

Global Crisis and its Impacts on Latin Am

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THE ASIAN TIGERS SHOWED SOLID ECONOMIC FUNDAMENTALS

- ***Fiscal discipline (solid fiscal surpluses)***
- ***Low inflation***
- ***High savings ratios***
- ***Significant gross domestic investment***
- ***Sustained high growth rates***
- ***Liberalized trade and financial markets***
- ***High capital inflows and robust local stock and fixed asset markets***

BUT, SOME WEAKNESSES MADE THEM VULNERABLE

- ***Weak banking system***

- over-lending to related industrial conglomerates
- highly leveraged financing of low return projects (real estate, infrastructure)
- massive speculative borrowing

- ***High and growing private external debt***

- ***Overvalued currencies and shrinking competitiveness***

- currencies pegged to the appreciating dollar
- low cost competitors (China and India)
- depreciation of the yen

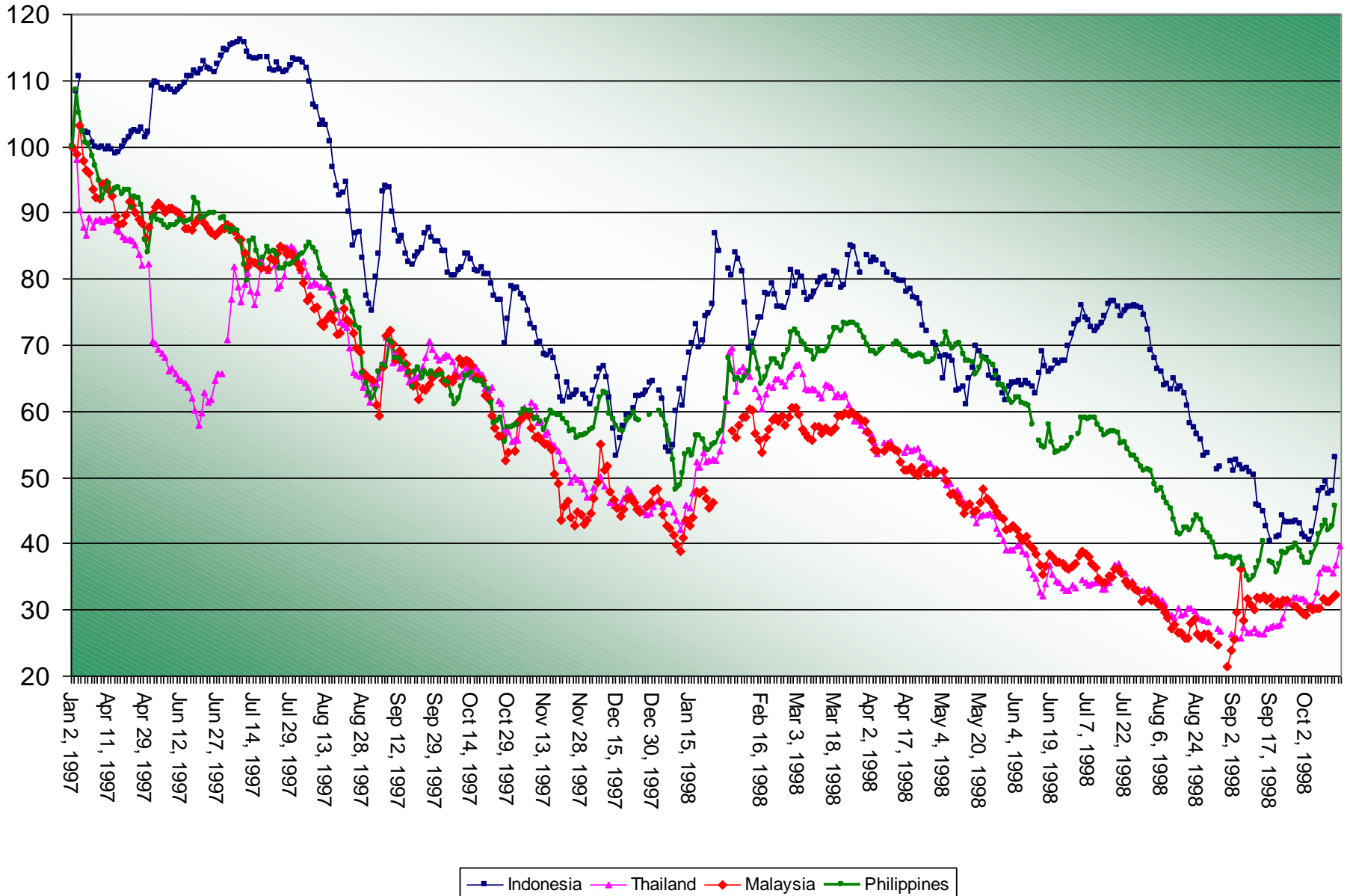
- ***Growing current account deficits***

THE OUTBREAK OF THE ASIAN CRISIS

- *Devaluation expectations in the South-East Asian countries*
- *Collapse of local capital markets due to massive sales of stocks and bonds*
 - *need of local liquidity to buy dollars*
 - *need of funds to cover margin calls*
- *Massive capital flight*
 - *speculative movements*
 - *hedging of private foreign liabilities*
- *Devaluations*

Asian Stock Markets Indexes

(Jan 2th 1997=100)

