

Inflation Management Seminar

The Latin American Experience

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Agenda

- Introduction
 - Inflation and stabilization programs in Latin America
 - Latin America and East Asia and the Pacific: a brief comparison
 - Recent surge in Latin American inflation: what's going on?

Agenda

- Recent anti inflationary measures in Latin American countries
 - Anchoring expected inflation
 - Increases in interest rates
 - Changes in trade taxes
 - [Compensating the poor]
- Fighting appreciation
 - Open mouth intervention
 - Buying international reserves
 - Capital controls
- Concluding remarks
 - Policy coherence
 - Fiscal discipline
 - Lessons

Inflation and stabilization programs in Latin America

Latin America is famous for its chronic inflation and hyperinflation

Inflation rate in Latin America: selected countries and periods
(percentage change yoy)

	1960-1969	1970-1979	1980-1989	1990-1999	2000-2007	2006	Mar-08
Argentina	22.4	132.9	565.7	252.9	8.9	10.9	8.8
Bolivia	5.7	15.9	1383.2	10.4	4.2	4.3	14.1
Brazil	n.a.	n.a.	354.5	843.3	7.3	4.2	4.6
Chile	26.6	174.6	21.4	11.8	3.1	3.4	8.5
Colombia	12.0	19.3	23.5	22.2	6.4	4.3	5.9
Ecuador	4.4	11.9	34.0	39.0	20.6	3.3	6.6
Panamá	1.1	6.0	3.2	1.1	1.6	2.5	8.5
Paraguay	3.8	11.1	20.2	16.4	8.7	9.6	12.3
Peru	9.9	26.5	481.3	807.9	2.2	2.0	5.5
Uruguay	51.4	59.3	57.6	48.9	8.9	6.4	8.0
Venezuela	1.0	6.6	23.0	47.4	19.0	13.7	29.1

Source: World Bank

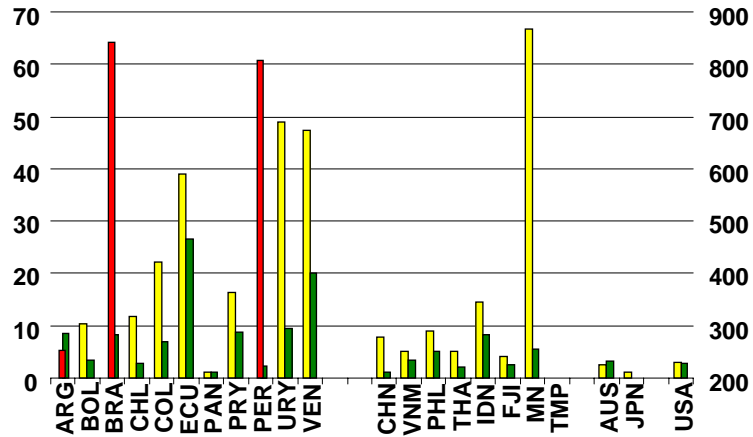
Exchange rate stabilization programs may work in the short run, but do not have happy endings

- “A key lesson of the recent experience is that fixed exchange rates are generally not a long-run solution to problems of monetary and fiscal instability, at least not in a world of high capital mobility. Indeed, despite the early successes, virtually all the Latin American exchange-rate pegs proved unsustainable and collapsed in a disorderly way. Exchange-rate over-valuation, imperfect credibility of both monetary and fiscal policy, and short-duration external debt all contributed to a high incidence of costly speculative attacks and financial crises in Latin America during the 1990s and into the new millennium.” Ben Bernanke.

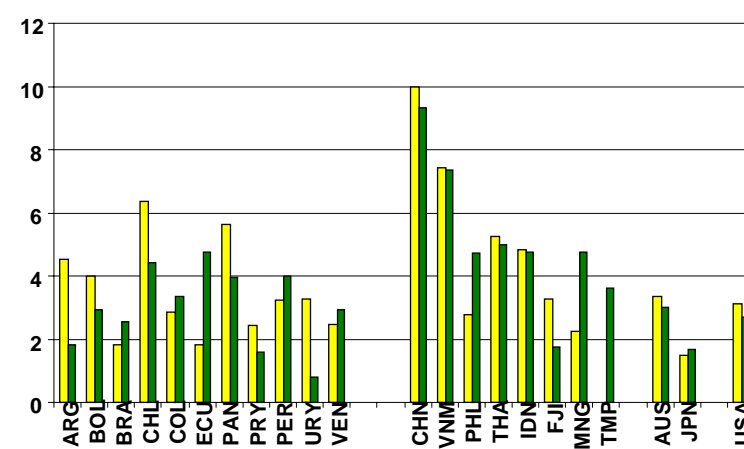
Latin America and East Asia and the Pacific: A Brief Comparison

LatAm and EAP have been different in terms of inflation, growth and saving rates

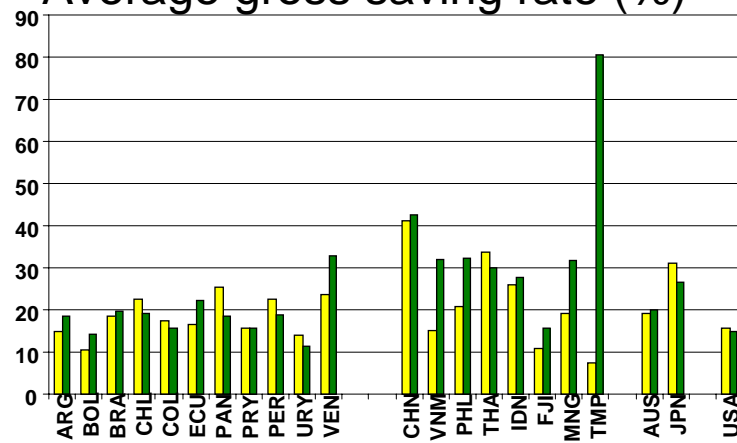
Average annual inflation rate (%)



Average annual GDP growth (%)



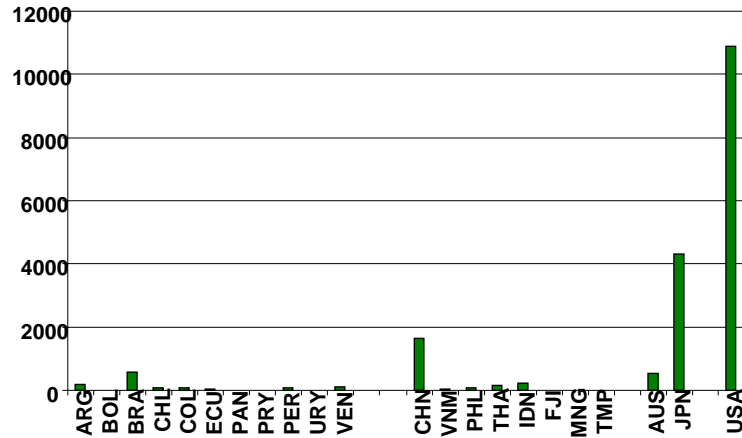
Average gross saving rate (%)



