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

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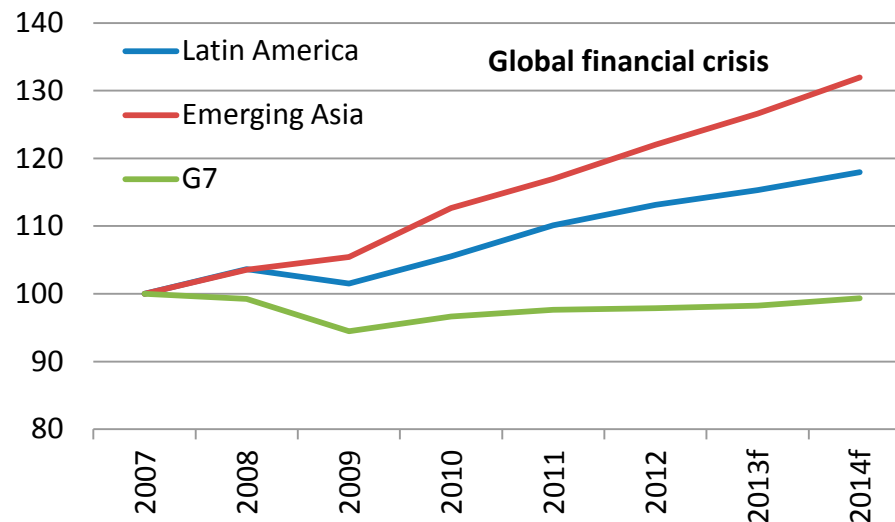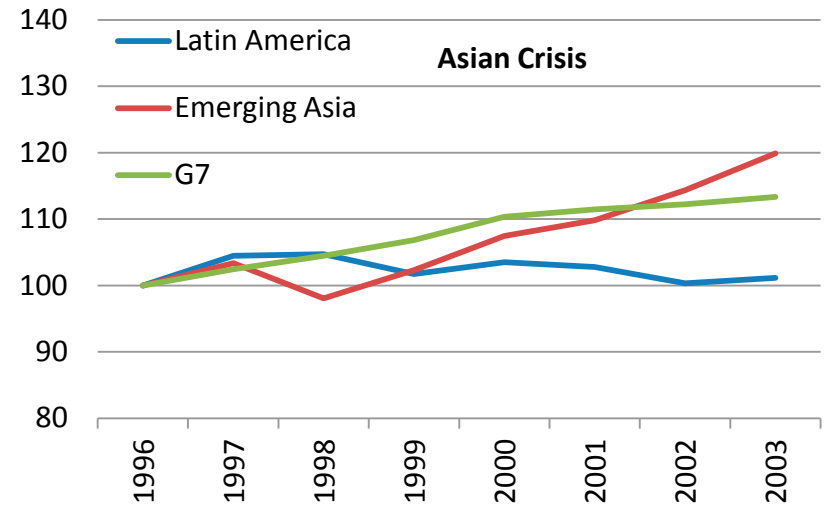# WHY DID LATIN AMERICA AND DEVELOPING COUNTRIES PERFORM BETTER IN THE GLOBAL FINANCIAL CRISIS THAN IN THE ASIAN CRISIS?

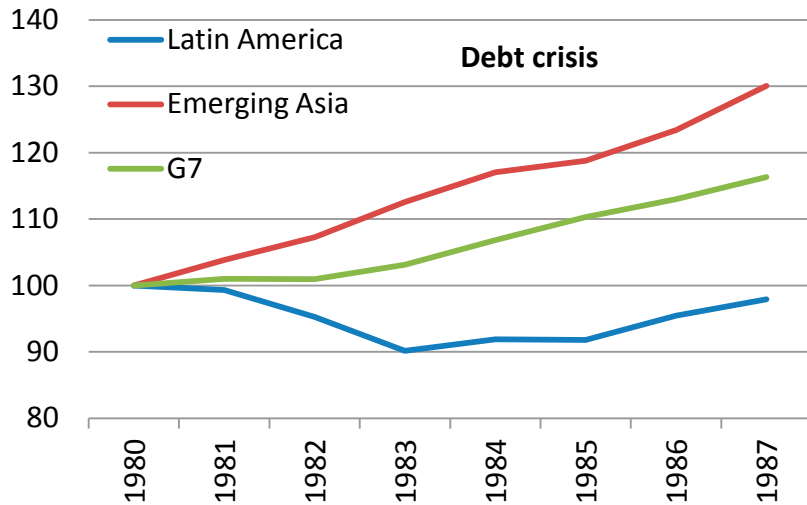Roberto Alvarez and José De Gregorio

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# GDP per capita in three recessions: The debt crisis – the Asian crisis and the Global Financial crisis

