector revenue or to prevent those prices from being transferred to the domestic market (ECLAC, 2009a).

In 2009 public expenditure expanded significantly more than GDP, due to increases in wages, social security benefits and capital expenditures. In particular, transfers to private sector (including energy, transport and food subsidies) held at approximately 4% of GDP[17] (ECLAC, 2009c, p.74). Indeed, primary fiscal surplus not only was it reduced – from 2.2% of GDP in 2008 to 1.2% on average in 2009-2010 – but also ran into deficit in 2011-2013

[16] One should be careful about the calculation of the inflation rate in Argentina due to changes in the methodology that have underestimated the real increase of CPI.
[17] This figure has been maintained in 2011-13, according to ECLAC (2013b).

(Figure 6). In 2009 the public debt increased slightly over the previous year's level to almost 50% of GDP (Figure 6).

Monetary policy was managed on different approaches. In 2008, rapid growth in the economy and pressure from international prices, especially food prices, led the Central Bank of Argentina (CBA) to control the money supply and consequently raising the interest rate (Figure 7). At the end of 2008 and in 2009, a conflict in the agricultural sector led to some financial turmoil in the economy, basically due to the CBA's intervention in the foreign market. As a result, interest rates oscillated, with large fluctuations around periods of turbulence (ECLAC, 2009). In 2009, monetary aggregates expanded more slowly, and the CBA increased gradually the interest rate, while in 2010 monetary policy was relaxed in response to the uncertainty of the GR, introducing measures to expand liquidity and lowering the interest rate, thereby increasing the supply of credit from the financial system (Figure 7).

CBA intervened in the foreign exchange market, buying and selling foreign exchange as circumstances dictated, in order to maintain the level of the international reserves, which stood by USD 48 billion in the end of 2009. Despite the considerable devaluation in 2008-2009, exchange rate policy continued its trajectory of preserving a stable and competitive real exchange rate (Figure 8). Both the continuing trade surpluses and the policy of accumulating foreign reserves helped to stabilize the exchange rate market and assure a relatively comfortable external situation (current account deficits of -0,6% of GDP on average in 2011-2013), at least until recently. EA in Argentina decided at the beginning of 2010 to use international reserves for servicing external public debt. Indeed, according to ECLAC (2013b) "the external sector has been under strain since mid-2011, owning to a reversal in the energy balance (…), an appreciating real exchange rate, and a strong demand for foreign assets, as tends to occur in countries with a dual currency system in these circumstances" (p. 2),

Although Argentina's trajectory of sustained economic growth had been interrupted, the situation at year-end 2009 was that unemployment stood at 9%, and inflation was 7.7%. The decline in the agricultural output and industrial activity (mainly automobile production) was the consequence of both falls in the external and domestic demand. By the

end of 2009, signs of recovery of the Argentinean economy were evident, boosted by the domestic demand and the renewed buoyancy of the Brazilian market.

In 2010-2011, there was a strong recovery of the Argentinean economy basically due to the new commodities mini-boom and the expansionary monetary and fiscal policies implemented in 2009 and maintained in the following years. In particular, the demand for exportable goods recovered as a result of developments in agricultural product markets (strong recovery in grain harvests) and the better performance of major trading partners such as Brazil.

In terms of exchange rate, EA intervened in the foreign exchange market to manage the nominal exchange rate to aim at, on the one hand, improving trade balance, and, on the other hand, to maintain inflation under control. As for inflation, it has been maintained high since 2010, a lot of factors have contributed to this: increase in the international food prices, nominal devaluation of the *peso*, and wage bargain, as the perceptions of substantially higher inflation vis-à-vis official rate has resulted often in the increase of real wages, that eventually contributes for a wage-prices spiral.[18]

In 2011, while the government maintained an expansionary fiscal policy, the CBA decided to raise the interest rate. To avoid inflationary pressures, exchange rate was geared to keep inflation under control by devaluing the currency more slowly than the rate of increase in domestic prices. At the end of the year the *peso* lost almost 8% of its value and, as a consequence, there was a decline in foreign-currency deposits and, more important, the international reserves dropped (Figure 5).

Throughout 2012, the government acted on two fronts: (i) adopted domestic price regulation measures in the form of agreements with producers of certain goods and services and restrictions on food exports to keep inflation under control; and (ii) due to the deterioration of trade balance, implemented measures to contain the erosion of international reserves. The main measures were: “the introduction of foreign-exchange regulations, including restrictions on hoarding of foreign currency and on repatriation of profits by foreign firms; (b) the management of goods imports; and (c) the renationalization of a majority holding the oil company Repsol YPF” (ECLAC, Economic Survey for Argentina,

[18] ECLAC (2012, p. 2) reports that average wages climbed by nearly 25% in 2012.

2013a, p.2). As total external debt is not increasing, the lower level of external debt (28% of GDP in 2013) can indicate that economic tensions in the Argentinean economy seen over the recent years and related to the balance of payments can have more to do with liquidity than external solvency.

Fiscal and monetary policies had contrasting features,: while the CBA continued to increase the interest rate, the government decided to maintain the expansion of public spending in order to expand the economy, with the largest increases in social security benefits and current transfers to the private sector. Inflation rate increased in 2012 (10.8%) and the GDP growth dropped to 1.0%, due to contracting global economy (including Brazil) and falling agricultural output because of the drought.

During 2013, the government continued its strategy to contain the erosion of international reserves, adopting the following measures: “the regulation of import flows, tougher restrictions on foreign exchange for the purposes of hoarding and overseas tourism (which created a parallel exchange market) and the introduction of some limits on the repatriation of profits by foreign firms” (ECLAC, Economic Survey for Argentina, 2014a, p.2). Unlike the CBA that implemented a contractionary monetary policy, the government, once again, maintained an expansionary fiscal policy (primary fiscal deficit of -1.4% in 2013), and “opted to fund this deficit by drawing on resources from the public sector itself, basically from the Central Bank of Argentina [CBA], the National Social Security Administration (ANSES) and the Bank of the Argentine Nation (BNA)” (ECLAC, Economic Survey for Argentina, 2014a, p.3).

In terms of the exchange rate, in 2013 the *peso* had a substantial depreciation against the dollar, which, however, did not avoid some deterioration in the trade surplus – from USD 15.3 billion in 2012 to USD 12.1 billion in 2013 – as exports stagnated (deterioration of the terms of trade and the stagnation of the exports to Brazil). Furthermore, this depreciation had a negative impact on the inflation rate, due to the pass-through mechanisms. In response to the increase of inflation rate, at the end of 2013, “the government launched the Precios cuidados price-watch program, in which the national government, supermarkets, distributors and the main suppliers undertook to control the prices on a basket of 194 products, subsequently extended to 302 products” (ECLAC, Economic Survey for Argentina, 2014a, p.5). Despite inflation problems, there

was a partial economic recovery in 2013 (growth of 2.9% per annum) pushed up by private consumption.

Preliminary data show that GDP growth dropped to -0.2% in 2014 and inflation rate pulled up to 24.2%, because of contractionary (and inflationary) effect of currency devaluation at the start of the year and the re-emergence of currency strains during the third quarter due to the judicial setback suffered by the country in its dispute with the so-called 'vulture funds' (ECLAC, 2014b).

3.2.2. Brazil

After the economic downturn in 2001 to 2003, the Brazilian economy recovered in 2004, pushed by the strong boom in commodities' exports that resulted from the greater global economic growth, and the increase of the household consumption, due to both government stimulus to credit and the increase in the purchase power of the households, and the public investment, especially investment under the Growth Acceleration Program (*Programa de Aceleração do Crescimento*, PAC).[19] All these factors together eventually resulted in a miniboom in 2004 to 2008, when the GDP grew 4.8% on average (Figure 1).

In this scenario, Brazilian's EA underestimated the IFC. When fourth-quarter 2008 GDP was announced (-3.6%), that cast doubt on the notion that Brazil was impervious to the effects of crisis. With the fall in all private components of demand, GDP growth fell to -0.3% in 2009, recovering strongly in 2010 (7.5%) as a result of the countercyclical policies. In 2011, economic growth slowed (2.7%), due to the depletion of idle industrial capacity and the impact of policies aimed at containing the surge in domestic demand and the resulting inflationary pressures. In 2012-2013, in spite of the implementation of more expansionary policies, the economy slowed even more (1.8% on average), pushed down by both investment and net exports, while consumption continued to expand, and employment levels continued to rise, albeit more slowly. Inflation rate, after falling to 4.3% in 2009, rose to around 6.0% on average in 2010-2013.

[19] The Brazilian government launched the PAC in January 2007 with three main objectives: to stimulate private investment; increase government investment in infrastructure; and remove the main obstacles to economic growth (bureaucracy, inadequate norms and regulation). For full details, see Brazil (2014).

