



**Crisis Prevention in Emerging Markets**

**Self Insurance, Regional Arrangements,  
and Preemptive Financing:**

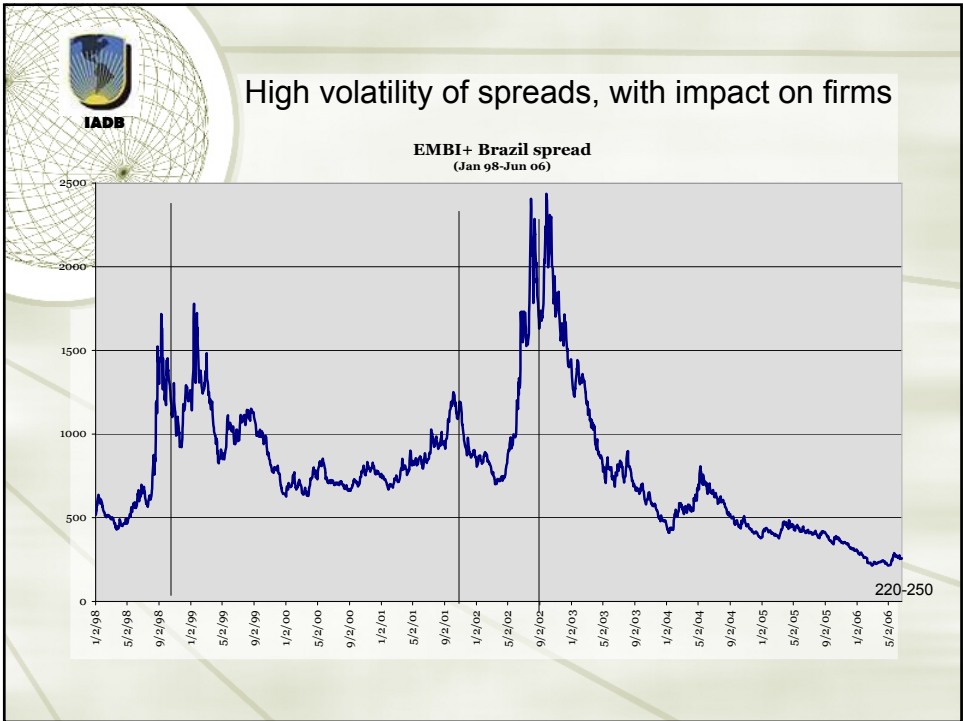
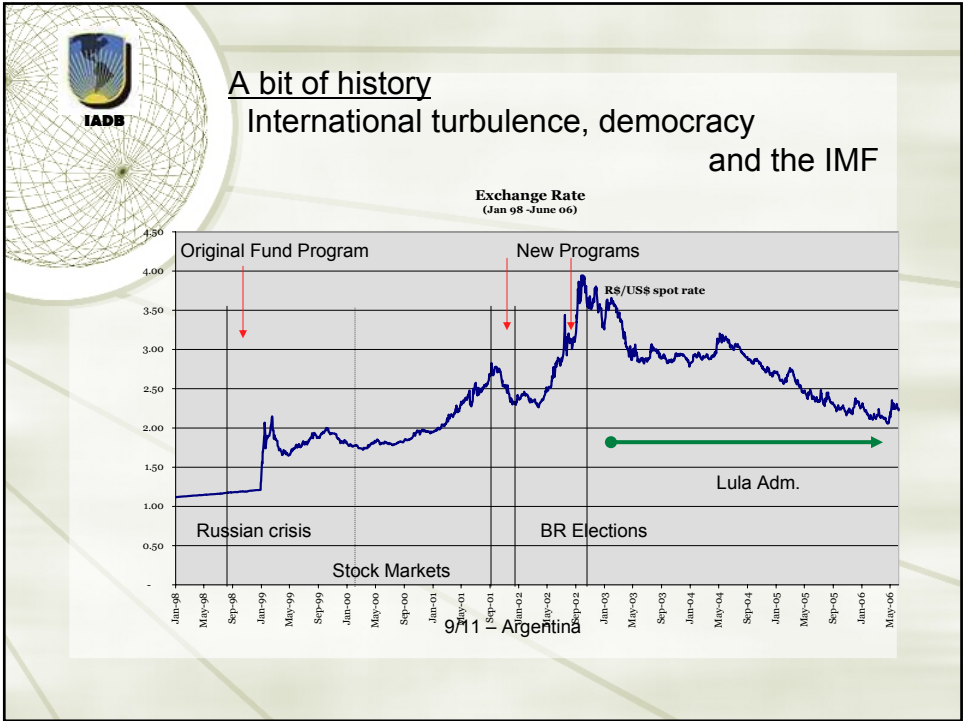
**The experience of Brazil**