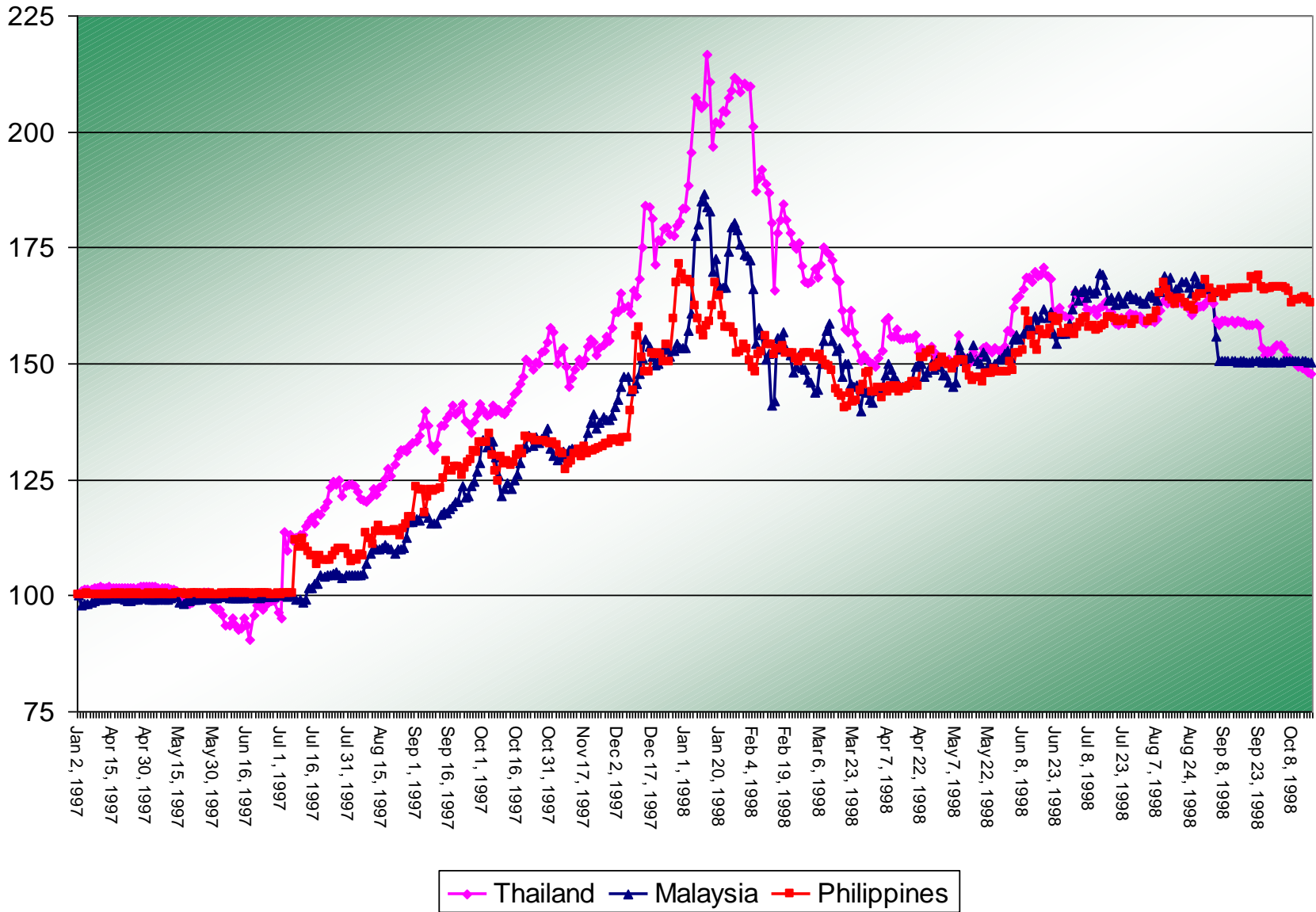


Indonesia Thailand Malaysia Philippines

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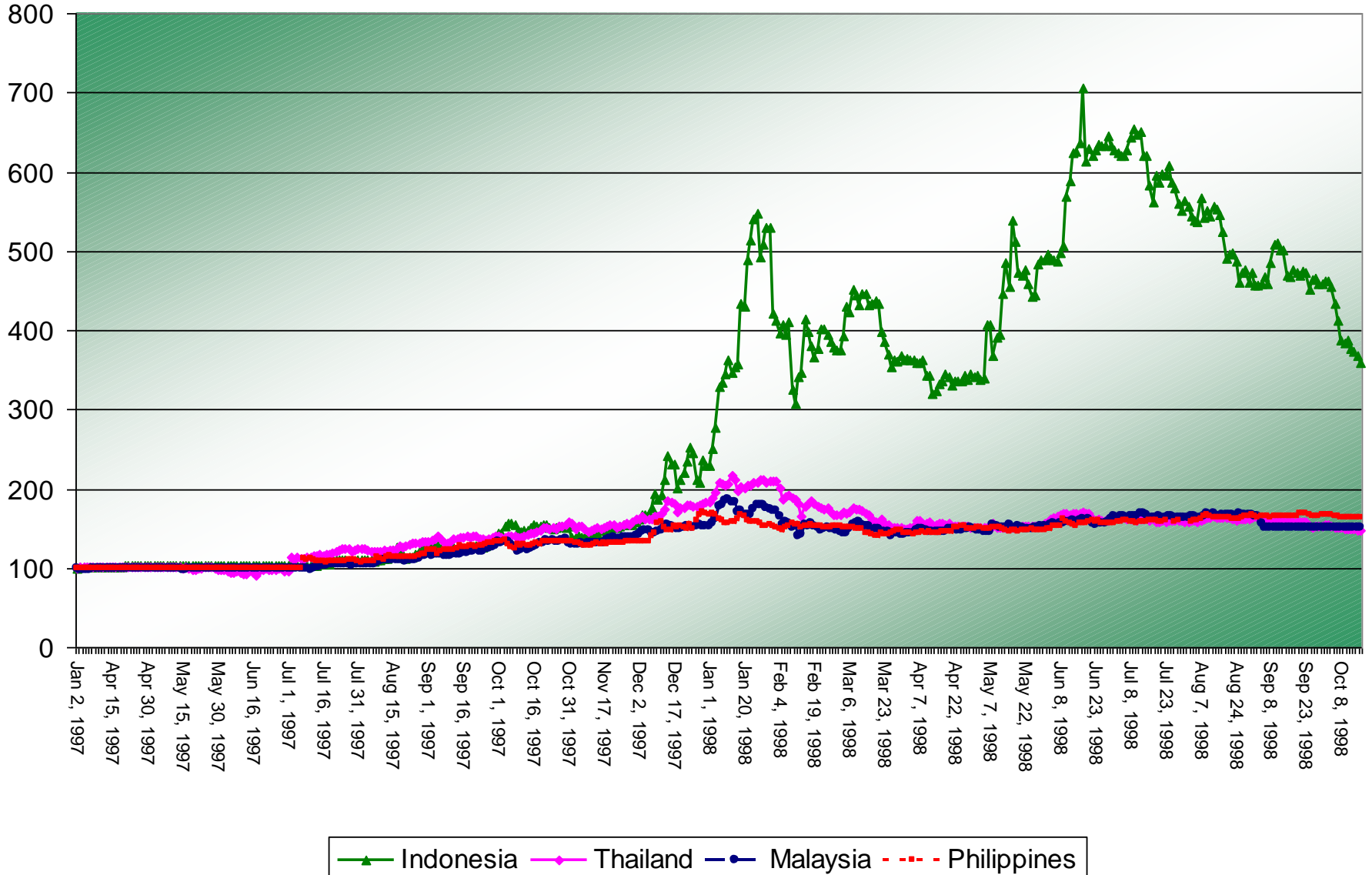
Asian Exchanges Rates Indexes (Jan 2th, 1997=100)