The immediate impact of the 2008 crash on the Brazilian economy was the capital flight related to the portfolio investments and foreign loans; on the other hand, the reduction in foreign credit lines to resident banks and firms increased the liquidity constraints of some firms, including some main Brazilian exports firms that had been benefiting from interest-rate arbitrage involving foreign exchange derivatives. The reversal in the capital flows (Figure 4) exerted strong pressure on the exchange rate, which depreciated 42.6% from September 1 to December 31. Another important transmission channel of the IFC in Brazil was the domestic credit market, due to the impact of the reduction of the international credit operations (financing of exports) and, due to the overall deterioration of expectations about the future, liquidity preference of the banks increased sharply, contributing to the slowdown of domestic credit.

Brazilian EA responded to the financial crisis by adopting a number of countercyclical measures (Barbosa, 2010; Paula *et al*, 2015): (i) in order to avoid the spread of the credit crunch, the Central Bank of Brazil (BCB) adopted a lot of liquidity-enhancing measures;[20] (ii) the BCB undertook interventions in the foreign exchange markets – selling USD 23 billion of its foreign reserves in the last quarter of 2008 in the sport market and offering foreign exchange swaps in order to provide hedge against currency depreciation; (iii) state-owned banks were encouraged to expand their credit operations, compensating the deceleration in the credit supply by private banks; according to Montero (2014), "[m]ore than 83 percent of the growth available credit to the private sector in Brazil in 2008 and 2009 came from the public banks" (p. 127); and (iv) the Ministry of Finance implemented a lot of fiscal measures in order to stimulate aggregate demand: reduction in the industrialized products tax (IPI) burden on motor vehicles, consumer durables and construction items, and an increase in the duration of unemployment insurance. In addition, the BCB with some delay eased monetary policy by lowering the basic interest rate from 13.8 % in January 2009 to 8.8 % in September 2009.

ECLAC (2009) points out that Brazil was one of the Latin American countries that made use of greater variety of tools to face the contagion effects of the crisis. According to

[20] Liquidity-enhancing measures included (i) a reduction in reserve requirements that resulted in an expansion of liquidity of around 3.3% of GDP in the money market; (ii) the creation of incentives for larger financial institutions to purchase the loan portfolios of small and medium banks; and (iii) an additional insurance deposit for small and medium banks.

Barbosa (2010), the delay in monetary policy to stimulate economic growth immediately after the 2008 crash had to be compensated by fiscal policy (primary fiscal surplus reduced from 2.8% of GDP in 2008 to 1.2% in 2009).

In 2009 the Brazilian economy suffered a recession due to the effects of the Lehman Brothers contagion – a decline of 0.2 %. in GDP, pushed down by the sharp reduction in industrial output (-5.6%). After the recession in the first semester of 2009, the economy recovered quickly in the second semester, and in 2010 GDP growth was 7.6%. Responding to the quick economic recovery and the consequent increase in the industrial capacity utilization, the investment rate increased from 17.0% of GDP in the first quarter of 2009 to 20.5% in the third quarter of 2010. A new surge of capital inflows to emerging economies started in the middle of 2009, and a further reason for such surge was the high differential between the internal and external interest rates – Brazil was one of the emerging countries that had a stronger trend of currency appreciation until 2011.[21]

By the end of 2010, with the fear of increasing system risk of the financial system, due to the surge of capital inflows and the quick increase of credit supply, the Brazilian government implemented some macro-prudential measures: (i) an increase from 8% to 12% in reserves requirements on sight and fixed term deposits; (ii) an increase of minimum capital required for personal credit with maturity up to 24 months; and (iii) a rise in the tax on financial transactions (IOF) from 1.5% to 3.0% in all credit operations and an increase to 6% in the IOF on new foreign loans with maturities of up a year.

The first three years (2011 to 2013) of Dilma Roussef's government was marked, on the one hand, by the gradual worsening in the international scenario due to the Euro crisis and the decline in growth in emerging economies (including China), and, on the other hand, there was some important changes in the '*modus operandi*' of economic policy, including the adoption of more gradualist strategy of the BCB to deal with inflation and the use of broader instruments of economic policy as a complement of the traditional tools.

After an initial period (first semester of 2011), when EA adopted more tightening economic policy in order to reduce aggregate demand to curb inflation acceleration, some countercyclical policies were implemented, due to the slowdown of the economy. Such

[21] From April 2009 to April 2011 Brazilian currency appreciated by 28%.

measures included the change in the mix of economic policy (reduction in the interest rate and devaluation of the currency), that was expected to boost growth; credit stimulus and tax relieving to some sectors; and the enlargement of the capital controls. Finally, EA enhanced its commitment with fiscal austerity, understood as necessary to open space for the reduction in the interest rate.

The deterioration of the Euro crisis since September 2011 and the deceleration of the inflation due to the reduction in the commodities prices and in domestic demand, made possible a steady policy of reduction of the Selic (basic interest rate) that fell from 12.5% per year in July 2011 to 7.5% in August 2012. Furthermore, in order to curb the deterioration in the competitiveness of the manufacturing sector, in both external and domestic markets, BCB induced a currency devaluation of 30% from July 2011 until May 2012.[22]

In 2012 EA adopted a countercyclical fiscal policy. The main fiscal tool was a tax exemption, which included the reduction of IPI on capital goods, exemption of the payroll in labor-intensive sectors, such as construction and textile industry that was gradually extended to other sectors, and the reduction of IPI on some consumer durable goods in April 2012. Those fiscal measures aimed at reactivating the economy and increasing the competitiveness of the domestic industrial sector.

During 2011 to 2013 economic growth disappointed: average growth was only 2.1%, while industrial output declined even more. All the components of demand decreased, but fixed capital contributed more of the decline. The poor economic performance was the consequence of both external and domestic factors. Although the economic situation of the Euro Area now seems to be not disruptive, the Euro crisis affected the Brazilian economy mainly by the commercial side and by the deterioration of the entrepreneurs' expectations about the future of the world economy. More recently, the announcement of the end of 'quantitative easing' policy by the FED and its possible future change in monetary policy, capital flows have become more volatile to Brazil and Latin America (Figure 4).

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[22] Data obtained from BCB (2014).

On the other hand, investment rate increased in 2010-2011 as firms were expecting that economic growth would continue to be high – which did not happen. As a result the capacity utilization rate of the industrial sector decreased, generating idle capacity that contributing to the slowdown of investments in 2012-2013.

Exporters lost external markets due to the lack of competitiveness and low external demand, while imports increased shifting part of the domestic industrial production – years of currency appreciation seem to be eroded by the competitive capacity of the domestic firms. Consequently, net exports did not contribute to higher growth. Household consumption was still high, but reduced gradually in consequence of the slowdown in the demand and supply of credit, due to the high level of the household indebtedness and non-performing loans.

Finally, public expenditures were not enough to compensate the overall reduction in the aggregate demand. Brazilian government hoped that the change in the mix of the economic policy (lower interest rate and more devaluated currency) together with some tax exemption to stimulate the demand and supply of goods, which would be enough to reach a robust economic growth. When it became clear that this was not the case, government sought to implement *ad hoc* measures to boost growth. Such action, however, was not well coordinated and lacked consistency (Paula *et al,* 2015).

Since the second half of 2012 there have been some changes in economic policy due to macroeconomic deterioration. First, the inflation rate began to increase in the end of 2012, with most pressure coming from services and food. Second, exchange rate became very volatile, reflecting both the uncertainties over United States monetary policy and the deterioration of the external accounts (current account of 3.6% of GDP in 2013). Economic policy changes included the increase in the BCB basic interest rate from 7.25% to 10.0% between September 2012 and December 2013, and the reduction of financial transactions tax on overseas investments in Brazilian bonds to 0%. In this context, the expectations of GDP growth for 2014 was only 0.2%, while inflation reached almost the upper target of 6.5% (6.4% in 2014).

3.2.3. Chile

In recent years the dynamics of growth in the Chilean economy can be characterized by a 'stop-and-go' pattern, at the same time that has had the highest GDP growth of the bigger economies of Latin America: the average growth rates were 2.9% in 2001-2003, 6.0% in 2004-2007, and 5.7% in 2010-2012, while the growth rates were 1.7% in 2008, -4.7% in 2009, and 4.2% in 2013. This has resulted from a series of factors, such as energy scarcity, some inflationary pressures stemming from agricultural and mineral commodity price rises on the international market, and drought-related agricultural harvest loss. The onset of the IFC aggravated these problems and Chile's GDP fell by about 2%. Inflation rate – one of the lowest of Latin America (average of 3.2% in 2000-2013, next to the inflation target of 3.0%) – has also oscillated a lot (Figure 1). Indeed as one of the more open economy in the Region, Chile's inflation is very influenced by imported goods.

