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Comments of "Why did Latin America and Developing Countries Perform Better in the Global Financial Crisis than in the Asian Crisis?"

Ilan Goldfajn
Itau Unibanco

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Session 4: Then and Now – Latin America

Paper discussion: Why did Latin America and Developing Countries Perform Better in the Global Financial Crisis than in the Asian Crisis?

De Gregorio and Alvarez, Universidad de Chile

Discussant: Ilan Goldfajn, Chief Economist and Partner, Itaú Unibanco

November, 2013

Why Did Latin America and Developing Countries Perform Better in the Global Financial Crisis than in the Asian Crisis?

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- ✓ **Nice paper by De Gregorio and Alvarez comparing performance in Asia crisis (1997-1998) vs. Global financial crisis (2008-2009).**
  - Case study of five Latin American economies (Brazil, Chile, Mexico, Colombia, Peru).
  - $\bar{g}_{i,fc} - \bar{g}_{i,ac} = \alpha + \beta\left(X_{i,bfc} - X_{i,bac}\right) + e_i$

- ✓ **The claim of the paper is that "this time is different"... I always dislike hearing this phrase evoked. But they might be right – this time was different!**

- ✓ **Was it different this time because of luck (terms of trade, China) or fundamentals?**

Main Results: Why Was This Time Different?

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- ✓ **Better performance was positively associated with:**
  - Exchange-rate flexibility.
  - Counter-cyclical monetary policy.
  - More-resilient financial system (lower private credit growth).
  - Trade openness.

- ✓ **Better performance is negatively associated with:**
  - More financial openness.

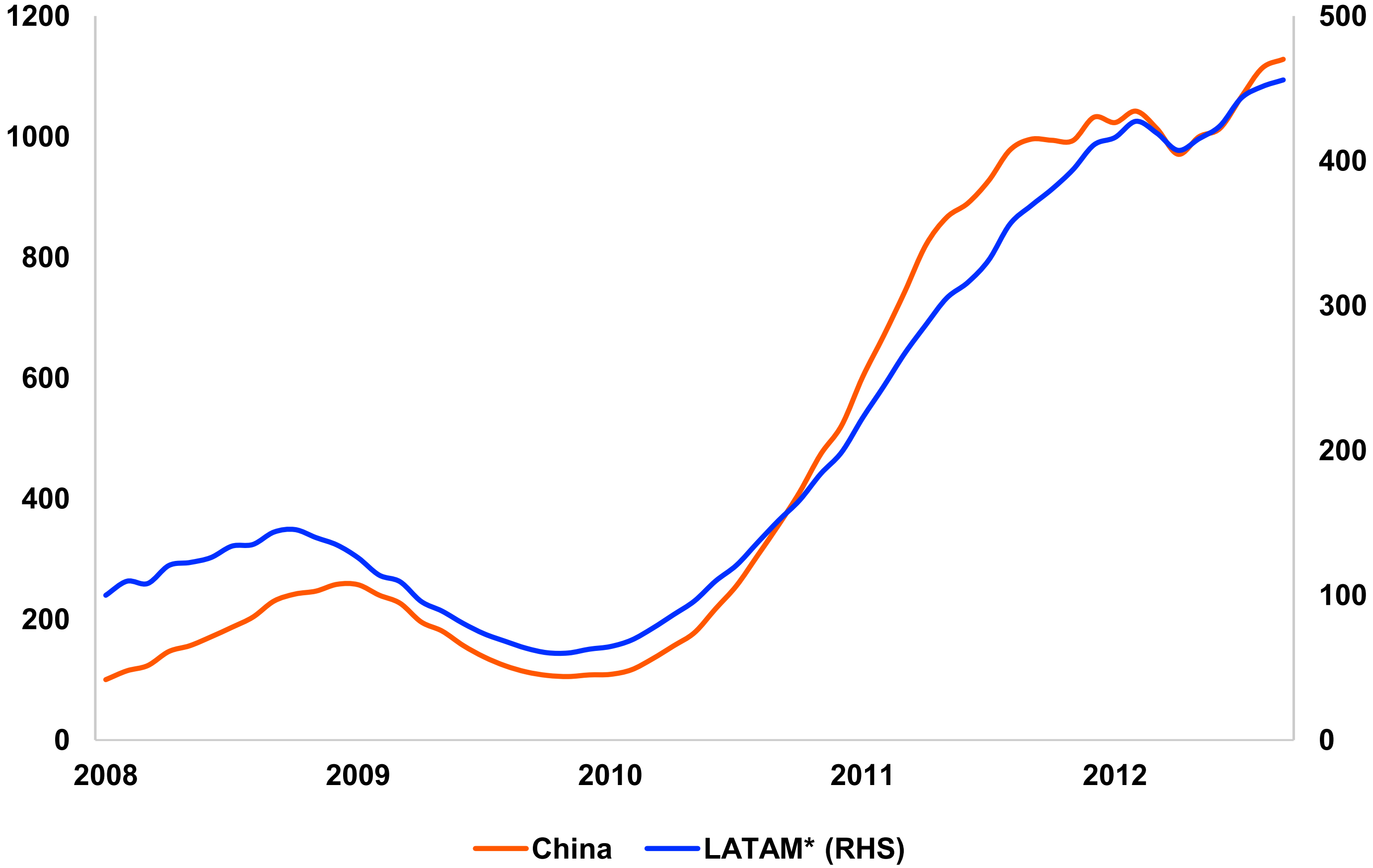
- ✓ **The “good luck” factor (terms of trade and China).**