◆ Thailand ▲ Malaysia ■ Philippines

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THE OUTBREAK OF THE ASIAN CRISIS

(cont.)

- *Tight monetary policies and high interest rates*
- *Local banking crises*
 - *deposit contractions*
 - *increase in non-performing assets*
 - *enlargement of foreign currency exposure*
- *Difficulties of debtors*
 - *higher local debt services (higher interest rates)*
 - *need to cover their creditors margin requirements*
 - *higher foreign currency prices*
- *Recession or slowdown*

OTHER ASIAN ECONOMIES EXPERIENCE ADVERSE SITUATIONS

- ***Japan has severe internal problems***

- *crisis in the banking system*

- *recession*

- *lack of proper economic policies*

- ***South-East Asian crises became contagious***

- *Korea suffered similar problems (devaluation, high interest rates, recession and weak stock market)*

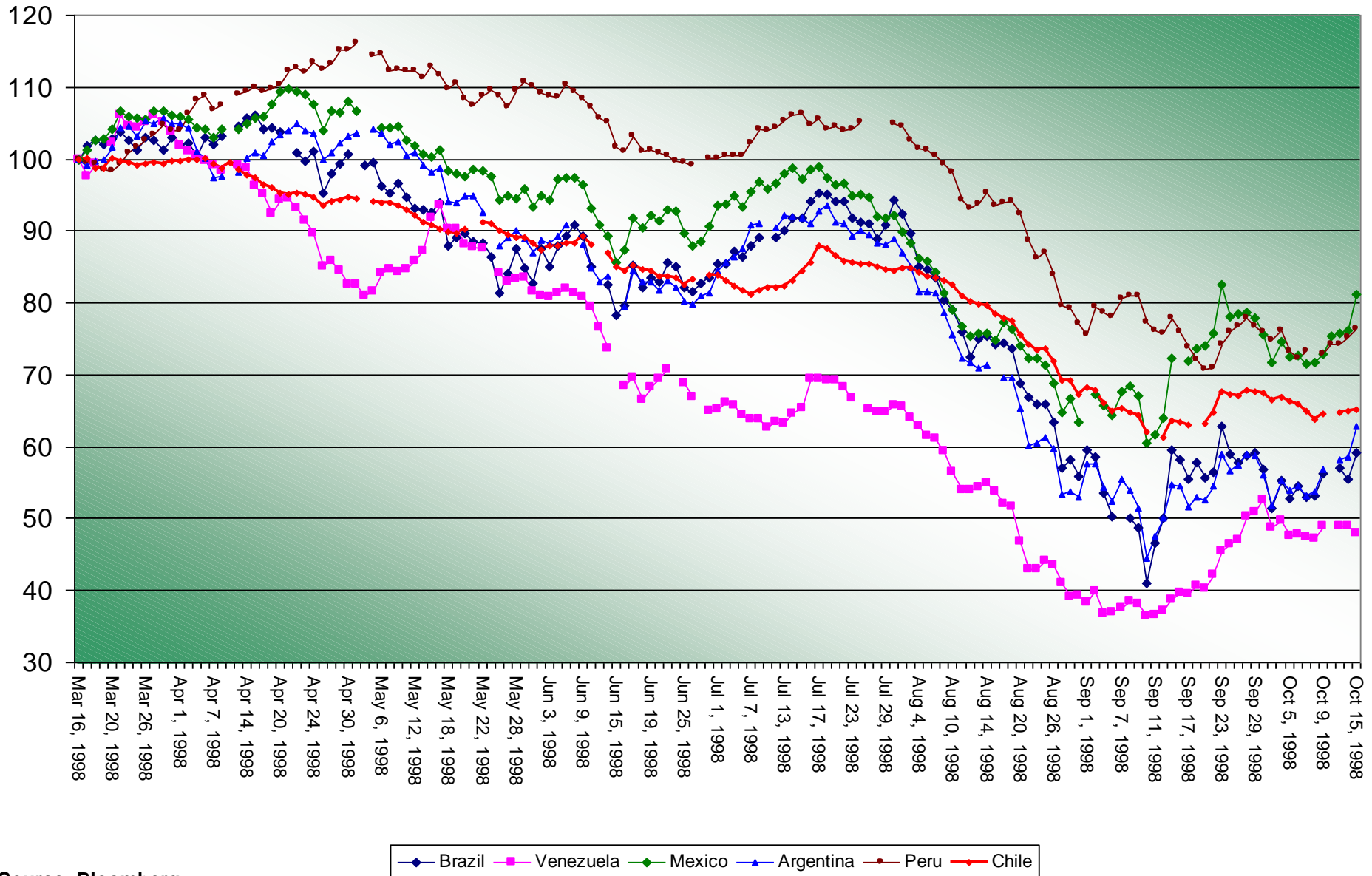
- *Hong Kong kept its exchange rate fixed but at a very high price (high interest rates, recession, severe contraction of stock prices)*