As the path of GDP growth shows, the Chilean economy was much affected by the turbulence in the global economy in the fourth quarter of 2008 and the early months of 2009, when exports dropped sharply, both in price and volume terms, and private spending in consumption (durable consumer goods) and investment fell abruptly.

The Chilean government's response to the crisis was to bring in a set of countercyclical measures which, consistent with the fiscal, monetary and exchange rate policies in place since the 2000s (intended to ensure macroeconomic stability and foster the build-up of foreign exchange reserves), were designed to mitigate the impact of the crisis on economic activity and the level of employment.

Of these countercyclical measures, fiscal measures had the most impact, either because they helped restore the level of domestic consumption and underpinned private investment or because they were responsible for reducing the government's fiscal surplus. Indeed, primary fiscal surplus fell from 5.7% of GDP on average in 2004-2008 to -3.9% in 2009 and 0.0% in 2010, increasing to 1.5% on average in 2011-2012 as economic growth and cooper prices triggered a jump in tax revenues (Figure 6).

It is worth mentioning that, for several years, fiscal policy had been directed towards attaining a structural surplus to aim at generating "savings during boom periods when copper prices are high and GDP expands at above-trend rates" (ECLAC, Economic Survey for Chile, 2009, p.121). According to Chilean EA, the idea of generating savings

during boom times would enable the country to take countercyclical action in a context of economic growth below-trend level or of economic crisis.

From the start of the IFC, the EA used the countercyclical capacity that had been built up to take fiscal measures aimed at propping up employment levels, stimulating domestic demand and preventing poverty from rising. Chilean EA was able to implement countercyclical policies, which helped to counter external turmoil and gradually bring about conditions conducive to a resumption of economic growth in 2010 (ECLAC, 2009).

The fiscal measures comprised both budget measures, among them temporary tax reductions and increased income transfers to the poorest population groups, and non-budget measures, including fund transfers to State enterprises that provided credit guarantees, to State banks for capitalization, and to the State copper mining enterprise. More specifically, the income transfers to the poorest sectors of Chile's population took the form of (i) higher subsidies for home buyers (the existing housing subsidy was temporarily doubled and a new temporary subsidy introduced), (ii) expanded funding for small business finance and production, so that small businesses could access credit granted by commercial banks, (iii) tax rationalization measures to accelerate tax reimbursements to companies, and (iv) during the first quarter of 2009, low-income families were paid USD 70 per family member. According to ECLAC (2009b, p.81), fiscal spending plan amounted to some USD 4 billion, or roughly 2.8% of GDP.

The Central Bank of Chile (CBC) despite the impact of the crisis on Chile's economy, initially maintained its restrictive monetary policy so that inflation would converge to its target values of between 2% and 4%. Furthermore monetary policy continued to be geared towards an inflation target of 3% per year on average for the medium term with a range of 1% on either side. The inflation rate in 2009 was negative and was raised during the year 2010 as the economy recovered.

As the inflation target for 2008 was not met and the signs of recession began to be increasingly recurrent in early 2009, the CBC embarked on a process of more flexible and considerably lower interest rates: in December 2008 it was about 8% and by December 2009 it had fallen to 2.5% (Figure 7). The CBC also introduced more flexible compulsory deposit requirements. By the end of the first half of 2009, these measures had produced a

slight recovery in the volume of credit, supported by low interest rates and reinforced by liquidity provision mechanisms.

In its exchange rate policy, the CBC continued intervening in the exchange rate market throughout 2008 and 2009, either to prevent the *peso* from appreciating or depreciating, or to buy exchange rate so as to strengthen Chile's foreign exchange reserves.

Initially the CBC was not successful: by the end of October 2008, one month after the collapse of Lehman Brothers, the exchange rate depreciated by 38.5% in nominal terms. However, at the end of 2008 and throughout 2009 the exchange rate reached levels comparable to those prior to the IFC.

Accordingly, in a context in which the exchange rate was being held stable in real terms (Figure 8), it added to a significant reduction in imports and slight improvement in copper prices in the international markets, with the trade balance improving and the current account balance of payments reversing from a deficit in 2008 to a surplus in 2009 (Figure 2 and Figure 4).

In 2009, the government continued its expansionary fiscal policy (the primary fiscal target was reduced to 0.5% of GDP) to boost the domestic market and the CBC decided (i) to reduce the basic interest rate to a historic low of 0.75% (Figure 7) and (ii) to adopt measures – such as the swap program was extended from one to six months – to increase liquidity in both *pesos* and dollars. Despite the expansionary monetary policy, the CBC continued to target annual inflation of 3% per year. Even with these measures, in 2009 the GDP growth was only 0.1% and the unemployment rate increased.

Throughout 2010, the fiscal target was reduced to 0% of GDP. According to ECLAC (2011), "[t]he total expenditure of the consolidated central government climbed by 7% in real terms to reach 23.1% of GDP in 2010, reflecting the continuation of the countercyclical measures adopted in response to the global financial crisis, which had already pushed public spending up strongly in 2009" (p. 118).

Unlike fiscal policy, the CBC, after implementing countercyclical monetary policies in 2009, the basic interest rate was raised from 0.5% in January 2010 to 3.25% by December of the same year.

Despite the CBC's adoption of a floating exchange rate regime since the 1990s, the exchange rate continued with little intervention by the CBC. Moreover, in 2010, due to the

dollar depreciation in the global market, the *peso* experienced average nominal appreciation of 8.8% over the 2009 value.

It is worth mentioning two additional factors that helped the recovery of the Chilean economy in 2010: first, due to the recovery of the international commodity prices, it also includes copper prices, as Figure 3 shows, the revenues of the National Cooper Corporation (CODLECO) jumped by 87.7% in real terms; and second, the government continued to contribute to its sovereign funds and, as a result, the foreign reserves slightly increased (Figure 5).

In this context, the ECLAC (2009) concluded, “[t]hanks to the capacities built up in previous years, the government was able to deploy countercyclical policies which helped to counter external turmoil and gradually bring about conditions conducive to a resumption of growth in 2010” (p. 87).

In 2011 and 2012, due to the economic recovery, the fiscal stimulus was reduced and public spending returned to trend values. The average GDP growth was around 3.2% and, as a result, some inflationary pressure occurred. The CBC’s response was immediate: monetary policy continued the gradual withdrawal of monetary stimulus and, as a result, at the end of 2011 the annual basic interest rate reached 5.25%, while in 2012, “the annual nominal rates for consumer and commercial loans rose (…) to 27.8% and 9.5%, respectively” (ECLAC, Economic Survey for Chile, 2013, p. 2). During this year, the exchange rate, still based on a floating regime with some CBC interventions, had a significant appreciation. To avoid the impacts of the *peso*’s appreciation on the returns of export and import substitute sectors, the CBC intervened in the market with a program of dollar purchases.

In 2013, the fiscal and monetary policies continued to be geared towards achieving structural balance in the medium term and targeting an annual inflation of 3%. Despite the monetary ‘austerity’, the domestic credit as percentage of GDP increased almost 10% when compared with the previous year (Figure 7). Moreover, the CBC maintained a free-float exchange-rate policy, with some intervention. At the end of 2013, the *peso* accumulated a depreciation of 11% in nominal terms. In terms of economic activity, the GDP growth reduced from 5.6% in 2012 to 4.1%, in 2013, that is still a better performance among the greater economies of Latin America (Figure 1).

It is worth mentioning that GDP growth in Chile after the contagion of the international crisis was mainly pushed by domestic demand that as we have seen was well managed by EA. After the recovery of trade surplus in 2010, as imports have grown more than exports, the balance of payments' current account dropped to -2.7% of GDP on average in 2011-2013.

3.2.4. Mexico

Before the IFC, the Mexican economy (in 2004-2007) was growing around 4% per year and the annual average inflation rate was on average 4.1% (Figure 1).

In 1999, Mexico adopted a flexible exchange rate regime and an inflation targeting regime as a framework to conduct monetary policy. In terms of fiscal performance, there was a primary fiscal surplus from 2000 to 2005,[23] while from 2006 to 2008 there was a primary fiscal deficit (Figure 6). However, during this period, the EA managed the public debt to GDP ratio – from 2000 to 2008 the average ratio was around 40%, as shown in Figure 6. In other words, before the contagion of the crisis, it seems that Mexican economy had presented consistent macroeconomic fundamentals.

