The Latin American Experience

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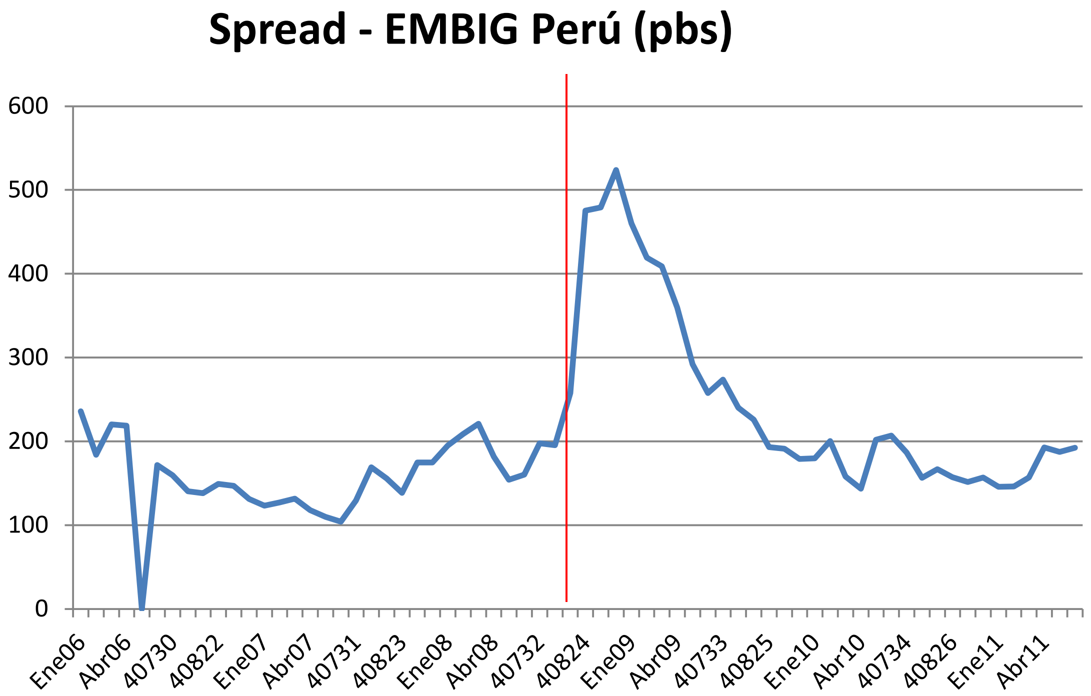
Introduction

- Recent Latin American IT experiences illustrate the issues and tensions in trying to implement “best practices”
- Céspedes, Chang, and Velasco (2014) review Brazil, Chile, Colombia, and Perú
- Here we will focus on the Peruvian case, for concreteness

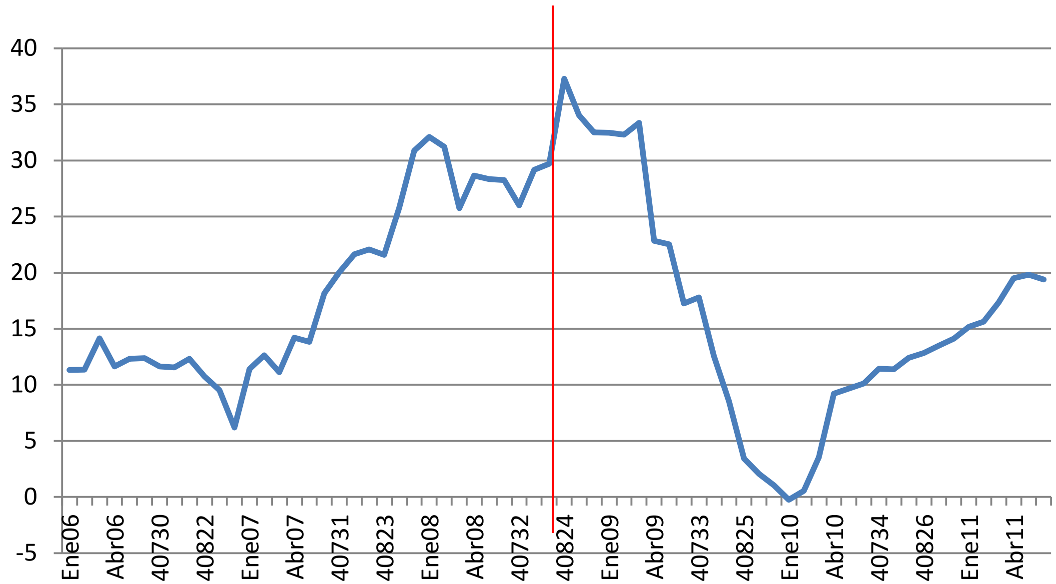
Perú Up to Lehman: Key Trends

- Strong Capital Inflows
- Fast Growth, Accelerating Inflation
- Exchange Rate Appreciation



Source: Central Bank of Peru

Peru, Bank Credit to Private Sector (12 month % growth)



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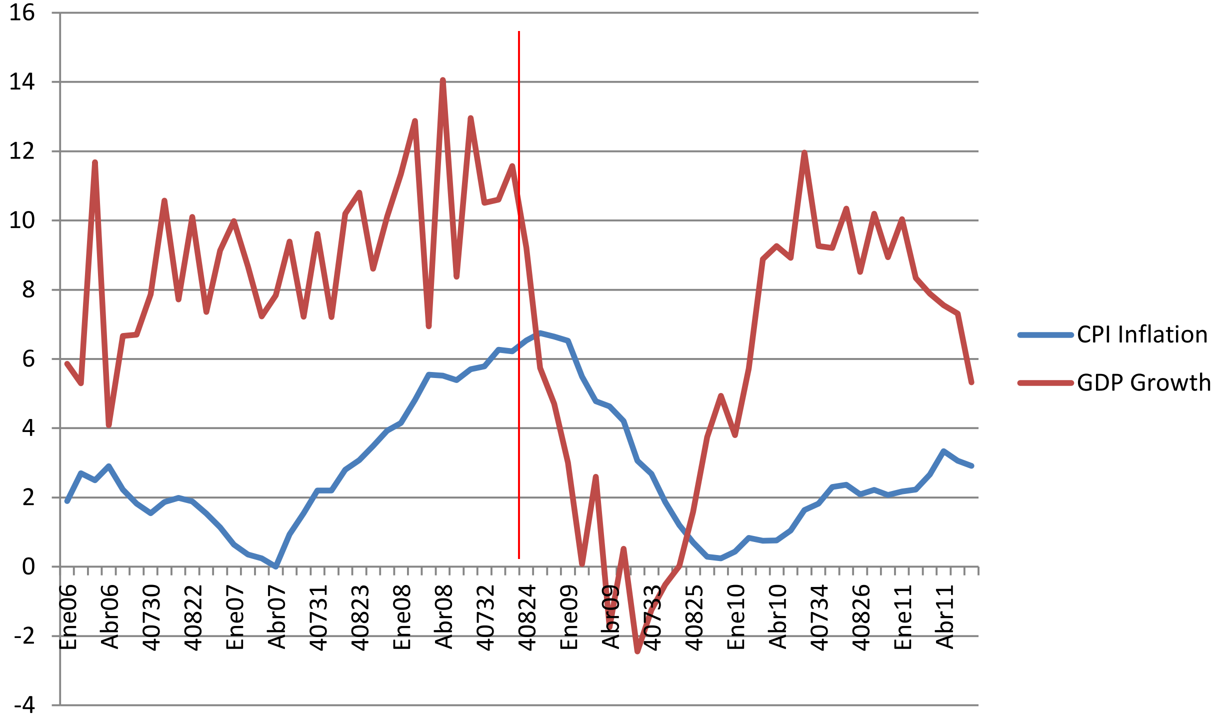
Peru, CPI Inflation and GDP Growth
(Annual Percentage Rates)



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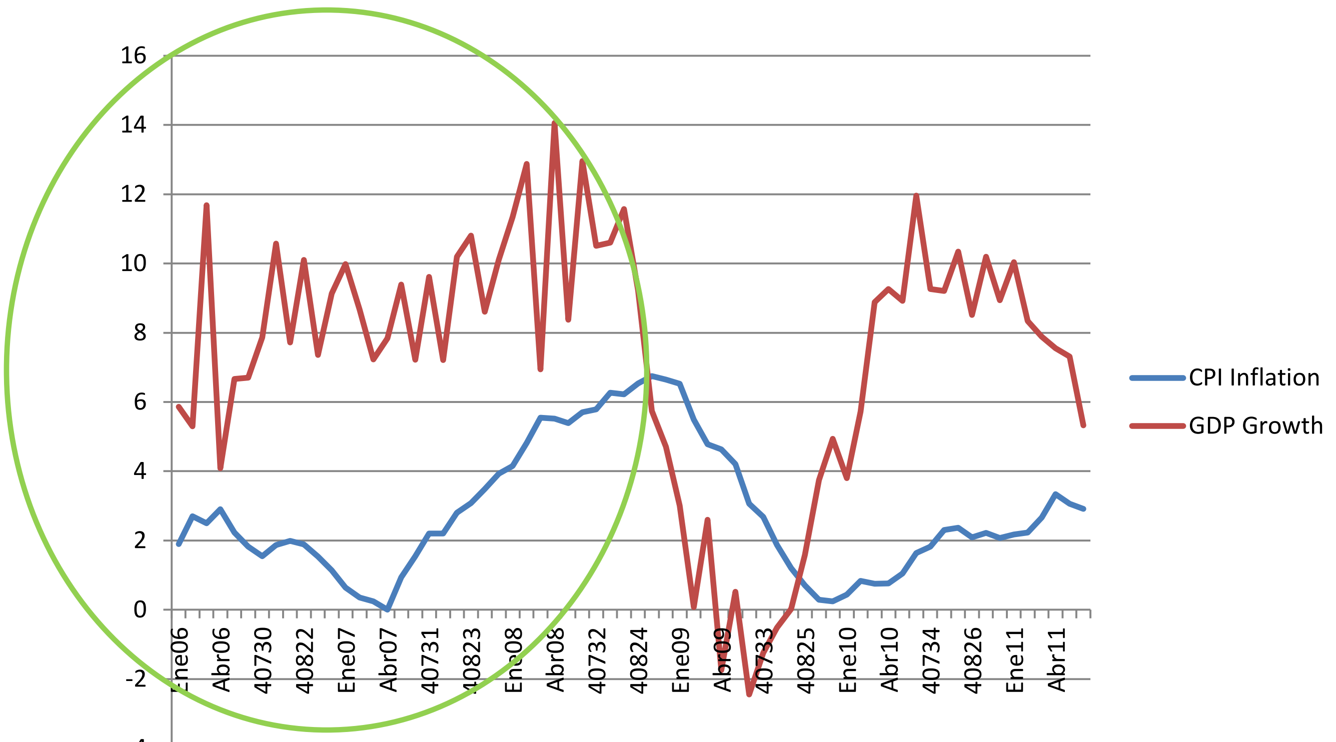