The Luck Factor: China-Led Growth

✓ **Strong demand from China helped LatAm countries recover faster from the last crisis.**

Industrial production

Index, Jan 2008=100

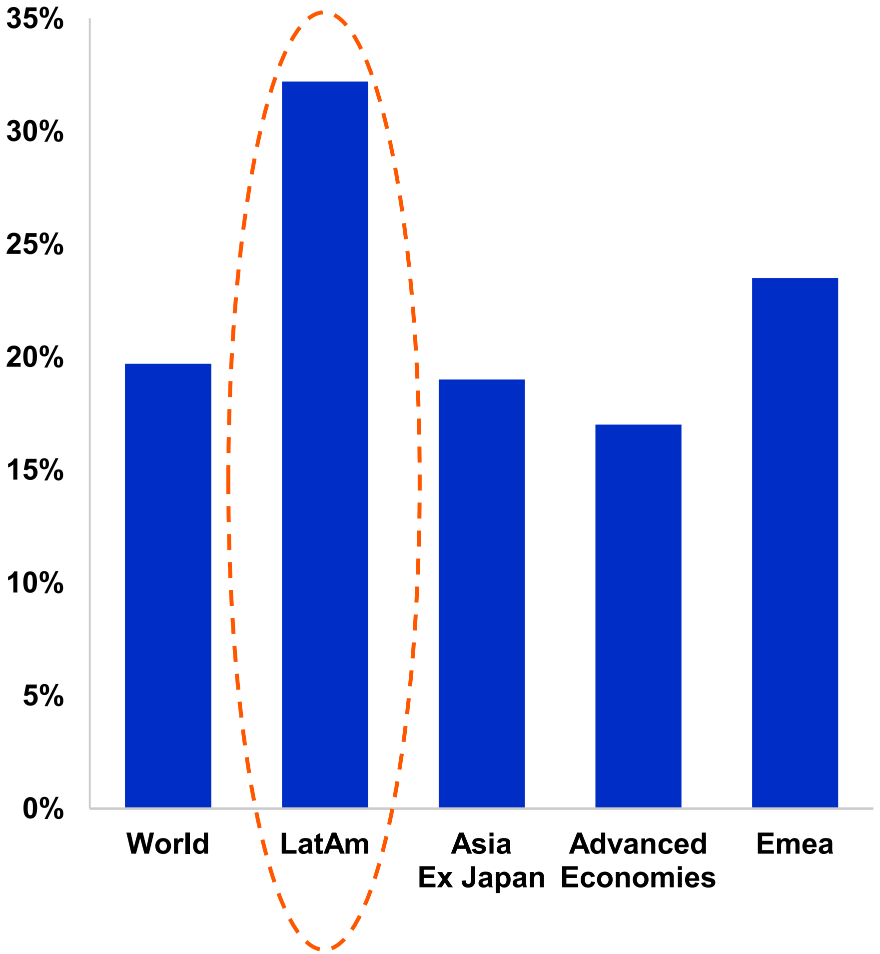


*Brazil, Chile, Colombia, Mexico, Peru

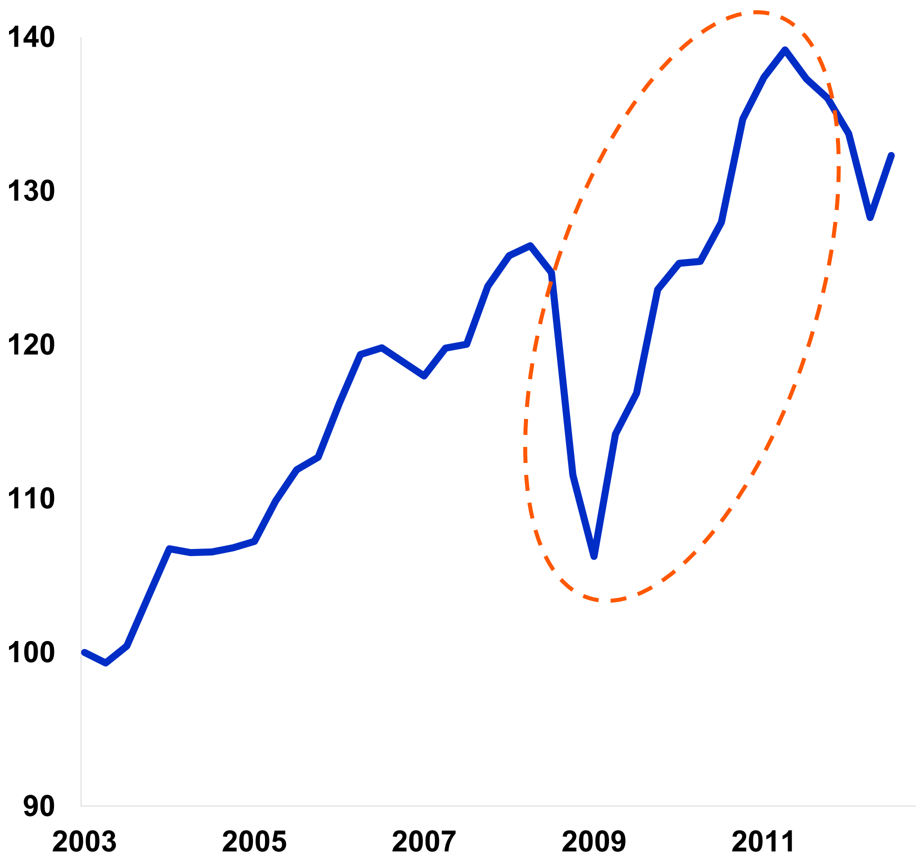
Source: Itaú Unibanco, Haver Analytics

Better BoP Conditions…

Exports to China – Annual Growth (last 10 years)