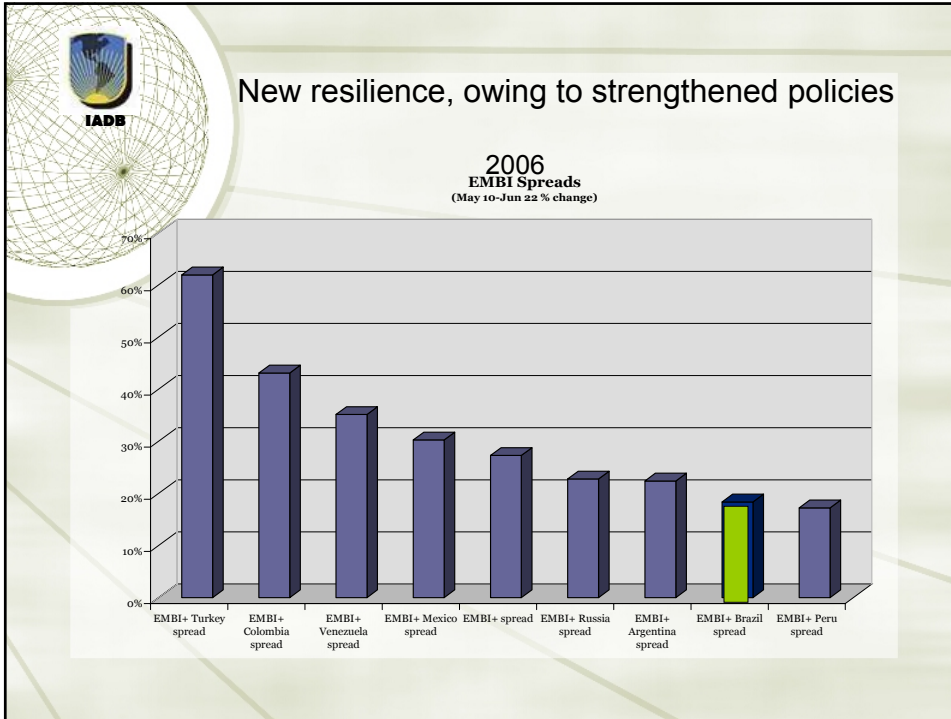
**High Level Seminar on Crisis Prevention  
July 10-11, 2006  
Singapore**

**Joaquim Vieira F. Levy  
Inter-American Development Bank (IDB)**



- ✦ **Brazil: Financial Turbulence and the IMF**
- ✦ **Brazil: Turnaround in the External Sector**
- ✦ **The Brazilian strategy 2003-2005**
- ✦ **Further Issues in Self-Insurance, Regional Arrangements and Preemptive Financing**





- 
- ### Factors that helped avoid a crisis in 2002
- Identifying the pressure as being mainly due to liquidity rather than solvency issues (*debt service was at moderate risk only, even considering the strong pressure associated with x-rate depreciation*)
    - **Floating** exchange rate, which facilitated resource allocation
    - **Fiscal performance** in the three previous years
    - **Strong banking system**, which weathered the sharp cut in credit lines
    - **Inflation Targeting** system, which helped the government to remain credible, while some traditional (quantitative) indicators moved out of line
  - Ability of IMF to trust presidential candidates and existing government, ensuring ownership to program and decreasing financial pressure due to political uncertainty
    - Willingness of candidates to signal intention of **ensuring public debt service**



- ✦ Brazil: Financial Turbulence and the IMF
- ✦ Brazil: Turnaround in the External Sector
- ✦ The Brazilian strategy 2003-2005
- ✦ Further Issues in Self-Insurance, Regional Arrangements and Preemptive Financing

