Financial Stability in latin America

José De Gregorio
Universidad de Chile
Peterson Institute for International Economics
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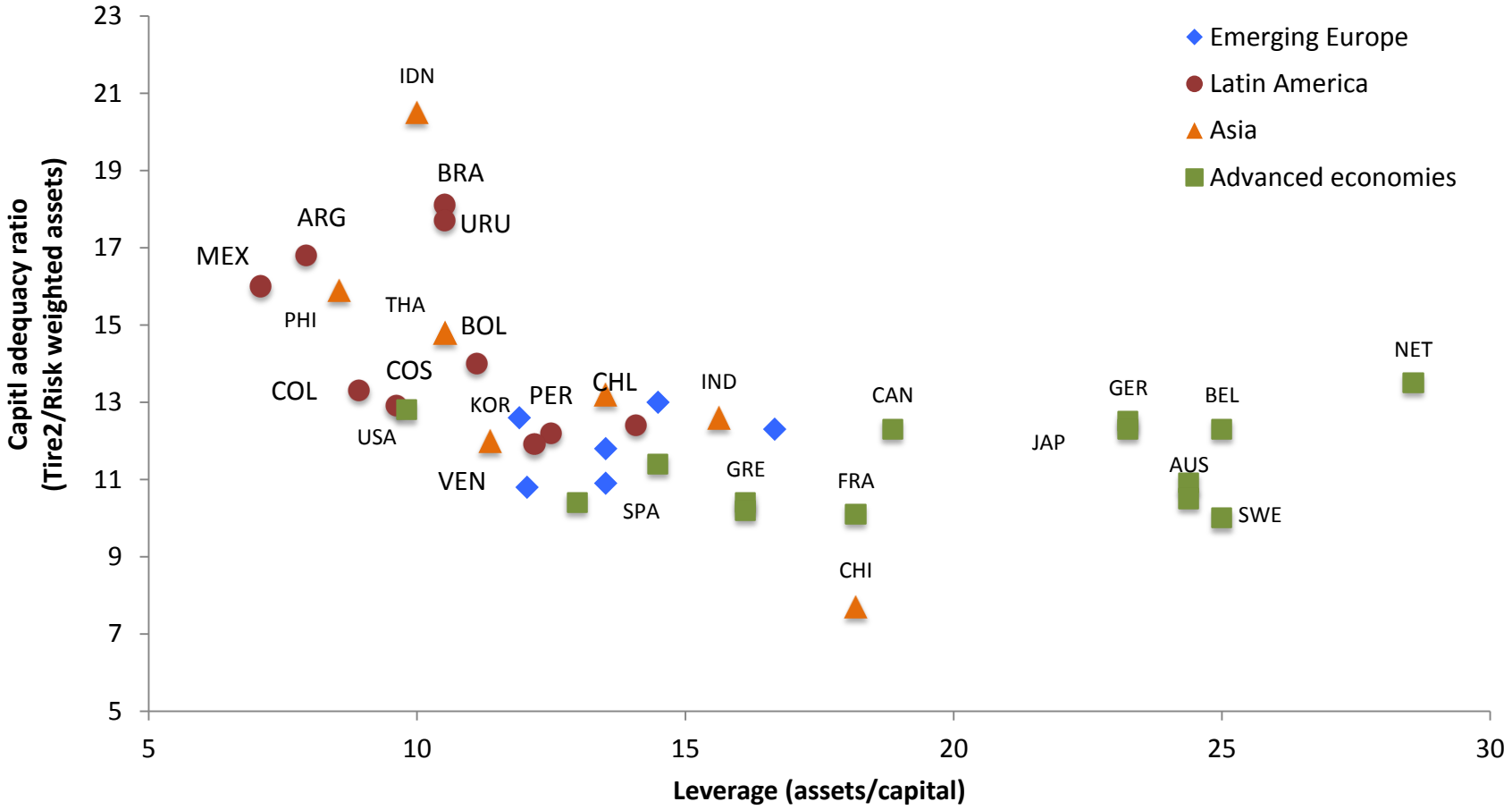
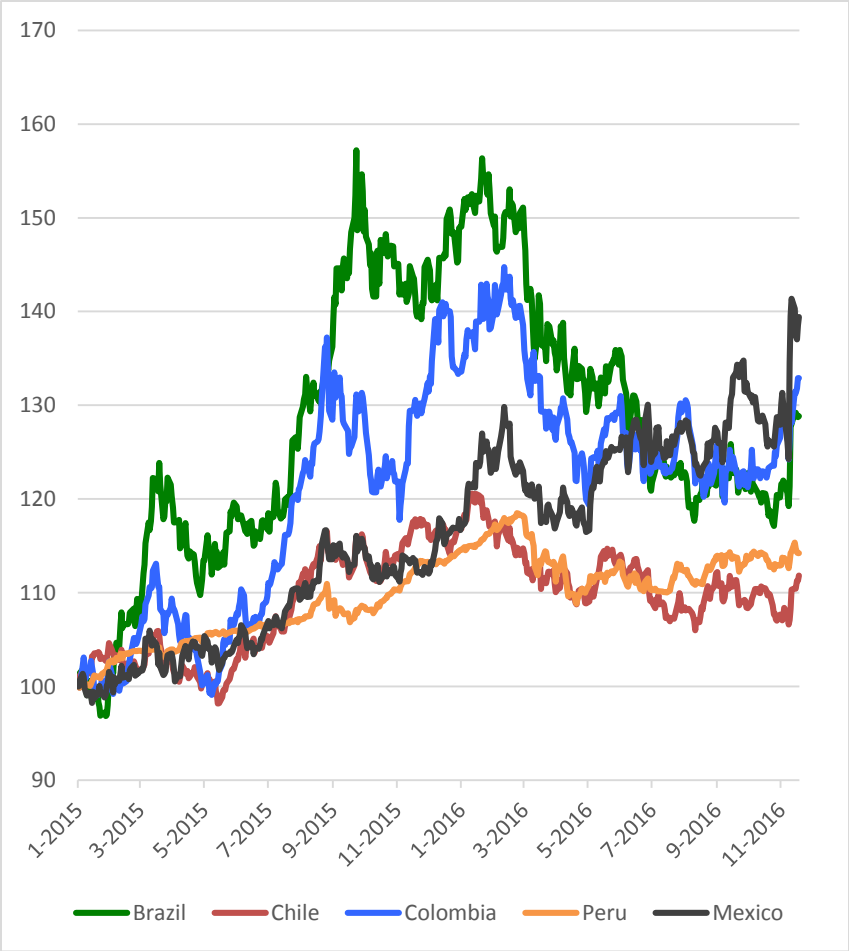
Agenda

