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Comments of “The Road to Redemption: Policy Response to Crises in Latin America”

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Comments on Vegh and Vuletin

- The recent slowdown in emerging markets growth and the financial turbulences that followed the FED's May 22 announcement have generated a concern of a potential crisis in emerging markets.
- In particular, a debate has emerged on how prepared are Latin American countries, to face a less benign external environment.
- The capacity of a country to adjust to a combination of higher international interest rates and lower primary commodity prices depends on the flexibility of its markets and its ability to use countercyclical macro policies.

Comments on Vegh and Vuletin

- The latter is the focus of the paper by Carlos Vegh and Guillermo Vuletin.
- The authors work with a quarterly sample of 8 Latin American countries including the LAC-7 (Argentina, Brazil, Chile, Colombia, México, Per and Venezuela) and Uruguay from 1970 to 2013.
- Then they measure the frequency, duration and intensity of crises in the above set of countries.
- Vegh y Vuletin define a crisis as a drop in real GDP with respect to its four-quarter moving average. Using this definition, they find that there were 34 crises in their sample.
- They also find that the frequency, duration and intensity of the post-1998 crises have been lower than the pre-1998 crises.

Comments on Vegh and Vuletin

- The latter result could have been the consequence of weaker external shocks rather than of differences in policy responses to crisis in the two periods.
- By analyzing correlations, the authors study the fiscal and monetary response to a crises before and after 1998, year that is defined as a breaking point in the developing of the capacity to adjust to a crisis.
- They find that Brazil, Chile and Mexico have been able to shift from having a procyclical fiscal policy response before 1998 to a countercyclical policy response after 1998.
- In contrast, Argentina, Peru, Uruguay and Venezuela all show procyclical fiscal policy responses both pre-1998 and post-1998.
- On the monetary policy side, the change is more pronounced, with Brazil, Chile, Colombia and Peru being able to carry out countercyclical monetary policies after 1998.

Comments on Vegh and Vuletin

- Thus, only Chile and Brazil have been able to pursue countercyclical fiscal and monetary policies post-1998.
- Adding up the country results, they find that on average, Latin America's fiscal and monetary policy responses to crisis have shifted from procyclical to countercyclical after 1998.
- Then, the authors analyze the effectiveness of the policy response showing that fiscal policy has helped them to shorten the duration of crises and lessen their intensity.
- In the case of monetary policy, its effectiveness is clear for the duration of crises but it is not for the intensity.
- Finally, they analyze the endogeneity of the policy responses.
- By assuming that external shocks are the main drivers of crises, they find that fiscal and monetary policies have been a true response to crises rather than the cause of such crises.

Comments on Vegh and Vuletin

- Furthermore, the synchronicity of crises and its very high correlation with external factors suggest that crises have been exogenous to the policy responses.
- I agree with the authors that much has changed in Latin America in the last 15 years to make a difference in the capacity to adjust to crises.
- In that period, a group of Latin American countries –Chile, Colombia, Mexico and Peru- and to a lesser extent Brazil have introduced important reforms in policies and institutions that have resulted in a much more robust macro/financial framework.
- Stan has been an important contributor to the promotion of these type of reforms (Fischer 1986 and 2003).

Comments on Vegh and Vuletin

- The strengthening of the macro framework of important Latin American countries has been analyzed also in several studies: Corbo and Schmidt-Hebbel (2011), IMF (2013) and World Bank (2013) among others.
- In particular, Corbo and Schmidt-Hebbel (2011) found that the improved resilience of Latin America to foreign shocks, when comparing the Asian and Lehmann crises, is associated to three factors:
 - (1) better monetary and fiscal policy frameworks (inflation targeting and fiscal discipline and rules);
 - (2) the success in building deeper and healthier financial systems and capital markets;
 - (3) the attainment of deeper trade and financial integration.