### Robust exports and strong external accounts

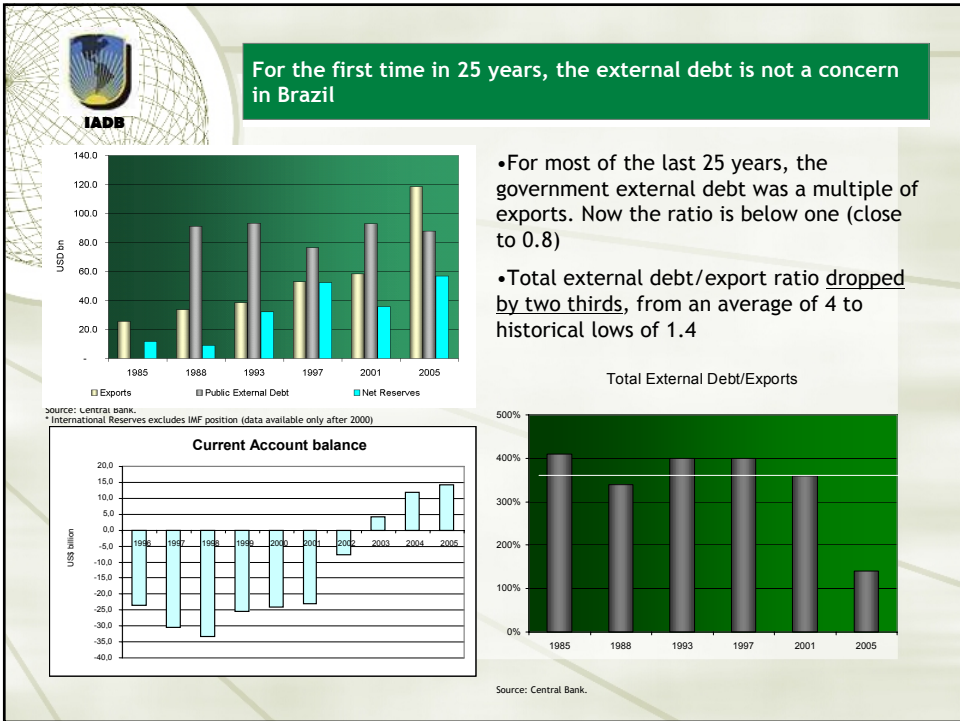
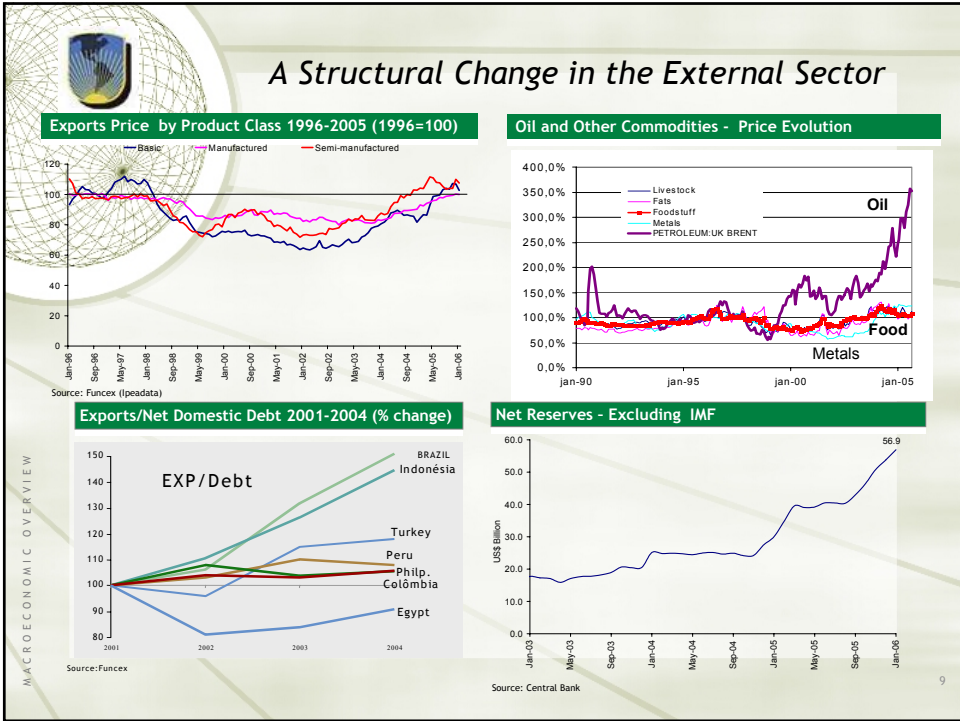
**Trade Balance (US\$ billion - 12 months accumulated)**