- Are financial systems resilient?
- Fostering financial stability: the role of prudential and monetary policies.
- The debt boom in the region

Banks' capital ratios and leverage (2008)



Exchange rates



Macroprudential policies

- Macroprudential Policies are those that look to limit the systematic financial risk.

  Avoiding crisis or smoothing the financial cycle?

  How to measure success: No crisis? Credit gap?
- They have a cross-sectional dimension to limit contagion, TBTF and amplification, and a temporal dimension to limit procyclicality and the accumulation of vulnerabilities.
- Many of them are basically the same as the microprudentials, but on the basis of changing the regulatory parameters according to the business cycle. Others are recalibrations according to the systemic relevance of institutions.

Macroprudential policies in emerging markets

- Periods of “excessive capital inflows” and pressures on the exchange rate: Exchange rate intervention, capital controls and even interest rates set for FS reasons. Potential conflict with macroeconomic objectives.
- Be careful: Macropudential policies are not an excuse to implement any policy (“license to kill”).

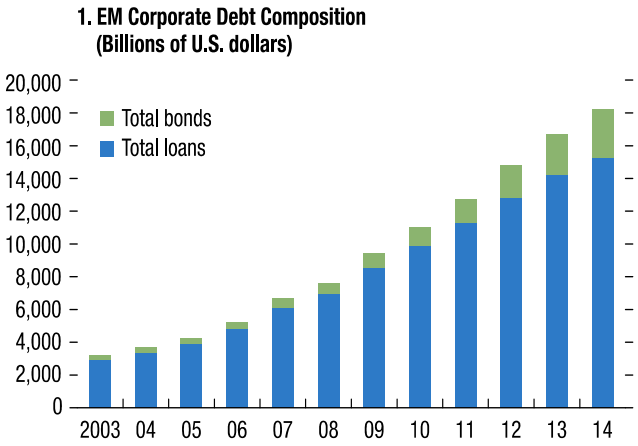
Reserve accumulation, capital controls and monetary policy

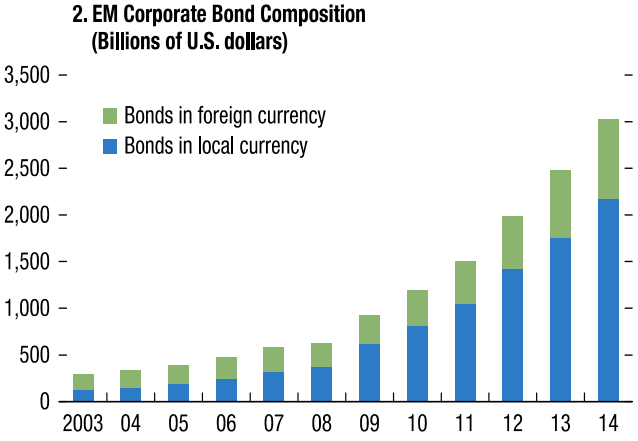
- Dual role: mercantilism and self-insurance. Both reasons coincide at times of strong currencies.
- Effectiveness on exchange rates is small in financially open economies.
- When and how in the context of inflation targets and flexible exchange rates?
- Capital controls: do they work?
- Monetary policy. Mexico today

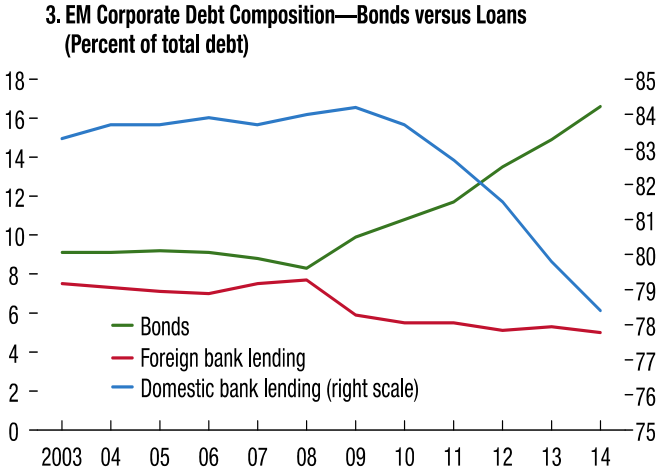
Discussion

- Are they complement or substitute? It depends on the objective. Not clear potential for misuse.
- Still the interest rate is the more appropriate for MP (specially in emerging markets where capital inflows can excecerbate with mP tightening) and Macropru and micropru for FS
- Counter-cyclical provisioning: it has some positive reviews and has been used in the region (Bolivia, Colombia, Peru and Uruguay).
- How to change parameters, discretionally during the business cycle?

