Capital Flows to Latin America in the Aftermath of the Commodities Super-Cycle

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Motivation

- Capital flows enable growth when domestic savings are insufficient to finance investment and when they bring technological and managerial improvements along with them.

- These two factors are particularly relevant for countries in LAC.

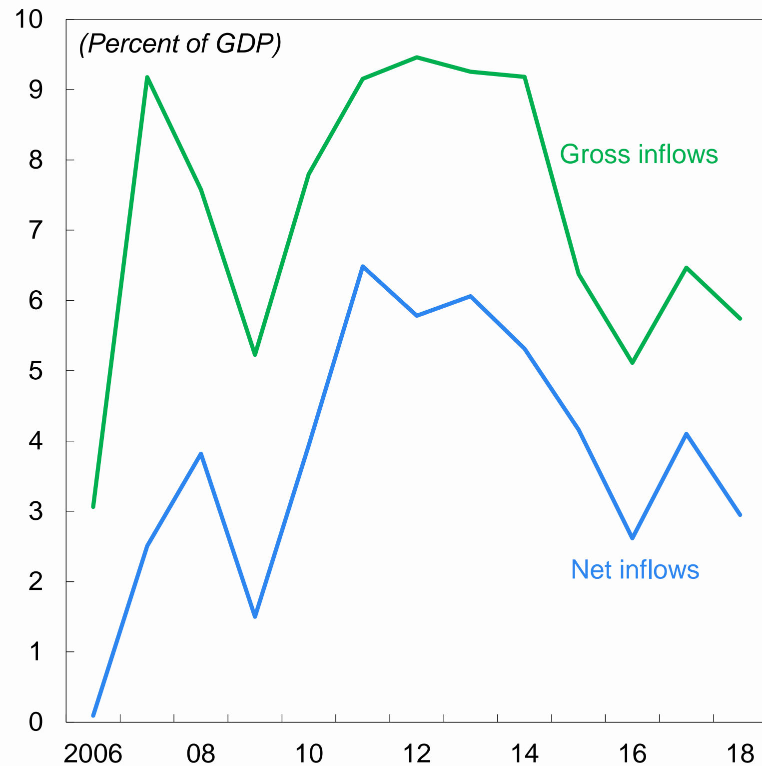
- Notwithstanding these benefits, there are also challenges. Volatile capital flows can disrupt the domestic economy during difficult times, or fuel overheating and asset price bubbles in boom periods.

- We document how the size and composition capital flows to LAC has changed after the end of the commodities super cycle, and explore policy options to mitigate the adverse effects of a possible boom-bust event.

Low Savings

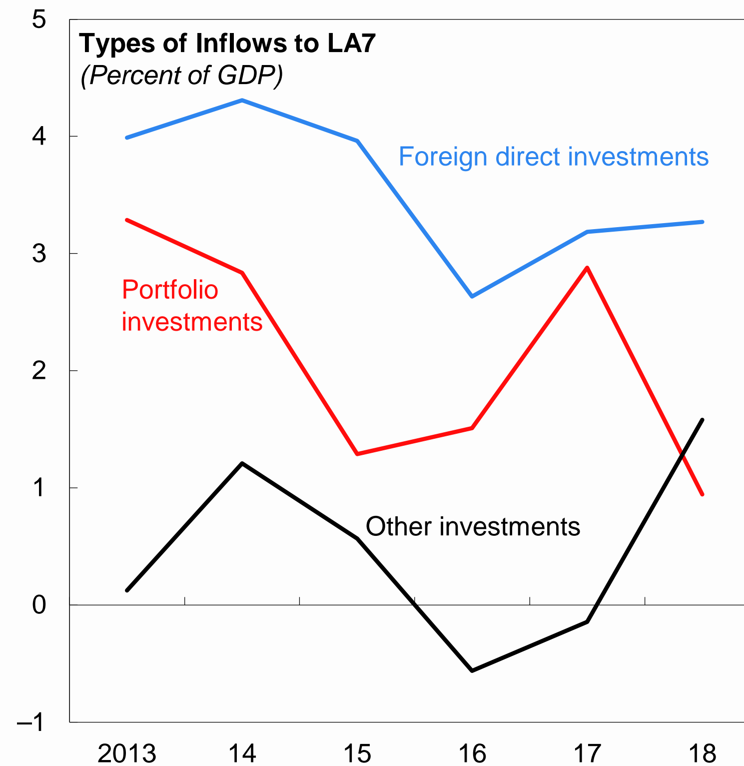
Portfolio Flows Take Center Stage

Net capital flows to LAC declined since 2014, mostly because of a fall in gross inflows.