**Export Growth 2002-2005 (% in 12 months)**

**Exports by Destination (US\$ billion)**

Others include Eastern Europe + Russia, M. East, Africa, Oceania, etc.

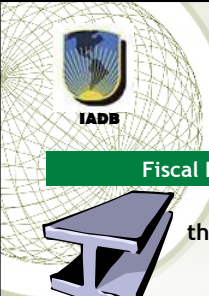
**Exports by product (US\$ billion)**








- ✦ Brazil: Financial Turbulence and the IMF
- ✦ Brazil: Turnaround in the External Sector
- ✦ **The Brazilian strategy 2003-2005**
- ✦ Further Issues in Self-Insurance, Regional Arrangements and Preemptive Financing




## *Architecture of robust growth*

**Fiscal Responsibility**




the main pillar of the economic policy

**Cautious Financial Policies**



price stability, strong banks and full transparency

**External Adjustment**



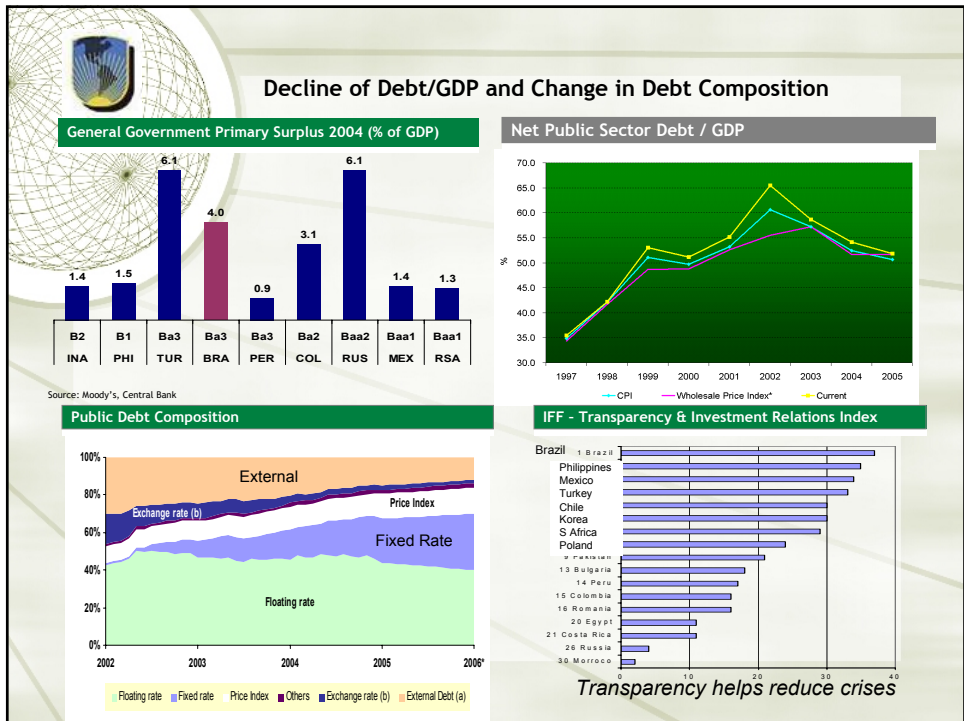
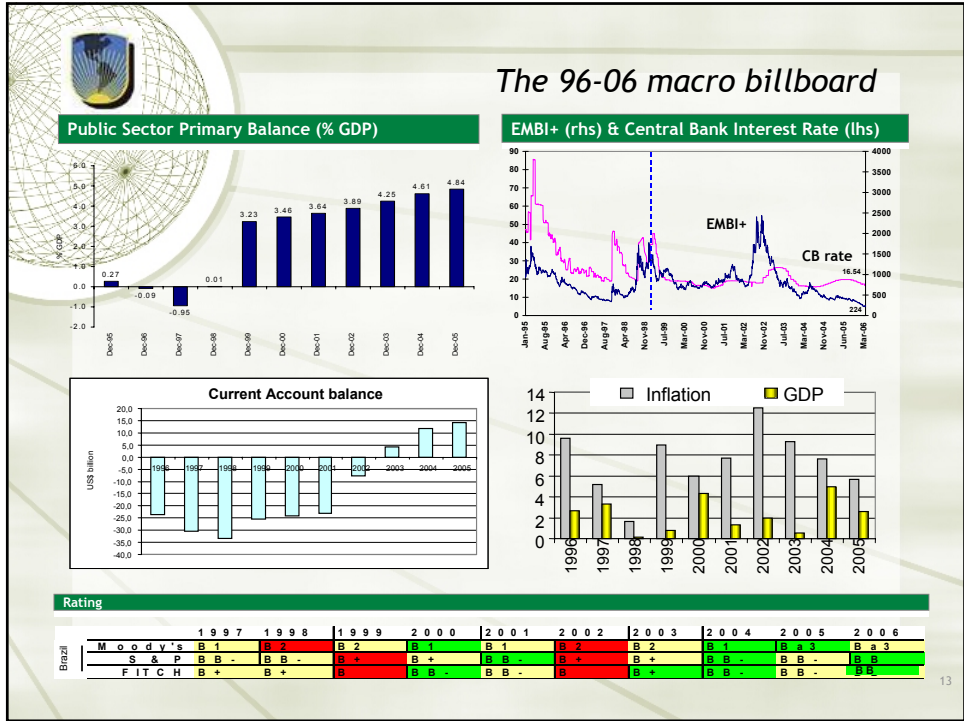
sustained export growth and strong external accounts