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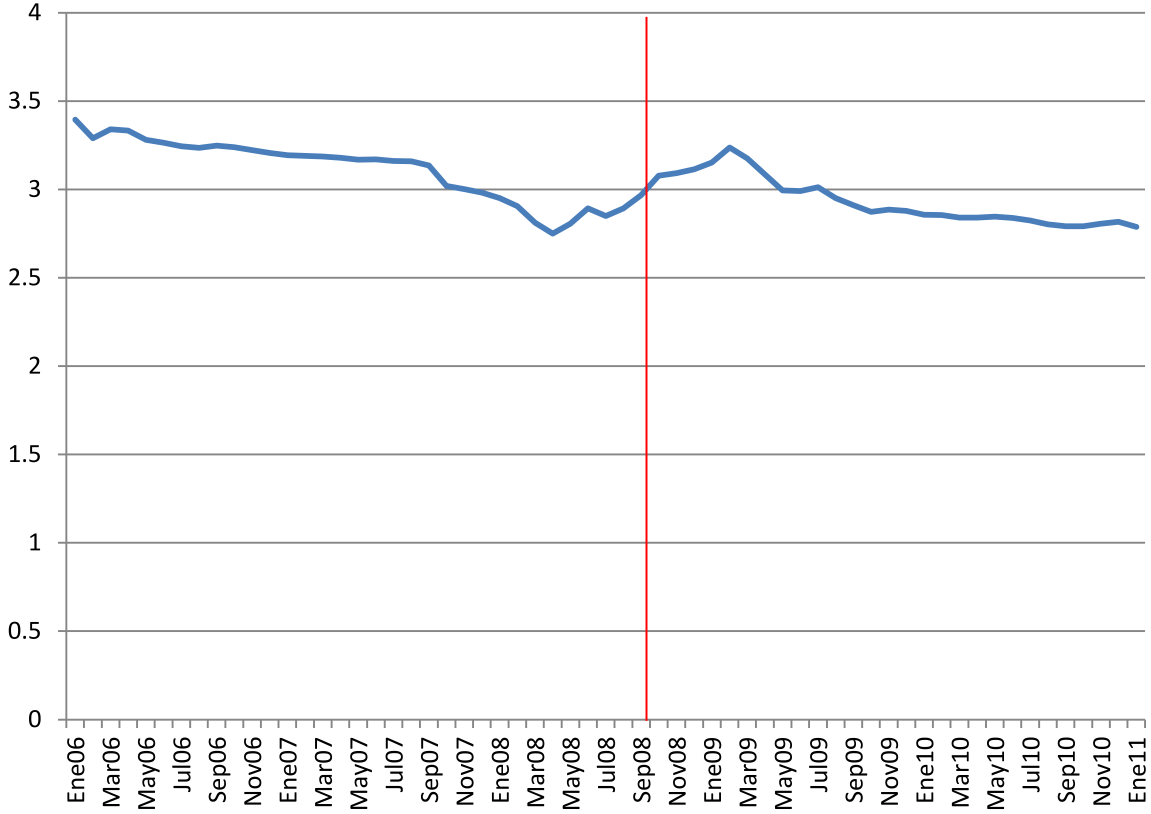
Peru, Exchange Rate (Sol per US$)



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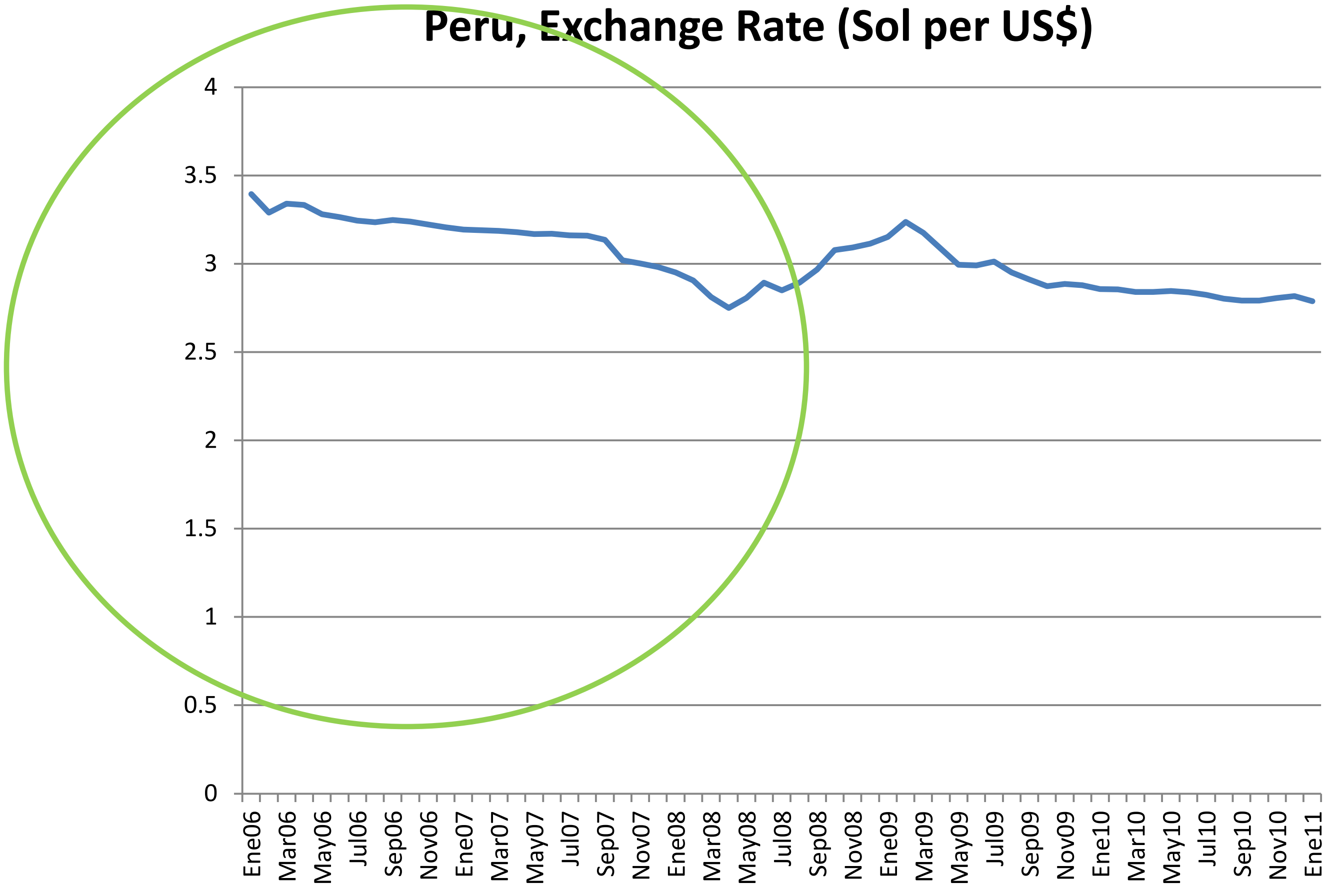

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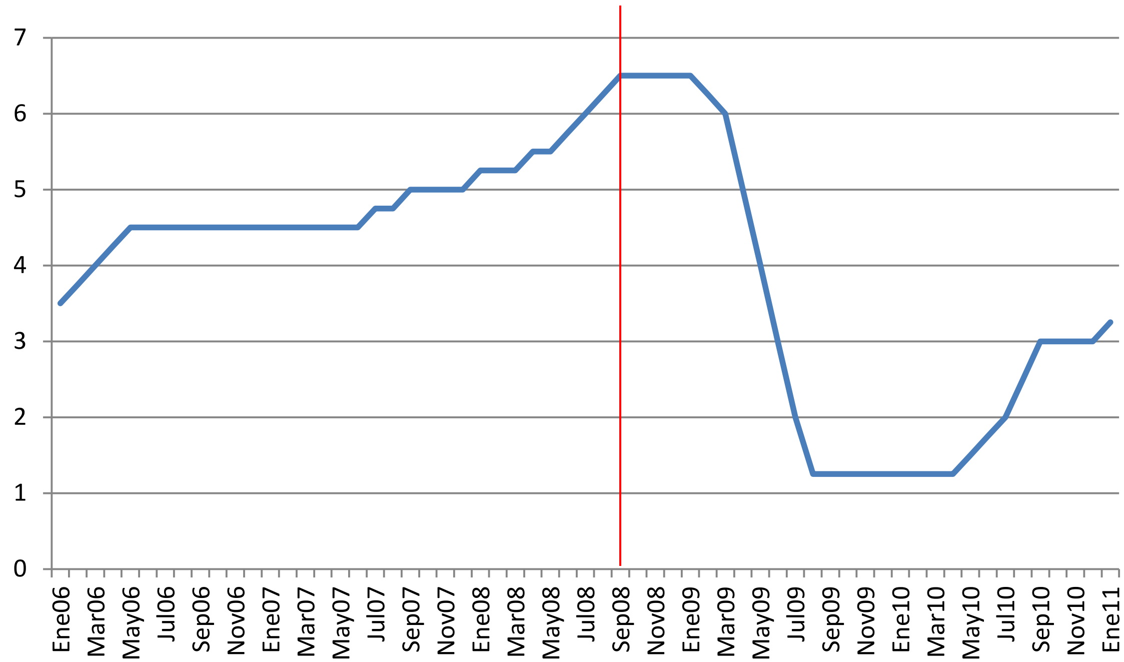
Up to Lehman: The Policy Response

- Policy Rate Increases to Bring Inflation Down
- FX Purchases
- Increases in Reserve Requirements