IMPACTS OF THE ASIAN CRISIS ON LATIN AMERICA

- ***High repercussion on the financial sector***
 - *higher country risk perceptions and devaluation expectations (overvalued currencies)*
 - *decline in stock markets*
 - *profits taken in Latin America to compensate Asian losses*
 - *need of local liquidity to buy dollars*
 - *net capital outflow and contraction of international reserves*
 - *deceleration of foreign investment*
 - *limited access to international capital markets*

Latin American Stock Market Indexes

(March 16th, 1998=100)



Source: Bloomberg

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IMPACTS OF THE ASIAN CRISIS ON LATIN AMERICA (cont.)

- **Negative effects on trade**

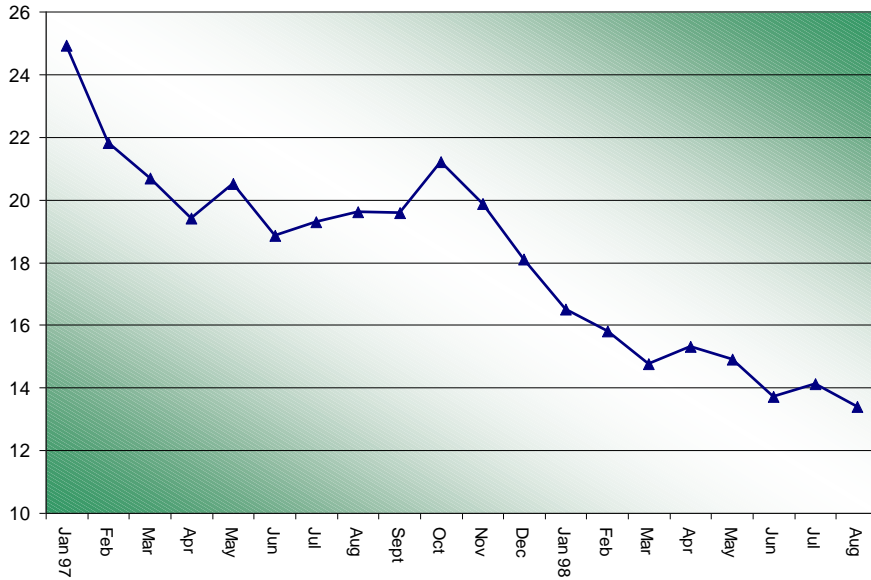
- contraction of exports volumes to Asian economies
- deterioration of terms of trade due to commodity price reductions
- lower competitiveness due to the devaluations of Asian currencies

- **Fiscal deterioration**

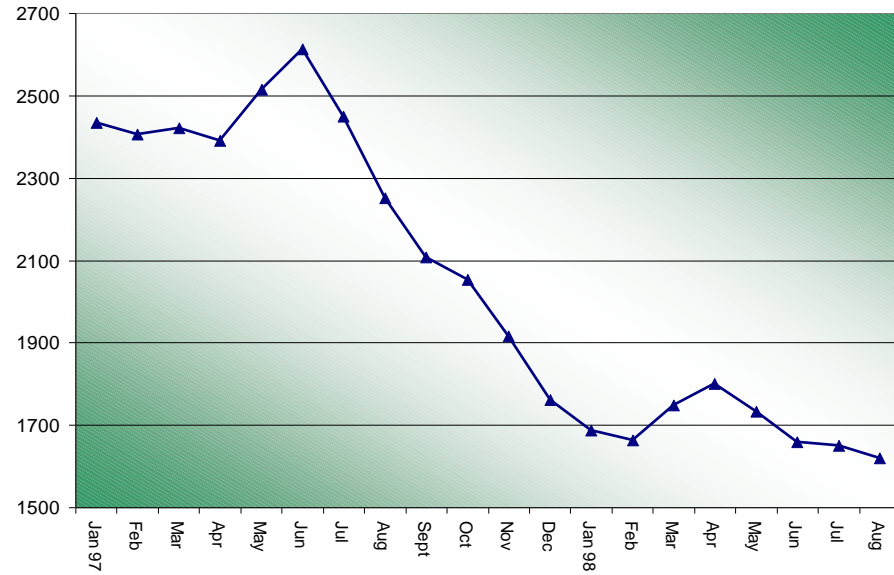
- lower fiscal revenues from commodity export activities
- reduction of tax collection due to economic slowdown
- higher internal debt service due to higher local interest rates
- adverse external borrowing conditions