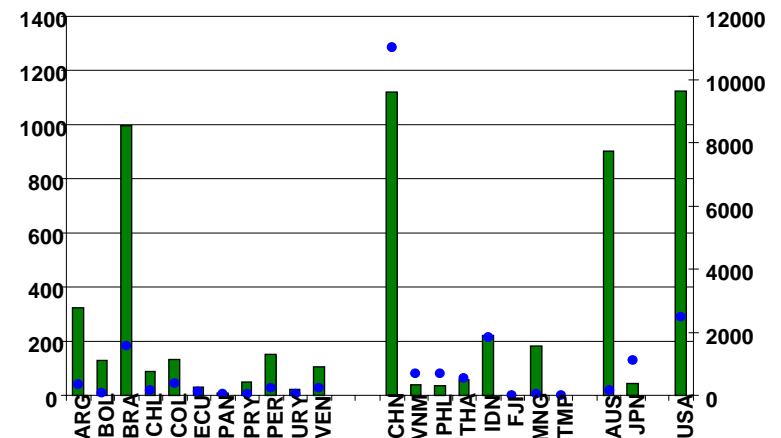
1990 - 1999
 2000 - 2005
 Hyperinflation (right axis)

LAC and EAP are relatively small, poor and open economies (compared to US and Japan)

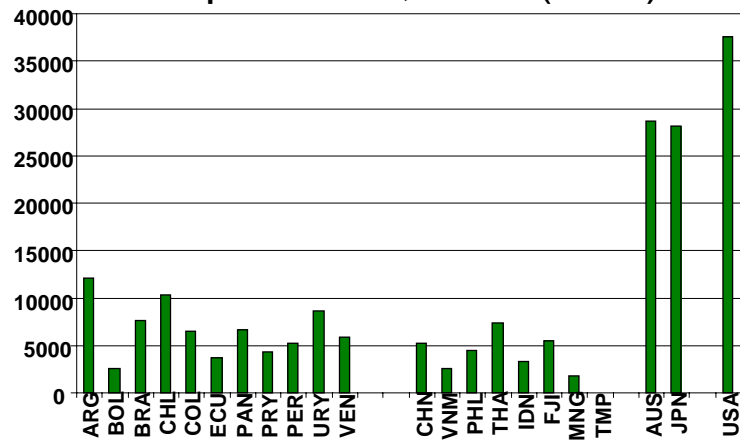
Average GDP (billions of US\$)



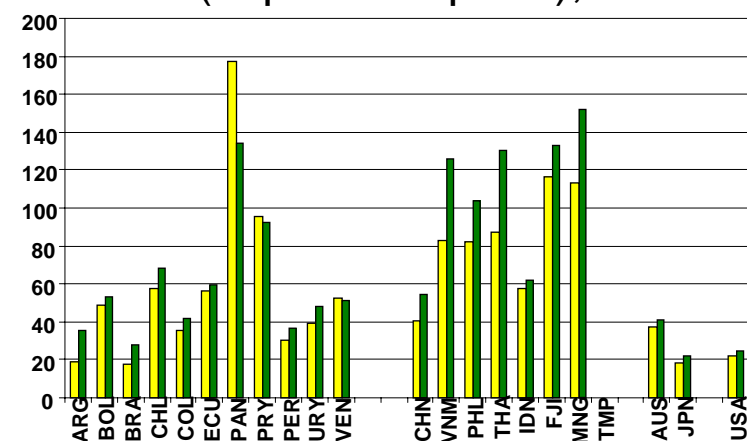
Size (sq. km.) and population (millions)



Per capita GDP, PPP (US\$)



Trade (exports+imports), % of GDP



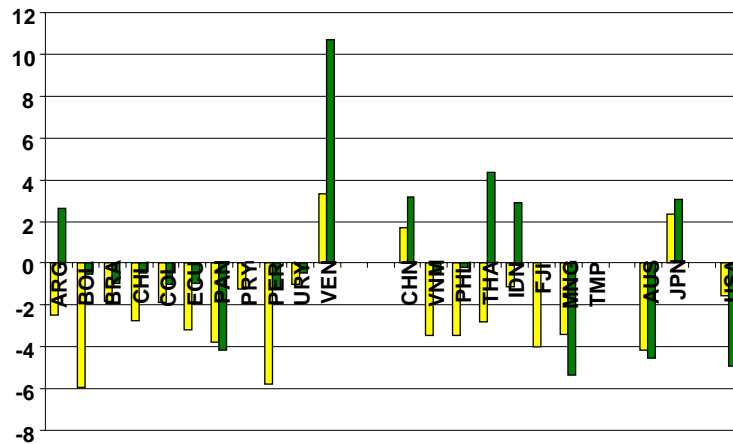
1990 - 1999

2000 - 2005

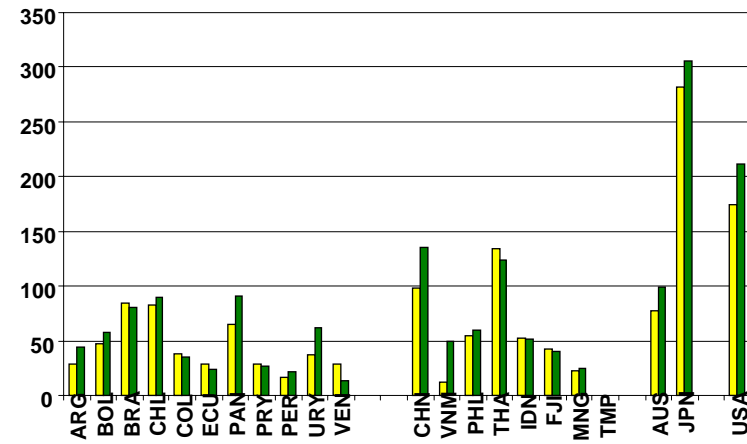
Population (right axis)