Peru: Policy Rate



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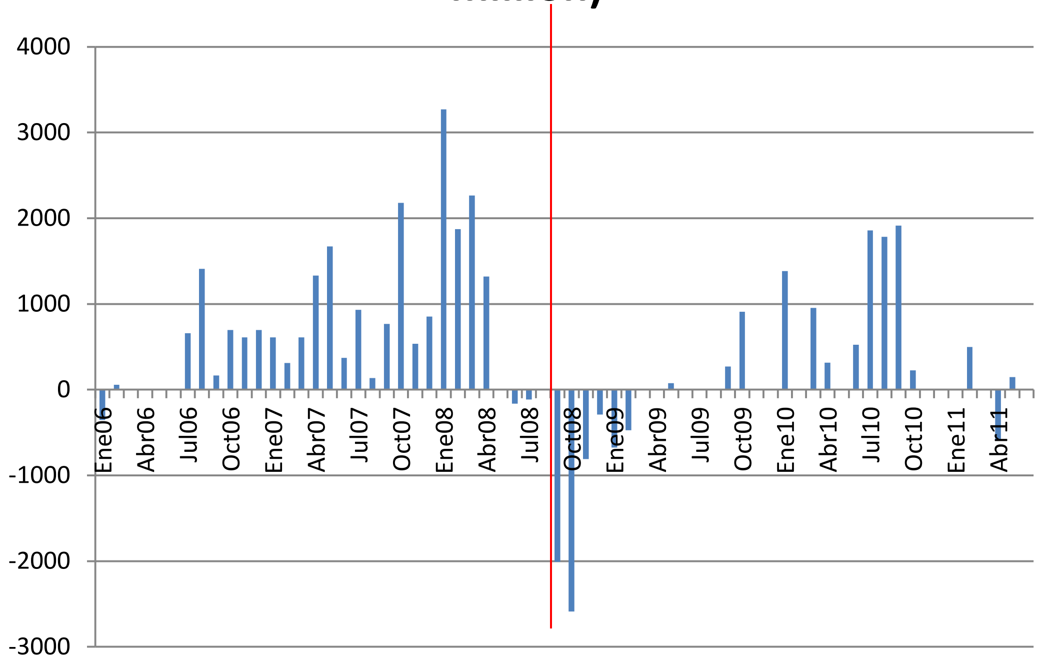
Peru: Central Bank Dollar Purchases (US$ million)



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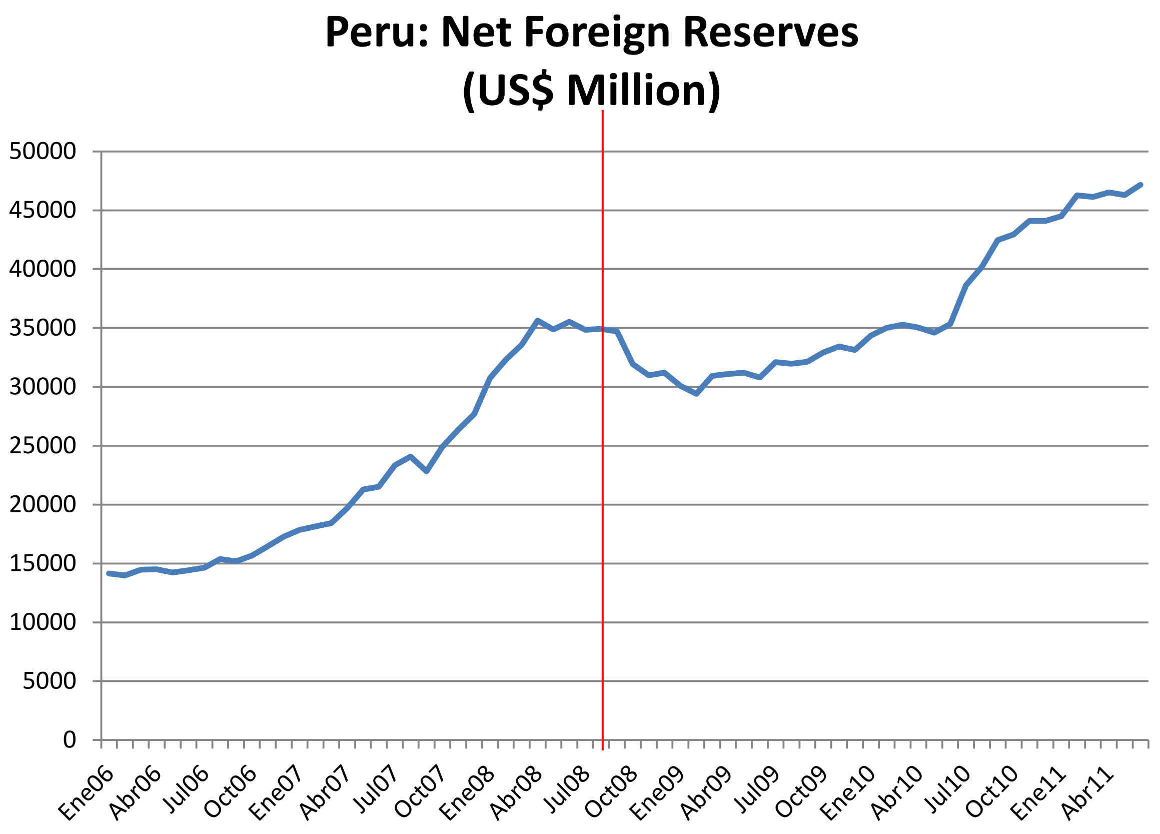
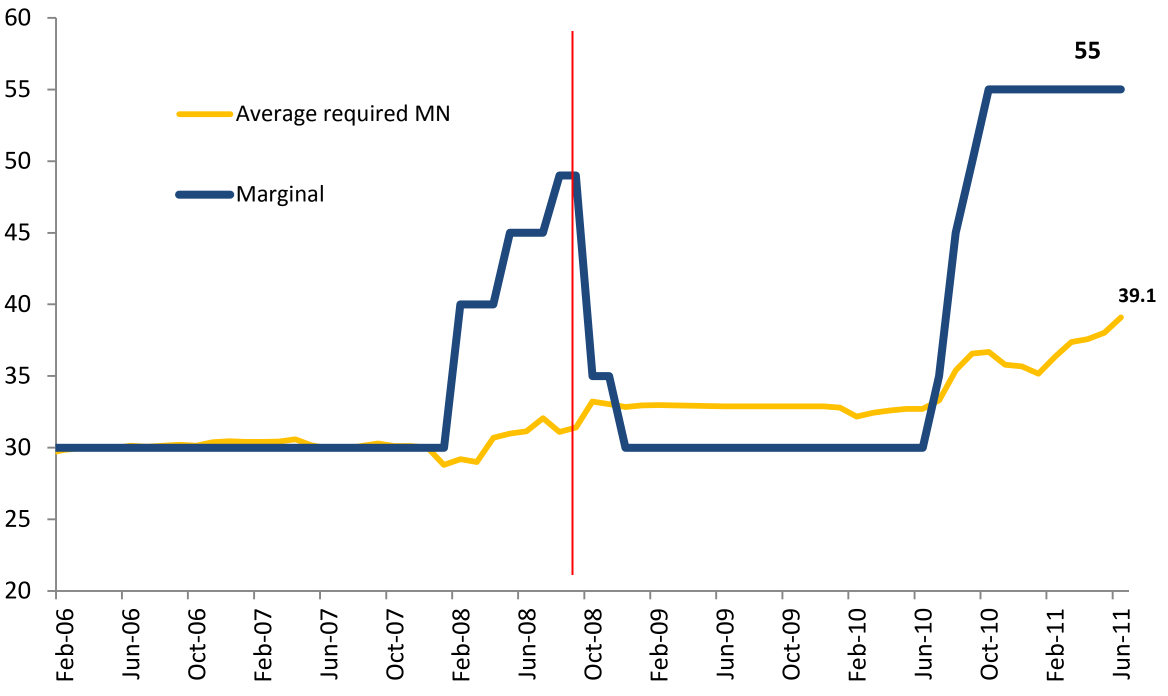


Source: Central Bank of Peru

Peru: Reserve requirements in foreign currency

(In percentage)



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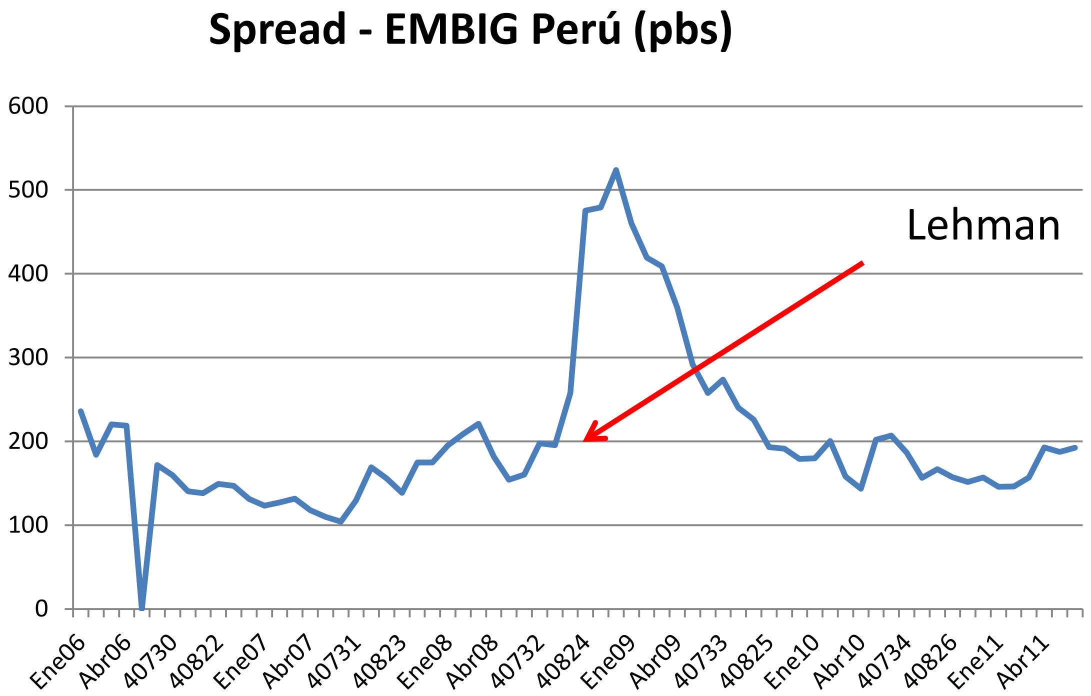
The Lehman Crisis

- Reversal of capital flows

- Credit Crunch

- Rapid depreciation of the *sol*



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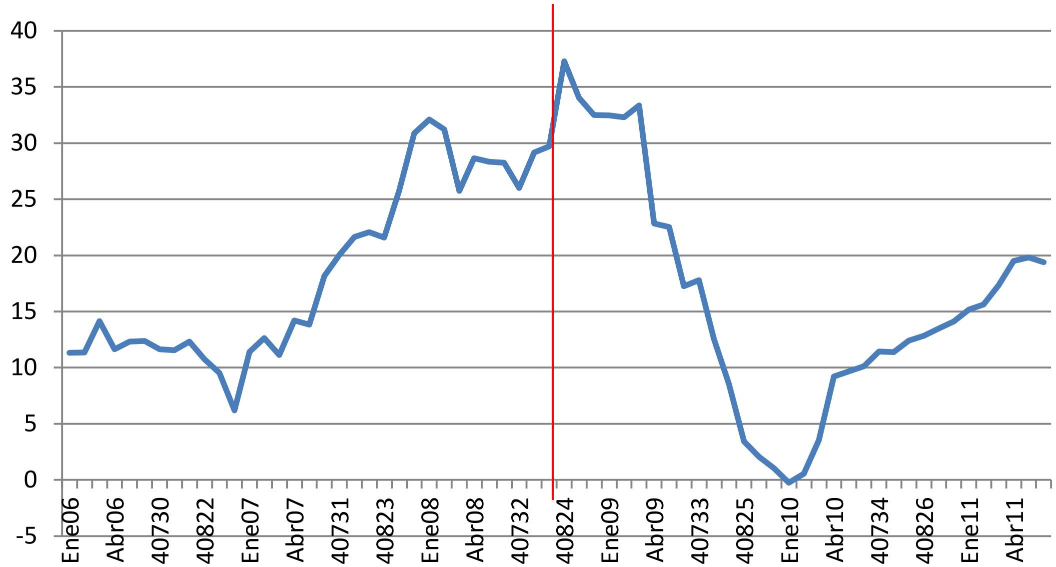