However, as is well known, the Mexican economy is highly dependent on the United States economy, mainly after the economic integration between the two economies trough the creation of the North American Free Trade Agreement (NAFTA), in 1994. For this reason, the effects of the financial crisis originated in the United States impacted Mexico's export sector significantly, considering that 85% of the country's exports go to the United States. Besides international trade, other channels of transmission of the global crisis included, to a lesser extent, declining foreign investment, tourism and remittances from workers abroad.

As a consequence, at the end of 2008 the economic growth dropped from 3.1% in 2007 to 1.4% per year and, consequently, the unemployment rate increased from 4.3% in September 2008 to 6.4% in September 2009. Moreover, the depreciation of the Mexican *peso* (almost 20% from 2008 to 2009) caused inflationary pressures: the annual inflation

[23] In 2002, the primary fiscal balance showed a slight deficit.

rate, in December, reached 6.5%. In 2009, the economy had shrunk by 4.7%, which it was reduced by more than in 1995 after the *Tequila* crisis. After appreciating in real terms from 2005 to August 2008, the peso depreciated abruptly from October 2008 until March 2009 (16% in real terms), and after this period a gradual appreciation emerged (ECLAC, 2009). According to ECLAC (2009b), "the global crises exposed [Mexican] structural deficiencies and its vulnerability to external shocks as well as the weakness and lack of resilience of its productive base and the limited maneuvering room there was for public policy to counteract the effects of those shocks" (p. 106).

Given the worsening economic situation in the world economy and the growing signs of its effects on the Mexican economy, the EA decided to implement countercyclical economic policies to boost the economy, although with more limited range compared to Argentina, Chile and Brazil.

In this way, the Bank of Mexico (Banxico) implemented measures to increase liquidity in the foreign currency market and in the banking system, such as: dollars were injected into the foreign currency market through extraordinary and daily auctions to aim at bringing down the exchange rate to its normal value; and Banxico reduced the basic interest rate by 375 basis points (at the end of the year the nominal interest rate was 4.5%, according to Figure 7), and "established a guarantee programme through the development bank for short-term private lending" (ECLAC, Economic Survey for Mexico, 2009, p. 193).

At the same time, the EA opted to run fiscal deficits (from 2009 to 2013 the average fiscal deficit was around 1% of GDP) to expand the economy, but this result was also due to the fact that public revenues sharply dropped as a consequence of the recession in 2009 and the fall of exports.

In 2010, the government continued to implement a countercyclical fiscal policy, with particularly large rises in social development spending and transfers to the states, while Banxico maintained its monetary expansionary policy. Throughout 2010, "international reserves were strengthened by the exchange-rate appreciation triggered by [the policy of reserve accumulation and] capital inflows" (ECLAC, 2011, p. 189).[24] At the

[24] At the end of December, the amount of reserves was about USD 113.6 billion (Figure 5).

end of the year, the Mexican economy recovered from the recession of the previous year: in 2010 the GDP grew by 5%, sustained by the dynamism of exports (pushed up by some recovery of the American economy) and with remarkable growth of the manufacturing sector and steadily declining unemployment rates. Such growth continued in the following two years (average growth of 4.8% in 2010-2012), while inflation was maintained more or less stable around 4.0% per year, but above the annual inflation target of 3.0% (with a range of 1% on either side).

In 2011, the fiscal revenue increased in real terms, mainly because of the recovery of oil prices in the international market (Figure 4). As a result, despite the expansionary fiscal policy implemented by the government, the primary fiscal deficit to GDP was slightly reduced and the public debt/GDP ratio remained stable (Figure 6).

In terms of monetary policy, Banxico, on the one hand, did not relax the monetary policy, mainly due to the fact that inflation rate was above the target, and, on the other hand, introduced some macro-prudential policies, in line of the Basel III liquidity regulations, to avoid systemic risk in the financial system.

The currency market went through two distinct periods in 2011: in the first 6 months, there was a trend towards nominal appreciation, while from July to December, due to the Euro crisis, the *peso* was devalued. At the end of the year, the exchange rate depreciation reached 13.2% and 6% in nominal and real terms, respectively. Despite the high volatility of the exchange rate, the international reserves increased to USD 148 billion (Figure 5).

In 2011, GDP growth reduced to almost 4.0%, in part as a result of the global economic slowdown, which weakened external demand. Economic growth was driven by both exports and domestic expenditure growth. The widening current account deficit (1.0% of GDP) reflected larger deficits in both the services account (payments for transport services) and income account (higher interest payments and profit repatriations); a trend that followed and deepened in the following years.

In 2012, Banxico continued to focus its actions on price stability and, for that reason, monetary policy was less expansionary. Although the Banxico became a little bit conservative in terms of monetary policy, the government continued to run a fiscal deficit. As a result of the monetary austerity and a moderate fiscal deficit, at the end of year the

inflation rate converged to the official target of 3%.

To avoid some pressures on the exchange rate, Banxico “launched a system for selling up to US$ 400 million in daily auctions, at an exchange rate at least 2% above the previous business day’s fix rate (peso depreciation)” (ECLAC, Economic Survey for Mexico, 2013, p. 3). Moreover, the international reserves continued to build up and by the end of December they reached USD 163.5 billion.

In December of 2012, the Pact for Mexico was signed one day after the inauguration of the Enrique Peña Nieto (from Institutional Revolutionary Party) administration. This Pact, which brought interest in the Mexican economy among international investors, was based on a set of reforms to assure: economic growth, employment and competitiveness; security and justice; transparency, accountability and combating corruption; and democratic governance. In 2012, Mexico also “entered negotiations on the Trans-Pacific Strategic Economic Partnership Agreement” (ECLAC, Economic Survey for Mexico, 2013, p. 4) with the expectation of boosting market diversification.

At the end of 2012, GDP grew by 4%, with the drop in external demand almost fully compensated by growth in domestic demand, especially investment.

In 2013, GDP growth rate dropped to 1.1% due to both significantly slower growth in exports and more sluggish domestic demand, especially in terms of capital formation. The current account deficit was 2.1% of GDP (Figure 2). With economic activity slowing heavily and inflation within the target range, the Banxico reduced the basic interest rate by 50 basis points, “after holding it steady at 4.5% for almost three years. This was followed by two further cuts of 25 basis points apiece in September and October, taking the rate to 3.5%” (ECLAC/Economic Survey for Mexico, 2014, p. 3).

At the same time, despite the promise of the new administration to announce a zero-deficit policy for the year and to maintain the Fiscal Responsibility, the government had to adjust this objective because economic activity was decelerating.

Regardless of the government’s attempt to boost the economy, at the end of the 2013 the main Mexican macroeconomic indicators deteriorated: the current account deficit increased, the exchange rate remained volatile with a trend of depreciation caused by the dollar strengthening on the international markets, and the GDP growth rate dropped.

3.2.5. Venezuela

Venezuela's economy is known to be highly dependent on oil exports and its government's revenues are connected with how oil prices perform on the international market. Accordingly, from 2005 to the end of 2008, when oil prices rose year on year (Figure 3), its trade balances were robust and growing (Figure 4); current account surplus was 13.1% of GDP on average in 2003-2008 and GDP also posted robust growth rates. On the other hand, GDP growth experienced an enormous oscillation: GDP growth of 8.6% on average in 2005-2008, dropping to -1.5% on average in 2009-2010, recovering by 4.9% on average in 2011-2012, and dropping again in 2013 to 1.3% (Figure 1). On the other hand, inflation is a big concern in Venezuela: since 2007 it has been more than 20% per year, while rising above exceeding 50% in 2013.

Since Hugo Chávez first took office in 1999, oil revenues – especially those of the state oil enterprise, *Petróleos de Venezuela S.A.* (PDVSA) – have been fundamental to the strategy of galvanizing aggregate demand in the Venezuelan economy through the public sector by infrastructure investments and social spending. It is worth mentioning that throughout the Chávez' government, many companies have been nationalized, such as energy and metallurgical firms, the Banco de Venezuela etc.

In 2008, aiming to reduce the high inflation rate, the Central Bank of Venezuela (CBV) implemented a monetary reform: the *bolivar* was introduced, and the exchange rate was kept at 2.15 *bolivares fuertes* (BsF) per United States dollar in 2008, and the CBV adopted some restrictions on capital outflows.

The Venezuelan government adopted some measures to stimulate national production, including the continuation of the farm subsidies policy. A law for the reordering of the domestic liquid fuels market was passed in October 2008. Intermediation in the supply and transportation of liquid fuels was made the State's prerogative under this law and subsequently entrusted to PDVSA, its affiliates and the corresponding service stations.

The IFC and GR affected dramatically the Venezuelan economy because: (i) the main partners of Venezuela entered into recession; and (ii) from the fourth quarter of 2008 to the first quarter of 2009, the oil prices on the international market abruptly dropped. As a

result, not only the trade balance deteriorated, but the government revenues were reduced due to the dependence on oil revenues.