In terms of financial vulnerability, there are no clear regional patterns

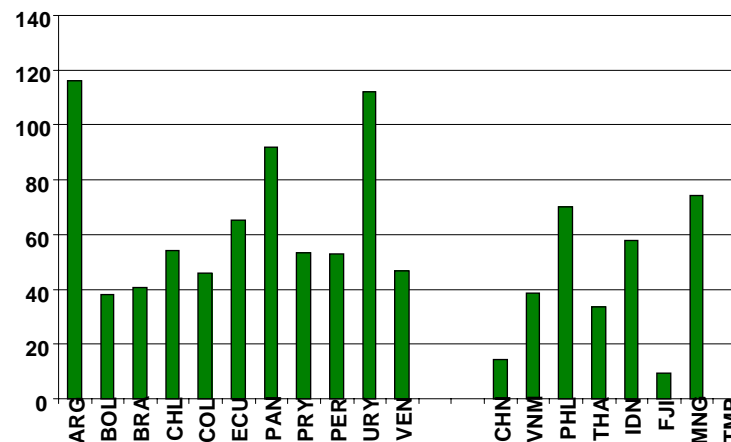
Current Account as % of GDP



Credit by banking sector % of GDP



Present value of debt (% of GNI)

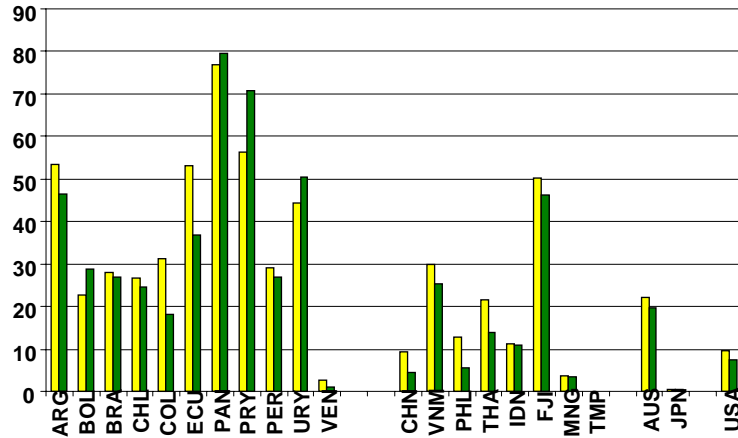


1990 - 1999

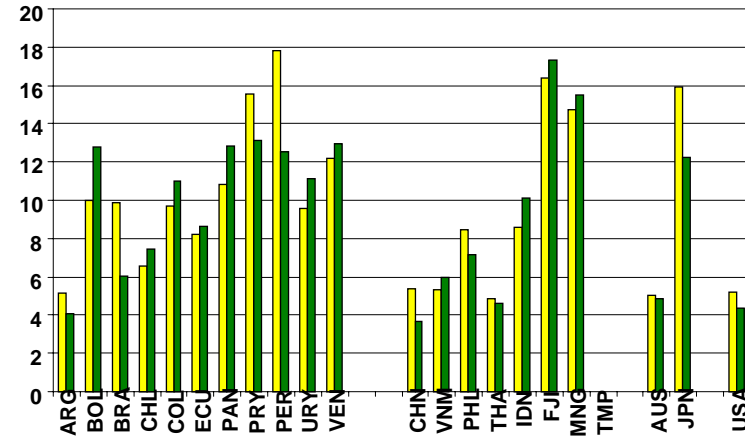
2000 - 2005

LAC is more a food exporter, and both regions are big fuel importers

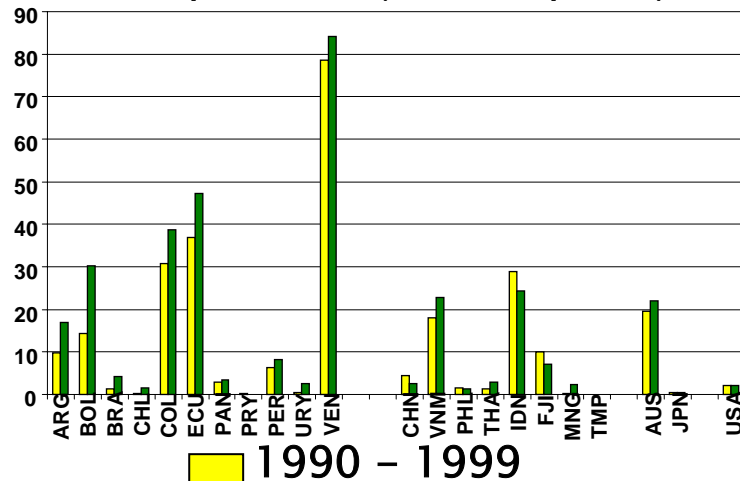
Food exports (% of exports)



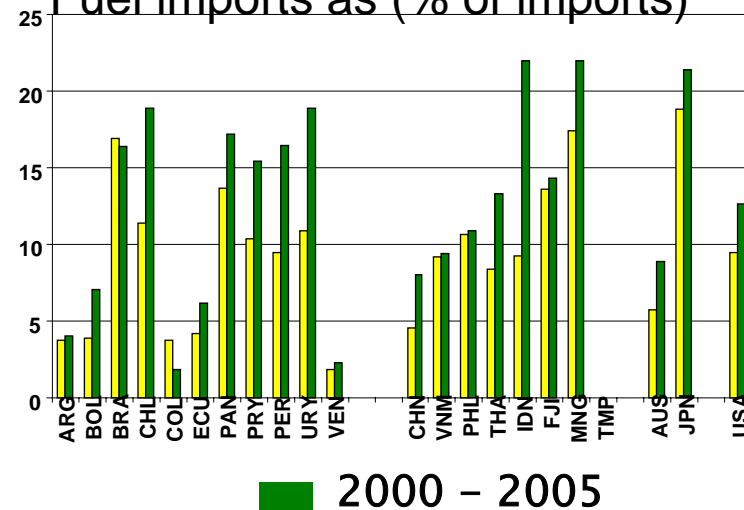
Food imports as (% of imports)



Fuel exports as (% of exports)



Fuel imports as (% of imports)