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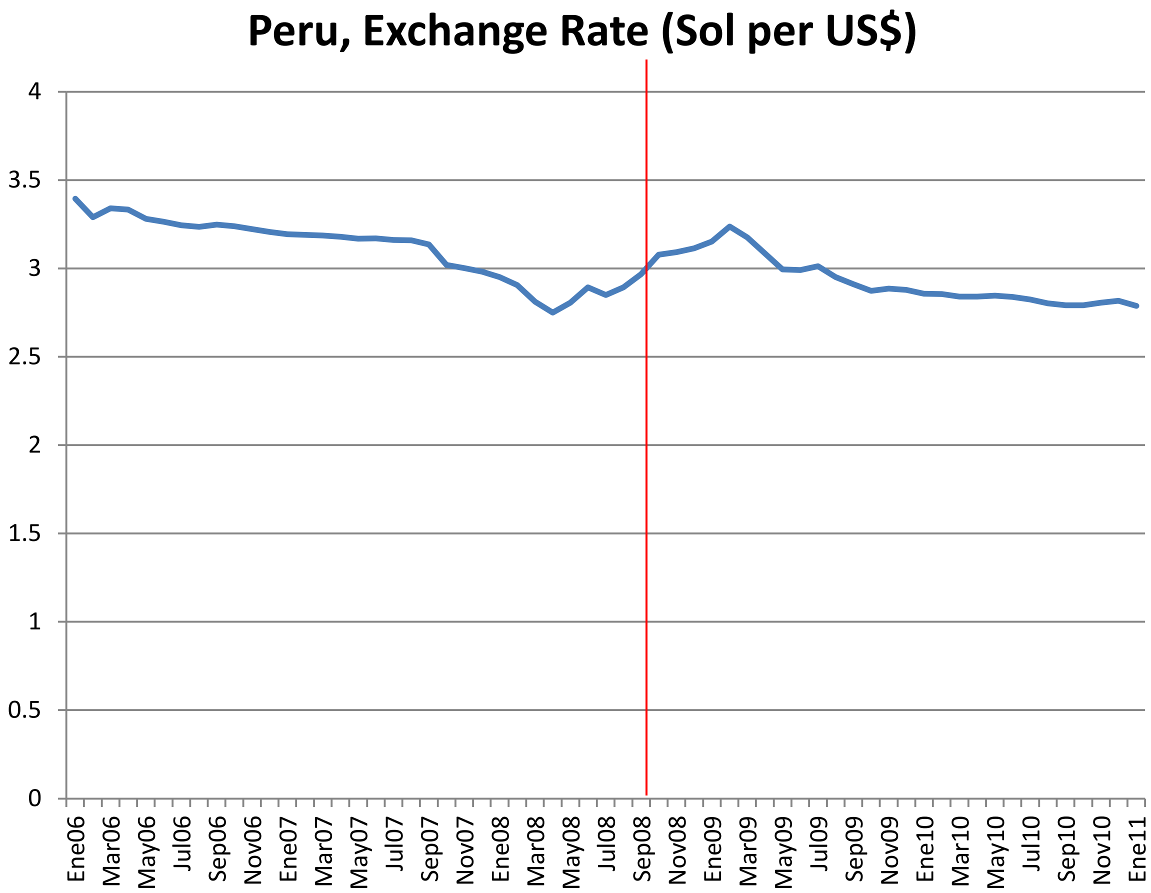
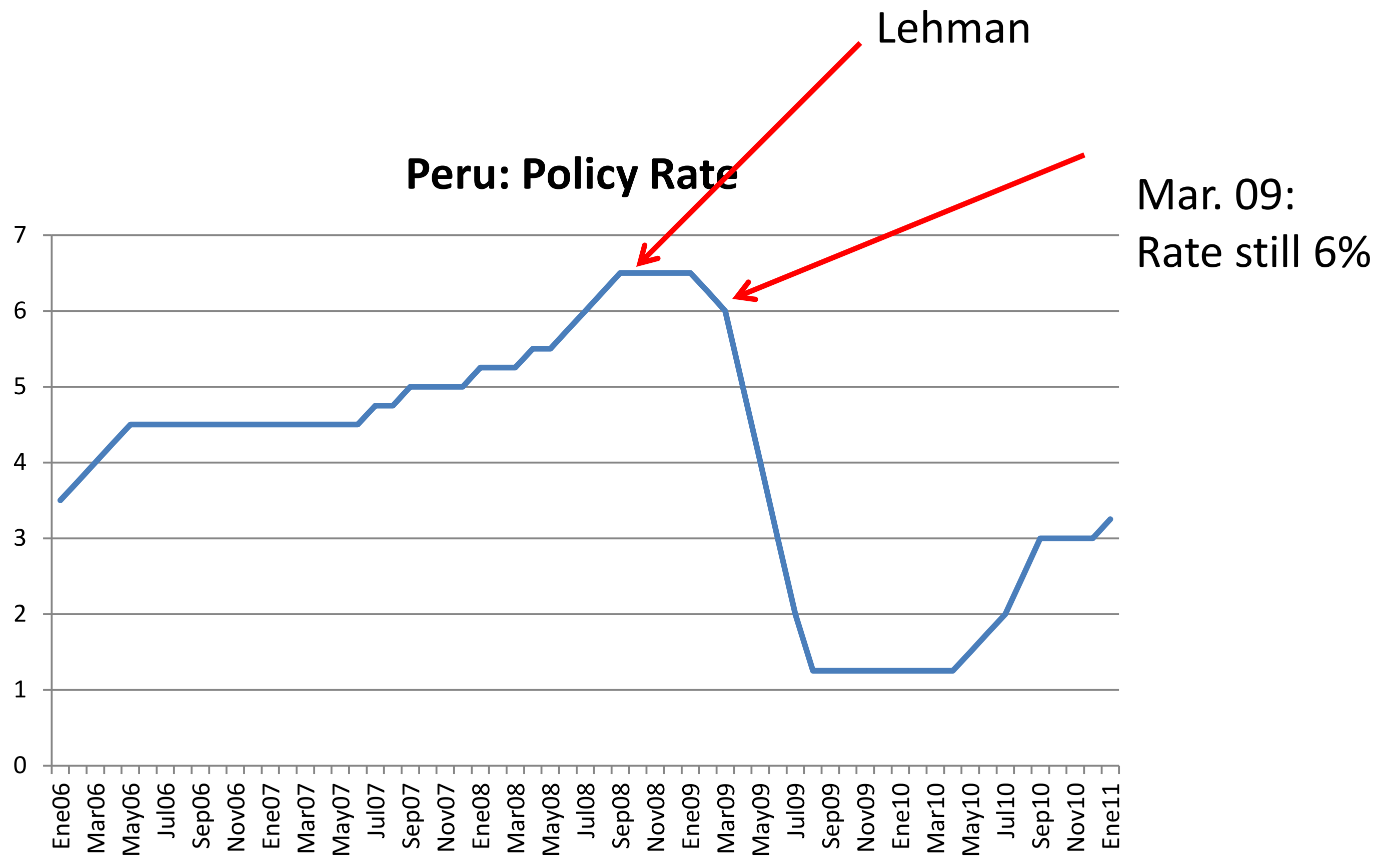


Source: Central Bank of Peru

Policy Response

- The policy rate was not lowered till several months later
- Instead, adjustment in *unconventional* instruments



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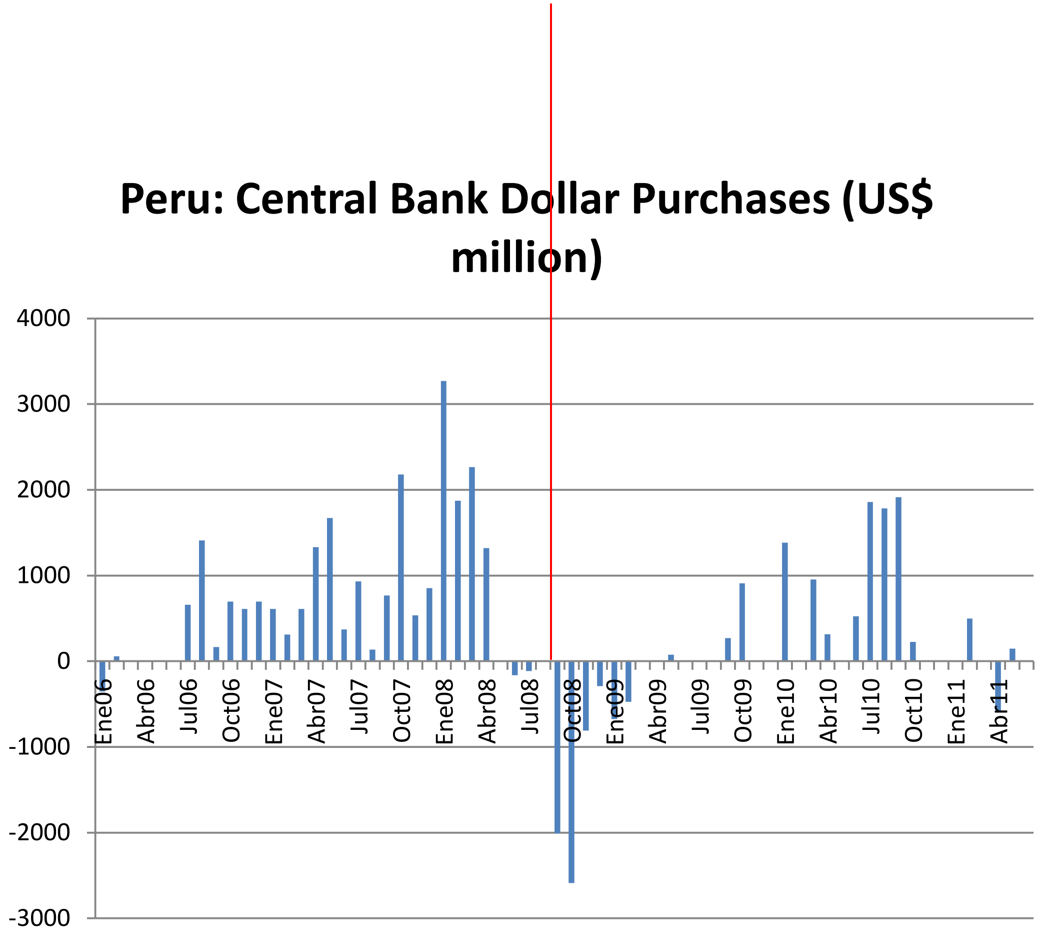