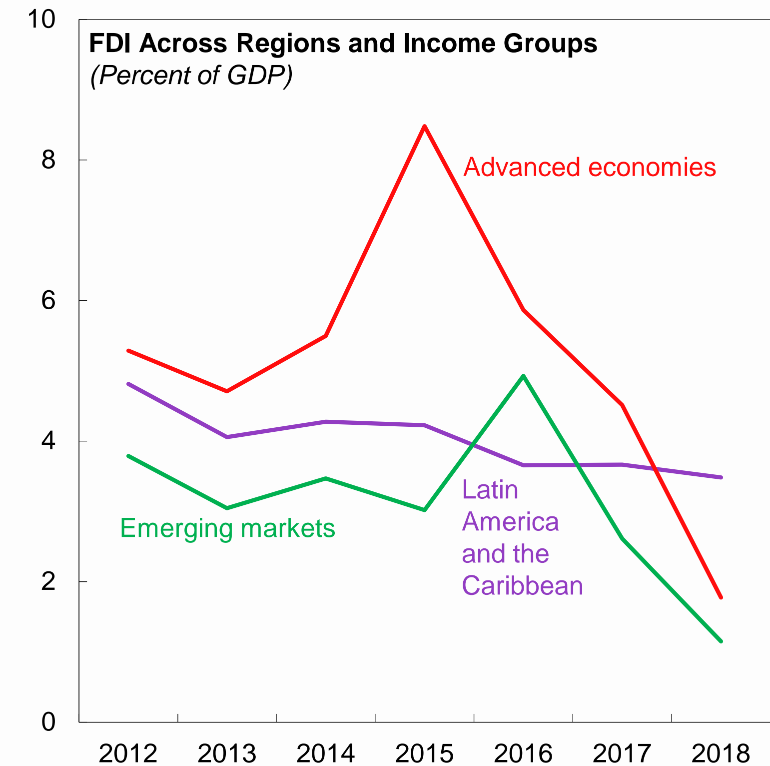
Sources: IMF, Financial Flows Analytics database; and IMF staff calculations.

This decline in turn was mainly driven by changes in portfolio inflows.



Sources: IMF, Financial Flows Analytics database; and IMF staff calculations.
Note: LA7 = Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay.

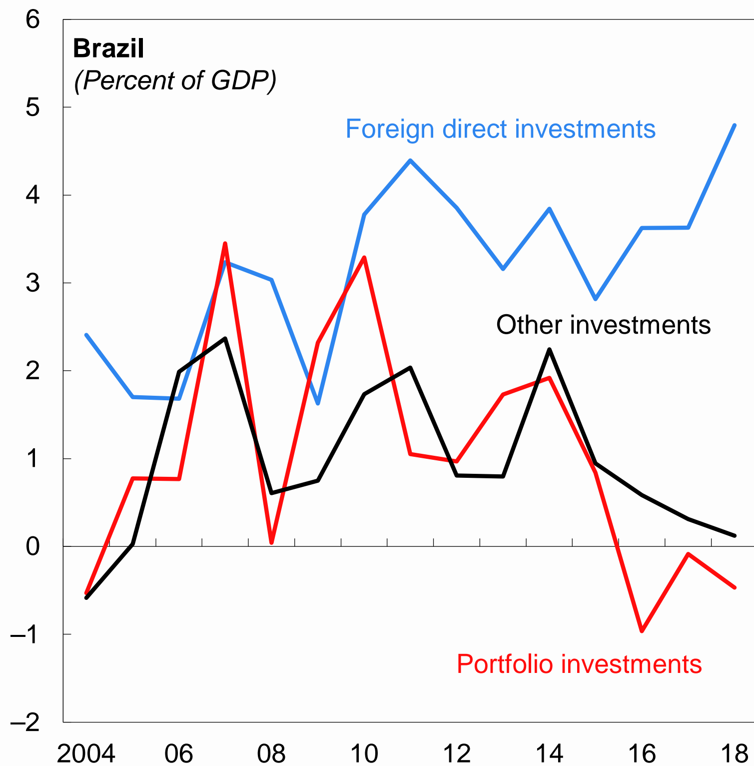
The resilience of FDI in LAC contrasts with steep decline in AEs and other EMs.



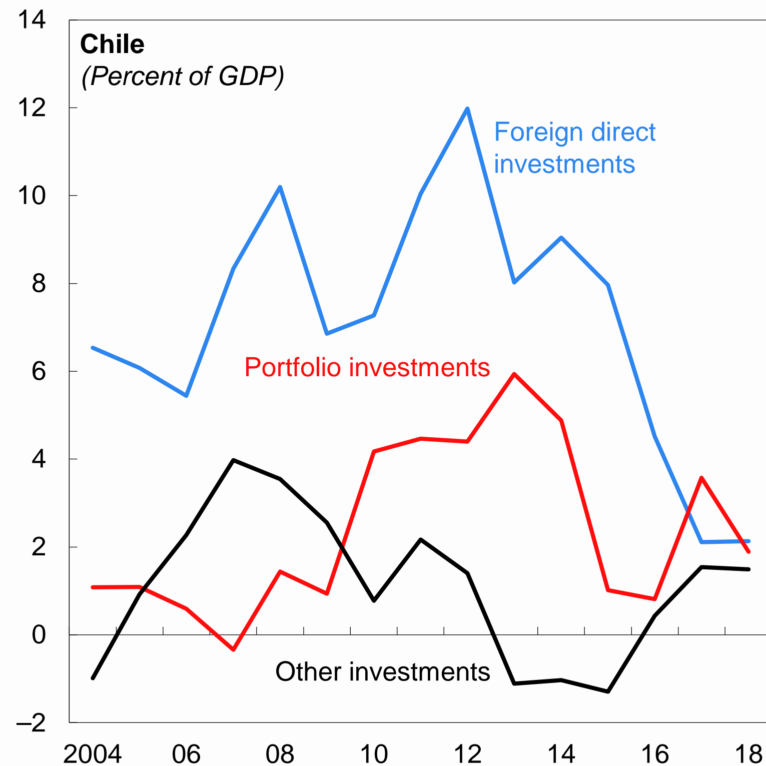
Sources: IMF, Balance of Payments Statistics database; and IMF staff calculations.
Note: FDI = foreign direct investments.

