International Reserves and Policy Space in Latin America

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Some Stylized Facts

• Before the Crisis
  – Capital Account Liberalization in the 1990s
  – Intense Reserve Accumulation by Emerging Countries
    • Long Experience with Balance of Payments Crises and “External Constraints”
    • Experience with IMF Adjustment Programs (1990s: and the rise of Structural Conditionalities)
Cont.

• But Some Reserve Accumulation Was Byproduct of Other Processes
  – Inflows of Large Amounts of Foreign Financial Investments (in a context of CA Liberalization)
  – Neo-Mercantilist Policies: Net Exports as Engine of Growth
Traditional External Fragility Indicators

External Vulnerability in Latin America

- **Debt service/Exports (%)**
- **Reserves/Debt-service payments**
- **Reserves/Imports (%)**

Years (2000 to 2008)

Percent
Counter-Cyclical Policies in LA

• All Major Economies in the Region Were Pro-Active
• Conventional Fiscal and Monetary Policies (fiscal spending, lower interest rates, etc)
• Non-Conventional Policies
  – Release of Required Reserves
  – Use of State-Controlled Banks
  – Sectoral Policies (Construction, Exports, Auto Industry)
  – Social Policies
The Crisis and Its Aftermath: Quick Recovery

Real GDP Growth Rates (WEO IMF)

- Argentina
- Brazil
- Chile
- Colombia
- Mexico
New Features

• Implementation of Anti-cyclical policies
• No Loss of Reserves, despite weak Current Account (Brazil, Colombia, Mexico, Peru)
• Most Significant: No Capital Flight by Residents
  – Protection by Reserves?
  – Nowhere to go?
No Loss of Reserves

Argentina
Brazil

2007 2008 2009

Argentina
Brazil
Accumulation of Reserves as Defensive Device

• Deflationary Impact on World Economy: Similar to Domestic Liquidity Preference

• But
  – No Scheme for Supplying International Liquidity in case of need
  – Liberalization of Capital Account Increased Balance of Payments and Exchange Rate Volatilities
  – Cost of IMF Support (Policy Meddling) is Excessive

→ Paradox: Best Policy under Globalization is still “Each One for Oneself”