In view of declining fiscal revenues, the Venezuelan monetary authorities began to perceive a trade-off: either they would have to take measures to contain public spending by incorporating a pro-cyclical factor into fiscal policy or fiscal policies would have to be expanded to prevent continuing recession and unemployment.

Initially the government opted for a fiscal adjustment, both because the public deficit had grown and because inflation accelerated in to more than 30% per year in 2008 (Figure 1). Accordingly, public expenditures, particularly investment, were cut back, fiscal transfers were reduced, value added tax was raised from 9% to 12% and public sector wages were adjusted upwards but below the yearly rate of inflation (ECLAC, 2009). EA believed that revenues should recover slightly, because the nationalization of certain oil and gas goods and service firms and others in the agricultural, banking and iron and steel industries would improve public sector accounts.

As regards monetary policy, one of the monetary authorities' main concerns was to bring rising inflation under control. At the onset of the IFC, alarmed at the possibility that an inflationary shock might result from the global trend towards exchange rate devaluations, the monetary authorities adopted an essentially restrictive monetary policy characterized by high basic interest rates and higher levels of compulsory deposits to be held by banks, which reduced liquidity and credit in the economy.

In this context, the economic activity slowed at the last quarter of 2008 and in 2009 the GDP declined by nearly 3%, when the drop in the overall demand (private consumption, investment and exports) was only partially offset by government consumption. In 2009 the worsening of fiscal situation was caused mainly by lower petroleum revenue and declining tax receipts, and since then primary fiscal position has been a deficit of 1.8% on average in 2009-2013.

During 2010, while the central government fiscal deficit was lower than in 2009 as the decline in revenue (due to lower income tax collections and falling oil revenue) was less than the drop in spending, the CBV adopted measures to boost the economy. Thus, an expansionary monetary policy was implemented, and the government intervened in the financial system to increase bank lending; on the one hand, 12 banks were nationalized,

and the marginal reserve requirements rates for financial institutions were cut (from 23% to 17%).

In January 2010 the government devalued the BsF and established two exchange rates: BsF 2.6 (for authorized imports of food and medicine) and BsF 4.3 per dollar (other imports authorized by the government).

Despite these measures, at the end of 2010 the economy continued its experience with recession: the GDP declined by 1.5%.

In 2011, the government ran a primary fiscal deficit equal to 1.8% of GDP, which was a slight improvement over the 2% of deficit posted in 2010. The reason for this improvement was that revenues, due to the recovery of oil prices in the international market, increased more than public expenditure. According to ECLAC (Macroeconomic Report for Venezuela, 2012), "[t]otal central government revenue went from 19.5% of GDP in 2010 to 22.7% of GDP in 2011 (…) oil revenue held steady at 6% of GDP" (p. 1). However, public debt continued to increase in 2011: it rose from 20% to 25% of GDP.

Monetary policy continued to be expansionary and the exchange rate was significantly depreciated (BsF 4.3). Due to high inflation in 2008-2013 period, real effective exchange rate appreciated – according to ECLAC (2012, p. 2), being 43.6% below the average recorded between 1990 and 2009.

In 2011 the CBV transferred USD 3.5 billion in international reserves to the National Development Fund (FONDEN), which is financed by PDVSA. Despite this transfer, the amount of international reserves at the end of the year was essentially the same nominal level as in December 2010 (Figure 5).

At the end of 2011, the Venezuelan economy grew by 4.2%, driven by the expansion of public spending on the back of the high oil prices.[25]

In 2012, due the high average price of the oil in the international market (it was around USD 100 per barrel in the first 10 months), the government decided to be more discretionary to allocate these extra-revenues and, consequently, public spending increase, including FONDEN. Moreover, a loan-for-oil agreement between China and Venezuela

[25] Two extra budgetary funds account for a substantial proportion of public spending execution: the National Development Fund (FONDEN) – funded by contributions from *Petroleos Venezuela* (public oil firm) and by excess of central bank reserves – and the joint Chinese-Venezuelan fund.

was created to finance the economic activity, mainly infrastructure.

In terms of monetary policy, it was more expansionary than in 2011. Under the context of expansionary fiscal and monetary policies, the government decided to adopt some non-traditional mechanisms to control inflation, such as, imports of consumption and final goods were encouraged and created a “law on fair costs and prices, which sets the maximum price for a number of products” (ECLAC, Macroeconomic Report for Venezuela, 2012, p. 1).

Considering that in 2012 Venezuela had a presidential election, the public investment increased – for instance, a housing program was created: ‘*Gran Misión Vivienda Venezuela’* – and, as a consequence, the economy was boosted by public investments. It is worth mentioning that the expansion of domestic investments (public and private) more than offset the significant outflow of foreign direct investment, due to political and social elections during the election period.

High inflation during 2012 was responsible for the appreciation of the BsF. The exchange rate valuation was the one responsible for the deterioration of the trade balance. Consequently, the current account supply dramatically dropped, from 7.5%, in 2011, to 3% of GDP, at the end of 2012 (Figure 2).

Although 2012 was an emblematic year, the GDP growth rate was around 5.3%, the highest rate since the beginning of the IFC, driven by the construction and services sectors; both of which were fueled by public spending funded by high oil prices and increased public borrowing (public debt over GDP increase from 28.6% in 2009 to 46.0% in 2012).

In 2013, fiscal and monetary policies were significantly expansionary.[26] According to ECLAC (Economic Survey for Venezuela, 2014), “[T]he greater abundance of liquidity [was] attributable to higher central government spending and the funding of State-owned enterprises via loans from the central bank” (p. 2).

The BsF was devalued from 4.30 to 6.30 against the United States dollar (loosing 47% of its value). Despite the devaluation, the Venezuelan currency remained overvalued, “since the real effective exchange rate in December 2013 was 47% less than the average

[26] The deficit of primary fiscal was equivalent to 2.2% of GDP (Figure 6), up by 0.5 percentage points from 2012.

seen from 1990 to 2009" (ECLAC, Economic Survey for Venezuela, 2014, p. 3). In 2013, the economic growth substantially dropped: the GDP grew by only 1.3%.

In summary, Venezuela's main economic problems of inflation and public sector imbalances have been apparent for some years, and the IFC merely aggravated them, mainly because international liquidity became scarcer, reducing the influx of foreign capital to emerging economies, and because the price of oil fell considerably lately on the international market.

4. Conclusions and recommendations

This chapter has shown that the main Latin American countries – Argentina, Brazil, Chile, Mexico and Venezuela – were substantially affected by GR, confirming that there was no 'decoupling' process in the world economy. In different degrees all these economies were strongly affected by the global crisis and the great recession that followed the crisis. With the exception of Venezuela, all the countries recovered strongly in 2010, with implementation of countercyclical policies, which were also favored by the recovery of the commodity prices by mid-2009. However, economic growth has oscillated a lot in recent years both because the uncertainties related to the world economy and some domestic issues related to the specificities of each of the economics examined for the purposes of this contribution.

The analysis of this chapter has also shown the efficacy of the countercyclical policies in a group of economies of Latin America, which depended on one hand on the 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. On the other hand, it depended on the structural characteristics of each economy and its insertion in the international economy. For instance, Mexico, nowadays, has its economic dynamics strongly tied to the United States economy, and Venezuela's economy depends basically on oil exports – the prices of which have dramatically been falling more recently. The policy framework can also favor the implementation of countercyclical

policies, as it is the case of fiscal policies in Chile, and the strong presence of state-owned banks in the case of Brazil.

The strengthening of Latin America to face the contagion of the global financial crisis was only possible due to the better performance of the balance of payments (current account surplus, foreign reserves accumulation, etc.) thanks to the exceptional external conditions before the global crisis of 2008. However, the uncertainty about the recovery of the global economy and the slowdown of the Chinese economy plus some domestic economic deterioration in some Latin American economies (high inflation, low GDP growth, increase of current account, and deceleration of credit supply, among others) seems to show that the policy space for implementation of countercyclical policies is somehow reduced in the Region.

Given this scenario, and considering that there is not a 'light at the end of the tunnel' for the solution of the GR, what should be done?

By the way of conclusion, we suggest briefly some economic policy recommendations to assure macroeconomic stability and to promote a consistent and robust economic integration in the Latin America region that could be explored. To achieve this objective, it is suggested that (i) monetary policies must explicitly consider the goal of employment stability, together with price stability, (ii) fiscal policy must prioritize public investment and social programs, and (iii) exchange rate policy must be designed to maintain balance of payments equilibria. At the same time, on the one hand, it is proposed the creation of a Regional Market Maker in the Latin America[27] to boost the economic and financial integration in the Region, and, on the other hand, it is necessary to consider recovery of the main State's functions, such as, inducer, financier and regulator of economic activity.