# Exchange Rates during the Asian and the Global Financial Crisis
(domestic currency per USD, period average=100)
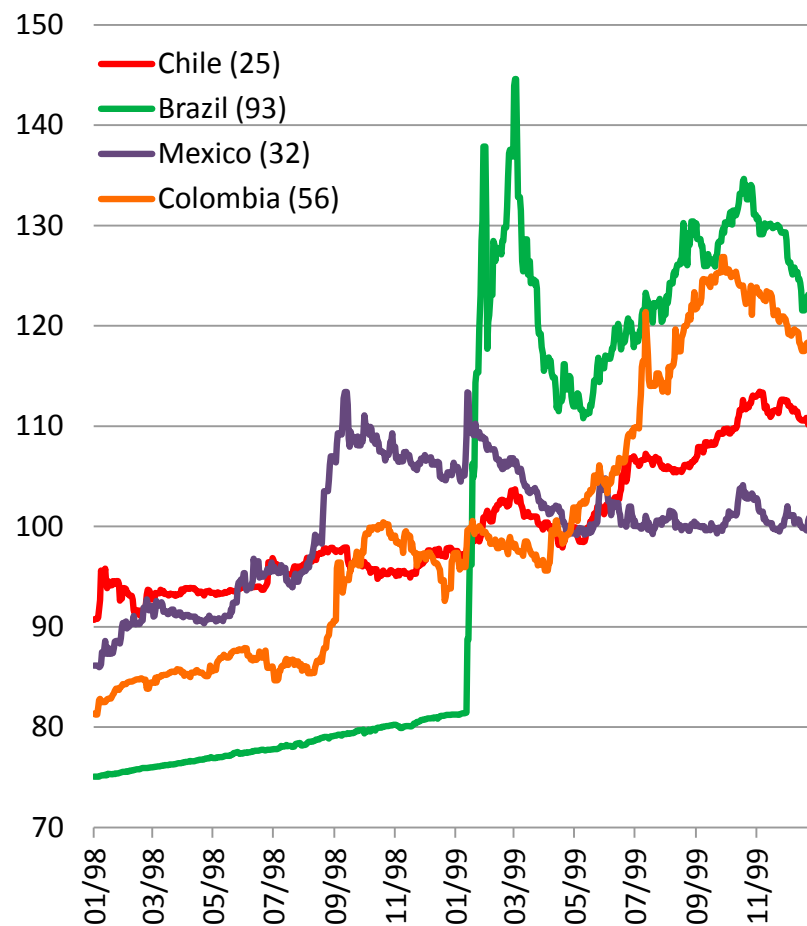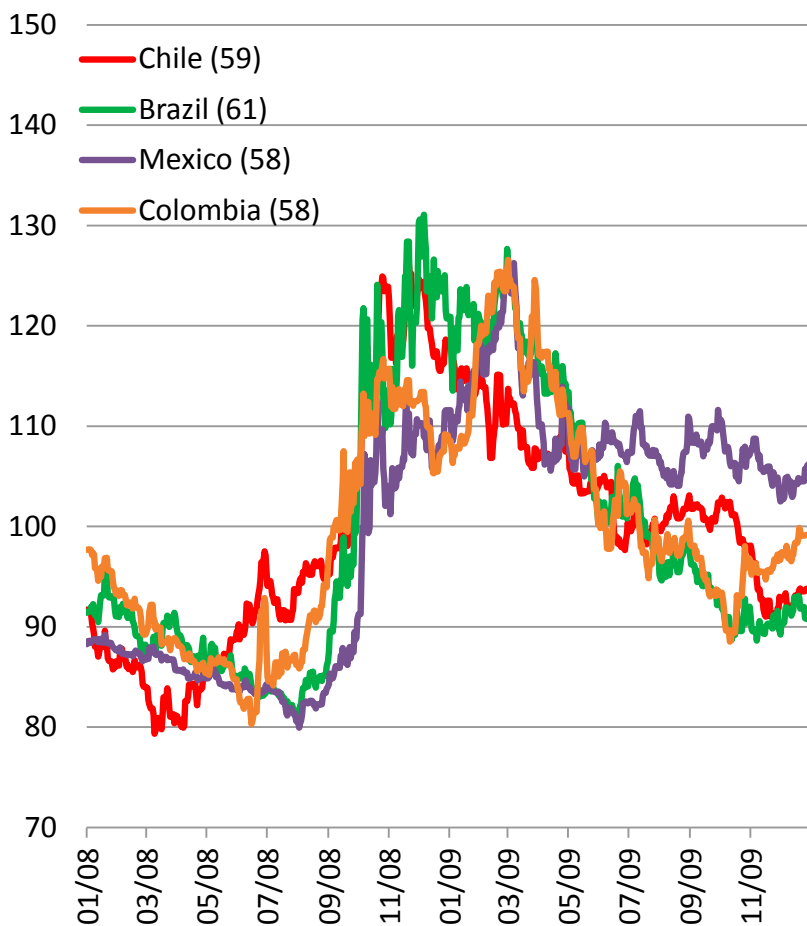


Source: Bloomberg. Figures in brackets indicates depreciation from bottom to top. An increase indicates a depreciation of the currency.