Emerging markets debt



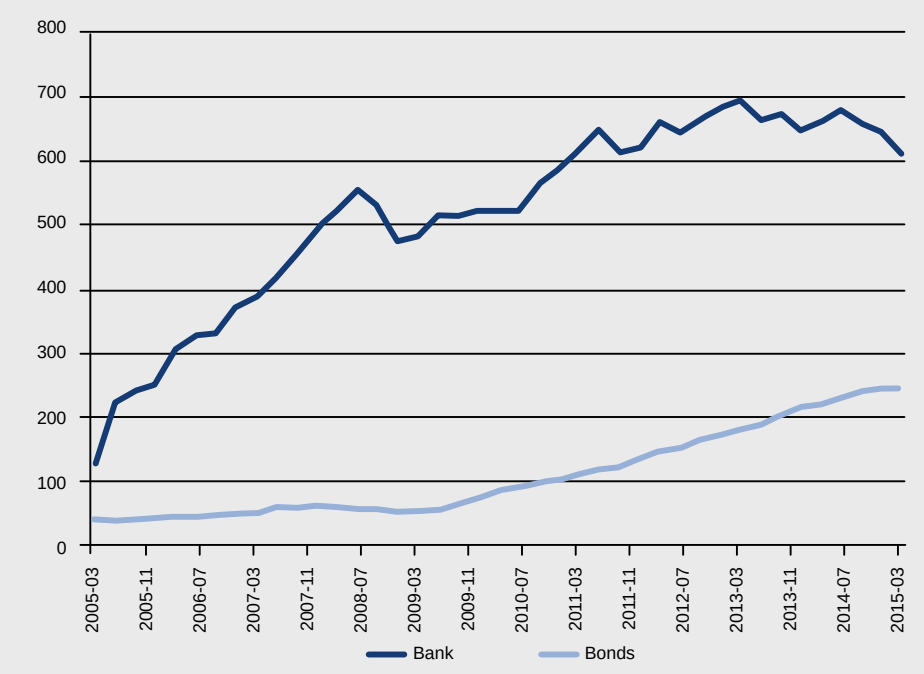




Sources: Ayala, Nedeljkovic, and Saborowski 2015; Bank for International Settlements; Dealogic; IMF, International Financial Statistics database; national authorities; and IMF staff calculations.
Note: EM = emerging market economy; figure depicts major EMs.

Debt in emerging markets

Outstanding International Bonds and Liabilities
LAC



Note: Bank is consolidated foreign claims and other exposures of reporting banks—ultimate risk basis, non-bank private sector (Table 9C). Bonds are international debt securities—nonfinancial corporations, amounts outstanding (Table 12D). Billions of U.S. dollars on vertical axis.
Source: BIS banking and securities statistics.