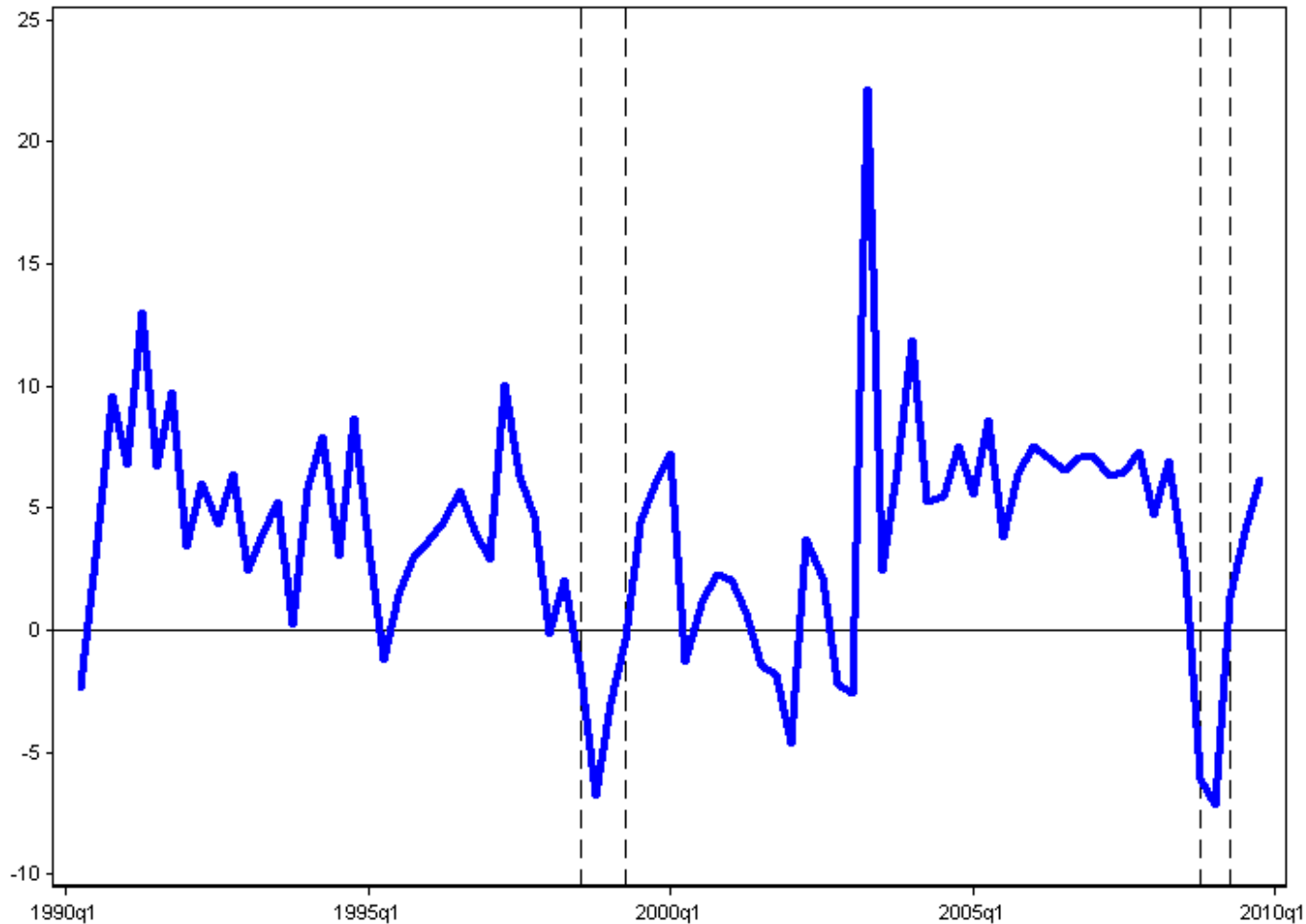
Comments on Vegh and Vuletin

- Thus, it has been thanks to a more robust macro framework that a group of Latin American countries have been able to use, for the first time in many years, traditional countercyclical macro policies to cushion the effect of negative foreign shocks.
- In particular, for countries with inflation close or below the target and with well-aligned inflation expectations with its target, there is less concern for the effects of the depreciation of the currency that accompany the lower interest rates.
- Chile has the additional advantage of having a well-developed and highly liquid capital market, providing liquidity when foreign investors want to reduce their exposure to domestic assets.
- The countercyclical role of monetary policy does not come clearly in the Vegh and Vuletin paper and this is surprising, more on this below.

