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

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

  - Case study of five Latin American economies (Brazil, Chile, Mexico, Colombia, Peru).
  - $\bar{g}_{i,fc} - \bar{g}_{i,ac} = \alpha + \beta(X_{i,bfc} - X_{i,bac}) + e_i$

- 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?

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

Depreciations improve net IIP conditions

Source: Itaú Unibanco, Haver Analytics
Exchange-Rate Flexibility (Losing the Fear of Floating) Was Due to:

Lower Exchange-Rate Pass-Through to Inflation

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Mexico*</td>
<td>0.94</td>
<td>0.03</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.84</td>
<td>0.05</td>
</tr>
<tr>
<td>Peru</td>
<td>0.11</td>
<td>0.09</td>
</tr>
<tr>
<td>Chile</td>
<td>0.07</td>
<td>0.03</td>
</tr>
</tbody>
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*According to Mexico Central Bank’s estimate after 2001

More-Adequate Monetary Policy Response This Time Around

Exchange Rate Depreciation vs. Interest Rates Response

Source: Itaú Unibanco, Haver Analytics, Countries’ Central Banks
But Flexible Exchange Rates Are no Panacea: Need Reserves

Source: Itaú Unibanco, Haver Analytics
But Less Affected by World Economy Growth Shocks

- 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)

<table>
<thead>
<tr>
<th>Dependent Variable: Latin America Growth</th>
<th>1996Q3 - 2004Q4</th>
<th>2001Q1 - 2011Q3</th>
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</thead>
<tbody>
<tr>
<td>World GDP growth (QoQ, %)</td>
<td>2.06</td>
<td>1.02</td>
</tr>
<tr>
<td>Principal component</td>
<td>0.005</td>
<td>0.0013</td>
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</table>

### VaR Analysis

<table>
<thead>
<tr>
<th>Cumulative response of Latin America growth to one unit shock</th>
<th>1996Q3 - 2004Q4</th>
<th>2001Q1 - 2011Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMDI (% of change)</td>
<td>0.04</td>
<td>0.02</td>
</tr>
<tr>
<td>World GDP growth (QoQ, %)</td>
<td>4.32</td>
<td>2.62</td>
</tr>
<tr>
<td>VIX</td>
<td>-0.0018</td>
<td>-0.0011</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.65</td>
<td>0.81</td>
</tr>
</tbody>
</table>

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.