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[27] In view of the process of integration under way in Latin America, more specifically the UNASUR, it is important to institute a Regional Market Maker to (i) coordinate among countries' macroeconomic policies, (ii) foster discretionary fiscal transfers to reduce economic and social differences and integrate among countries' infrastructures, (iii) indicate a common trade policy and distribute the costs of achieving balance of payments equilibrium among the two groups of countries (those in deficit and those in surplus), (iv) propose that the system of local currency payments be generalized, and (v) set up and operate a reserve fund for countries to access when faced by external shocks, contagion from which may lead to exchange rate crises. For more, see Ferrari-Filho (2014).

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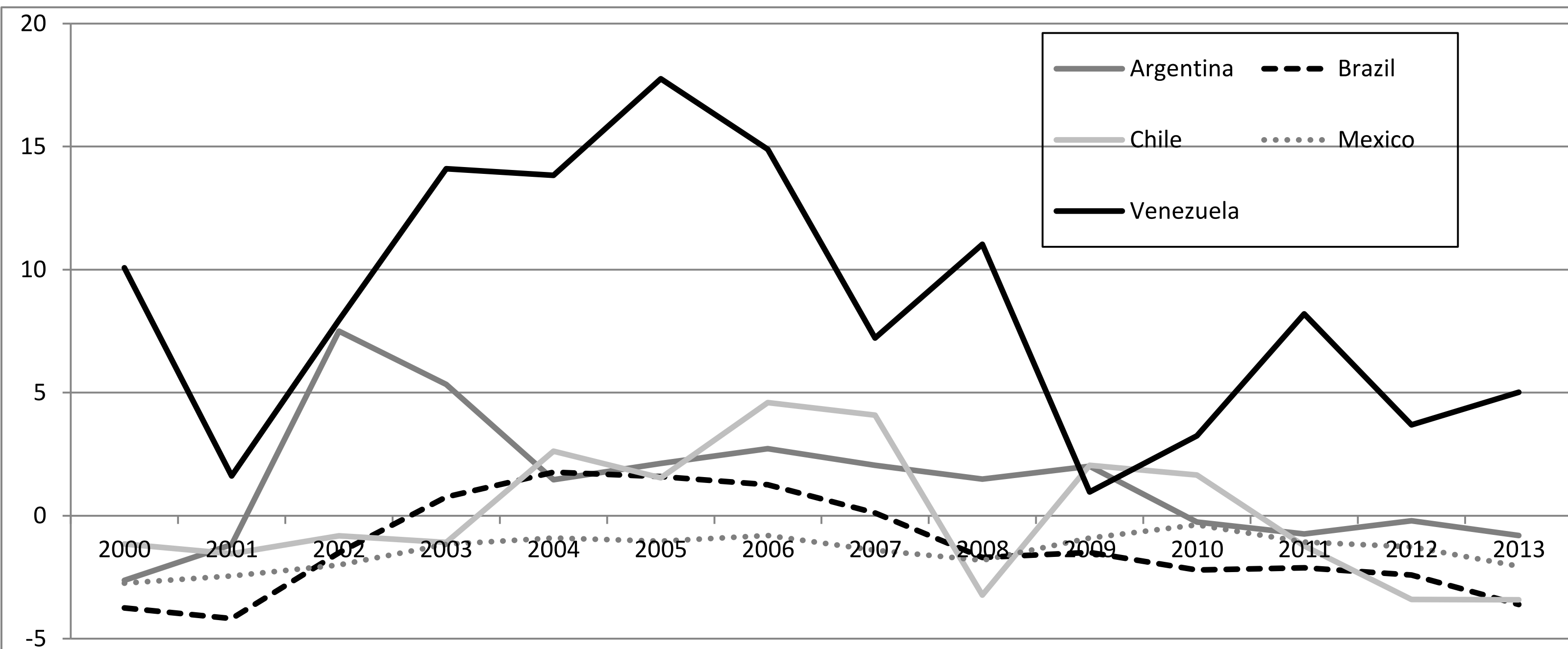
Figure 1: Annual GDP Growth and Inflation Rates, % (2000-2013)

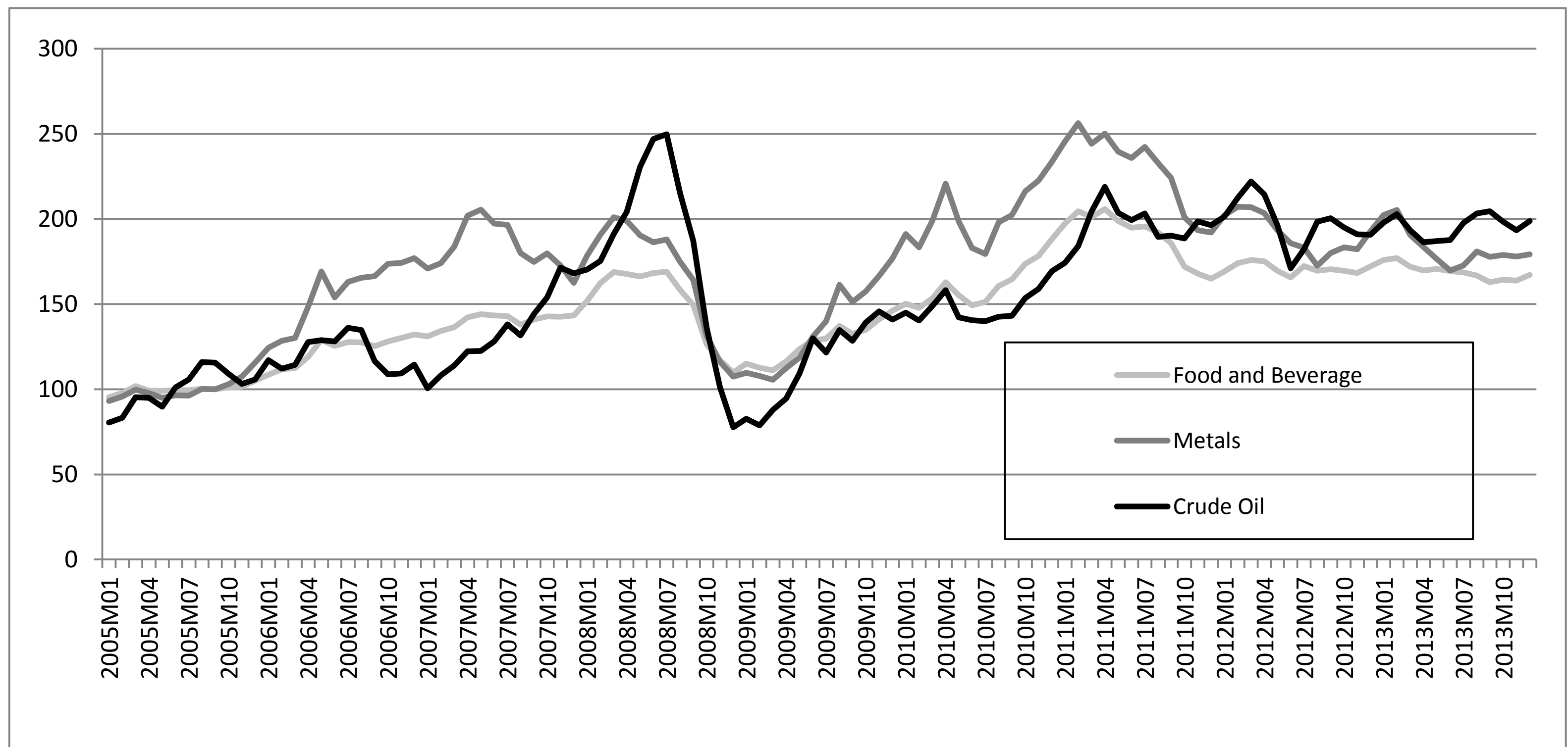
Source: IMF (2014) and ECLAC (2015).