Selected Commodity Prices Indicators

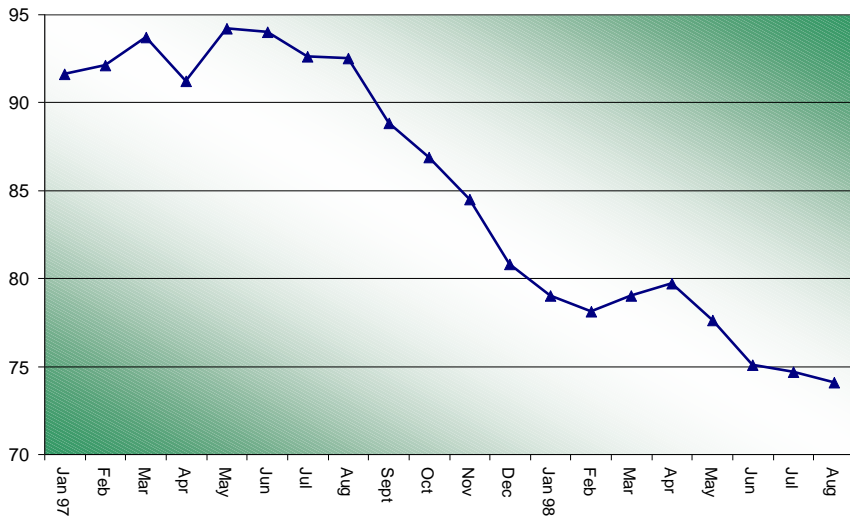
Oil Prices (WTI) US\$/B



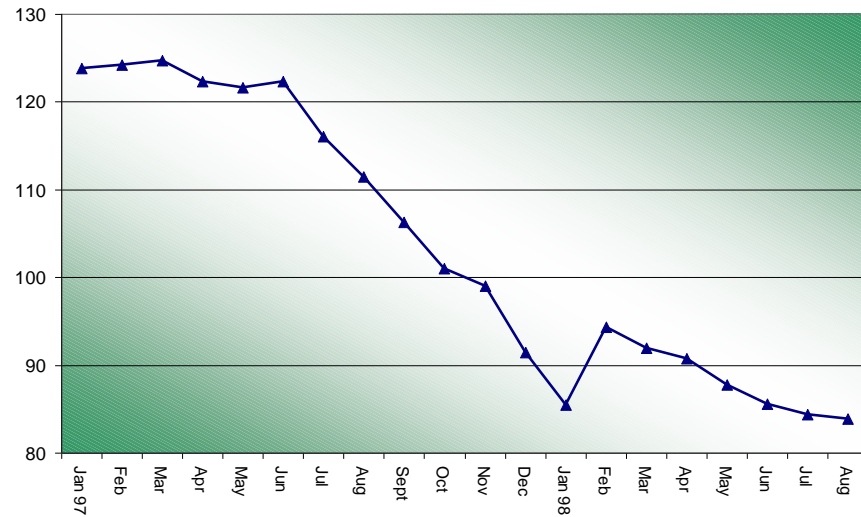
Copper Prices US\$/mt



Metals and Minerals Prices Index (World Bank 1990=100)



Raw Materials Prices Index (World Bank 1990=100)



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POLICY MEASURES TO COPE WITH THE CRISIS

- ***Tight monetary policies in response to speculation against local currencies***
 - *higher interest rates*
 - *liquidity contractions*
- ***Restrictive fiscal policies***
 - *higher taxes*
 - *cuts in expenditures*
 - *limited amounts of additional borrowing due to financial market restrictions*
- ***Anti-dumping and safeguard measures to protect local producers from Asian products***
- ***Production cuts in oil exporting countries in order to reinforce international prices***

THOSE POLICIES HAD IMPORTANT CONSEQUENCES

- ***Economic slowdowns***
- ***Higher unemployment and worsened social conditions***
- ***Negative effects on the banking systems***
 - *contraction of deposits due to capital flight*
 - *portfolio deterioration due to high interest rates*
 - *limited access to central bank financing*
 - *higher reserve requirements*
 - *higher costs and lower earnings*
- ***Halt or deceleration of important investment projects***

THE RUSSIAN CRISIS WORSENERED THE LATIN AMERICAN SITUATION

- ***The origins of the Russian crisis were multiple***

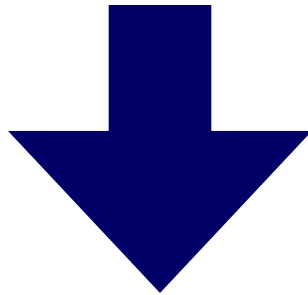
- decline of export commodity prices, particularly oil and gas (Asian crisis effect)*
- political instability*
- recurrent and growing high fiscal deficits*
- massive borrowing to finance fiscal deficits causing interest rates to soar*
- high exposure of local banks to government bonds*

- ***Confidence on government securities and the ruble waned in spite of some initial help from the IMF***

- capital flight*
- decline of security prices*
- fast drop of international reserves*