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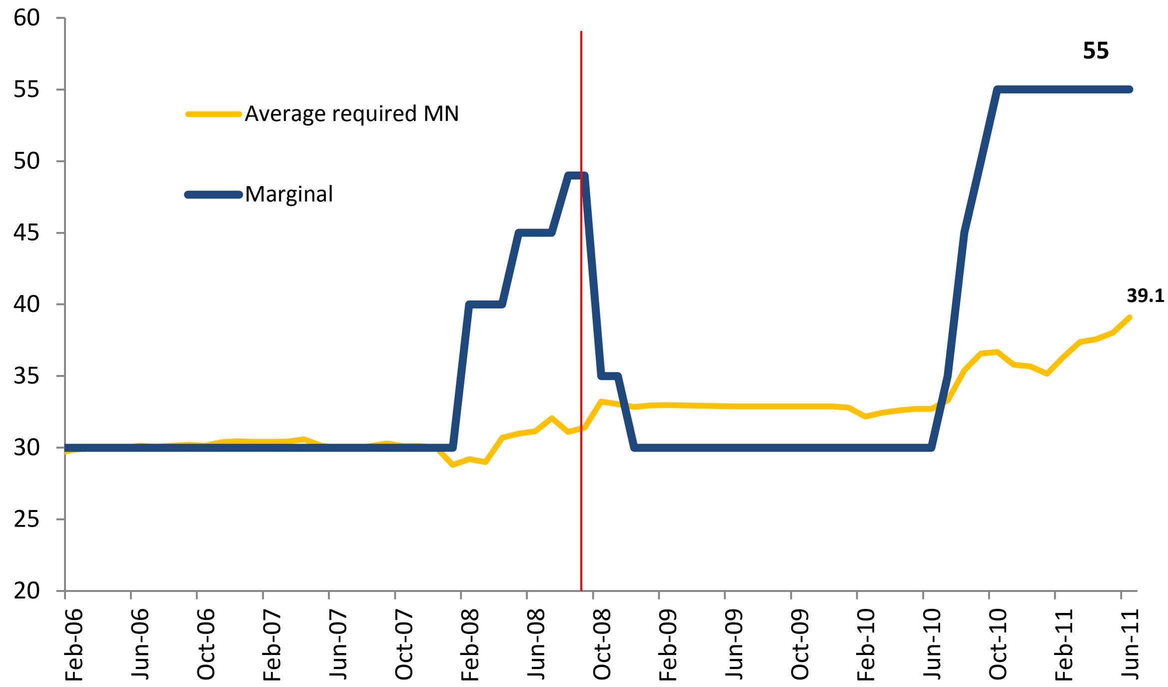

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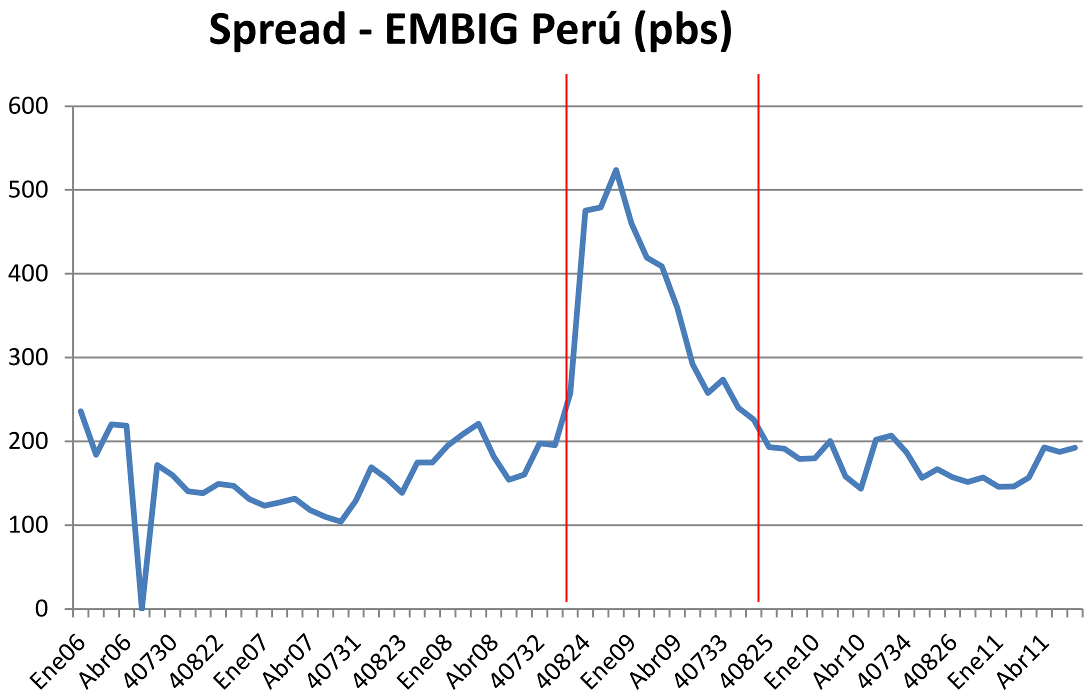
Period After the Global Crisis

- Relatively recovery
- Strong growth, capital inflows, appreciation resumed
- Same combination of conventional and unconventional measures as before the Lehman period



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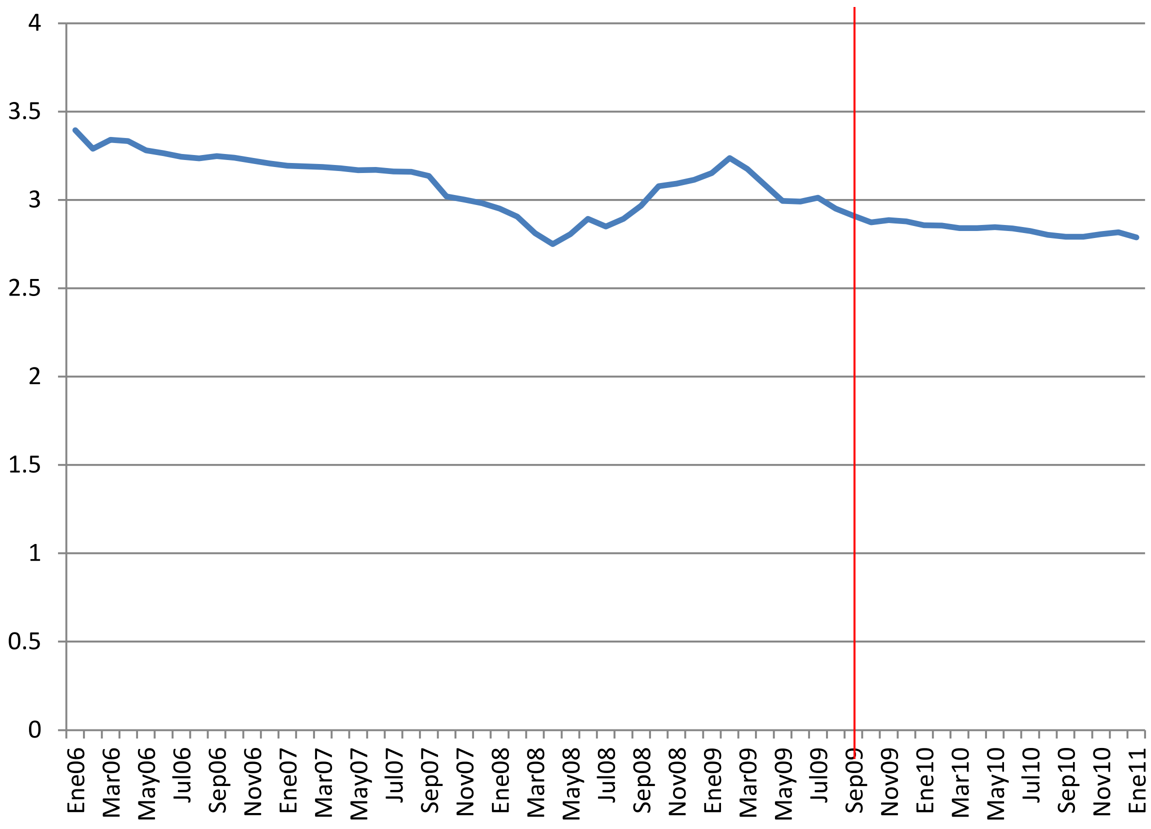
Peru, Exchange Rate (Sol per US$)



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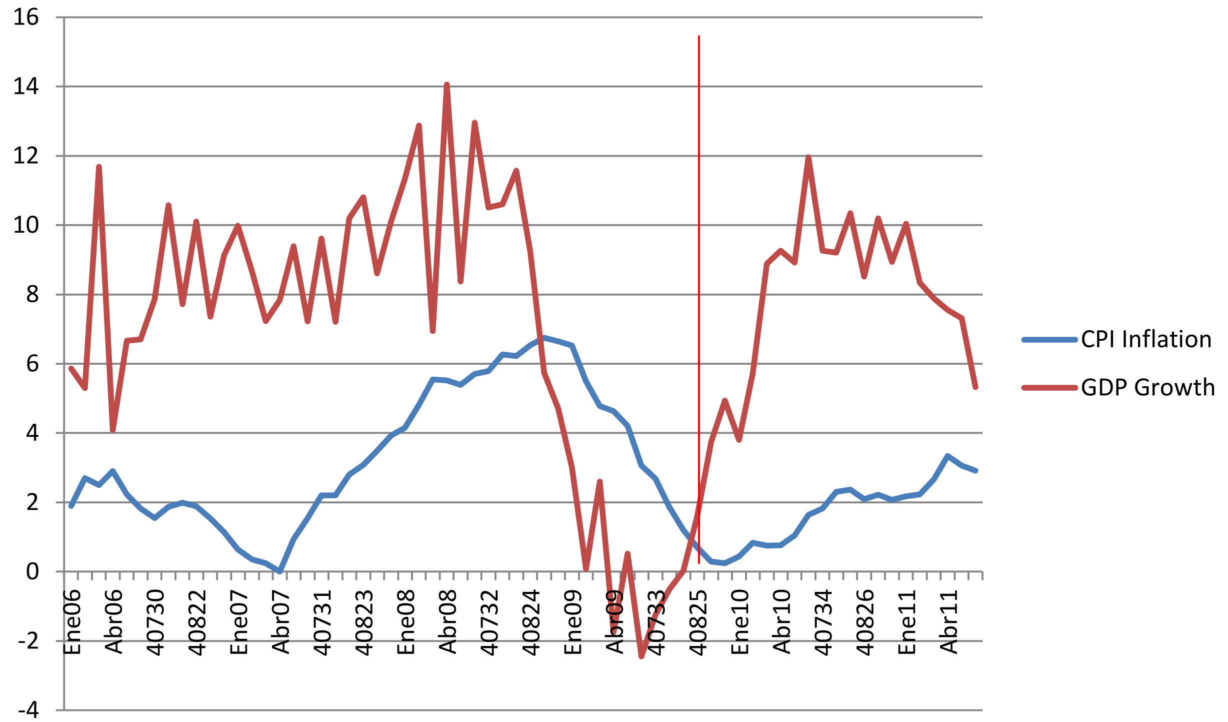