Figure 2. Current Account/GDP, % (2000-2013)



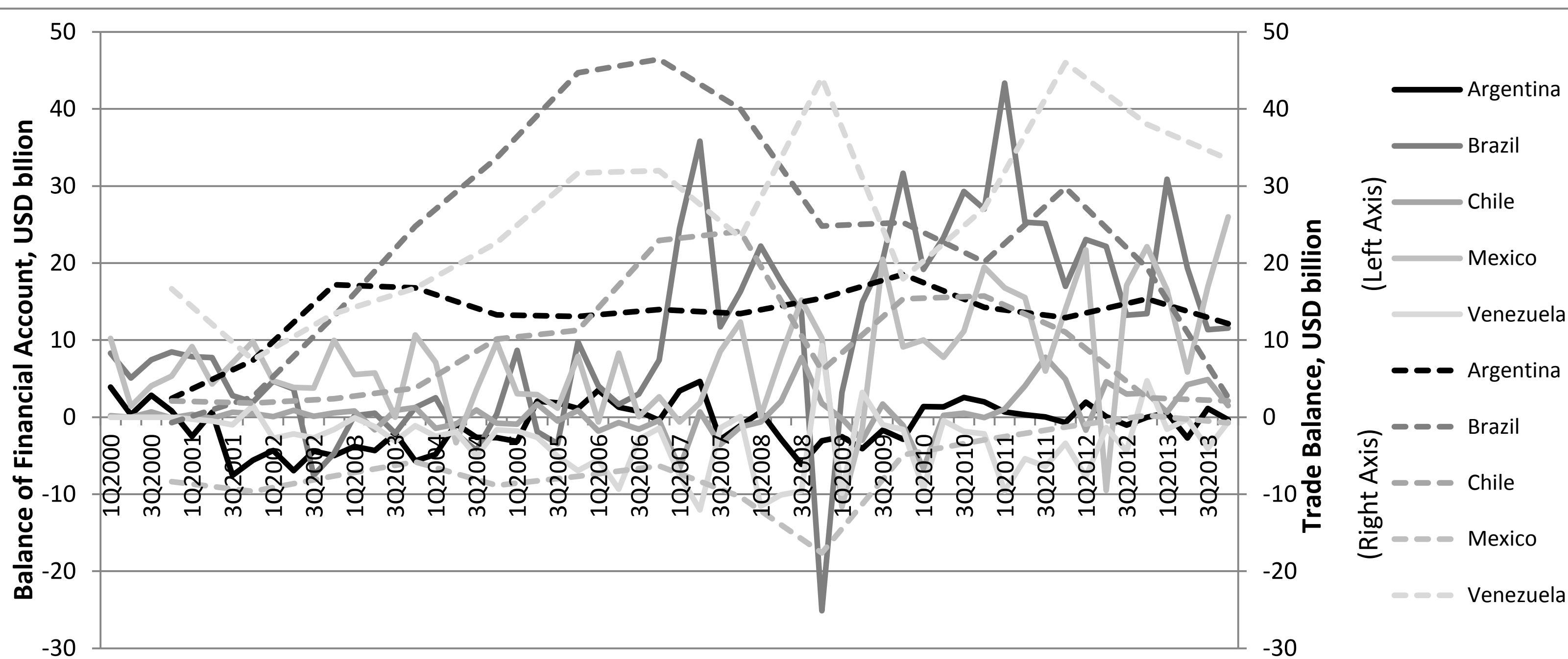
Source: IMF (2014).

Figure 3. Commodity Prices and Oil Prices, USD (2005-2013)



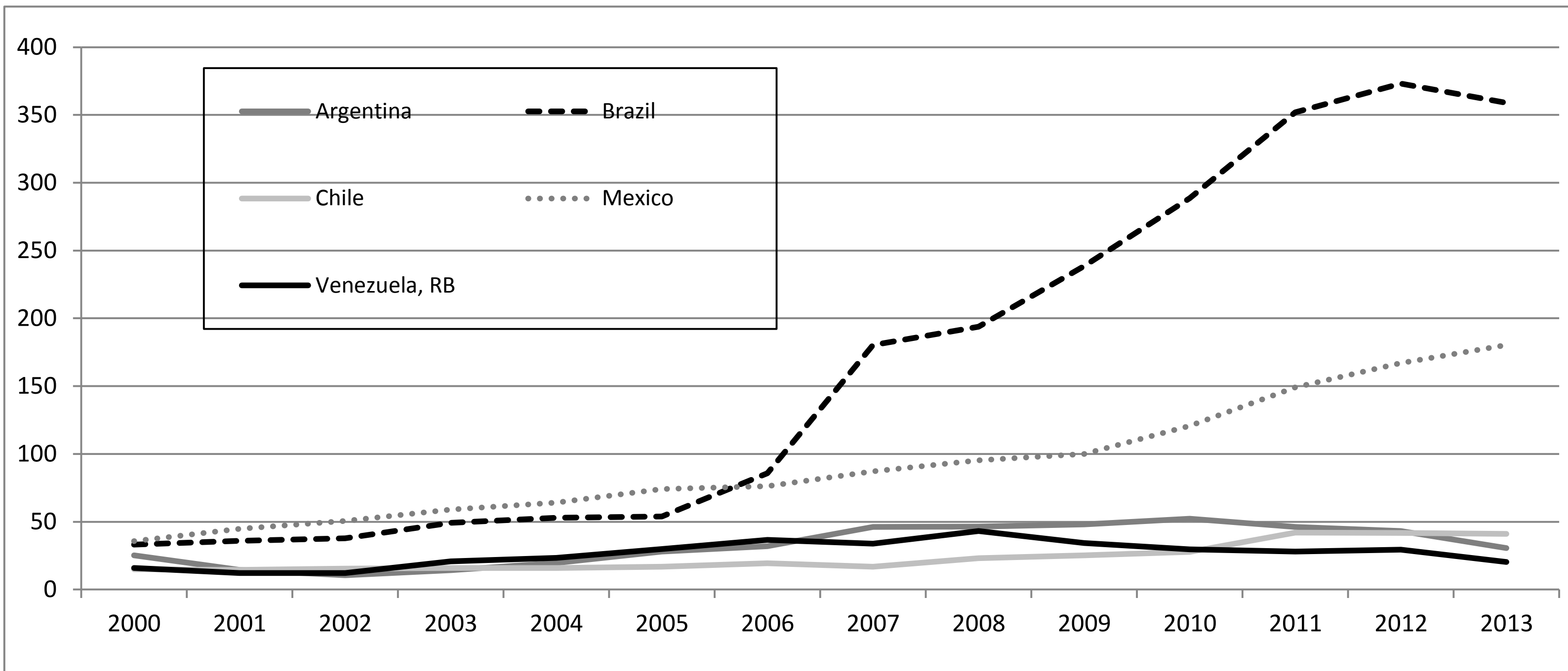
Source: IMF (2014).

Figure 4. Balance of Financial Account and Trade Balance, USD billion (2000-2013)



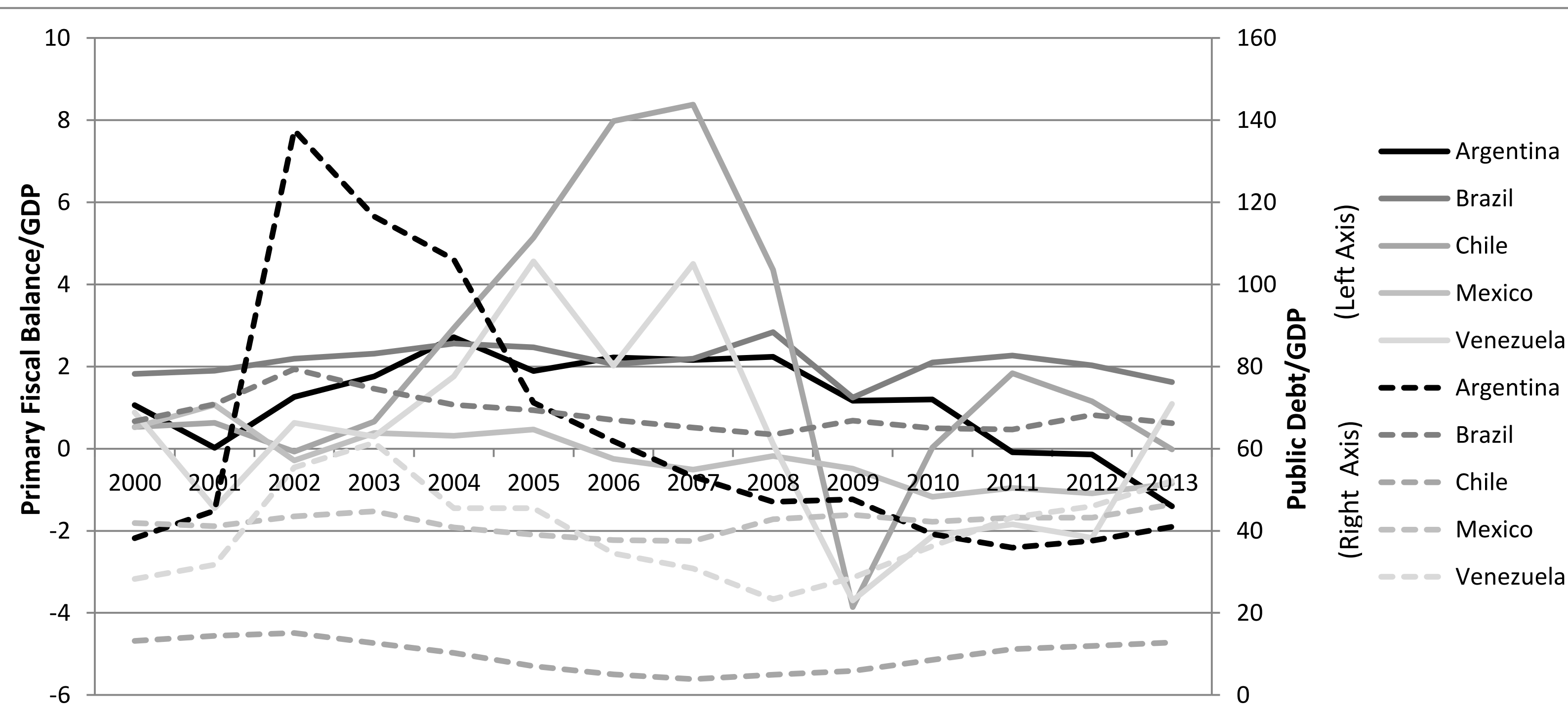
Source: ECLAC (2015) and World Bank (2014).