LatAm Terms of Trade

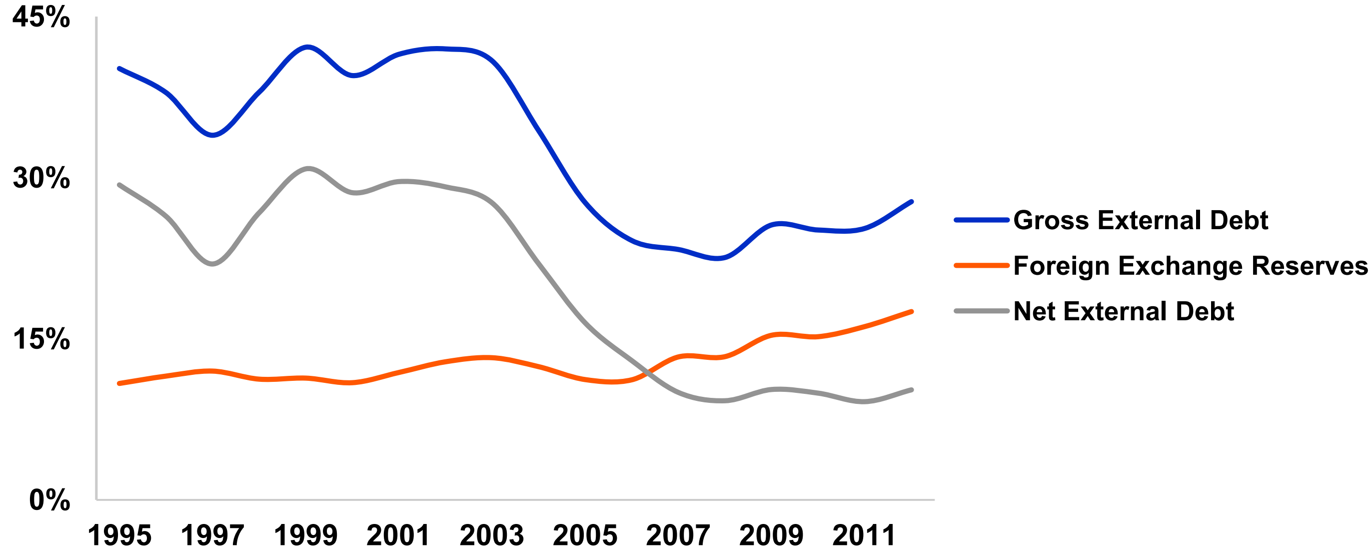


Source: Itaú Unibanco, Haver Analytics

… Led to an Improvement in External Sustainability Indicators

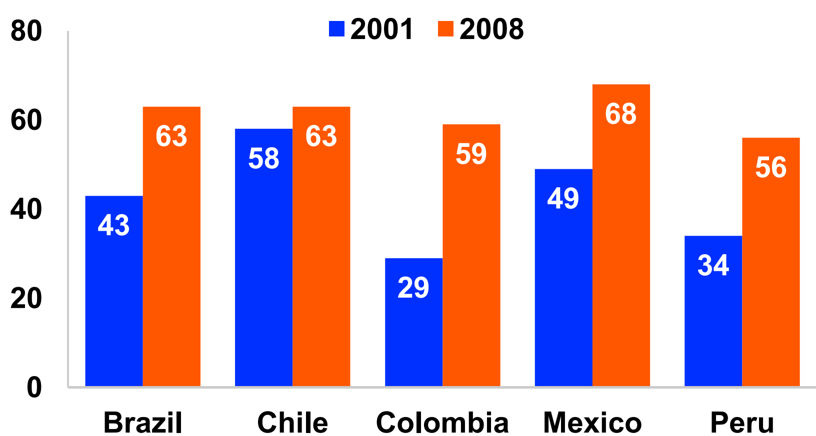
Average* External Sustainability Indicators – % GDP

*Brazil, Chile, Colombia, Mexico, Peru



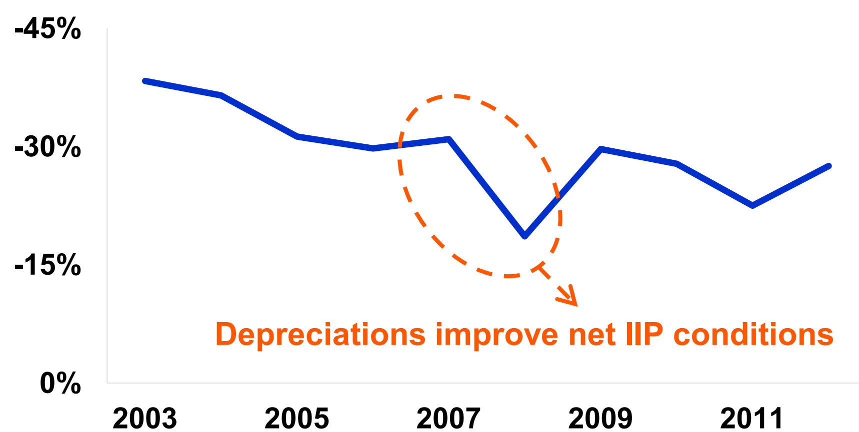
Share of Equity in Gross External Liabilities

(percentage, at year-end)



Net International Investment Position

(as percentage of GDP, end of period)



Source: Itaú Unibanco, Haver Analytics

Exchange-Rate Flexibility (Losing the Fear of Floating) Was Due to:

Lower Exchange-Rate Pass-Through to Inflation

Countries	1990-2000	1994-2006
Mexico*	0.94	0.03
Brazil	0.84	0.05
Peru	0.11	0.09
Chile	0.07	0.03

*According to Mexico Central Bank´s estimate after 2001

Source: Itaú Unibanco, Haver Analytics, Mihaljek and Klau (2008)