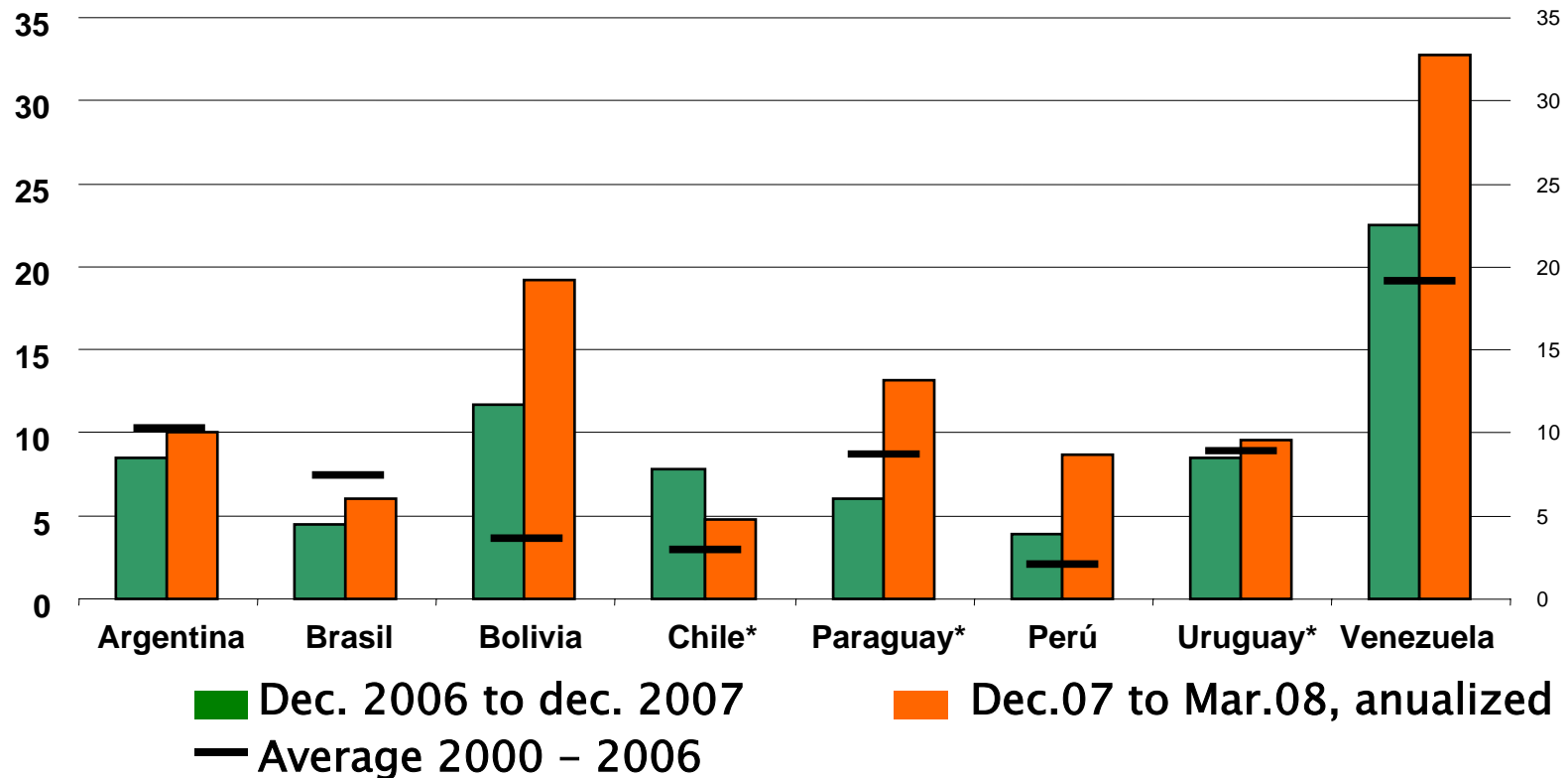
1990 - 1999

2000 - 2005

Recent Surge in Latin American Inflation: What's Going On?

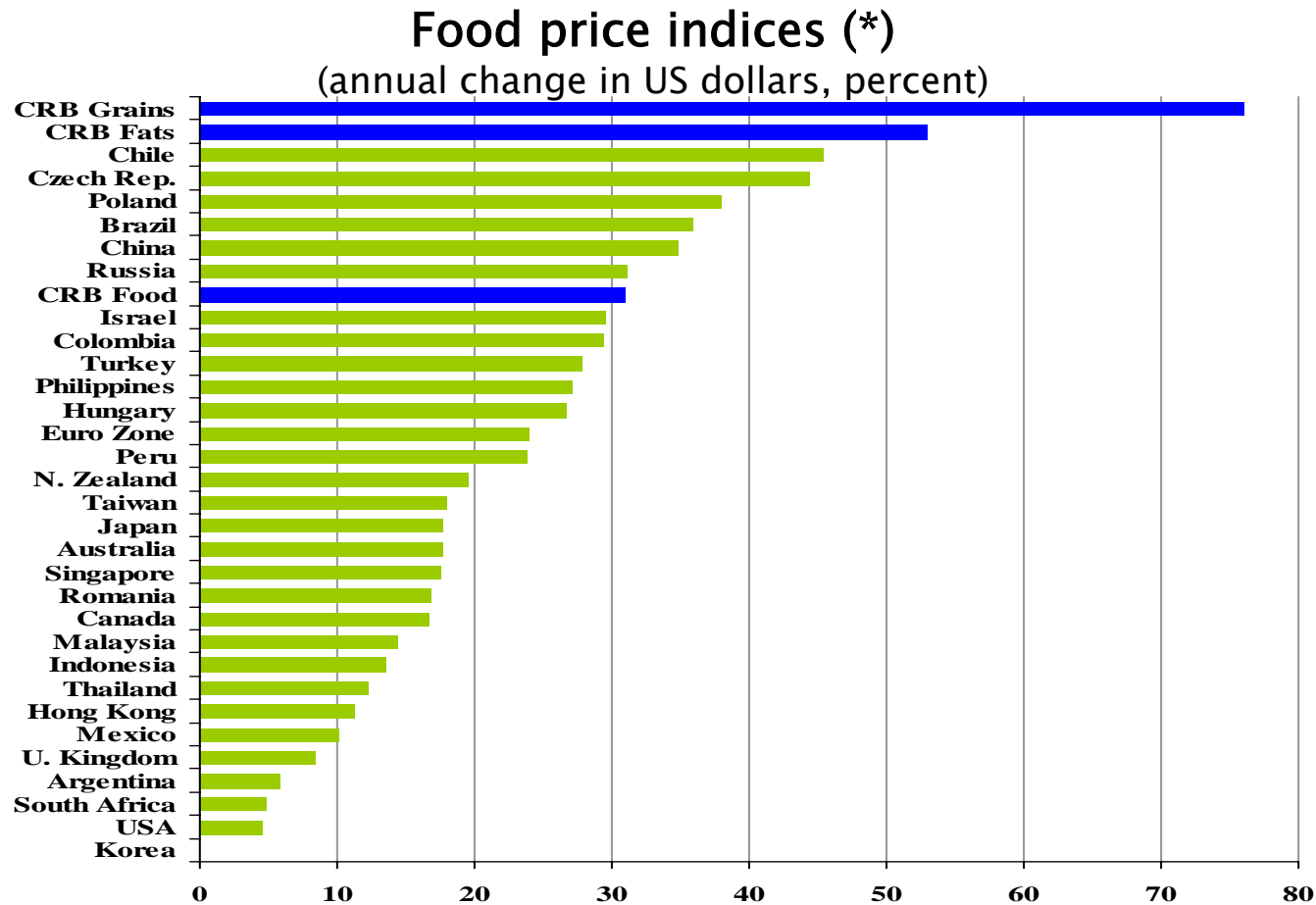
After half a decade of relatively low inflation, LAC countries are seeing it go up again