# International Reserves Now and Then
(index, period average=100)
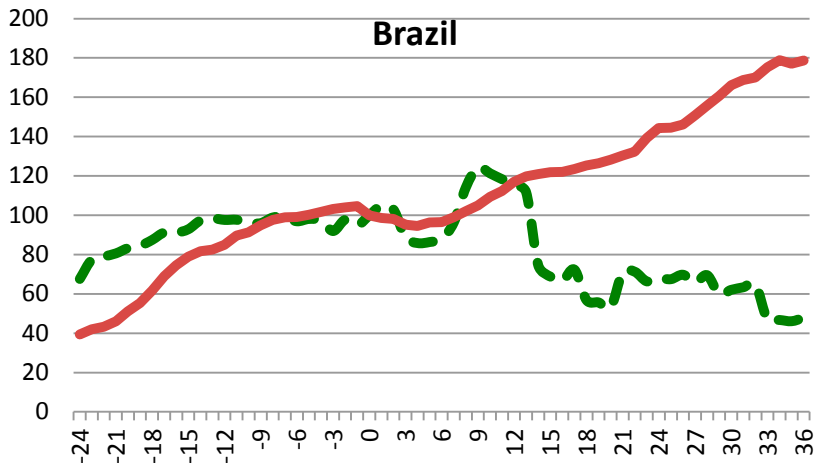
# **Change in international reserves** (24 months window)

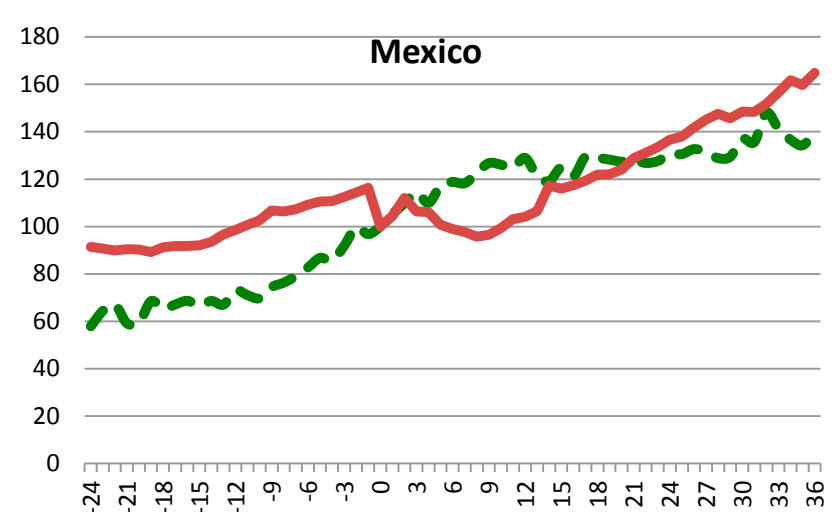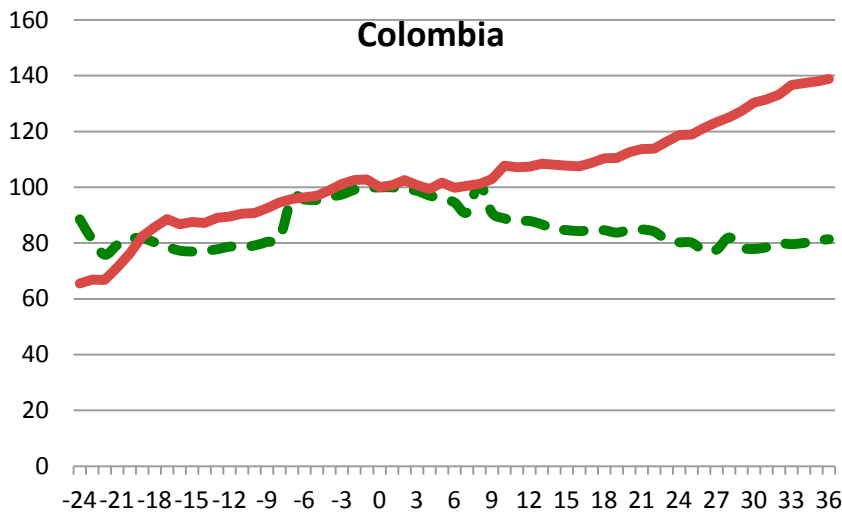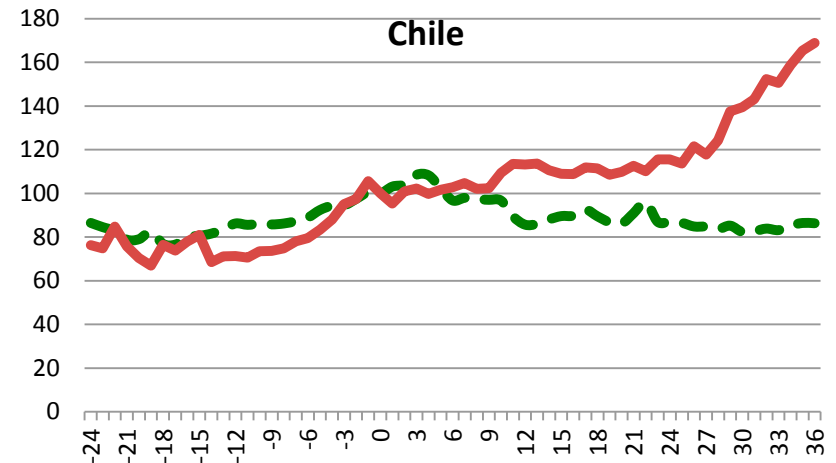|  | Asian crisis | Global financial crisis |
|---|---|---|
| Argentina | -9.2 | -7.9 |
| Brazil | -53.5 | -3.1 |
| Chile | -17.4 | 4.2 |
| Colombia | -16.2 | 1.7 |
| Mexico | -0.1 | -14.1 |
| Peru | -17.9 | -13.9 |
| Venezuela | -32.3 | -34.4 |
| *Average* | *-20.9* | *-9.7* |
| *Median* | *-17.6* | *-8.8* |
| China | 3.8 | 8.5 |
| India | -7.6 | -20.4 |
| Indonesia | -18.4 | -11.9 |
| Korea | -40.2 | -23.5 |
| Malaysia | -28.5 | -29.6 |
| Philippines | -27.4 | 3.0 |
| Thailand | -34.9 | -7.4 |
| *Average* | *-21.9* | *-11.6* |
| *Median* | *-24.7* | *-11.7* |

Sources: IMF-IFS.