More-Adequate Monetary Policy Response This Time Around

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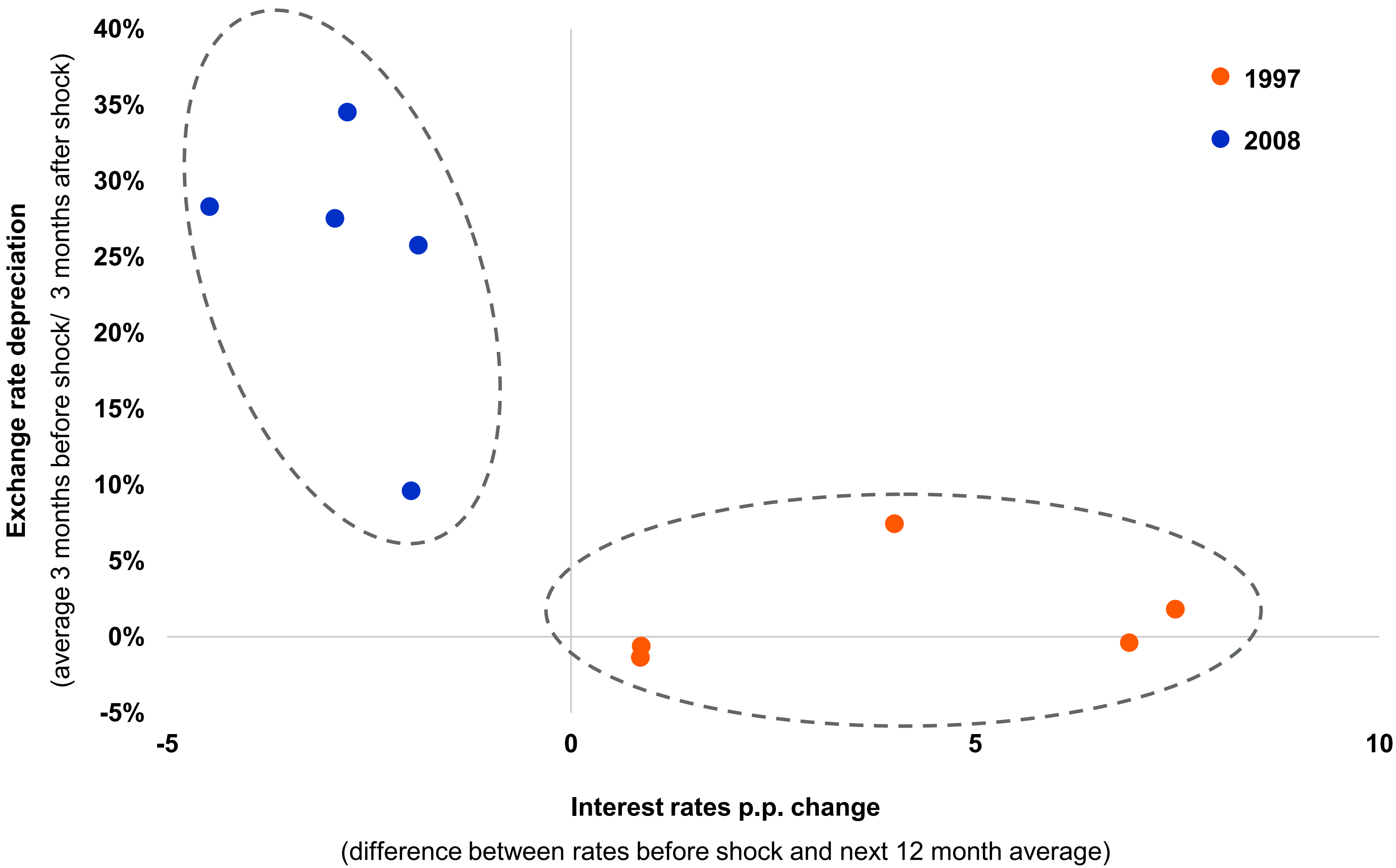
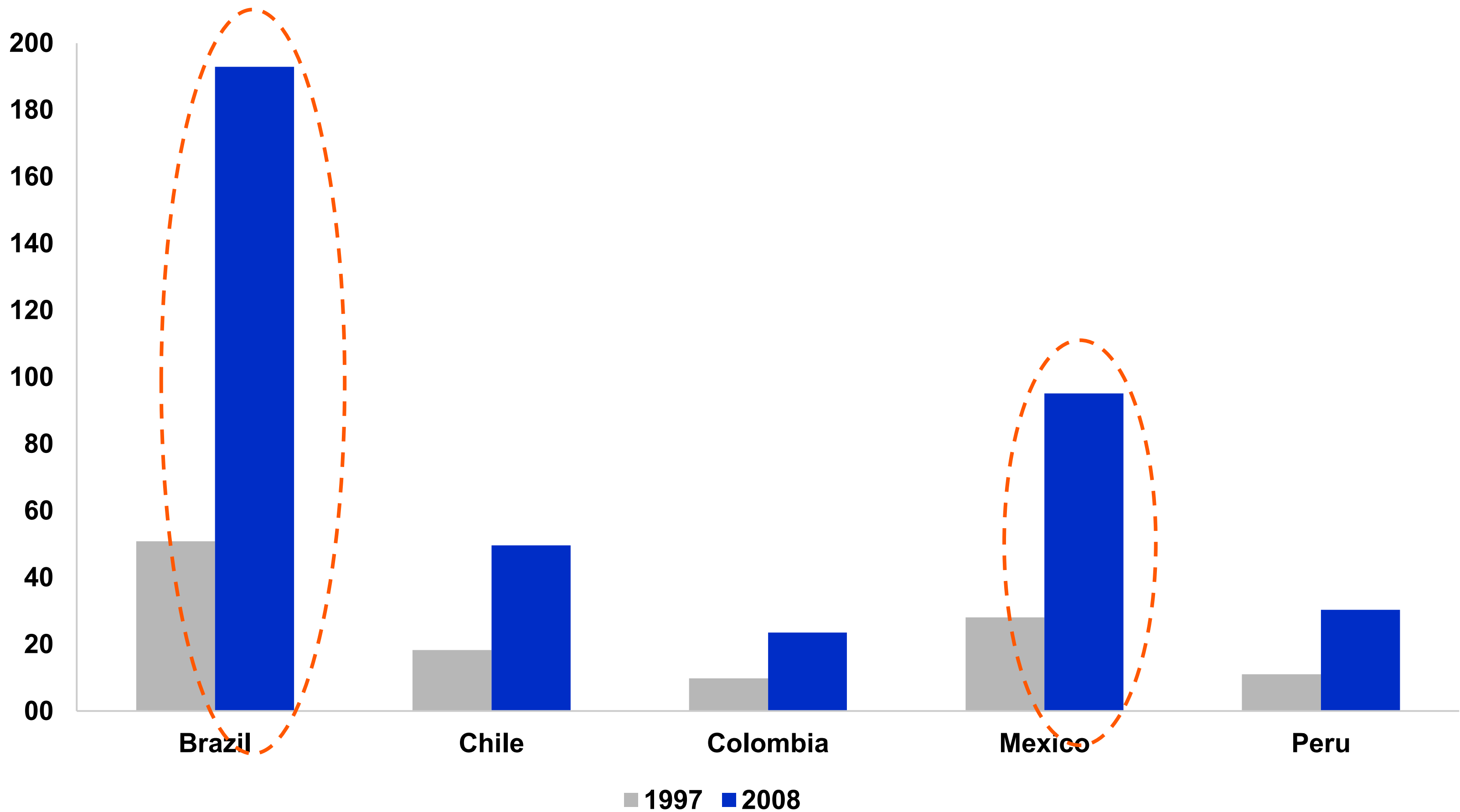
Exchange Rate Depreciation vs. Interest Rates Response