The Financial Structure of Emerging Market Economies

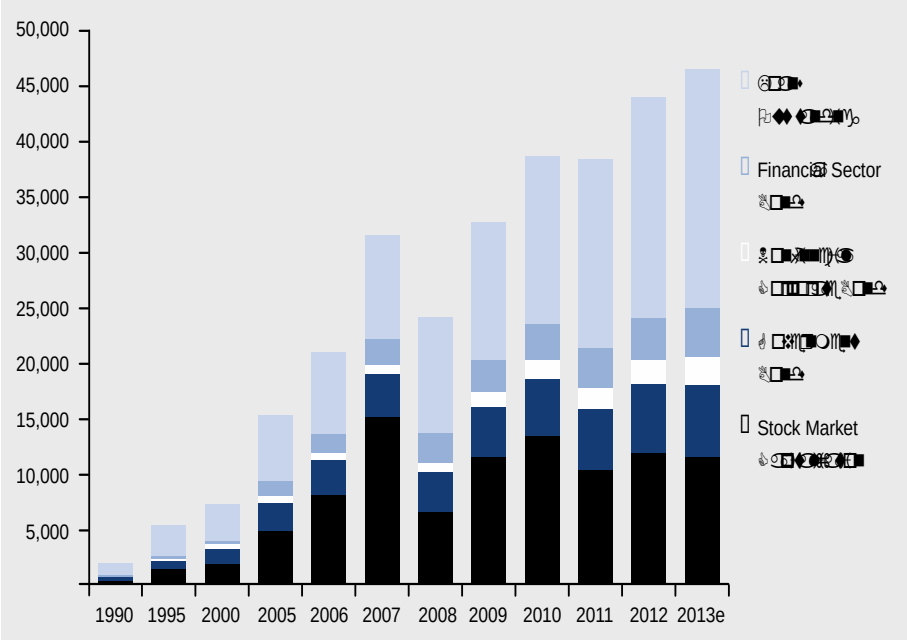
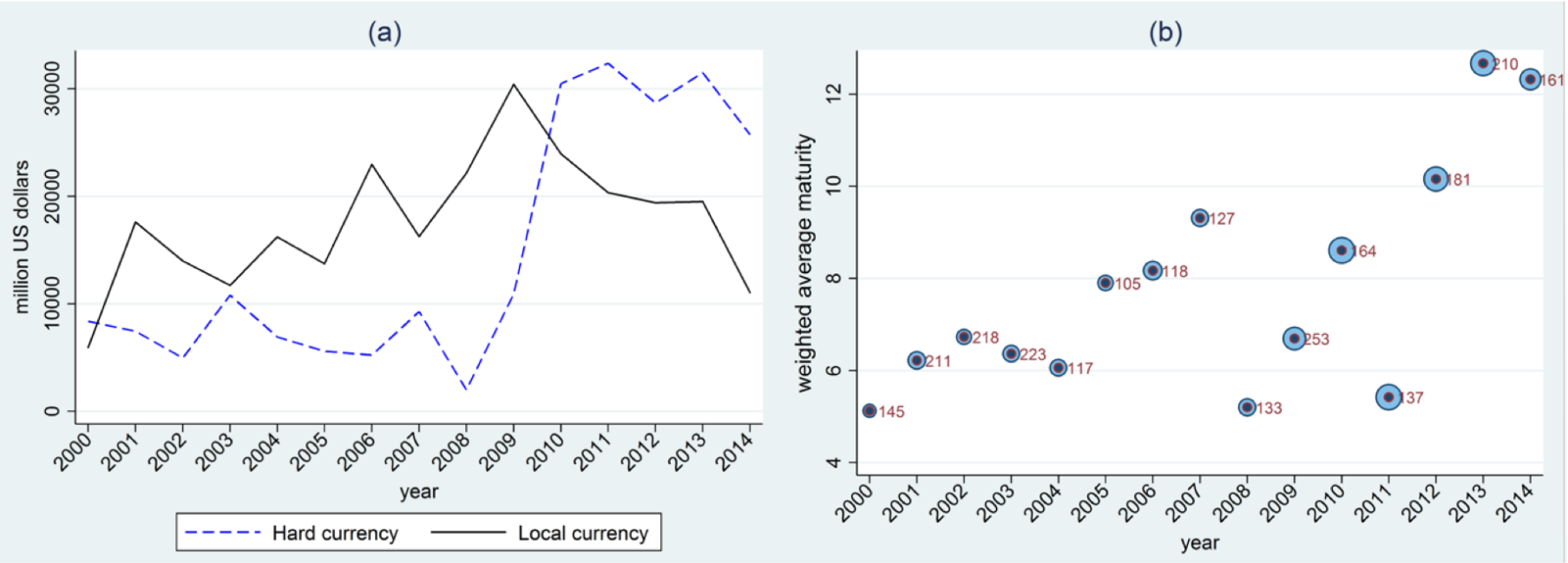


Figure 1: Hard currency & Local currency issuance per year for Latin American non-financial firms



Panel (a) plots the total US bond issuance amount per year decomposed by hard and local currency. Panel (b) plots the total US bond issuance per year. The size of the circle represents the size of the issue, the height represents the average maturity (weighted by the amount of the issue) and the center value represents the issuance number.

Cash holdings & Investment, baseline regression GMM

Dependent Variable (y):	Cash	Cash 2008-2014
	(1)	(3)
FXBH_t	0.045***	0.043***
	(0.016)	(0.016)
$\mathrm{FXBH} * \mathrm{SP}_t$	0.891***	0.935***
	(0.304)	(0.343)
FXBH_{t-1}		
$\mathrm{FXBH}_{t-1} * \mathrm{SP}_{t-1}$		
Cash_{t-1}	0.611***	0.483***
	(0.041)	(0.051)
Inv_{t-1}		
$\mathrm{CFO/Assets}_t$	0.203***	0.171***
	(0.038)	(0.041)
$\mathrm{Ln(Assets)}_t$	-0.002	-0.001
	(0.003)	(0.004)
$\mathrm{Q\ tobin}_t$	0.005	0.010**
	(0.004)	(0.004)
$\mathrm{Debt/Assets}_t$	0.048**	0.060**
	(0.022)	(0.028)
$\mathrm{LT\ debt}_t$	-0.031*	-0.005
	(0.017)	(0.019)
The spread is		
Observations	1,584	990
Number of id	184	181
Country-Year FE	YES	YES
F-Test	162.3	11.09
Auto(2)	0.213	0.871
Hansen p-value	0.978	0.877
Marginal Effect		
$\partial y / \partial FXBH$	0.0479***	0.0438***
	(0.0163)	(0.0165)