# Monetary policy rates Now and Then
(%)
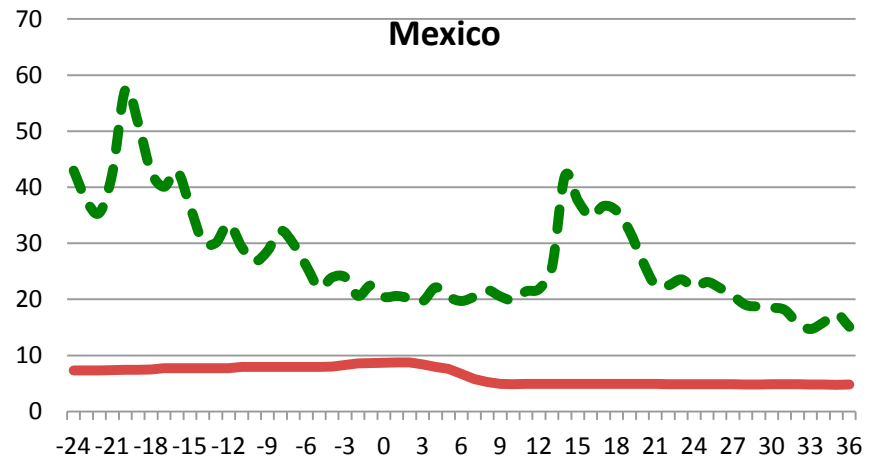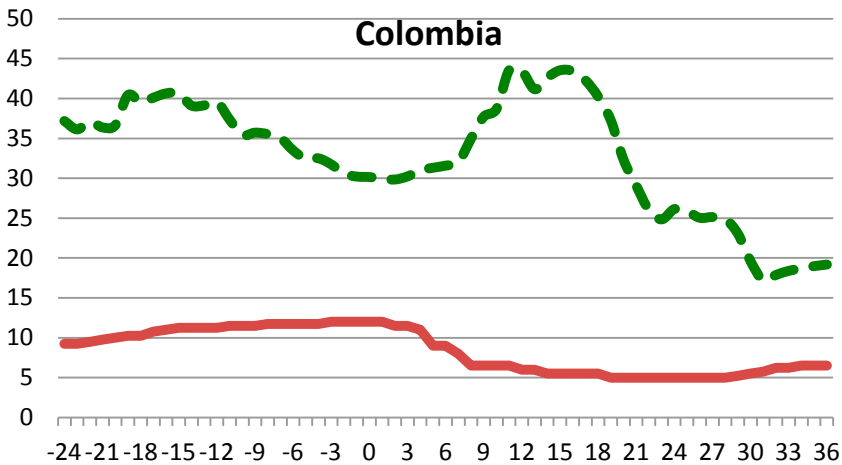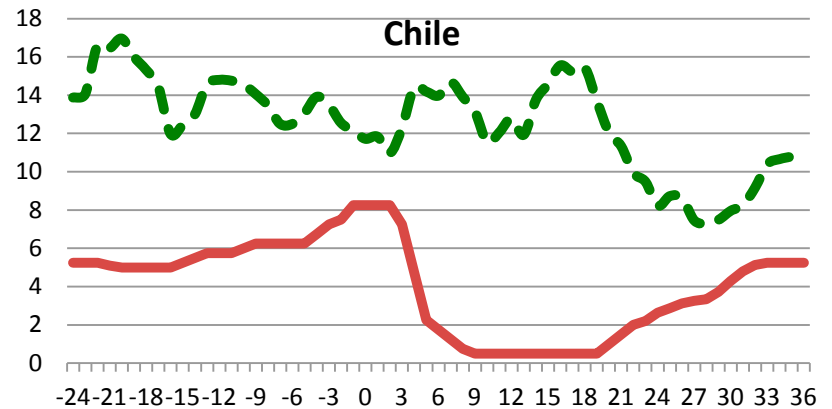