Source: Itaú Unibanco, Haver Analytics, Countries' Central Banks

But Flexible Exchange Rates Are no Panacea: Need Reserves

International Reserves (USD in Billions)



Source: Itaú Unibanco, Haver Analytics

But Less Affected by World Economy Growth Shocks

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- ✓ The long-run elasticity of LatAm growth both to World growth and to the first principal component of relevant external prices (VIX; commodities) fell.
- ✓ A VaR analysis also confirms lower vulnerability to external shocks.

Regression results: Goldfajn and Resende (2012)		
Long Run Elasticities		
Dependent Variable: Latin America Growth	**1996Q3 - 2004Q4**	**2001Q1 - 2011Q3**
World GDP growth (QoQ, %)	**2.06**	**1.02**
Principal component	**0.005**	**0.0013**

VaR Analysis		
Cumulative response of Latin America growth to one unit shock		
	1996Q3 - 2004Q4	**2001Q1 - 2011Q3**
CMDI (% of change)	**0.04**	**0.02**
World GDP growth (QoQ, %)	**4.32**	**2.62**
VIX	**-0.0018**	**-0.0011**
R-squared	**0.65**	**0.81**

Source: Itaú Unibanco, Haver Analytics, Goldfajn and Resende (2012)

Conclusion

- **This time was different indeed: better performance than in the Asian Crisis.**
- **Good Luck (China and terms of trade) was quite important this time.**
- **But also fundamentals: exchange-rate flexibility, counter-cyclical policies (ability to do so), resilient financial system, trade openness.**
- **Good luck and fundamentals are not dissociated: reserve accumulation during good times allowed for flexibility and better balance sheets.**
- **More attention should be given to current tail risks, such as Chinese Hard Landing.**