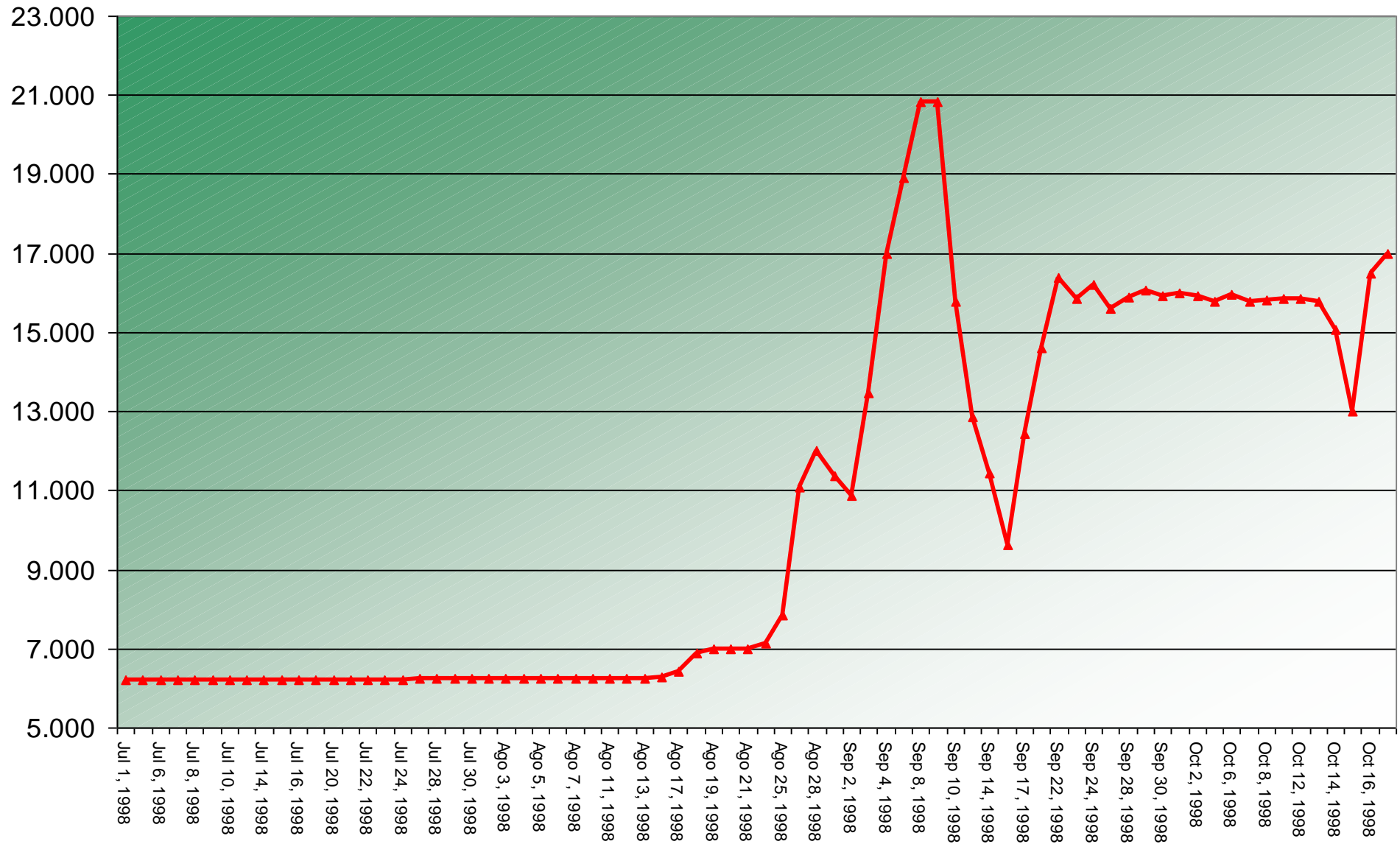
THE RUSSIAN CRISIS WORSENERED THE LATIN AMERICAN SITUATION (cont.)

- *On August 17, 1998 dramatic decisions were taken*
 - *devaluation of the ruble*
 - *default on domestic debt*
 - *capital account restrictions, including moratorium on repayment of foreign financial obligations such as forward exchange contracts*