Comments on Vegh and Vuletin

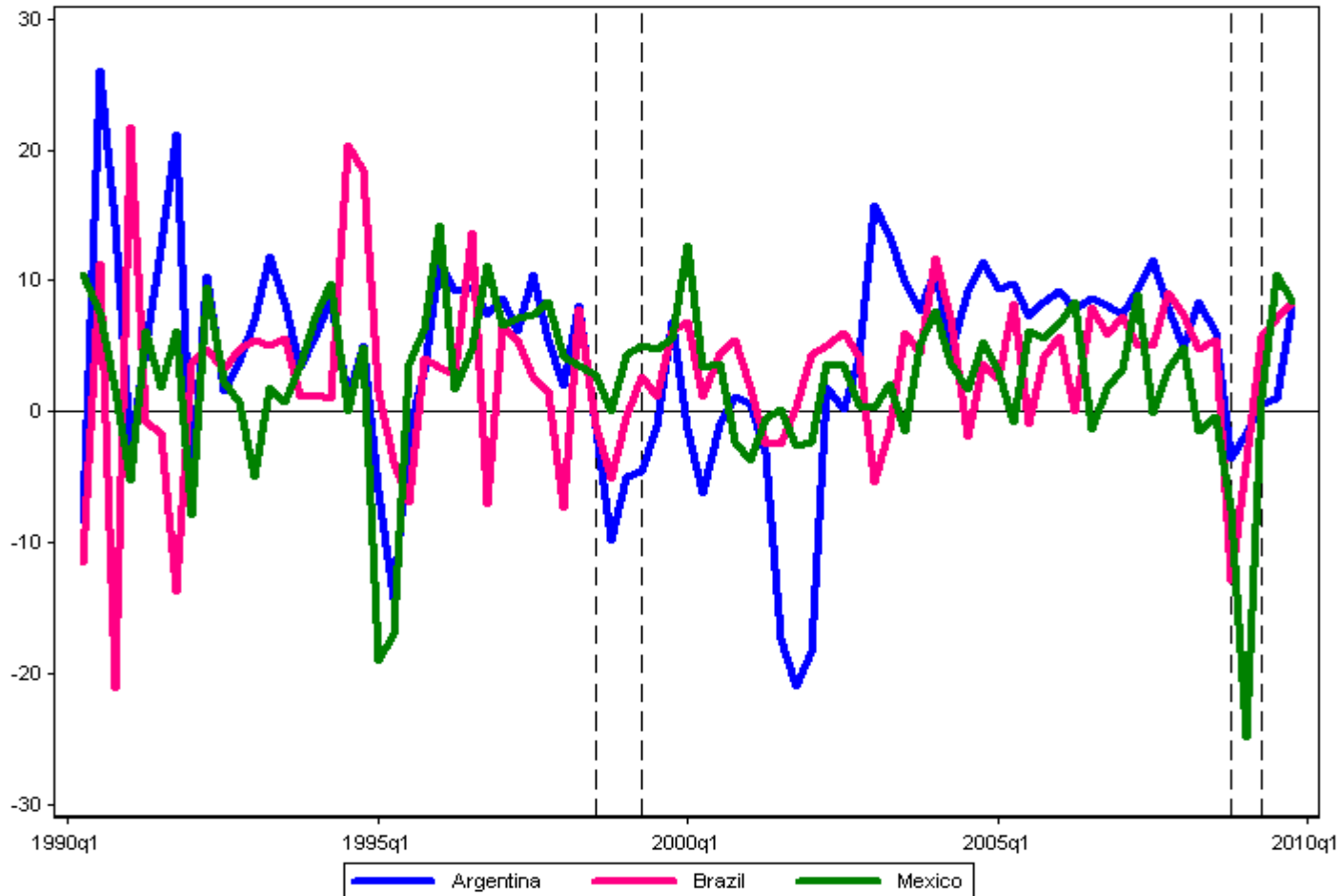
- Some comments:
 - I find the definition of crisis too encompassing. It is possible that mild recessions are being identified as crises.
 - In this sense, it would be useful that the authors show the exact dates of the crises identified for each country.
 - An alternative definition of a crisis could be based on the accumulated drop in real GDP below a given threshold.
 - Figure 6 of the paper, that examines the relation between the cyclicity of policies and the duration of crises, is based on only 14 crises from a total of 34 and does not differentiate between pre and post Lehmann crisis.
 - It could have been interesting to have an analysis of the responses to the Lehmann Brother's shock, shock that was one of the strongest that have hit Latin America in the last 80 years as it is illustrated below.