But aggregate trends mask differences across countries

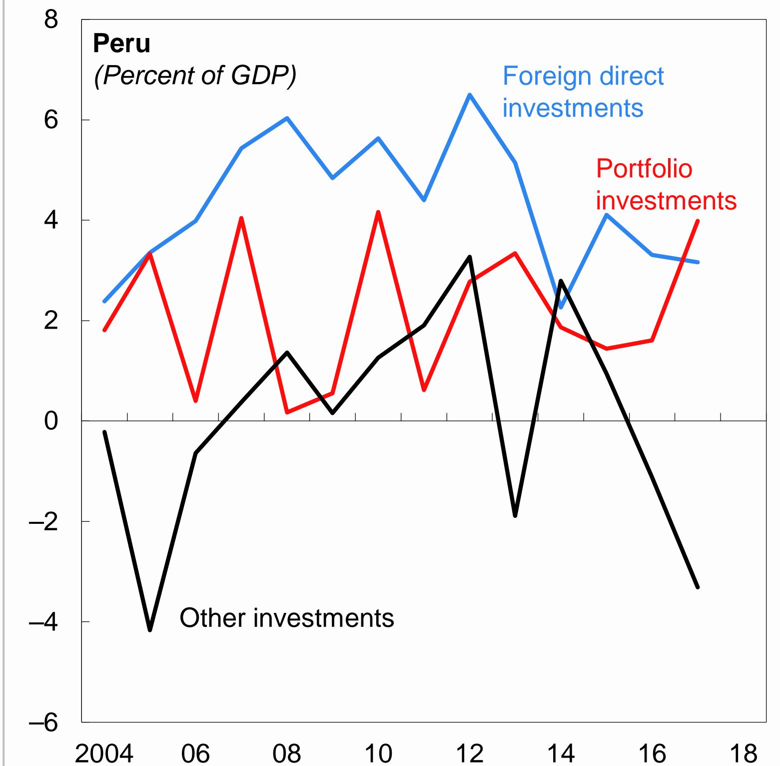
Since 2014 FDI increased in Brazil…



… but fell in metal exporters (Chile and Peru).



Gross portfolio inflows declined in most countries, except for Peru.



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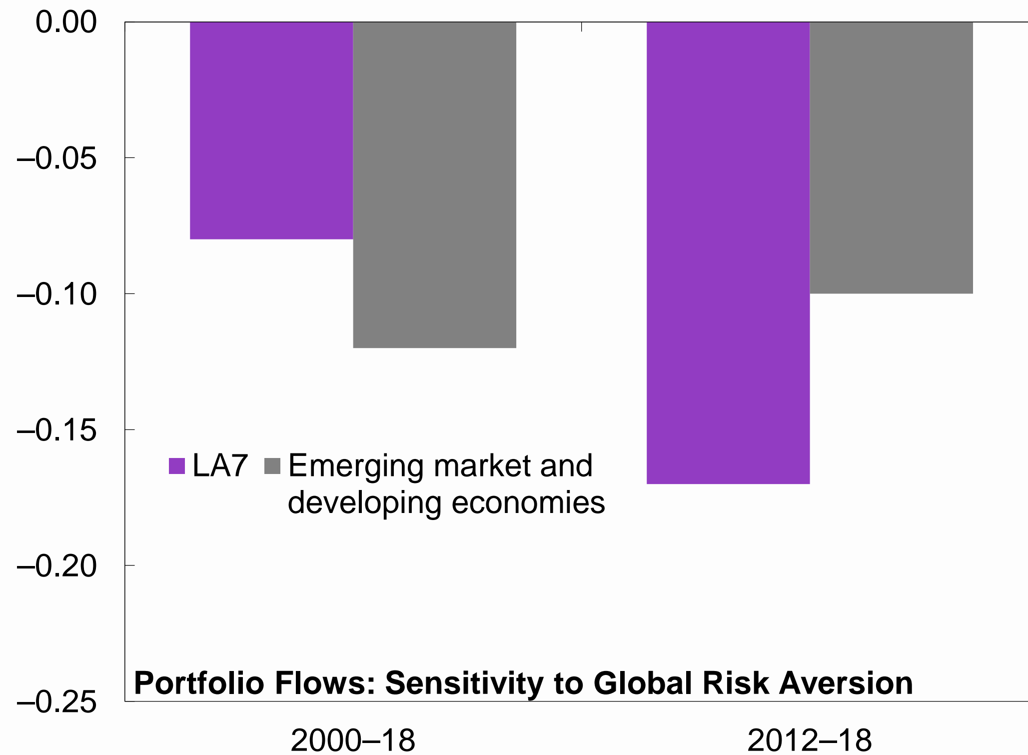
Note: FDI = foreign direct investments.