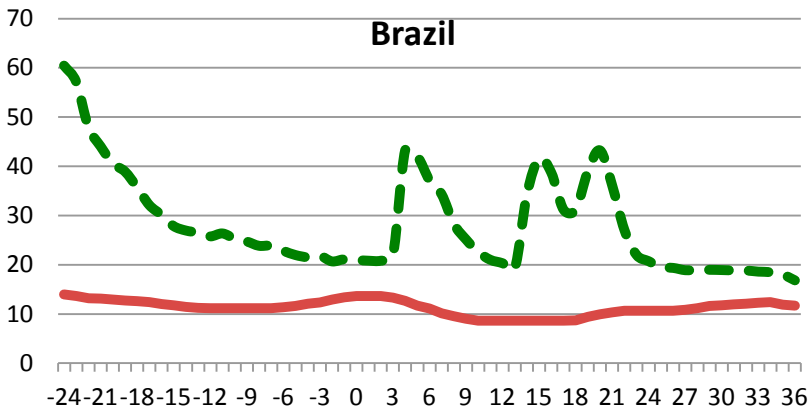
# Monetary Policy Rates in Latin America (%)
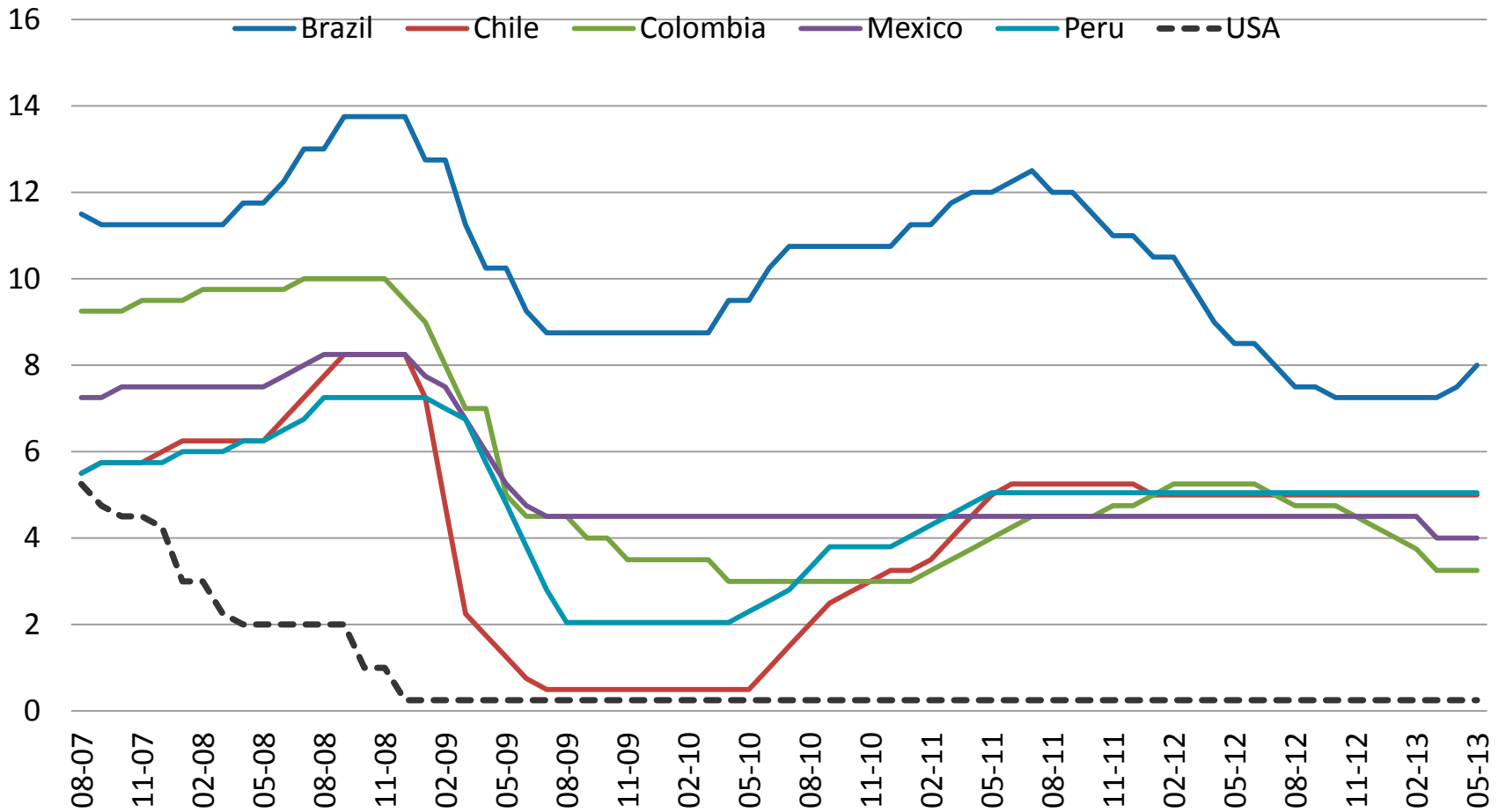