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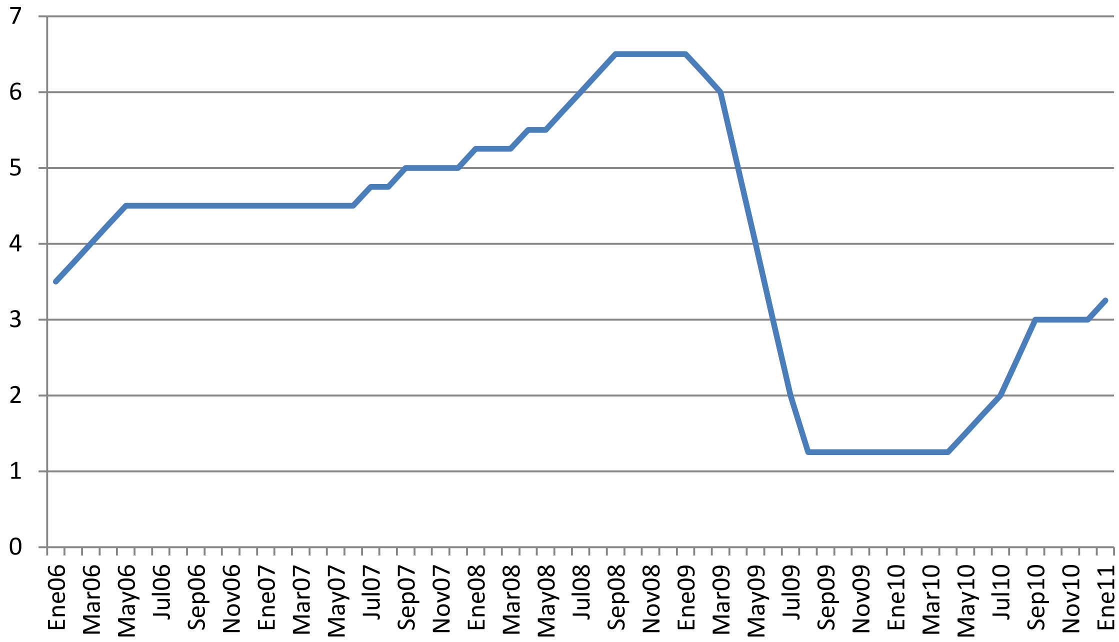

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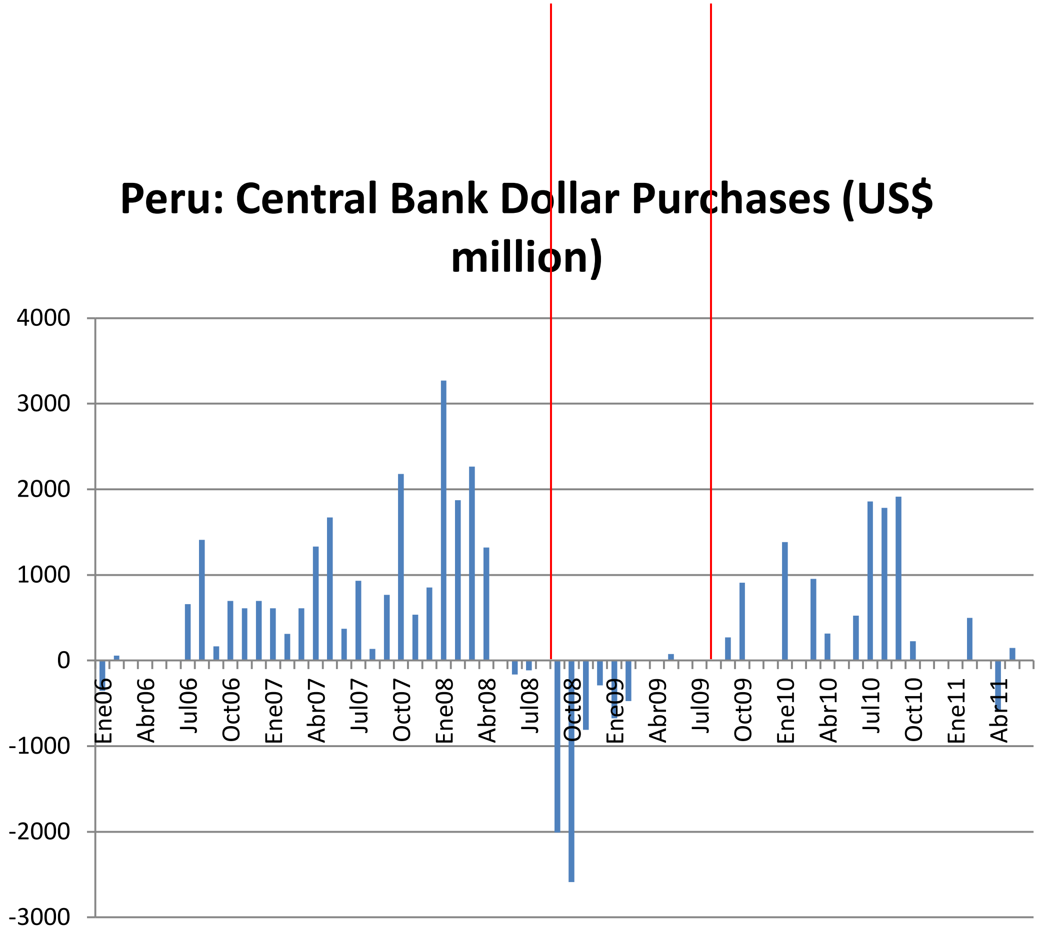

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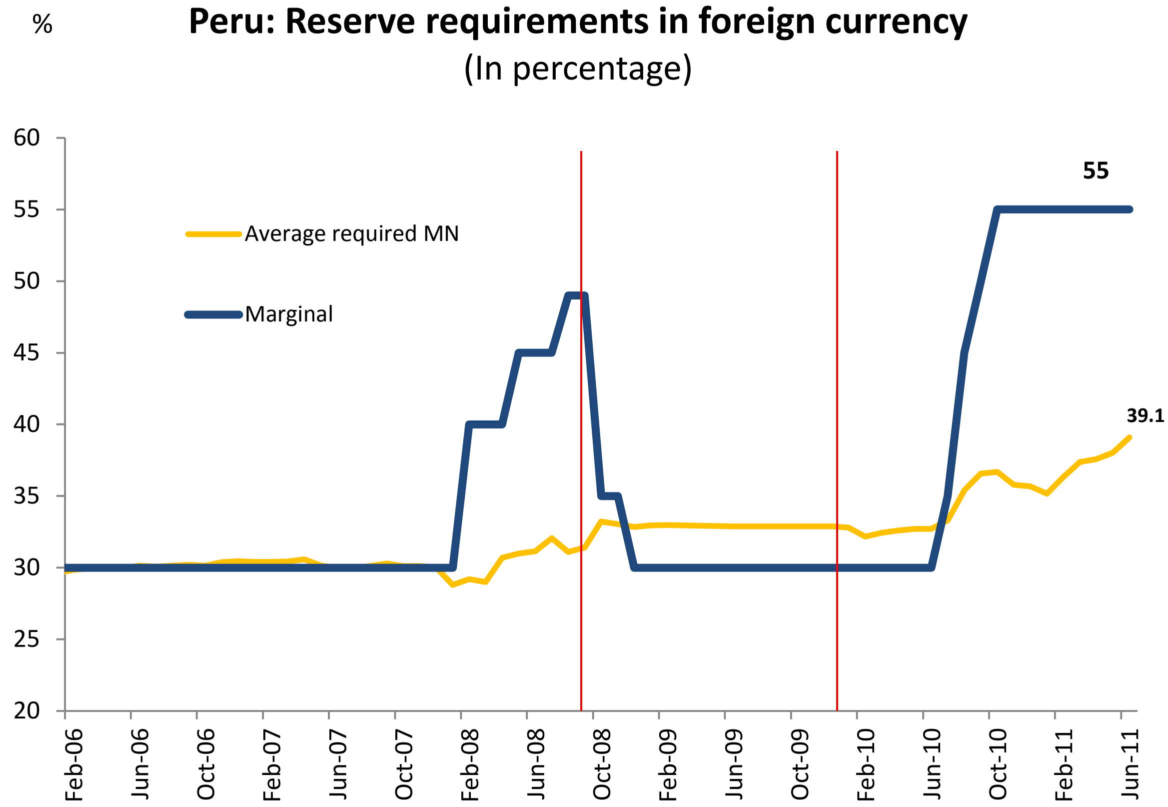


Source: Central Bank of Peru

Tentative Lessons

- Differences in cases of capital inflows and capital outflows
- In cases of inflows, central banks in LA used the conventional policy instrument to try to fight “overheating”, and unconventional tools (FX intervention, reserve requirements, taxes on capital inflows) to curb appreciation
- Limited success