Total price indexes
(Percentage change)



*April 2008

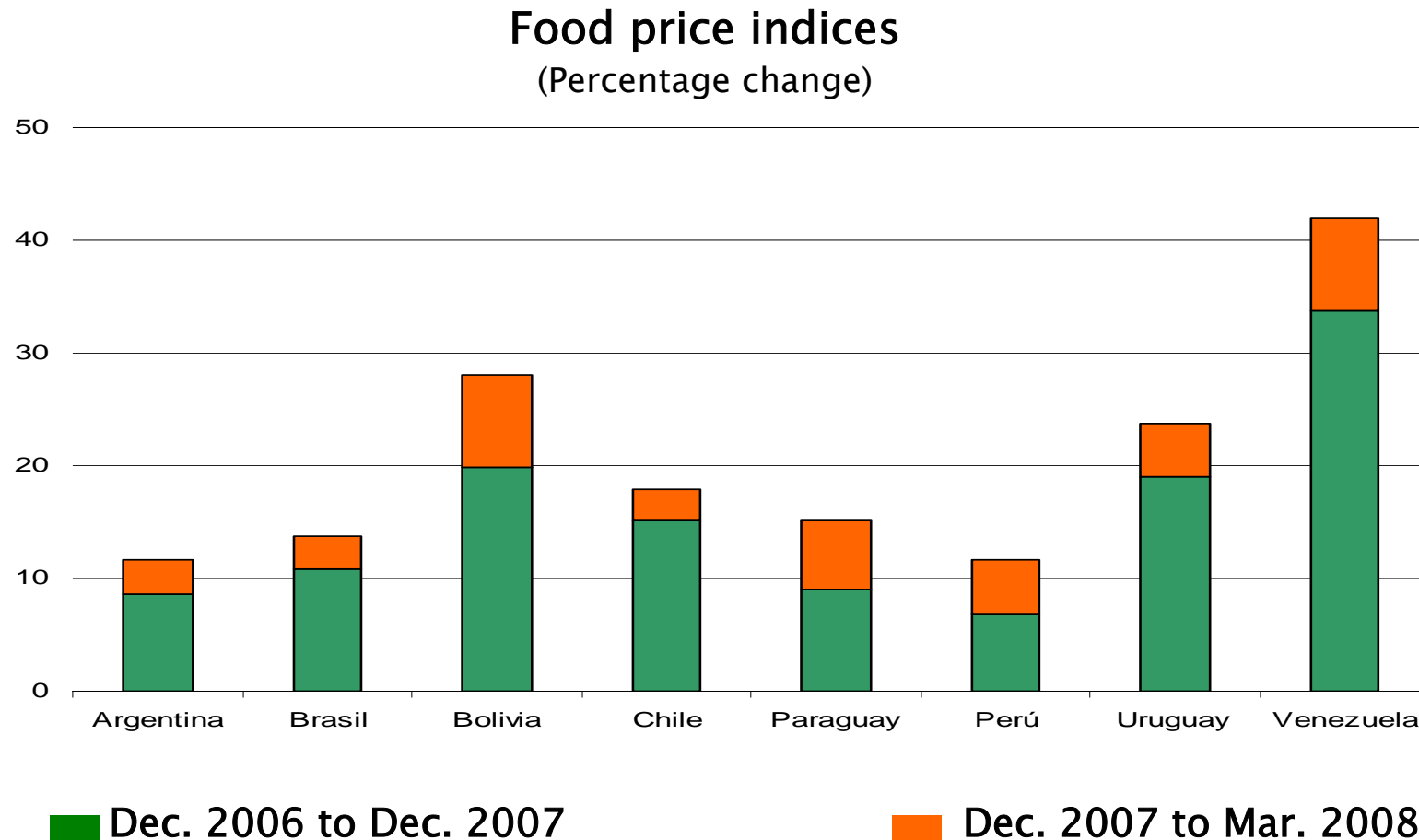
There has been a dramatic increase in the international price of foodstuff



(*) (*) Figures as of February or March, as available.