Sources: Bloomberg.

# Fiscal Policy:
## Structural primary balance (% potential GDP)
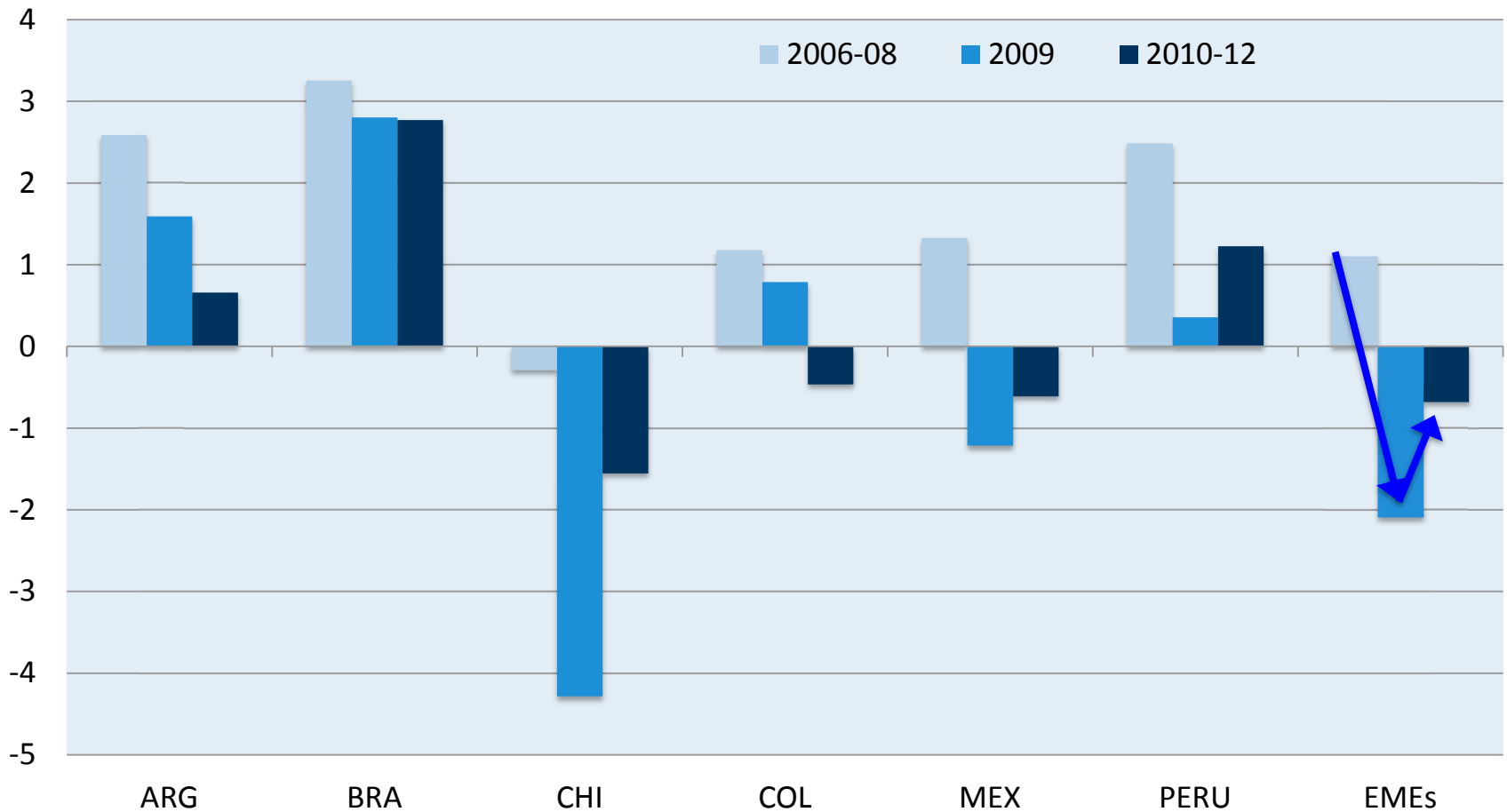
# Commodity prices (period average=100)
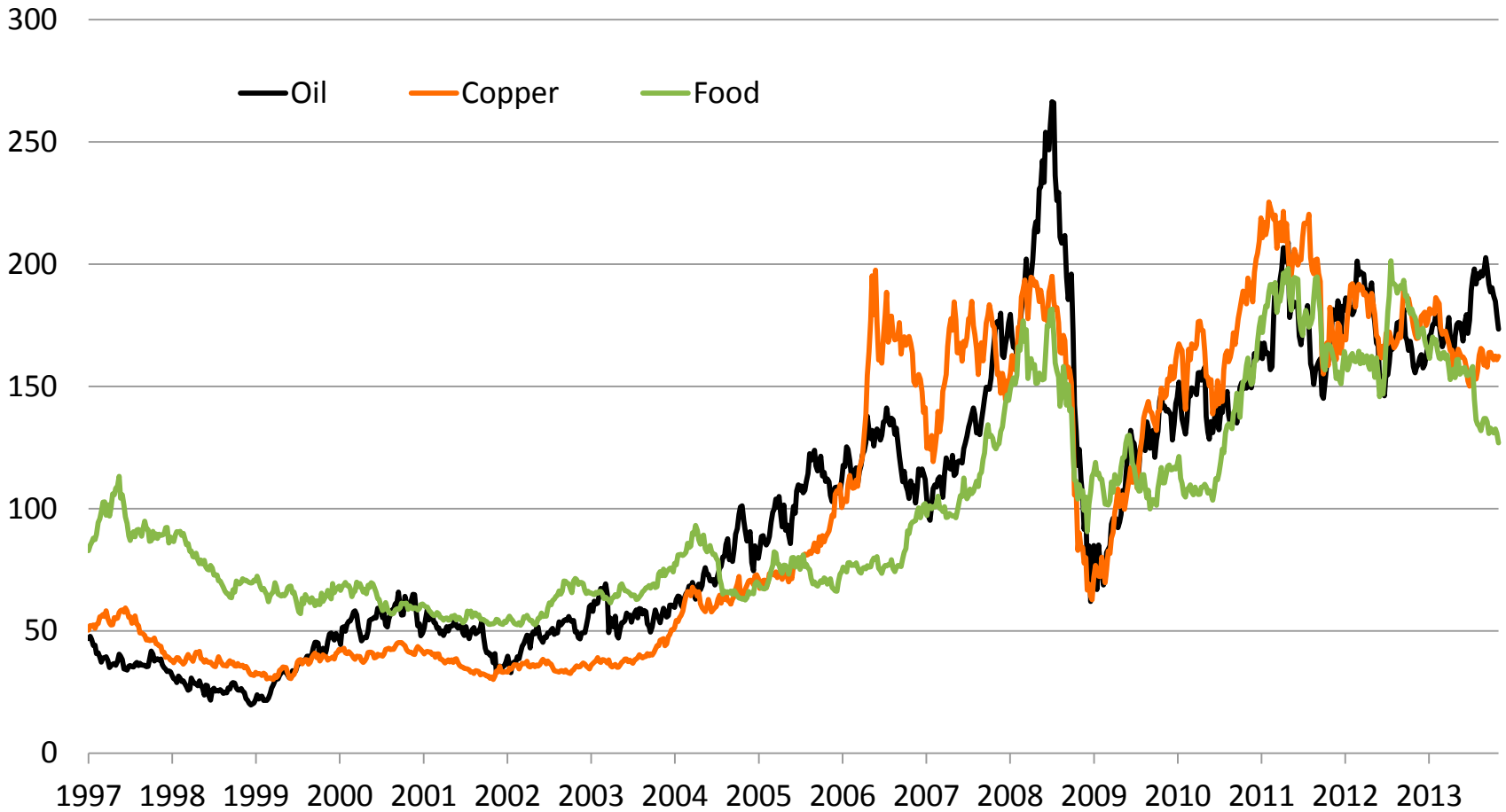