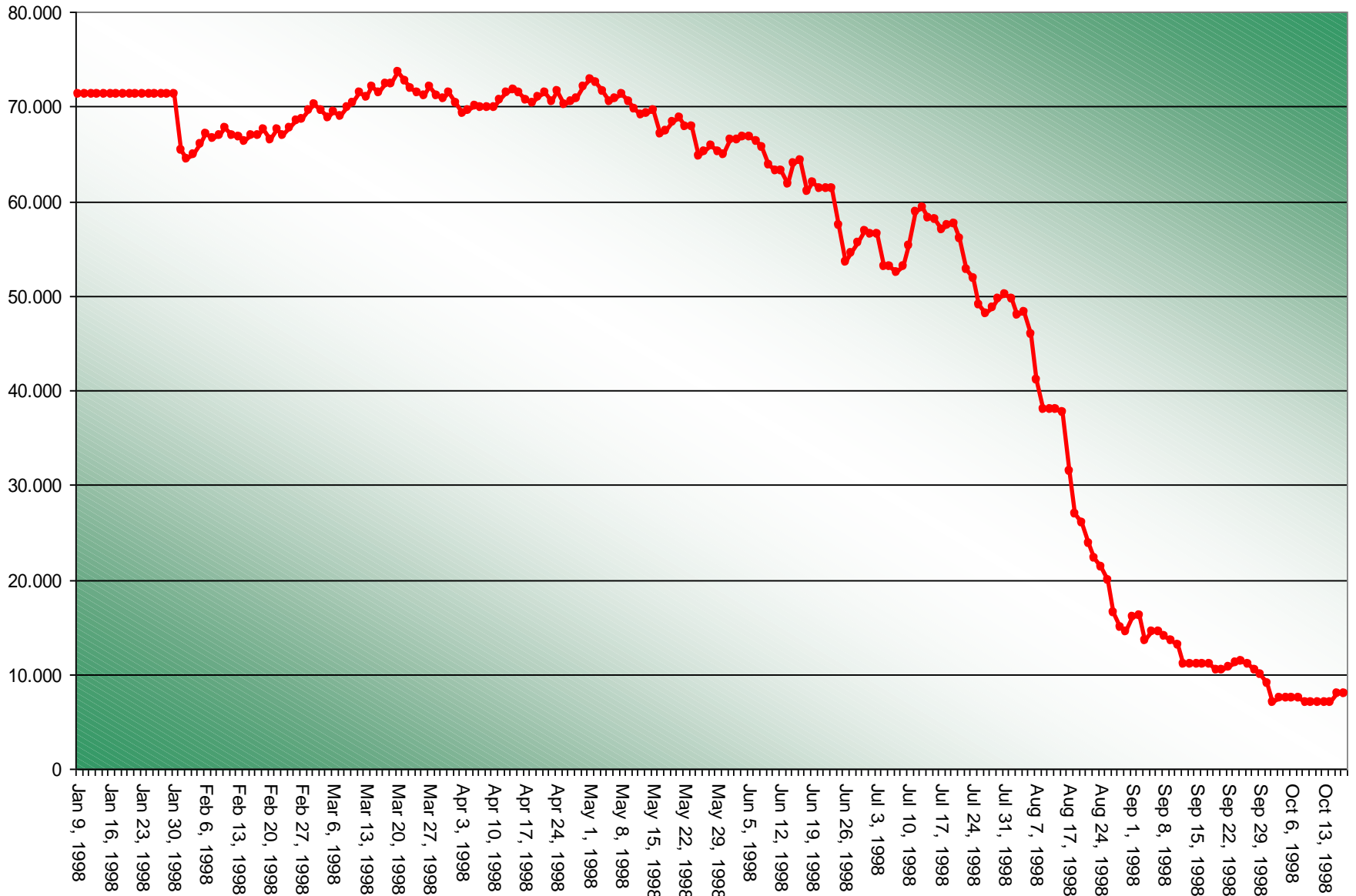


**A GENERALIZED ACUTE CONFIDENCE
CRISIS DEVELOPED**

Ruble Exchange Rate (R/US\$)



Russian International Bond Price (Ian)



THE RUSSIAN CRISIS AFFECTED GLOBAL FINANCIAL MARKETS AND EMERGING REGIONS, LATIN AMERICA AMONG THEM

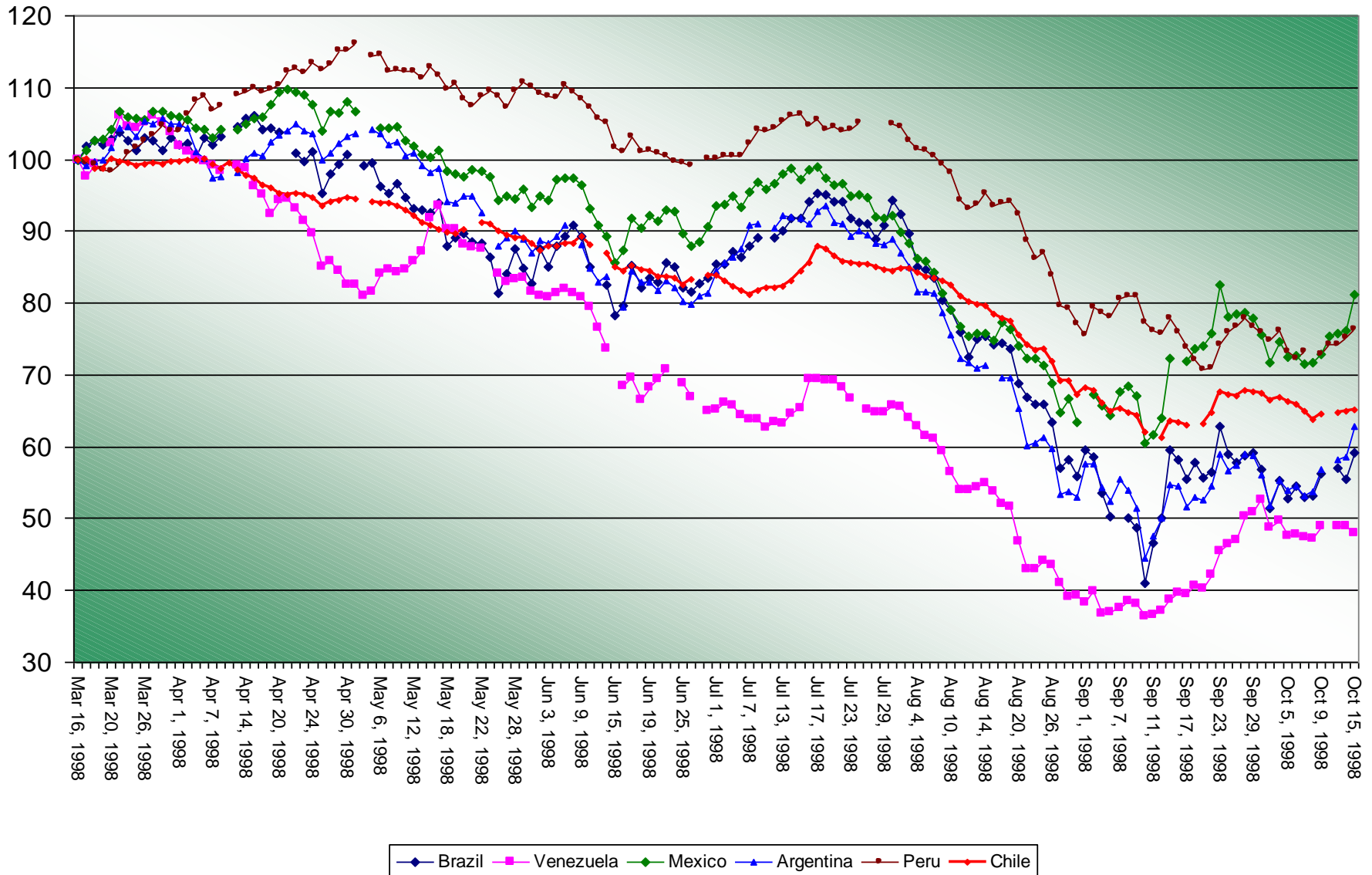
- *The collapse of Russian bonds made international investors lose heavily*
- *Investors' risk tolerance waned, particularly in the emerging markets*
- *Massive capital flight from Latin American economies took place*
 - *selling of high risk local securities in order to avoid further losses (contagious effect)*
 - *devaluation expectations*
 - *higher country risks (vulnerability of regional economies to external pressures)*

THE RUSSIAN CRISIS AFFECTED GLOBAL FINANCIAL MARKETS AND EMERGING REGIONS, LATIN AMERICA AMONG THEM (cont.)