Sensitivity to Main Drivers has Changed

Portfolio flows to the region have become more sensitive to global factors…



Source: IMF staff calculations.
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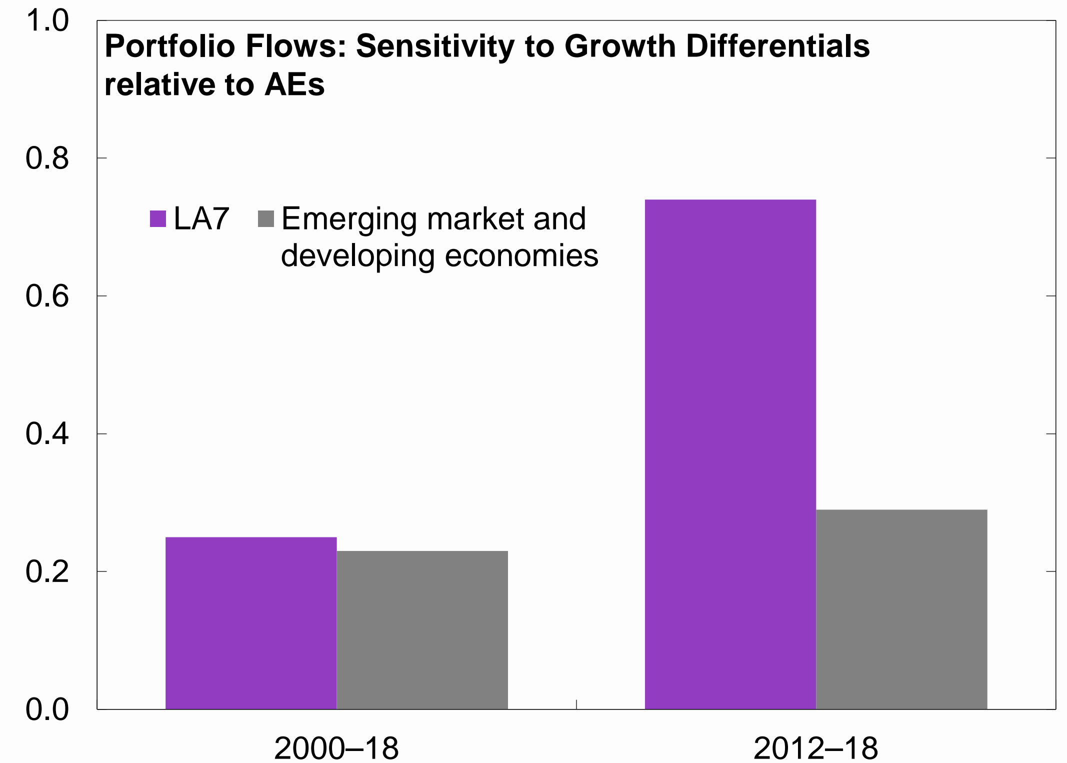
… and also to growth differentials. This implies increased vulnerabilities, given current global environment.

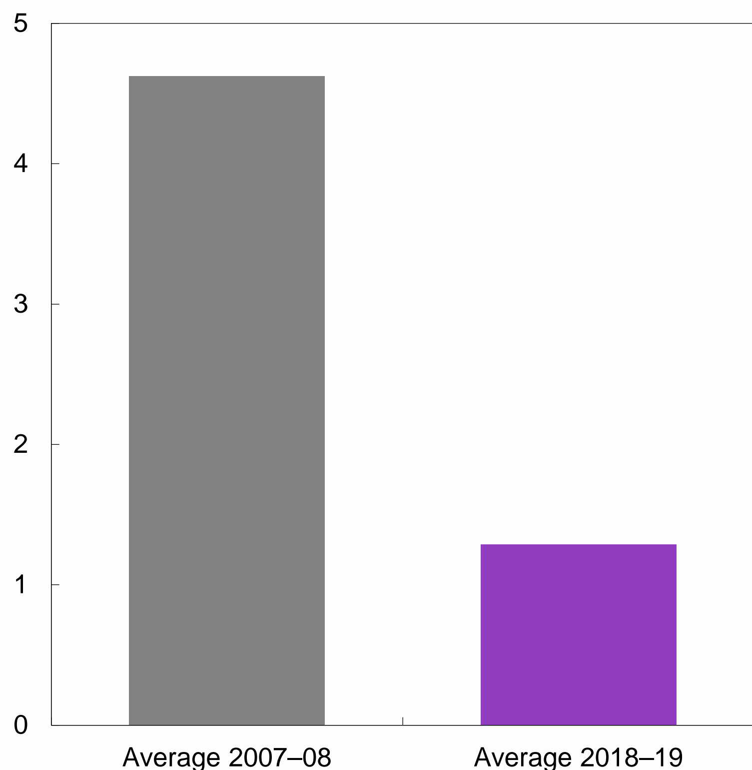


Source: IMF staff calculations.
Note: LA7 = Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay.

Currently the region has weaker domestic fundamentals than prior to 2008–09 event…

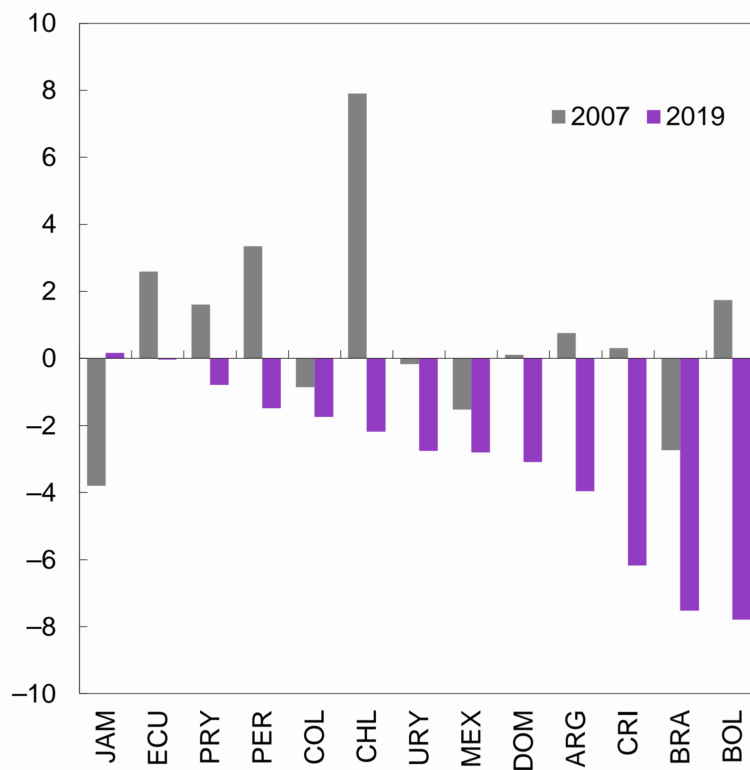
Growth in the region is lower and fiscal deficits, and public debt are higher today than at the end of 2007 in most countries…

