International Reserves and Policy Space in Latin America

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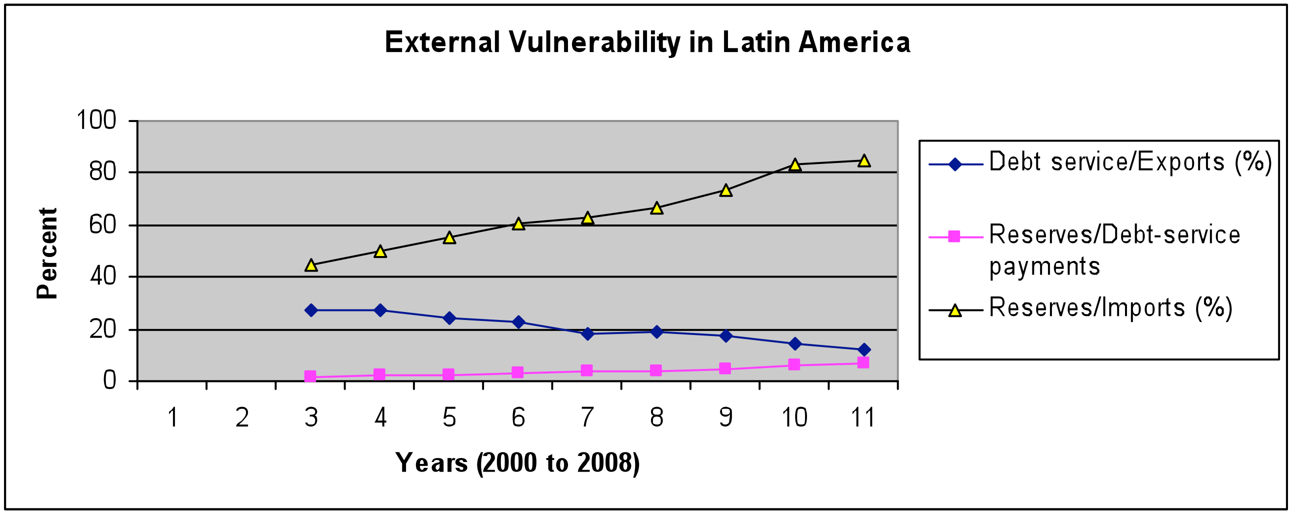
Some Stylized Facts

- 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

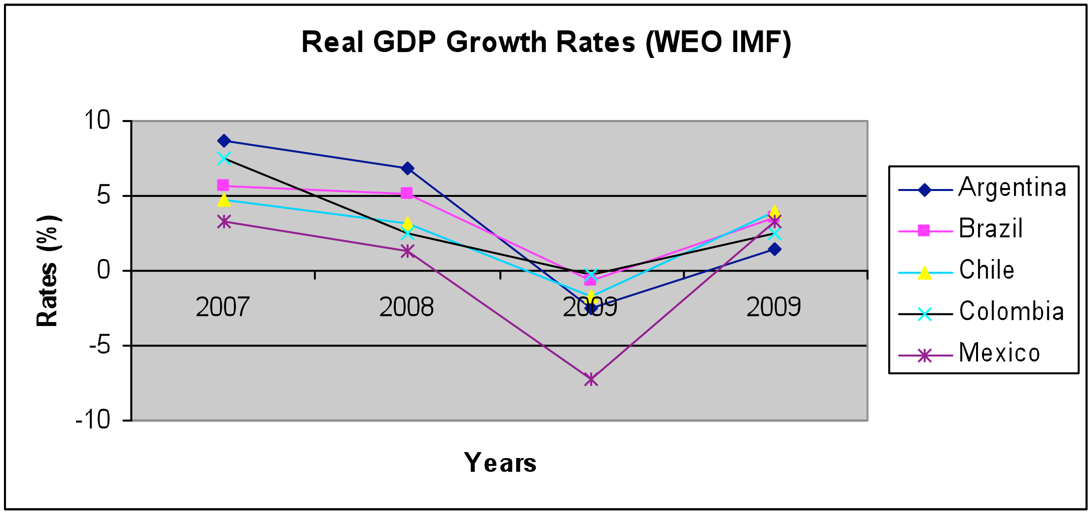
Traditional External Fragility Indicators