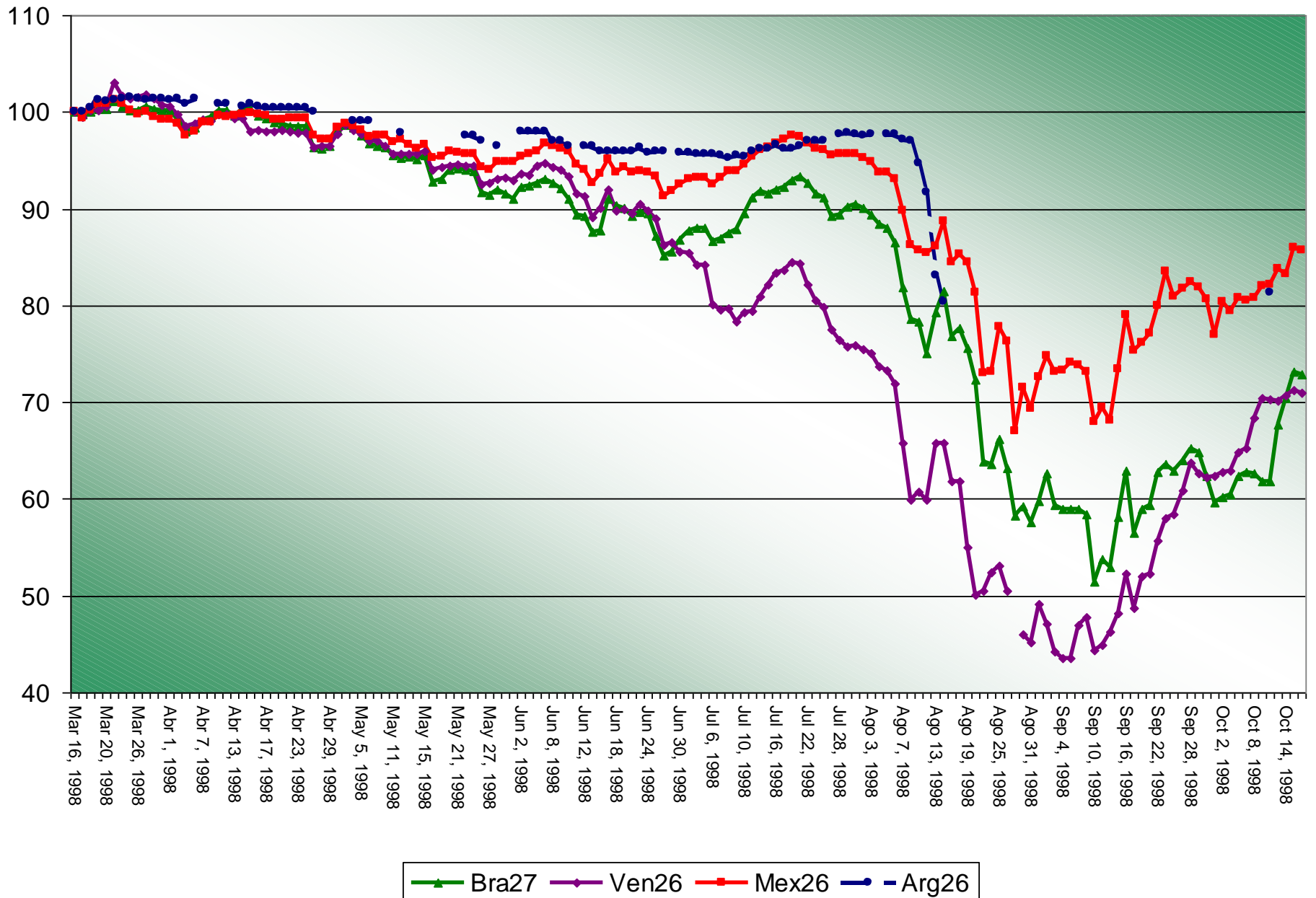
- ***This situation has had negative consequences on these economies***
 - *stock prices have plummeted*
 - *international bond prices collapsed limiting international financing*
 - *international reserves contracted*
 - *monetary restriction and high interest rates had negative effects on banks*
 - *economic activity slowed down*
- ***The situation has been particularly critical in Brazil (inevitable severe adjustment)***

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External Debt Prices (Index 1990=100)



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LESSONS TO LEARN

- *Globalized world economy makes emerging markets very vulnerable to external crises (contagious effect)*
- *The presence of internal imbalances substantially increases that vulnerability*
- *It is critical for these economies to keep economic fundamentals in check*
- *Some type of safeguard mechanisms should be developed in order to reduce the exposure of emerging economies to those external crises*

A SUGGESTION

Some sort of sovereign insurance mechanism, provided by a multilateral organization that would protect foreign and local investors of acute losses of their assets in these economies, should be studied. The premium of that insurance, to be paid by the different affiliated nations, would be established in line with some predetermined standards of economic performance, making that premium the higher the farther the economic reality is from those standards. The basic objective of such insurance is to strengthen the confidence of investors, thereby reducing the possibilities of destabilizing massive speculative actions to take place. In addition, such a facility would reinforce the response capacity of emerging economies to external adverse situations, therefore minimizing the very negative contagious effects of the recent economic crises or of those to come.