Tentative Lessons

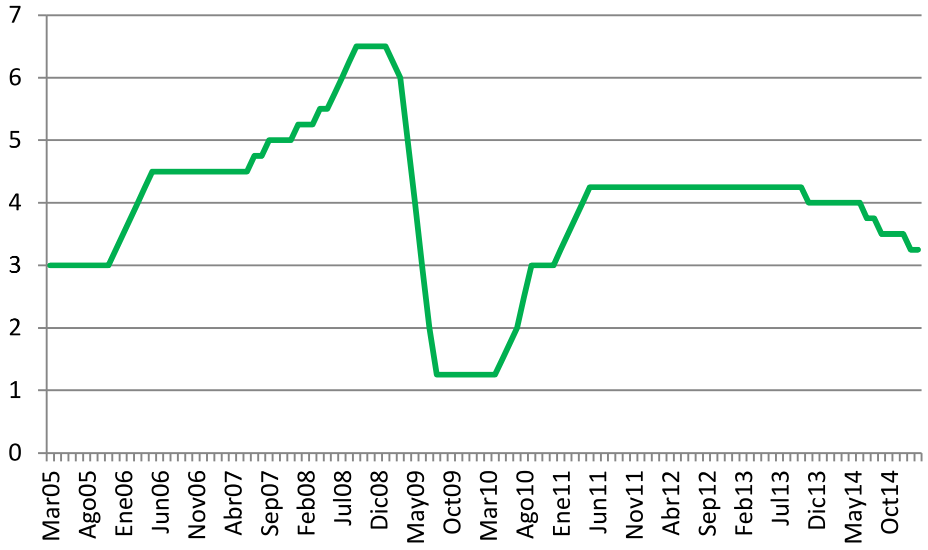
- Under capital outflows, the first line of defense was again unconventional tools; the policy rate was adjusted more slowly (central banks were concerned with "credibility" as inflation fighters)
- Central banks could be quite forceful in providing foreign exchange liquidity, because they had ample FX reserves
- Policy was successful: countries recovered quickly

Tentative Lessons

- The case studies suggest that unconventional policies are quite effective in episodes of outflows, much less so in cases of capital inflows
- This is consistent with theoretical models

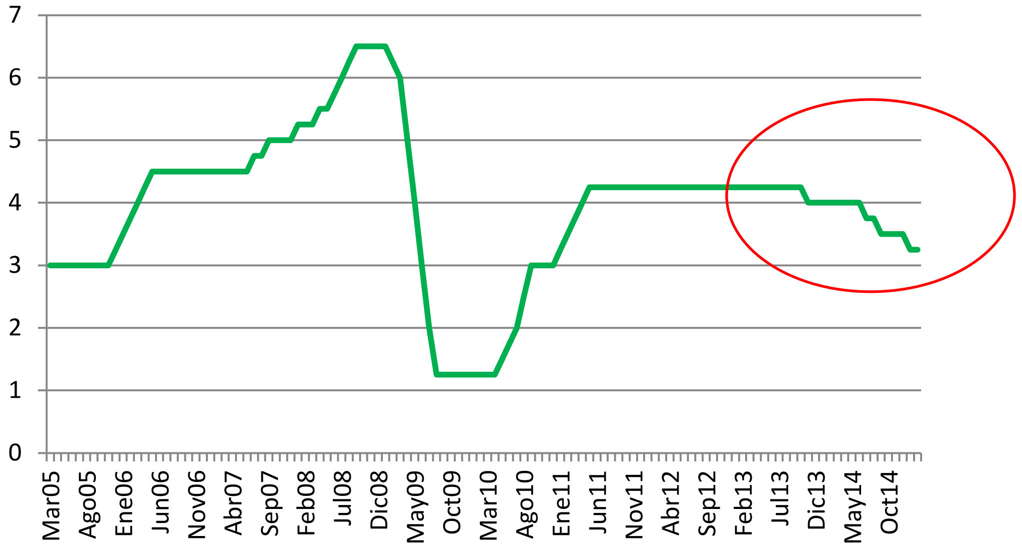
More Recent Developments

- After “tapering” episode of May 2013, FX intervention policy at odds with overall monetary stance



Peru: Reference Interest Rate

Source: Central Bank of Peru



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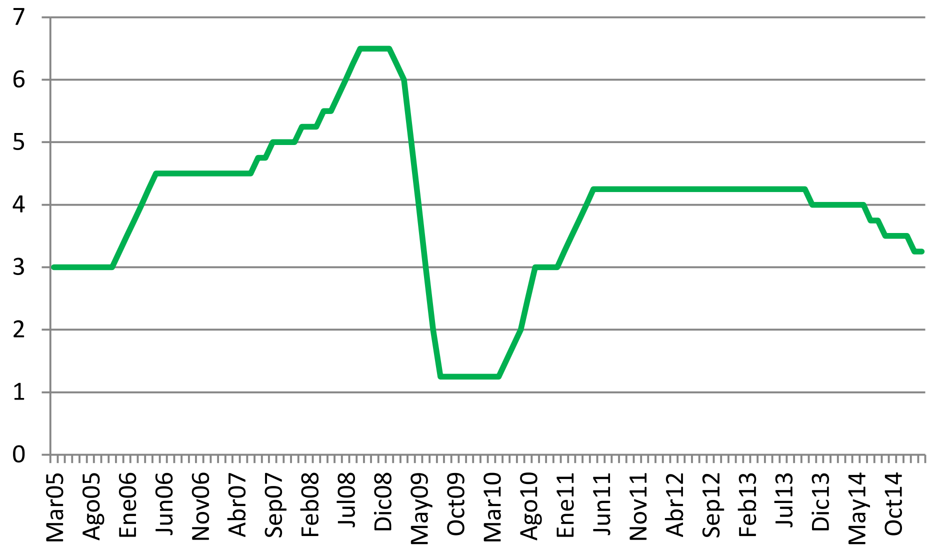
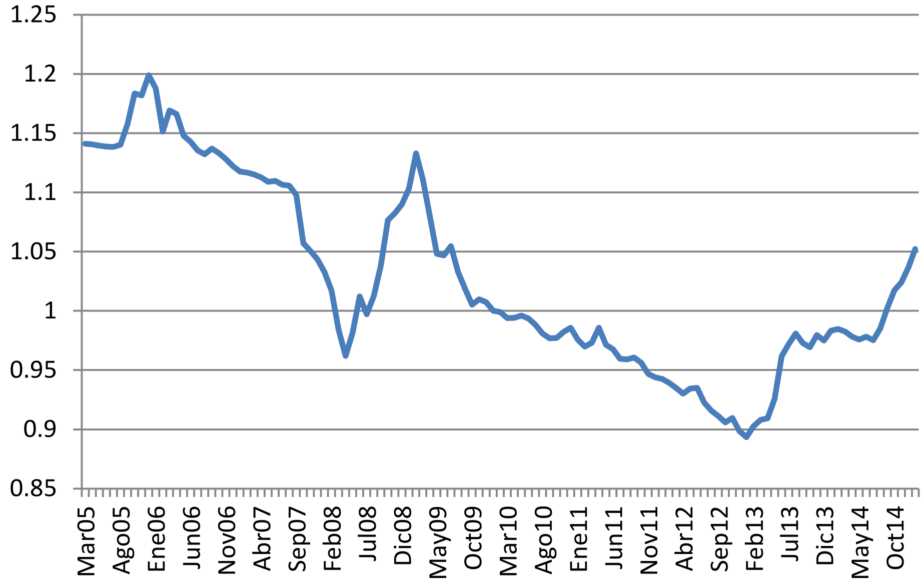
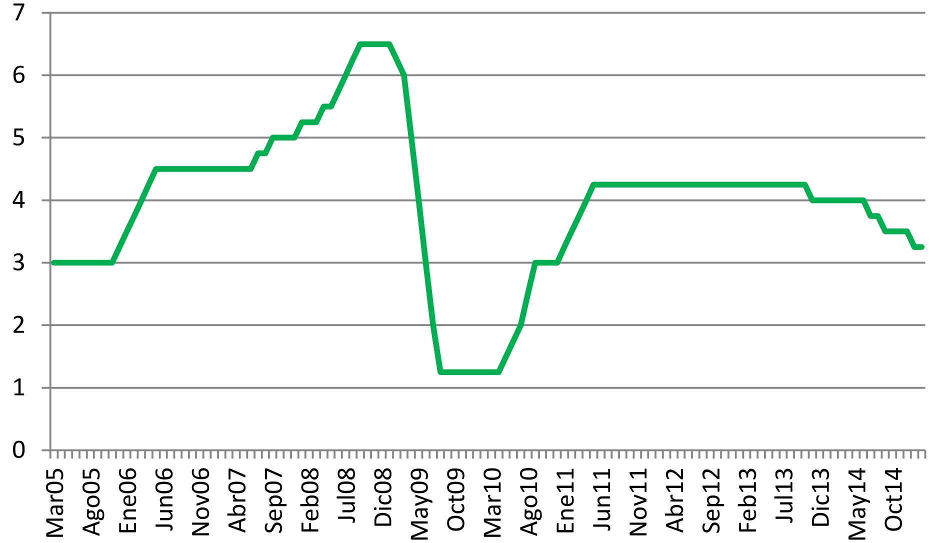
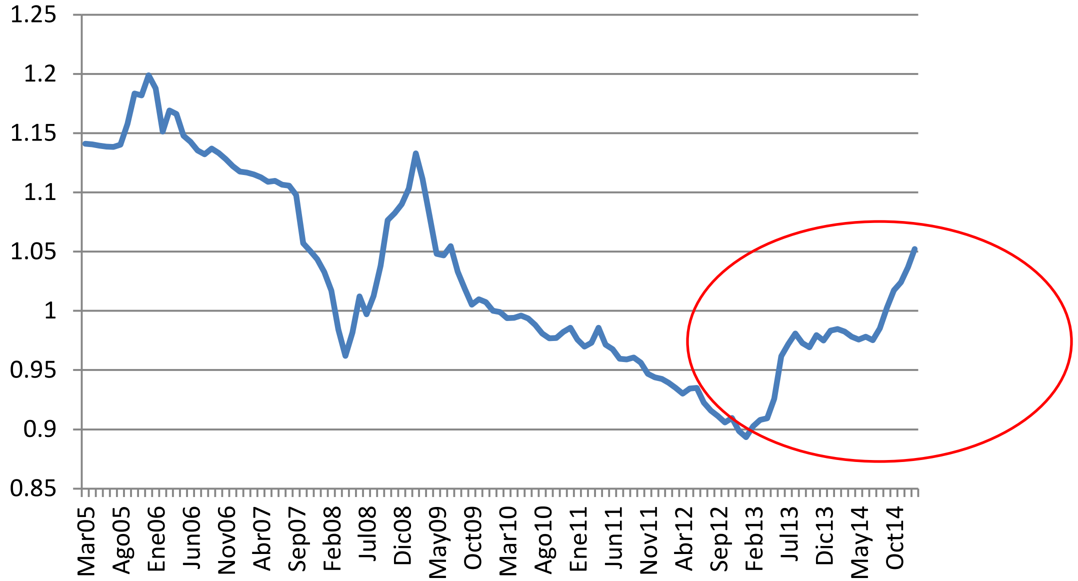




Peru: Exchange Rate (Soles Per US$, Jan. 2010 = 1)