FXBH is the hard currency issuance. FXBH*SP is an interaction term between the hard currency issuance and the spread (deposit interest rate over BAA US corporate bond yield). CFO/Assets is the income based cash flow over lagged total assets. Ln(Assets) is the log of total assets. Q Tobin is the market cap plus total debt over total assets. Debt/Assets is debt over total assets and LT Debt is long-term debt over total debt. Auto(2) is a test of second order serial autocorrelation of the residuals under the null hypothesis of no serial correlation. The Hansen test is a test of over identifying restrictions, asymptotically distributed as χ^2 under the null hypothesis of no correlation between the instruments and the error term. *T-statistics* from Robust Standard Errors are in parentheses. ***, **, and * represents a level of significance lower than 1%, 5%, and 10%, respectively.

Cash holdings & Investment, baseline regression GMM

Dependent Variable (y):	Cash	Investment	Cash 2008-2014	Investment 2008-2014
	(1)	(2)	(3)	(4)
$FXBH_t$	0.045***	-0.005*	0.043***	-0.009**
	(0.016)	(0.003)	(0.016)	(0.004)
$FXBH * SP_t$	0.891***		0.935***	
	(0.304)		(0.343)	
$FXBH_{t-1}$		0.023*		0.021*
		(0.013)		(0.012)
$FXBH_{t-1} * SP_{t-1}$		0.618**		0.630**
		(0.281)		(0.287)
$Cash_{t-1}$	0.611***		0.483***	
	(0.041)		(0.051)	
Inv_{t-1}		0.486***		0.461***
		(0.045)		(0.050)
$CFO/Assets_t$	0.203***	0.023	0.171***	0.003
	(0.038)	(0.021)	(0.041)	(0.026)
$Ln(Assets)_t$	-0.002	0.001	-0.001	0.000
	(0.003)	(0.002)	(0.004)	(0.002)
$Q\ tobin_t$	0.005	0.007***	0.010**	0.007***
	(0.004)	(0.002)	(0.004)	(0.002)
$Debt/Assets_t$	0.048**	-0.011	0.060**	-0.011
	(0.022)	(0.017)	(0.028)	(0.020)
$LT\ debt_t$	-0.031*	0.005	-0.005	0.021
	(0.017)	(0.010)	(0.019)	(0.016)
The spread is	Deposit interest rate - US corporate bond yield BAA			
Observations	1,584	1,584	990	990
Number of id	184	184	181	181
Country-Year FE	YES	YES	YES	YES
F-Test	162.3	150.3	11.09	94.70
Auto(2)	0.213	0.491	0.871	0.510
Hansen p-value	0.978	0.993	0.877	0.804
Marginal Effect				
$\partial y/\partial FXBH$	0.0479***	0.0246*	0.0438***	0.0217*
	(0.0163)	(0.0136)	(0.0165)	(0.0127)

FXBH is the hard currency issuance. FXBH*SP is an interaction term between the hard currency issuance and the spread (deposit interest rate over BAA US corporate bond yield). CFO/Assets is the income based cash flow over lagged total assets. Ln(Assets) is the log of total assets. Q Tobin is the market cap plus total debt over total assets. Debt/Assets is debt over total assets and LT Debt is long-term debt over total debt. Auto(2) is a test of second order serial autocorrelation of the residuals under the null hypothesis of no serial correlation. The Hansen test is a test of over identifying restrictions, asymptotically distributed as χ^2 under the null hypothesis of no correlation between the instruments and the error term. *T-statistics* from Robust Standard Errors are in parentheses. ***, **, and * represents a level of significance lower than 1%, 5%, and 10%, respectively.