LAC: Real GDP Growth
(Year-over-year percent change; average; excludes Venezuela)



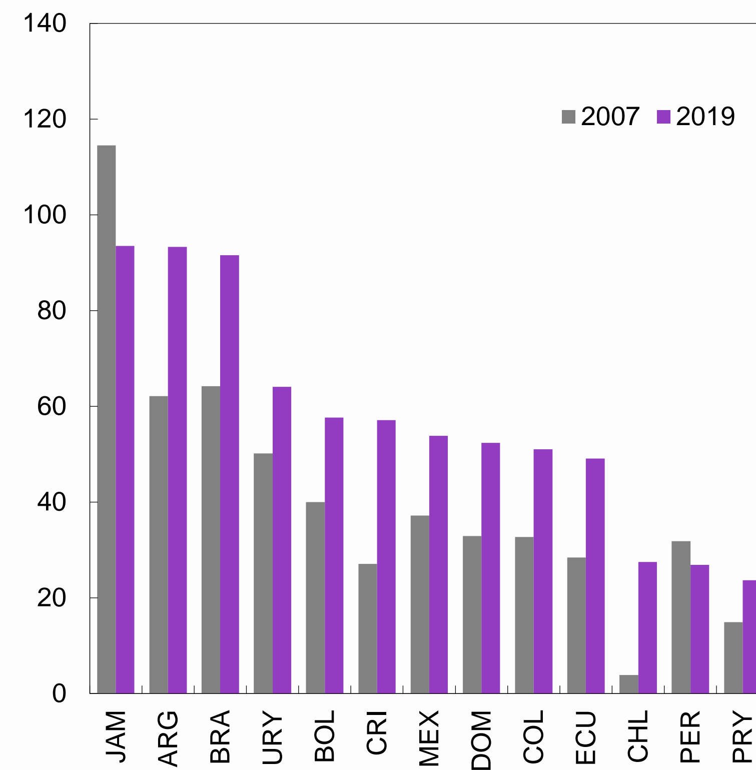
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Purchasing-power-parity GDP-weighted average.

Fiscal Balance
(Percent of GDP)



Source: IMF, World Economic Outlook database.

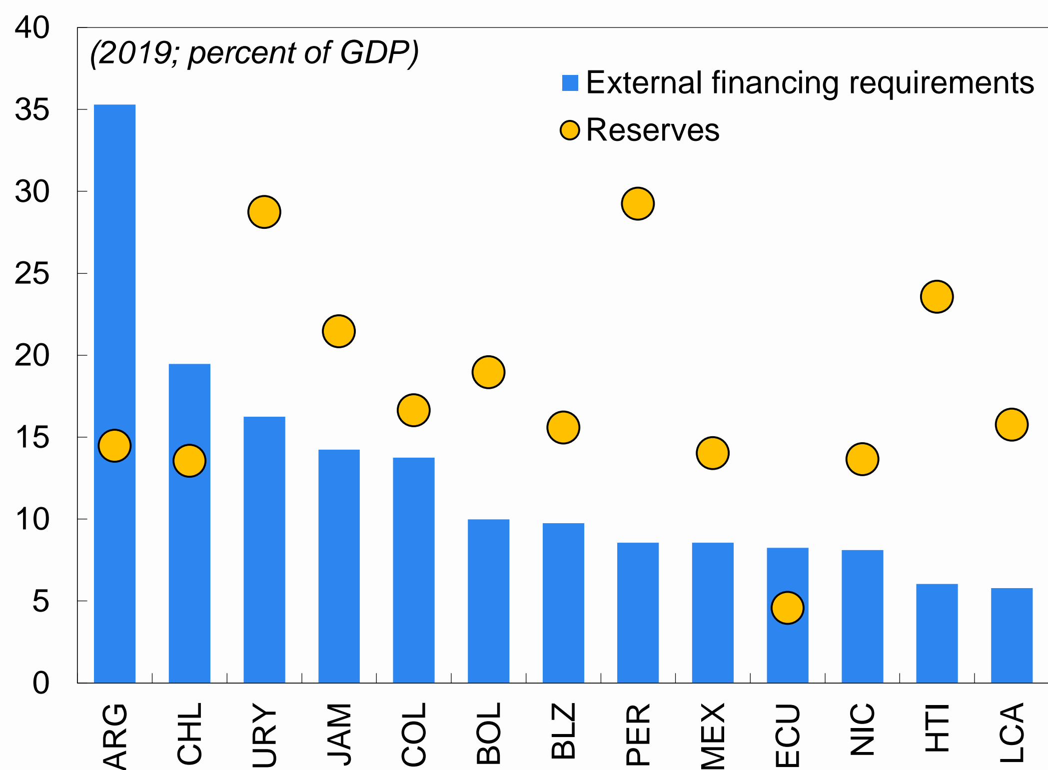
Gross Debt
(Percent of fiscal year GDP)



Source: IMF, World Economic Outlook database.
Note: Gray bar for Uruguay reflects data for 2008.