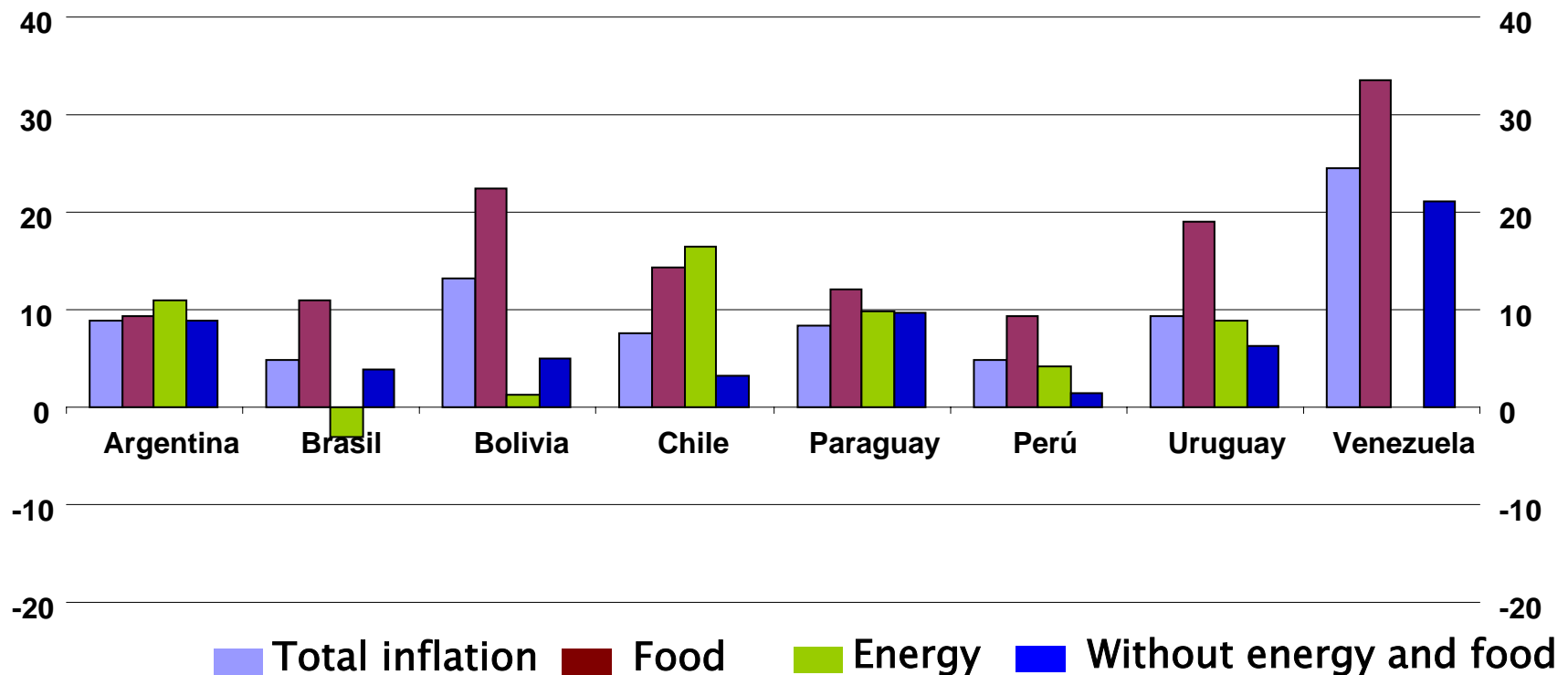
Sources: Each country's central bank, Bloomberg, Commodity Research Bureau (CRB), each country's statistics bureau and International Monetary Fund.

There have been hikes in the domestic price of foodstuff in almost every country in LatAm

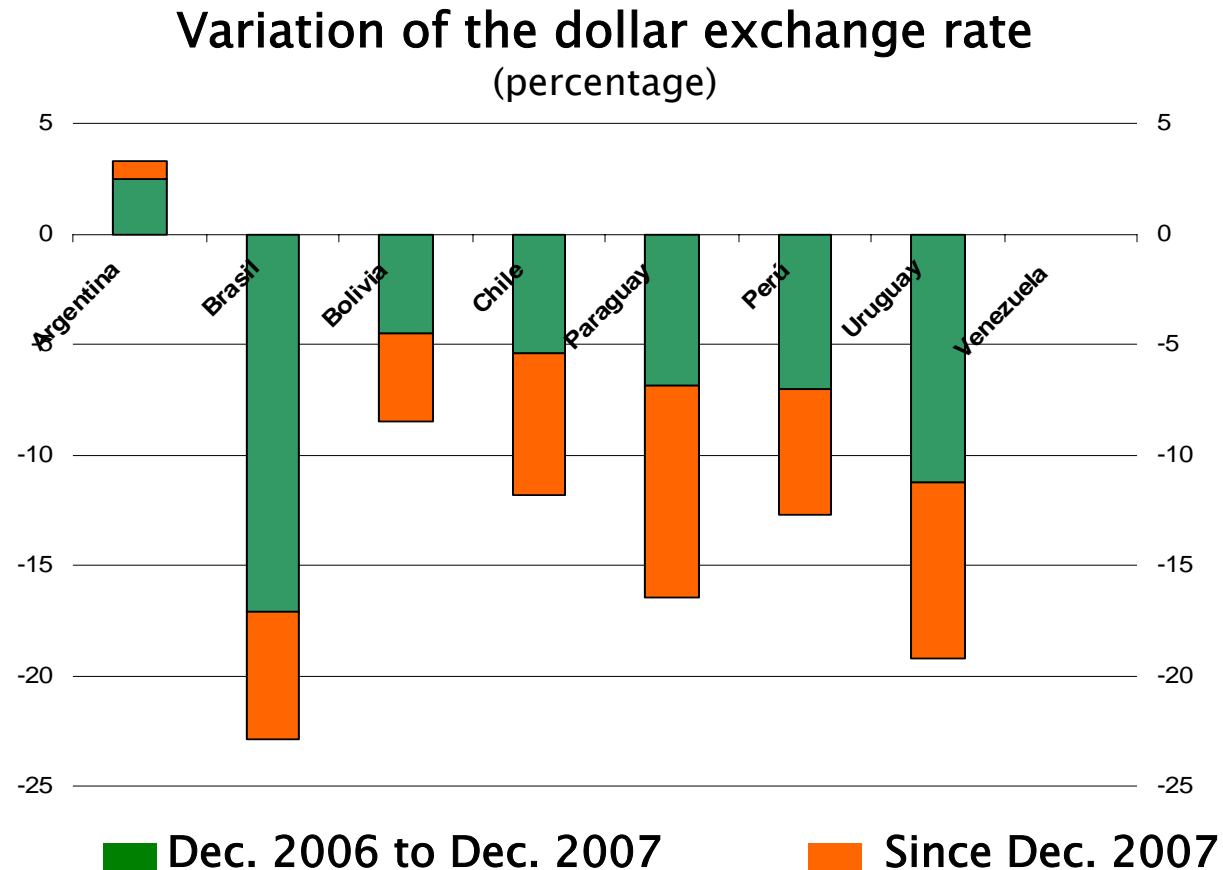


For some of the countries, there has been an additional shock from the price of energy