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

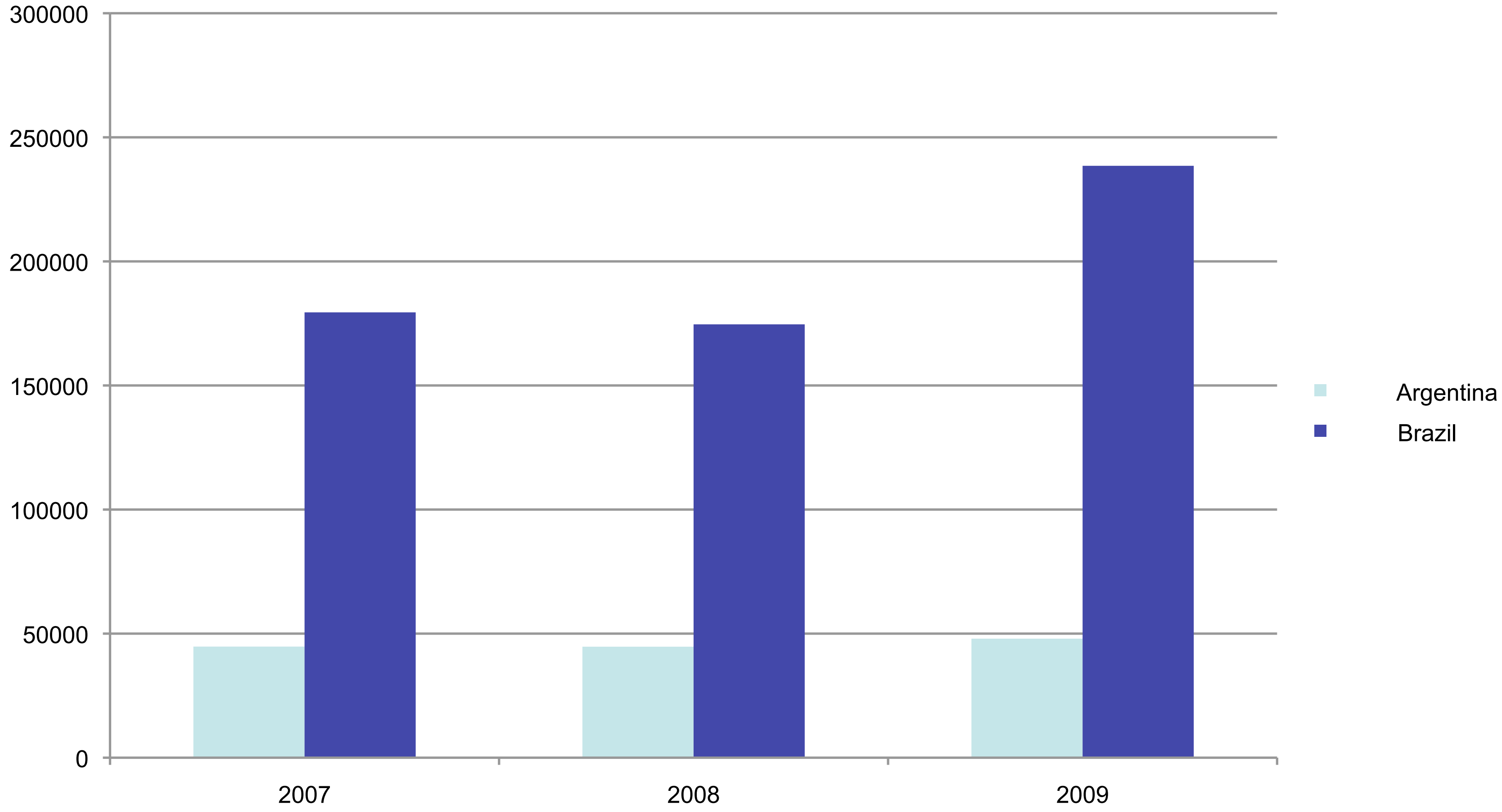
The Crisis and Its Aftermath: Quick Recovery