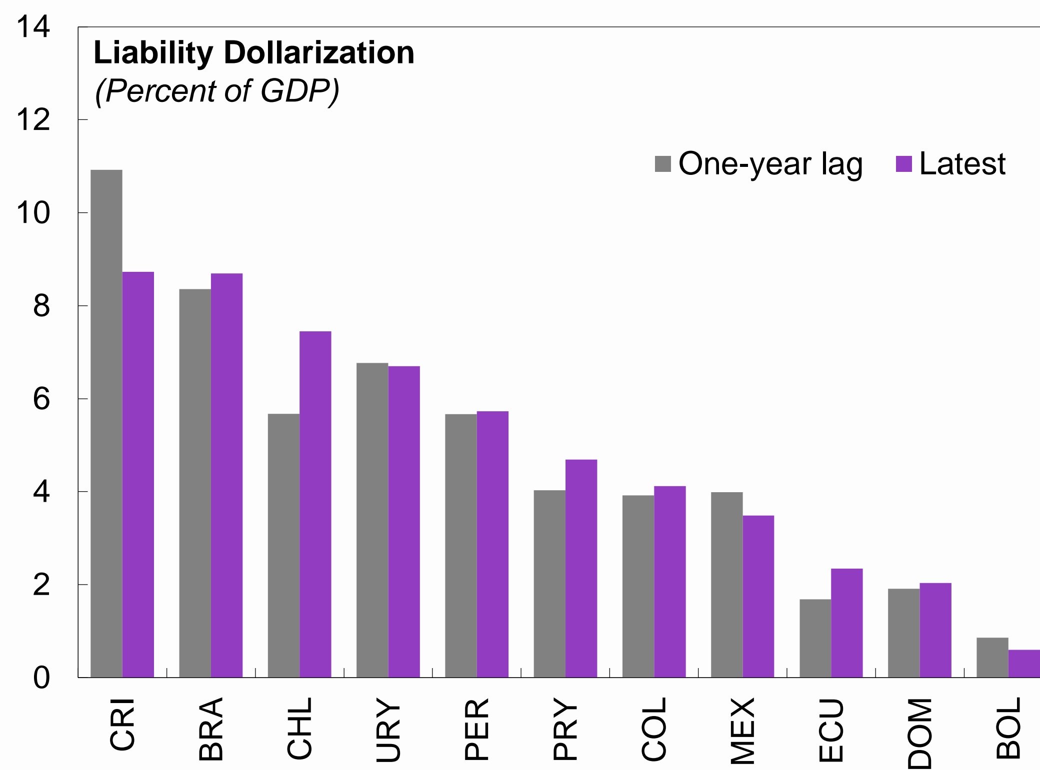
… but most countries have lower external vulnerabilities

Most countries have adequate reserve buffers relative to the projected external financing requirements.



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Note: External financing requirements (public and private sector) calculated as the difference between short-term debt on a remaining maturity basis and current account balance.

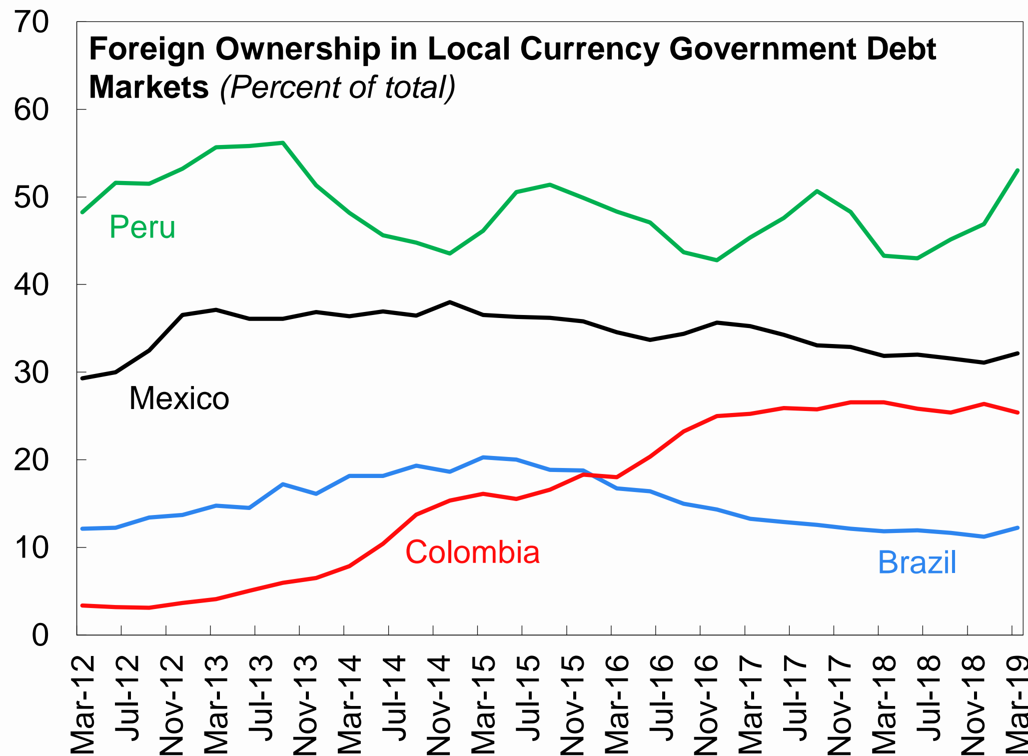
Liability dollarization has remained broadly stable over the past year.



Sources: IMF, International Financial Statistics database; IMF, World Economic Outlook database; and IMF staff calculations.