Lead  
to...

- ✓ Converging, low inflationary expectations (4%-5%)
- ✓ Improved debt dynamics and continued resilience of the banking system
- ✓ Strong External Accounts
- ✓ Room for micro-reforms
- ✓ More credit, more jobs
- ✓ More Growth

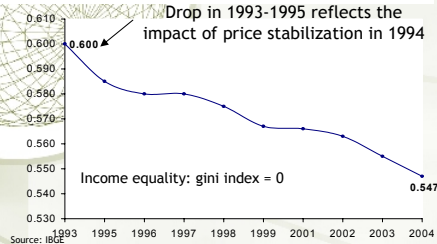
MACROECONOMIC OVERVIEW

12



## Less poverty, more jobs, more access

### Gini index of the labor incomes

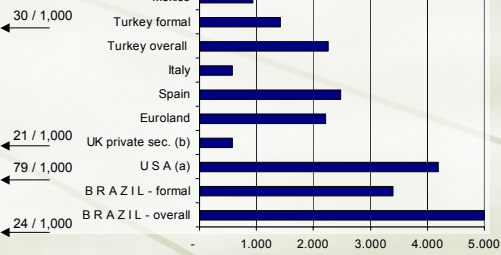


### A social safety net that avoids extreme poverty

	% Population living with		Survey date
	< US\$ 1/day	< US\$ 2/day	
BRASIL	8,2	22,4	2001
CHINA	16,6	46,7	2001
ÍNDIA	35,3	80,6	1999-00
RÚSSIA	<2	7,5	2002
INDONÉSIA	7,5	52,4	2002
MALÁSIA	<2	9,3	1997
MÉXICO	9,9	26,3	2000
FILIPINAS	15,5	47,5	2000
TAILÂNDIA	<2	32,5	2000

### Job Creation 2003-2005 in thousand positions

# users of Internet		
China	94.000.000	2004
Japão	57.200.000	2002
Alemanha	39.000.000	2003
Coreia do Sul	29.220.000	2003
Reino Unido	25.000.000	2002
França	21.900.000	2003
Itália	18.500.000	2003
Índia	18.481.000	2003
Canadá	16.110.000	2002
<b>Brasil</b>	<b>14.300.000</b>	<b>2002</b>
México	10.033.000	2002
Turquia	5.500.000	2003
Rússia	6.000.000	2002



Source: IBGE


In sum, Brazil took advantage of the favorable environment in 2003-2005 to:

- ✓ Strengthen its economy, based on fiscal discipline and structural (micro) reforms
- ✓ Reduce the public debt/GDP ratio and change the composition of public debt
- ✓ Increase trade and reduce external vulnerability
- ✓ Create more than 1 million jobs a year on average





- ✦ Brazil: Financial Turbulence and the IMF
- ✦ Brazil: Turnaround in the External Sector
- ✦ The Brazilian strategy 2003-2005
- ✦ Further Issues in Self-Insurance, Regional Arrangements and Preemptive Financing



### Significant Dispersion in Saving Behavior ...

	2000-2003		2003
	Sav/GDP	Credit/GDP	Credit/GDP
Malaysia	43,6		103,5
China	40,4		147,7
Thailand	32,4		79,2
Vietnam	28,3		49
Chile	24,1		63,6
Indonesia	23,3		24,2
India	23,1		33,9
<b>Brazil</b>	21,5		28
<b>Mexico</b>	19,4		18,5
Poland	18		29
Philippines	17,5		30,6
Uruguay	13,1		44,6
<b>Brazil 2004</b>	24,3		33 *

**Savings and Credit as % of GDP (2003)**

**Savings 2004 (as % of GDP)**

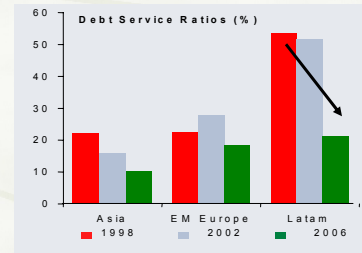
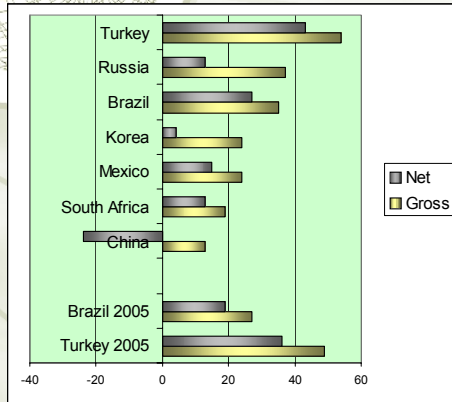
Country	Savings 2004 (%)	Moody's Rating
INA	25.3	B2
PHI	19.5	B1
TUR	20.7	Ba3
BRA*	24.3	Ba3
PER	21.1	Ba3
COL	15.0	Ba2
RUS	35.1	Baa2
MEX	20.7	Baa1
RSA	17.2	Baa1

\* 2006  
\* Data of 2005, II Quarter  
Source: Moody's, IBGE



### ... As well as in external debt & debt service

External GG Debt/GDP in 2004 (%)

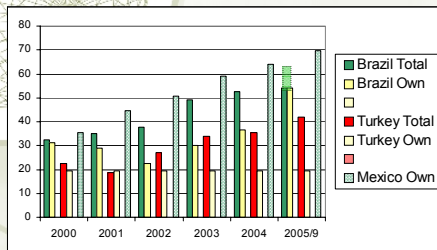


Source: ING

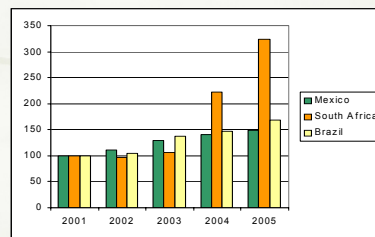


### ... And a few common trends

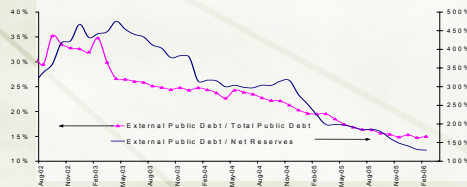
International Reserves in US\$ billion



International Reserves 2000=100

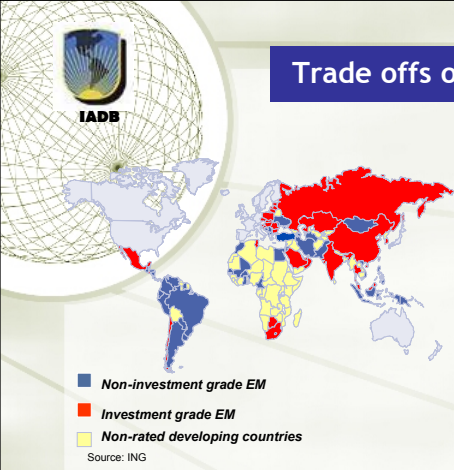


BRAZIL: External CG Debt as a % of Total NFPS Debt and of Net Reserves



• South Africa, Mexico and Brazil, although increasing their holdings of international reserves, still keep a broad approach of balancing the amount of resources locked by the government in foreign currencies.