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



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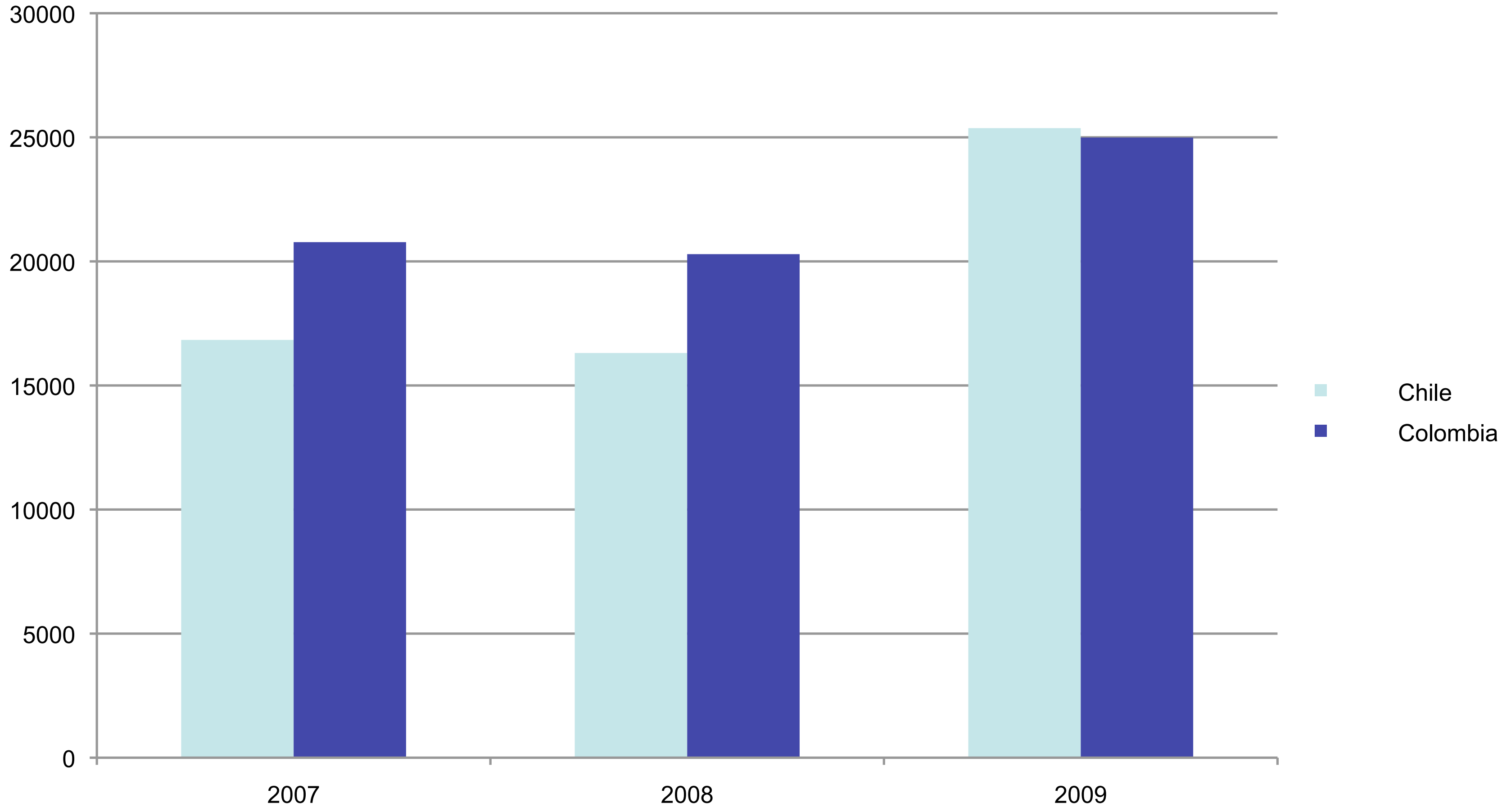
30000
25000
20000
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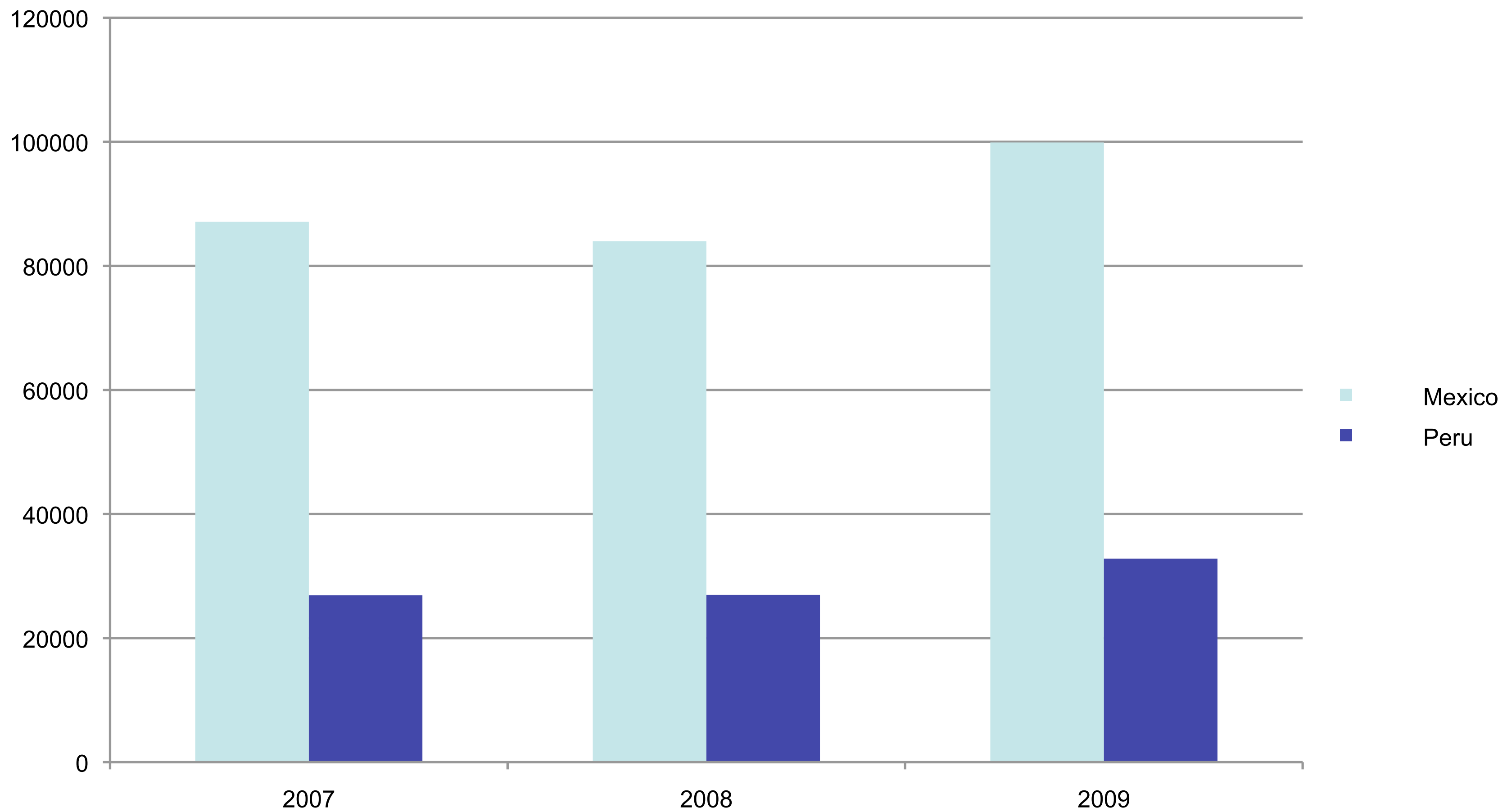
2007
2008
2009
Chile
Colombia

Concl.



120000
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60000
40000
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0
2007
2008
2009
Mexico
Peru

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"