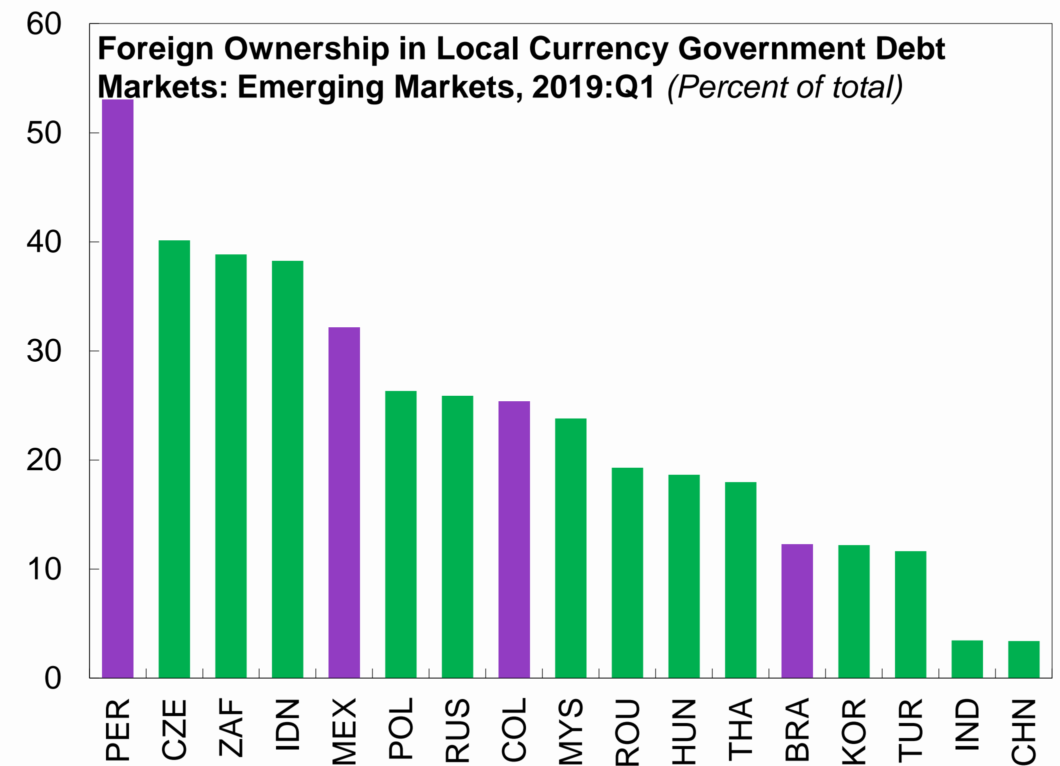
Even though some countries have a high share of foreign participation in domestic bond markets

Foreign participation in domestic debt markets has increased in Colombia, but remained stable in Brazil and Mexico.



Sources: Haver Analytics; and The Institute of International Finance.

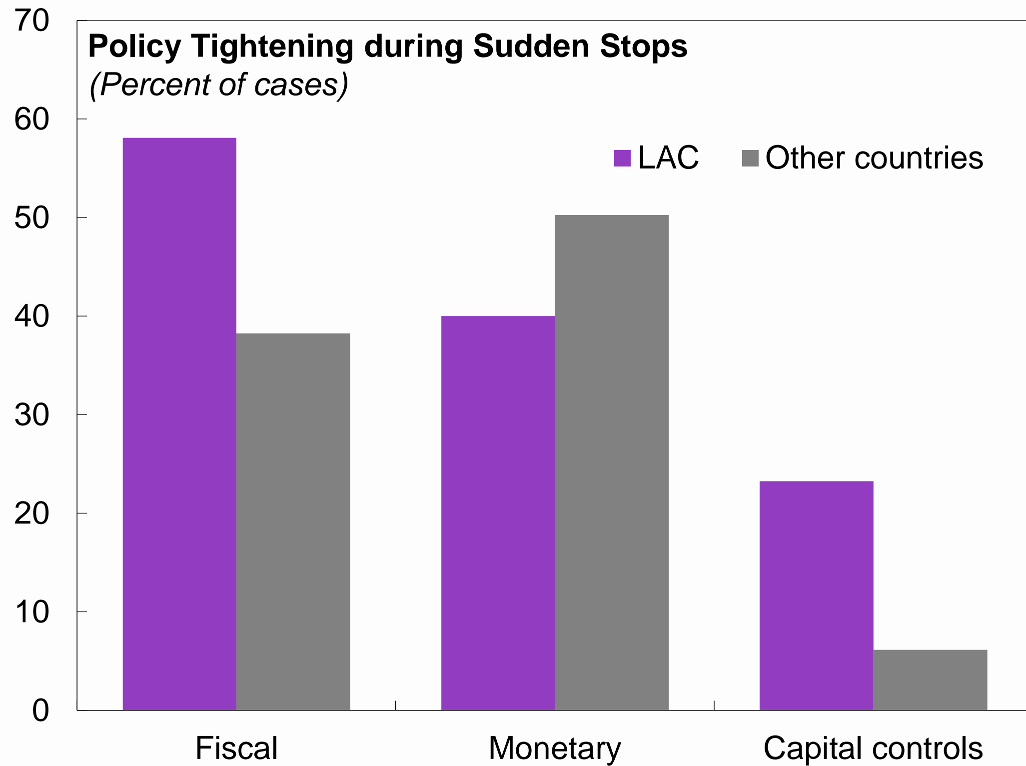
Peru stands out as having a relatively high levels of foreign participation in debt markets.