Sources: Bloomberg. Food is the simple average for wheat, corn, soybean and coffee.

# Terms of Trade Now and Then
(index, 1989-2011=100)
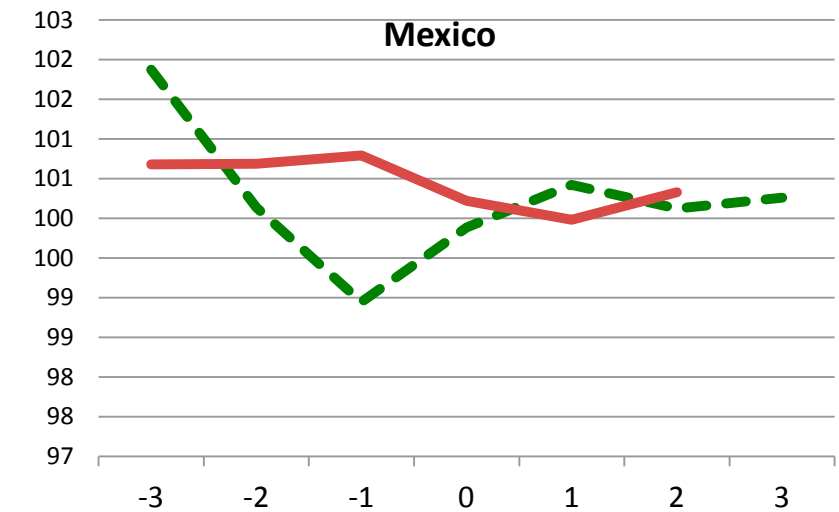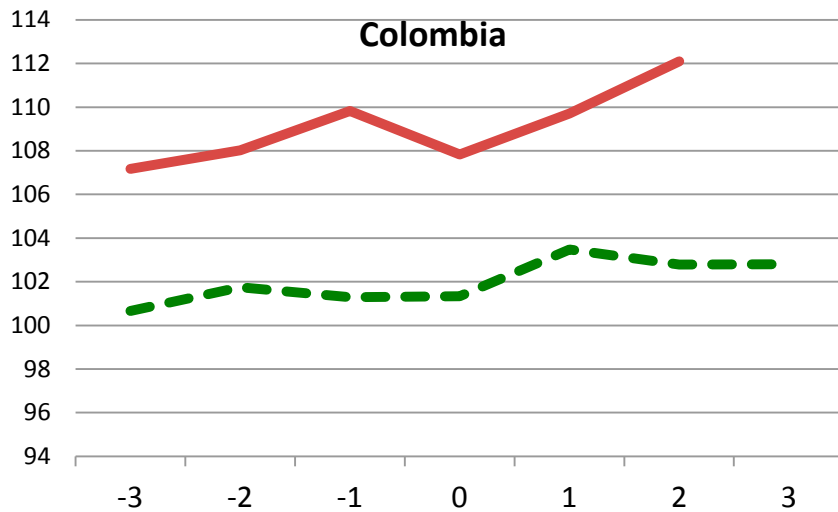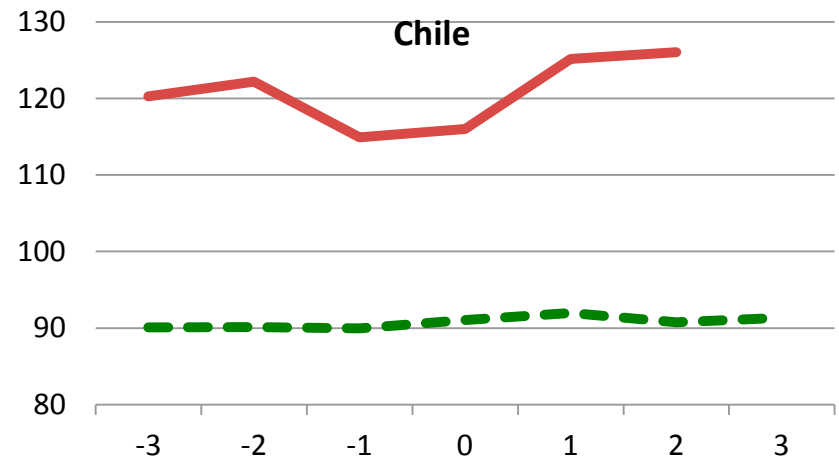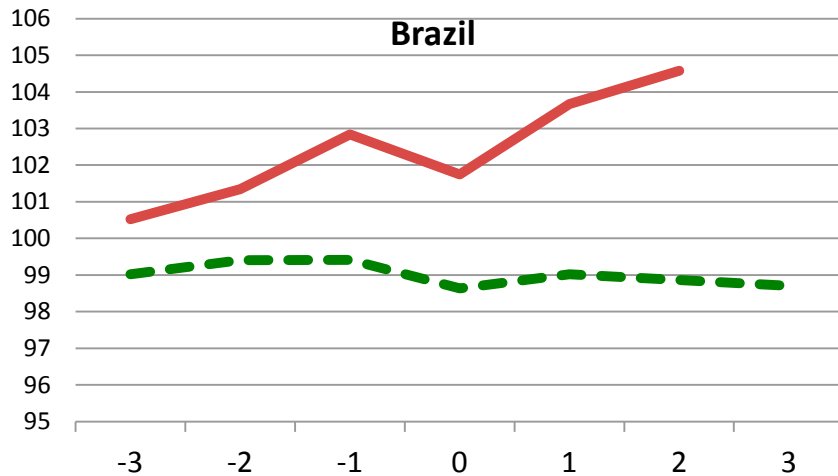
# Econometric evidence