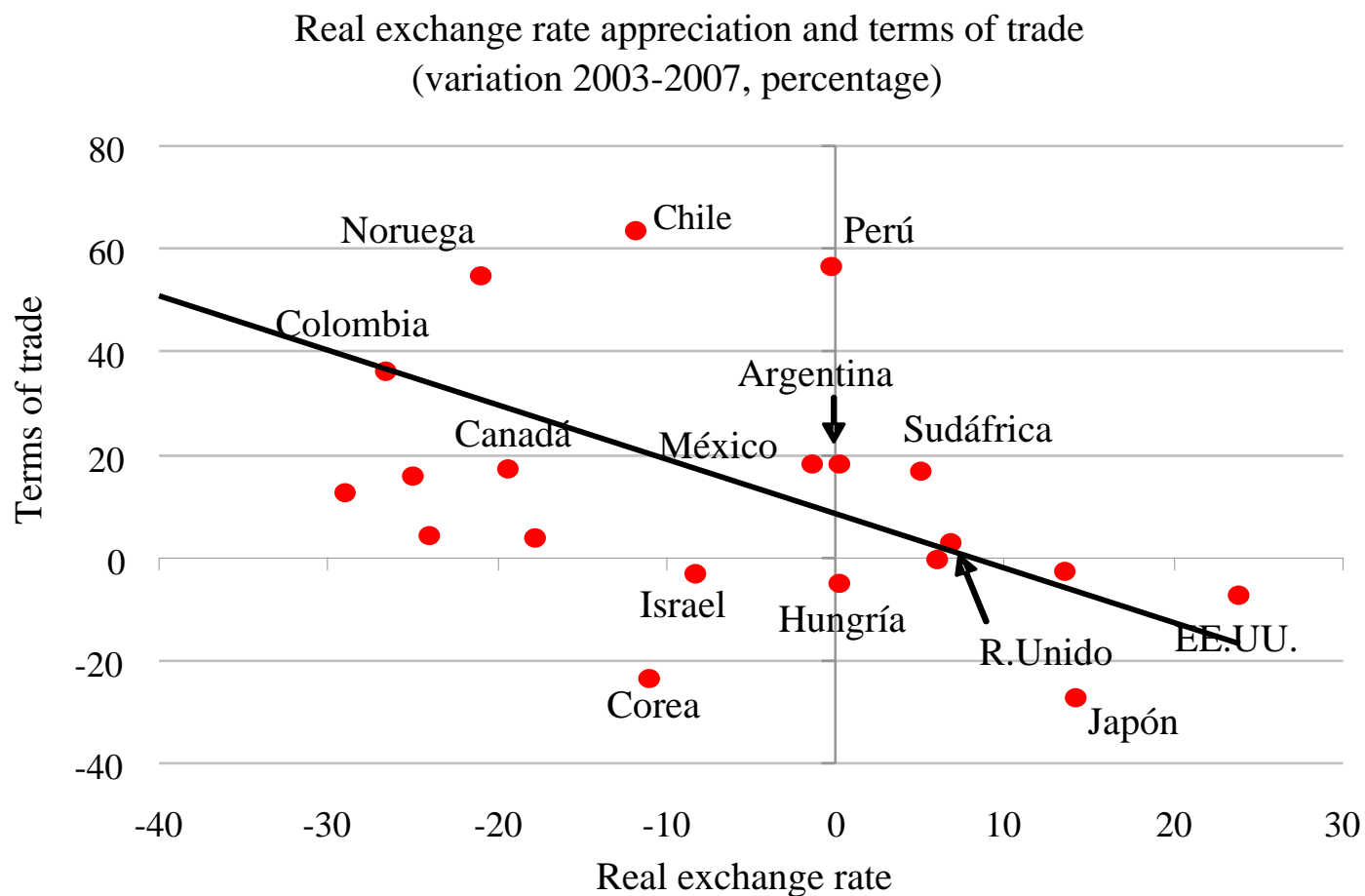
Energy and food inflation
(dec 2006 to mar 2008, anualized percentage)



In the last fifteen months, the exchange rate has appreciated in almost every LAC country



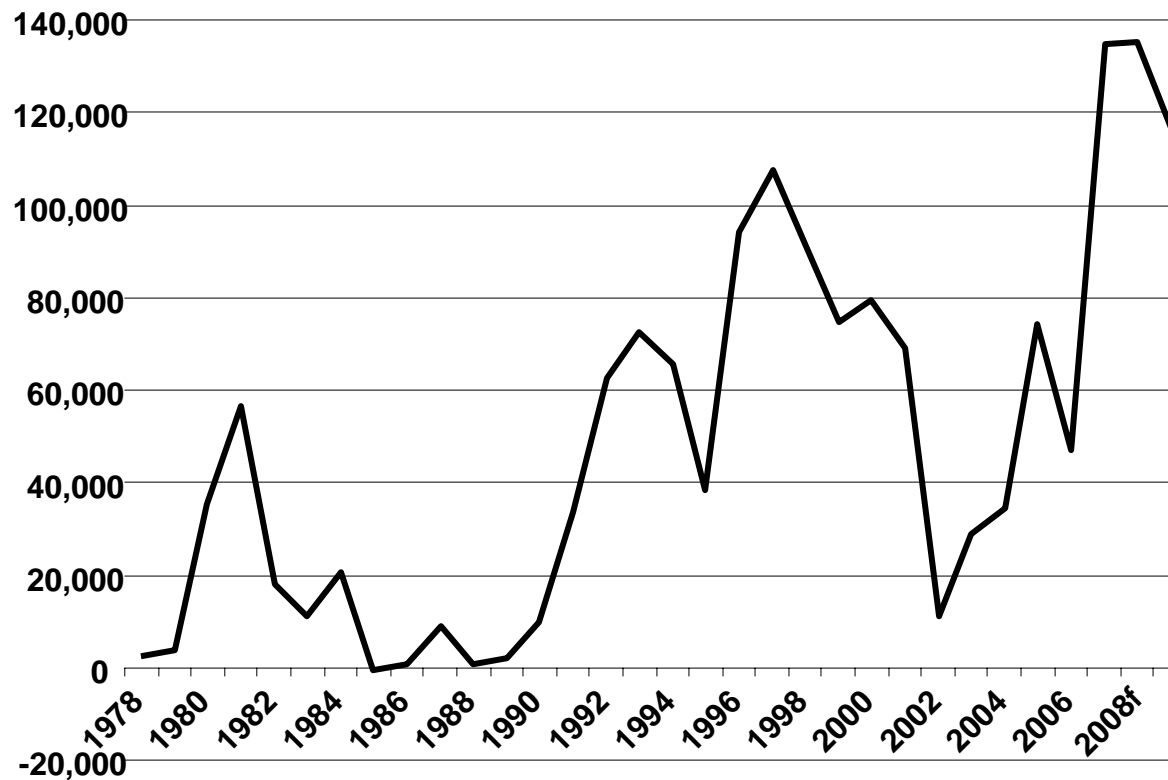
Terms of trade gains puts pressure on the currency to appreciate



RER variation goes from January 2003 to February 2008.
Source: FMI, Bloomberg, IIF and Banco Central de Chile.

Net private capital flows to Latin America have reached a three decades record in 2007

Net private capital flows to Latin America and the Caribbean
(millions of dollars)



Source: IIF.