Sources: Haver Analytics; and The Institute of International Finance.

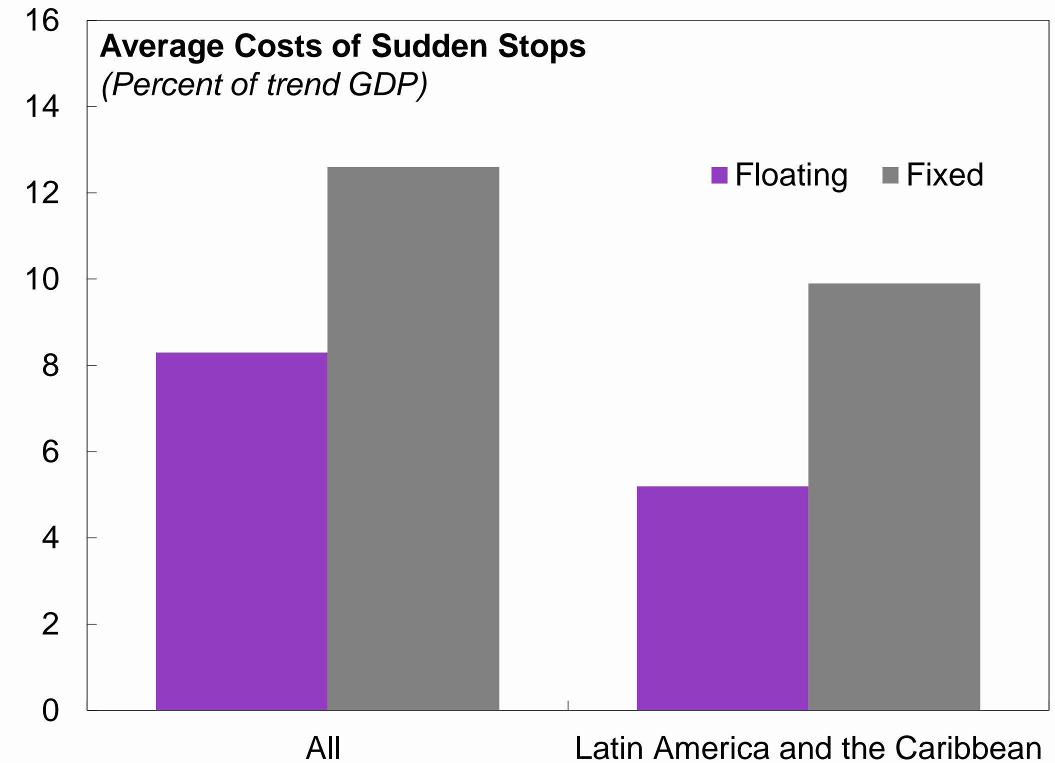
How Have Countries Responded to Sudden Stops?

LAC countries are more prone to tighten fiscal policy and use capital controls after the onset of sudden stops.



Source: IMF staff calculations.

Sudden stops tend to be less costly in countries with floating exchange rate regimes (at the onset of the episode).



Source: IMF staff calculations.

How to Deal with Sudden Stops? Shortening the Pain

Duration Models of Sudden Stops and Growth Decelerations

	Sudden Stops		Growth Decelerations	
	(1)	(2)	(3)	(4)
	Weibull	Gompertz	Weibull	Gompertz
GDP per capita (initial)	0.76**	0.76**	0.74**	0.75**
	(-2.43)	(-2.18)	(-2.30)	(-2.21)
Exchange rate regime (initial)	1.62***	1.96***	1.84***	1.81***
	(2.86)	(3.76)	(2.80)	(2.86)
Δ Terms of trade	1.13***	1.12***	1.10***	1.09***
	(2.95)	(2.84)	(2.64)	(2.88)
Δ Monetary	1.03	1.06*	1.05***	1.05***
	(1.16)	(1.93)	(3.06)	(3.23)
Δ Fiscal	1.02	1.02	0.99	0.99
	(0.71)	(0.82)	(-0.18)	(-0.31)
Δ Reserves	1.01**	1.01***	1.01	1.01
	(2.12)	(2.65)	(1.50)	(1.59)
Δ Capital controls	0.96	1.00	0.97	1.03
	(-0.17)	(-0.014)	(-0.066)	(0.073)
Constant	0.16	0.41	0.34	0.79
	(-1.57)	(-0.74)	(-0.85)	(-0.19)
θ	2.90***		1.57***	
	(12.69)		(8.07)	
		1.83***		1.06***
γ		(10.39)		(5.70)
Observations	145	145	97	97

Coefficient means that featuring a flexible exchange rate regime increases the odds of exiting the sudden stop in 81%.

Source: IMF staff calculations.
Note: Exponentiated coefficients. t-statistics in parentheses. Standard errors clustered by country. Weibull and Gompertz refer to the distributions assumed for the baseline hazard (see Annex 3).
*** p<0.01, ** p<0.05, * p<0.1

Conclusions

- Capital flows have become more sensitive to global risk aversion, U.S. interest rates, and growth differentials vis-à-vis advanced economies.
- Domestic fundamentals are weaker than in 2007-08 but external vulnerabilities are lower.
- Floating exchange rate regimes reduce the duration of sudden stops and the output losses associated with them (a flexible regime increases the probability of exiting a sudden stop by at least 60 percent).
- Monetary policy tightening also shorten the duration of sudden stops, while capital controls do not have statistically significant effects.

Thank You