$$\text{Growth}(j)_{2012\text{-}08} - \text{Growth}(j)_{2002\text{-}1998} =$$
$$\alpha + \beta \left[ X(j)_{2012\text{-}08} - X(j)_{2002\text{-}1998} \right] + \varepsilon(j)$$

Baseline:

Pre-crisis
- Reserves/GDP
- Inflation rate
- Exchange rate regime
- Public debt/GDP
- Private credit/GDP
- Trade openness
- Financial openness
- Current account

Contemporaneous
- Terms of trade
- Monetary policy interest rate
- Government expenditure

# Econometric evidence

- Three samples:
  - All countries (109 observations)
  - Developing and emerging market economies (93 observations)
  - Emerging market economies (31 observations)
- Report univariate results, all regressors, and stepwise general-to-specific significant covariates.

# Results

|  | All countries | Dev&EMEs | EMEs | EMEs |
|---|---|---|---|---|
| Exchange rate regime | 0.241** | 0.198*** |  |  |
| Inflation |  |  | -0.00518* |  |
| Private credit | -0.0191*** | -0.0197** | -0.0333** |  |
| Public debt |  |  | 0.0688* |  |
| Trade openness | 0.0302** | 0.0254*** |  | 0.0656** |
| Financial openness | -0.214** |  | -1.457*** | -1.831* |
| Interest rate | -0.149* | -0.150* | -0.104** | -0.0872* |
| Terms of trade |  |  | 1.574*** |  |
| Commodity exporter |  |  |  | 2.764* |
| No. Observations | 109 | 93 | 31 | 31 |
| R2 | 0.52 | 0.46 | 0.79 | 0.83 |

* p<0.01, ** p<0.05, *** p<0.1

Not significant: reserves, government expenditure and current account.
Regional dummies: constant is East Asia and Pacific, negative dummy Developing Europe and Central Asia, western Europe, North America. Latin American dummy is zero.

# Extensions

- Components of capital account included separately.

  Assets: reserves and other assets.

  Liabilities: Portfolio investment, FDI and Banking.

  Only "other assets" significant, wealth shock.

- The extent of intervention (Min R – $R_{t=0}$): for the sample of All countries and Dev&EMEs negative and significant, and E-Regime not significant.

# Extensions

- Institutional changes: average of (i) government stability, (ii) law and order, (iii) corruption, (iv) democratic accountability, and (v) bureaucracy quality from International Country Risk Guide. Not significant.

- Average GDP growth of the previous three-years. Not significant.

# Conclusions

- Latin American performance was remarkable compared to the past. Policies made a big difference, exchange rates were allowed to float, monetary and fiscal expansion…and good international conditions.

- Our empirical evidence shows that better performance is associated with with more exchange rate flexibility, lower private credit growth, and monetary policy loosening, and negatively associated with more financial openness. We do not find effects of fiscal policies. There is also some evidence that increased trade openness helped to mitigate the effects of the crisis. The effect of the exchange rate regime is significant for the broader samples, but not in the small sample of emerging markets. There is some evidence for "good luck" as an explanation of good performance for emerging markets.