Recent Anti-Inflationary Measures in Latin American Countries

Latin American countries have been taking several measures to control inflation

- Anchoring expectations: inflation targeting and central bank independence
- Increase in reference interest rates
 - Mostly in reaction to changes in expected inflation and allowing relative price adjustment
- Increase in export taxes and reduction in import tariffs
- Price controls
- [Income compensation (for the poor)]

Fighting appreciation

Real exchange rate appreciation has been a preoccupation for these countries

- Open mouth intervention
- International reserves accumulation
- Controls to capital flows

Almost every country in Latin America is buying reserves these days

International Reserves as of December 31, 2007

	Argentina	Brazil	Boliv	Chile	Paraguay	Peru	Uruguay	Average
Level (million of US\$)	46,176	179,000	5,308	16910	2,462	27689	5,087	40,376
% of anual GDP	16.1	13.6	40	10.3	21	25.4	20.3	21
% of external debt	34.7	108.1	98	30.3	79.7	88.3	41.9	68.7
As % of M2	100	40.6	113	35.9	100.9	187	155.7	104.7
% of short term debt	na	1585.5	934	74.9	232.6	351	286.4	577.5
% of anual imports	92	140.8	164	38.4	38.1	147.4	67.8	98.4
% growth 2006 to 03/2008	57.7	128.0	149.2	-7.8	na	123.4	42.8	---

Capital controls have been introduced by a few countries in order to reduce capital inflows

- Colombia: 40% unremunerated 6 month mandatory deposit
- Peru: 0.05% tax on international transfers
- Brazil: President publicly considers capital controls
- Chile: Senators ask for controls, but President of Central Bank argues against:
 - Are difficult to implement
 - May have perverse distribution effects
 - Not likely to work: capital flows by residents

Concluding remarks


Some additional relevant considerations

- Without fiscal discipline, inflation control is virtually impossible
 - The region has made great progress
 - Chile has implemented a fiscal rule
- Policies must be consistent
 - It is just not possible to increase growth, depreciate the value of the currency and reduce inflation, all at the same time
- Exchange rate appreciation helps reduce inflation in the context of higher international prices

Lessons from the Latin American case to control inflation

- Fiscal discipline and coherence of policies are the basics
- Interest rate increases are the most common policy and have helped contain further increases in aggregate demand
- Price controls are very costly, but may work in some particular cases (tortillas--flatbread)
- The experience with export taxes and export controls has not been satisfactory
- Reduction of tariffs may work if they are big

Lessons from the Latin American case to control inflation

- Available evidence does not show that accumulation of international reserves has helped contain appreciation of the currency
 - This policy can be very costly
- Capital controls have been implemented only in few countries
 - Are difficult to implement
 - May have perverse distribution effects
 - Past evidence from Chile shows that they had (almost) no effect
- In fact, appreciation of the currency helps contain inflationary pressure 
- Additionally, appreciation is likely to stop excessive and speculative capital inflows: bad Chilean experience with capital controls and exchange band

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The Latin American experience

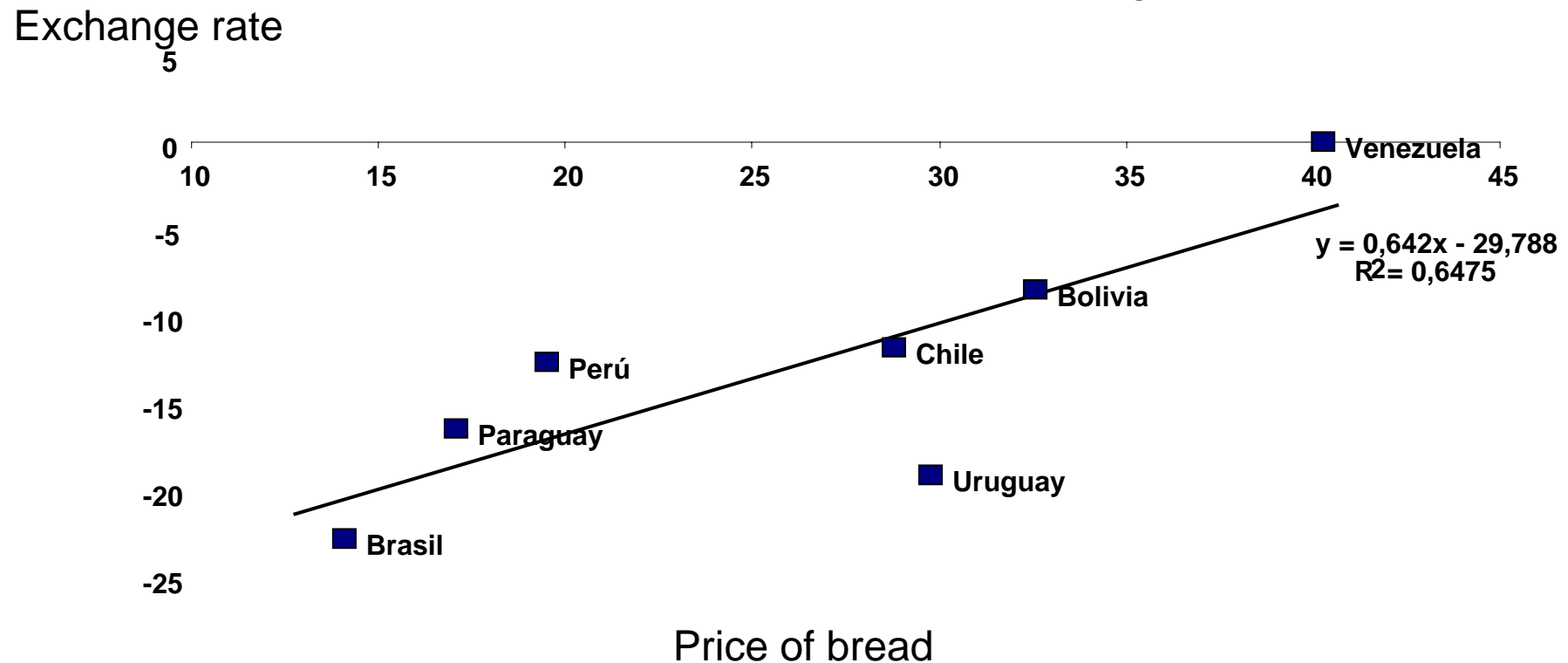
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June, 2008

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An example: bread has increased less in countries where the exchange rate has appreciated more

Variation in the price of bread and the exchange rate
(variation from Dec06 to Mar08, percentage)



The poorer the countries the higher the importance of food stuff in total CPI