Figure 5. International Reserves, USD billion (2000-2013)



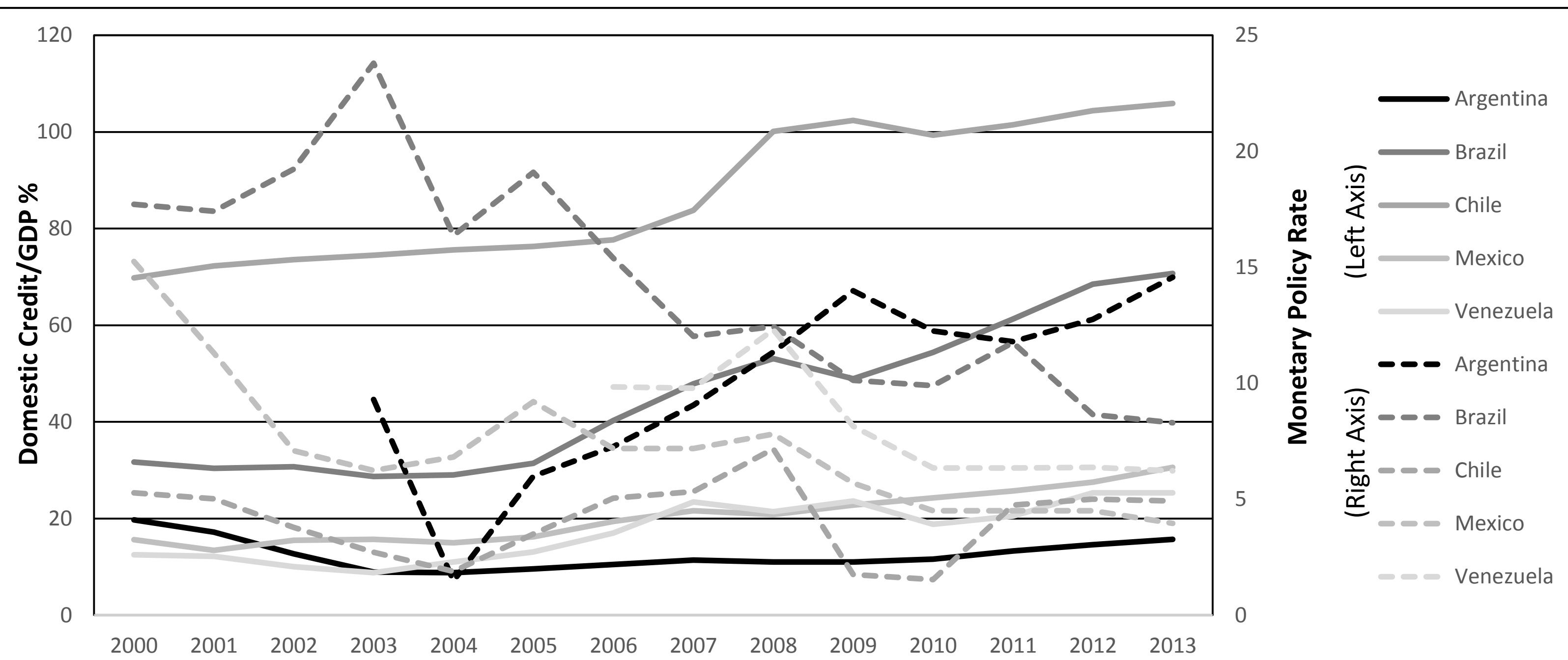
Source: IMF (2014).

Figure 6. Public Debt/GDP and Primary Fiscal Balance/GDP, % (2000-2013)



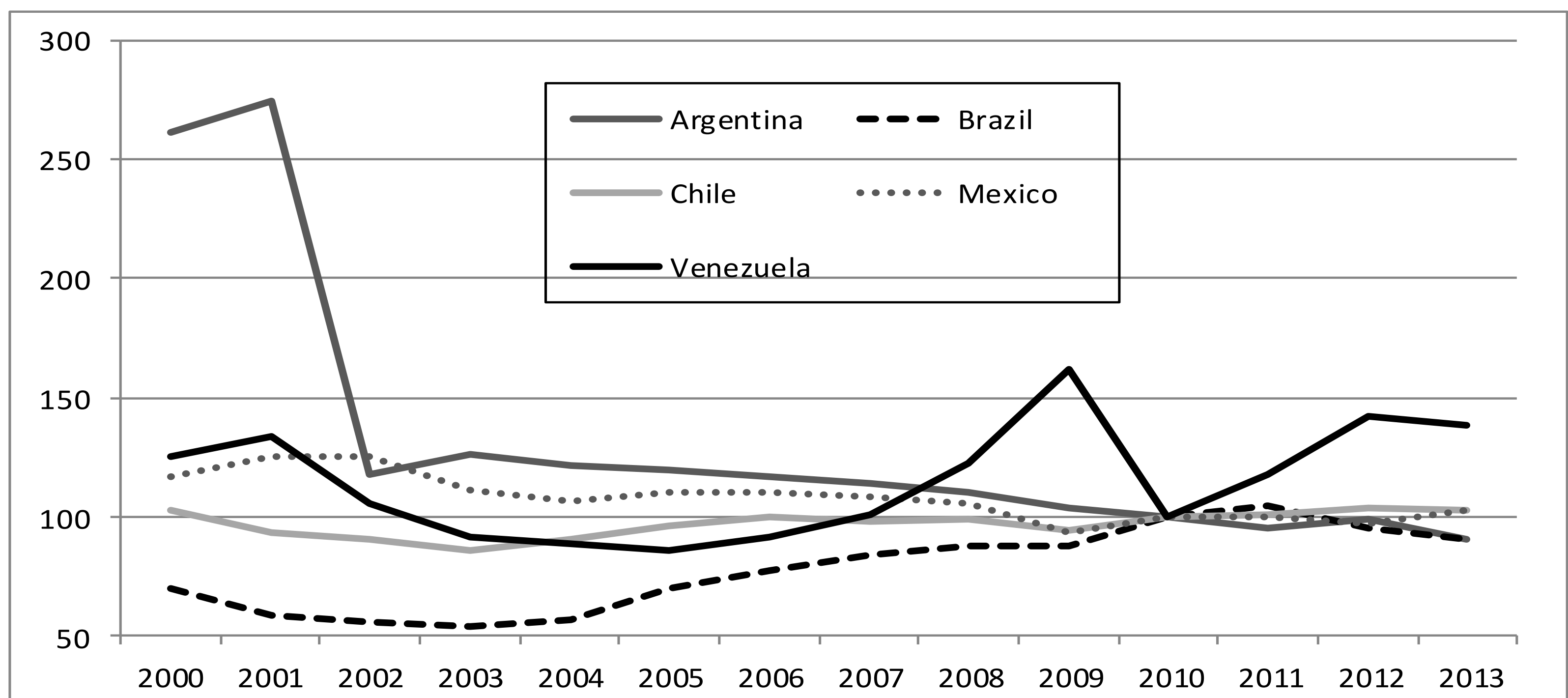
Source: IMF (2014) and World Bank (2014).

Figure 7. Monetary Policy Rates (Annual Average) and Domestic Credit/GDP, % (2000-2013)



Source: ECLAC (2015) and World Bank (2014).

Figure 8. Real Effective Exchange Rate (2010=100) (2002-2013)



Source: BIS (2014).