■ ■ ■ Average GDP Growth in LatAm



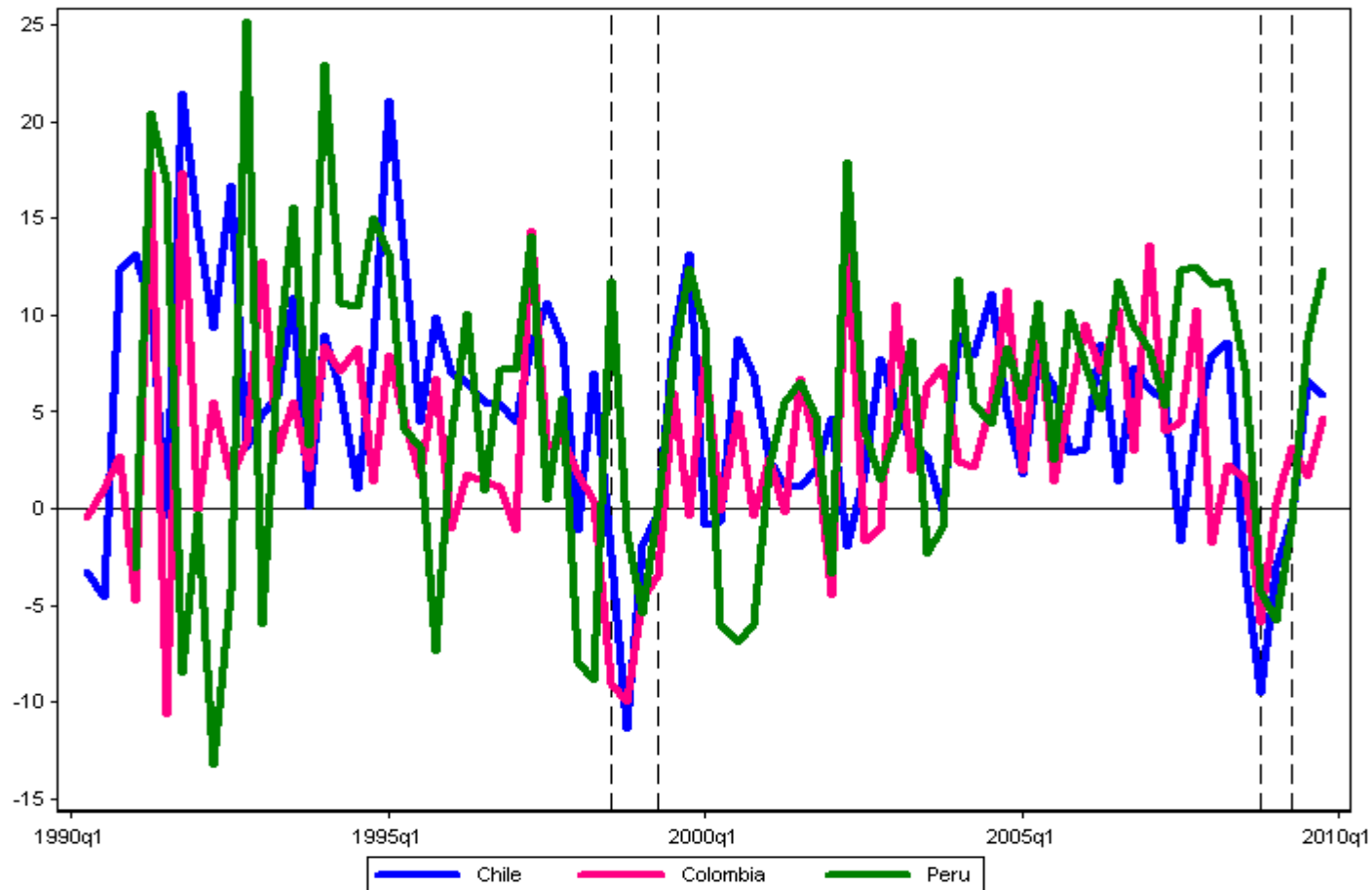
Simple average of annualized quarterly GDP growth rates of seven major Latin American countries, based on official GDP series that are seasonally adjusted by national authorities.

■ ■ ■ GDP growth in LatAm countries (1)



Note: Annualized quarterly GDP growth rates, based on official GDP series that are seasonally adjusted by national authorities.

■ ■ ■ GDP growth in LatAm countries (2)



Note: Annualized quarterly GDP growth rates, based on official GDP series that are seasonally adjusted by national authorities.

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