Source: National Treasury and Central Bank




## Trade offs of Self-insurance

- International Reserves are expensive ...
  - *returns on reserves are low, impacting fiscal accounts; and reserves may “lock” resources*
- ... however, credit rating agencies appear to strongly believe that they are important
  - *“liquidity & geography matter”*

• Alternatives to self insurance may point to traditional regional integration (e.g., Mexico, Chile, Peru, Colombia, with the USA; Mercosul) OR international financial integration


- *role of multilateral organizations, such as IMF, OECD (through membership or active informal participation) and regional development banks*

Source: ING

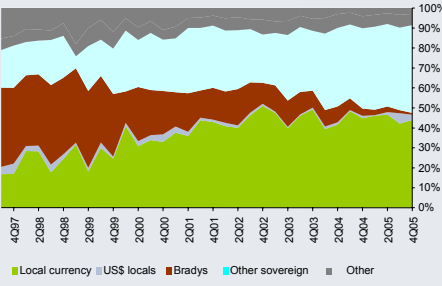


## What the IDB is doing

- Strengthening the Policy Dialogue
  - *unique relationship with borrowing members throughout the Region*
  - *in part because of its capital composition, the Bank has foreshadowed the reaching out strategy that, e.g., the IMF is increasingly adopting*
- Making available a significant contingent facility
  - *the IDB is prepared to lend up to US\$ 6 billion in emergency/ precautionary loans and accelerate the disbursement/approval of other loans in stress scenarios (high returns from loans increased the Bank's equity in recent years ensuring the Bank ability to deliver on that)*
  - *the increasing sophistication of IDB's membership and transparency of their accounts can help market communication and coordination with the IMF, favoring a high degree of country ownership and focus on core issues*
- Providing new products
  - *Development of **local currency/ local capital markets**, as well as mechanisms to **Build Opportunities to the Majorities** contribute to diversify finance sources for member countries and foster good policies.*




## Roles for Local Currency debt

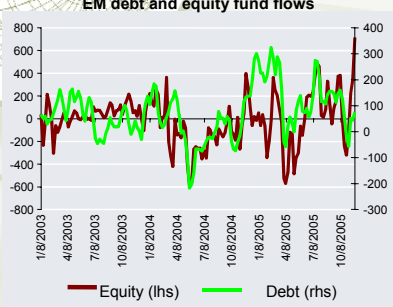


Source: Emerging Markets Trade Association (EMTA)

- Avoid “original sin” for more susceptible countries
- Inflation Indexed Debt allows for additional risk sharing
  - borrower: higher correlation with local cash-flows
  - lender: less downside risk in an environment in which inflation is a new concern
- Inflation Indexed bonds may help deliver long-term appreciation in developing countries with less volatility



## Features of Inflation Linked Local Currency Bonds



- Can help diversify investment portfolios in developed countries as well as in Asia to include LATAM components
- Can bring together some of the attractiveness of the well-established EM equity market and features of fixed income instruments (e.g., less downside risk)
- It is an instrument with more than 40 years of trading experience in the region and increasing acceptance in developed markets



The image features the IADB logo in the top left corner, which consists of a stylized globe with a blue and yellow emblem and the letters 'IADB' below it. To the right of the logo is a map of Latin America, showing the outlines of Mexico, Central America, the Caribbean, and South America (including Colombia, Venezuela, Ecuador, Peru, Brazil, Chile, and Argentina). The map is color-coded by country.

*Thank You !*

Latin America  
Fiscal Responsibility  
High Quality Investment  
Strong Export Drive  
...  
Leading to  
Better Finances  
Opportunity for the Majority  
Effective Development

25