Source: Central Bank of Peru





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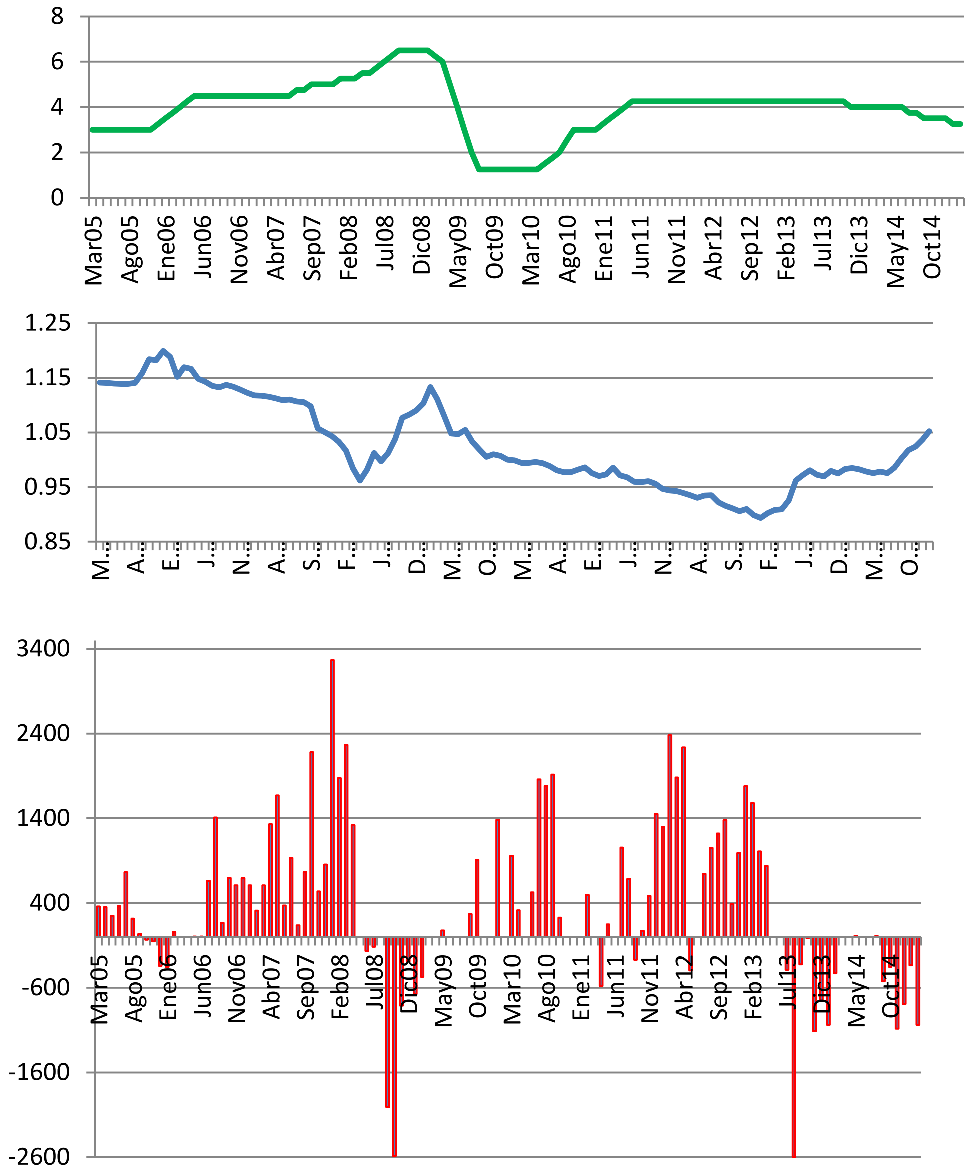
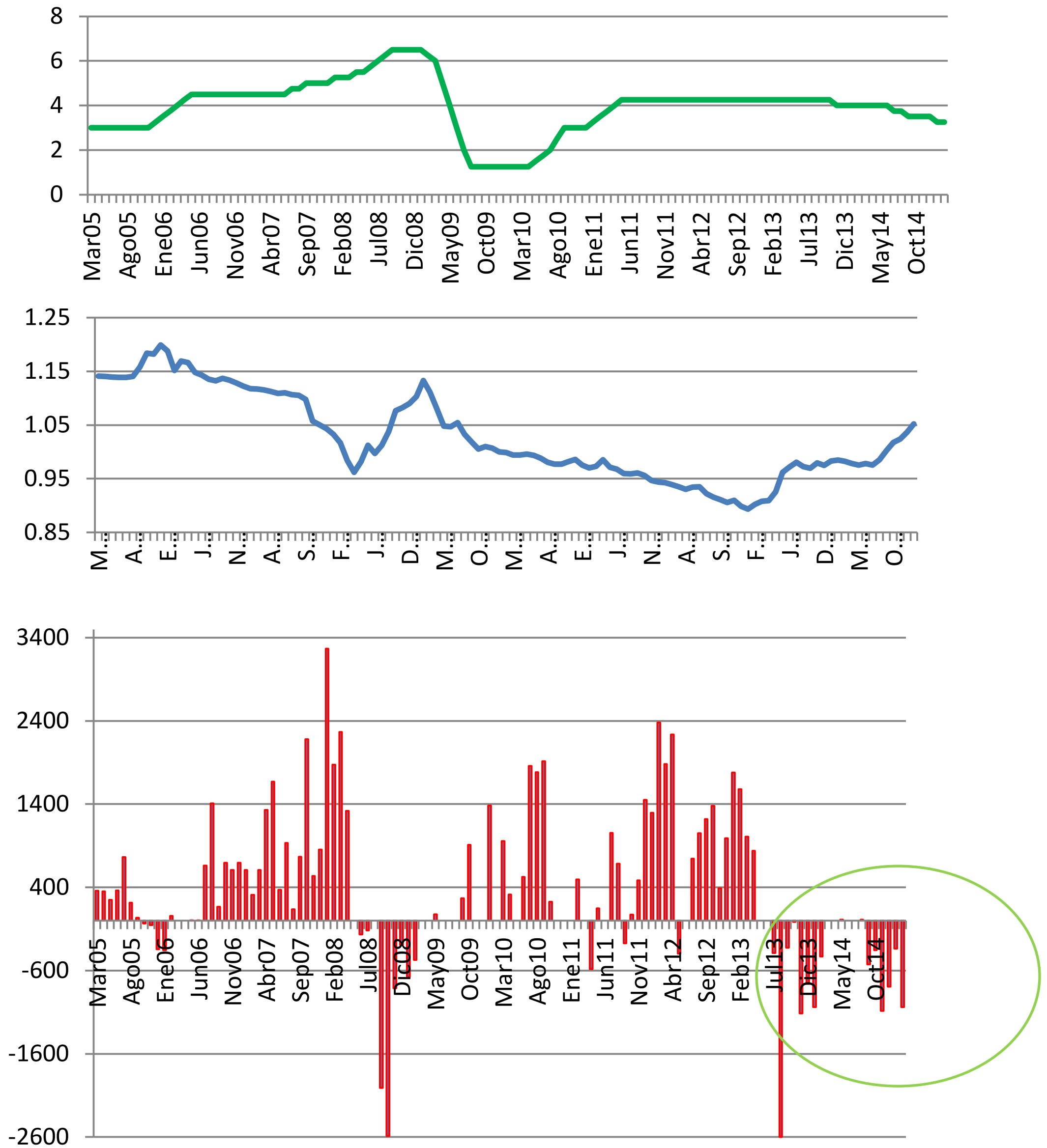


Peru: FX Intervention (millions of US dollars)

<u>Source:</u> Central Bank of Peru



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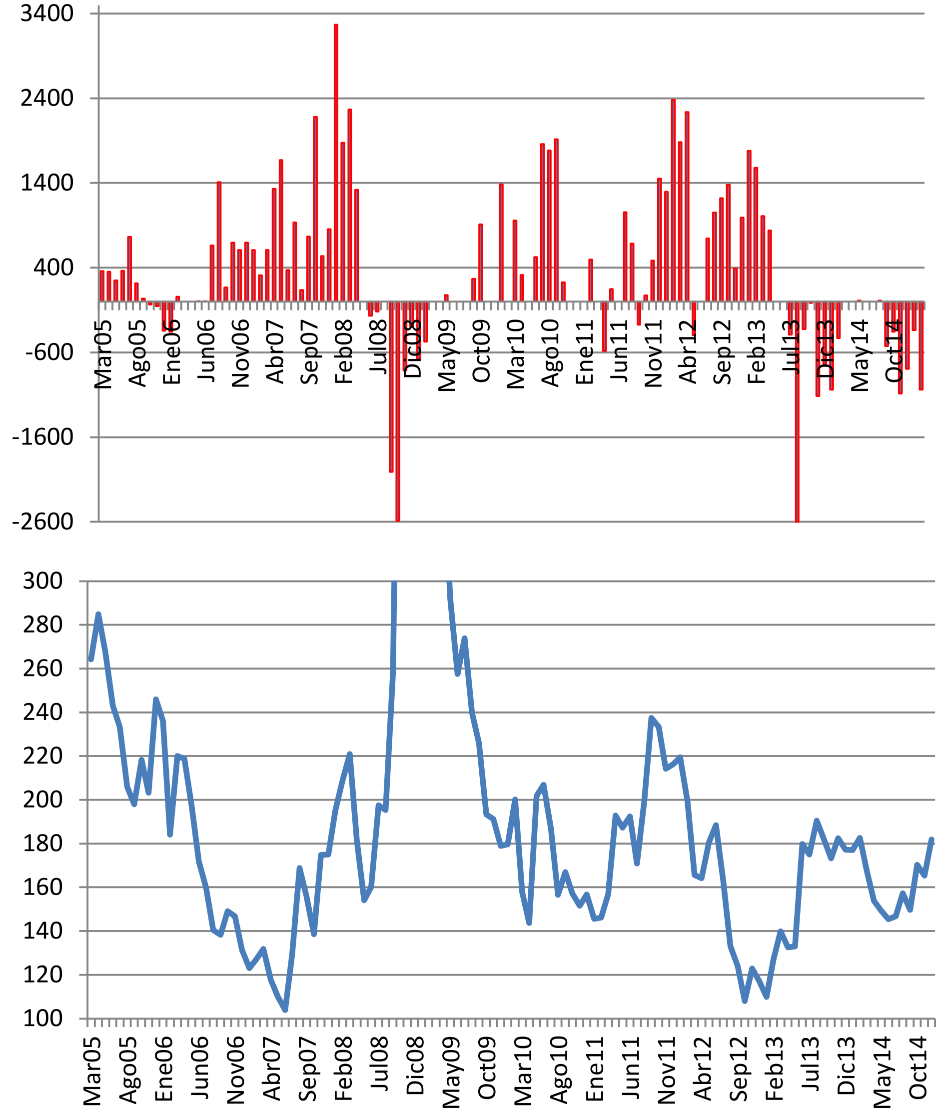

Peru: EMBIG Spread

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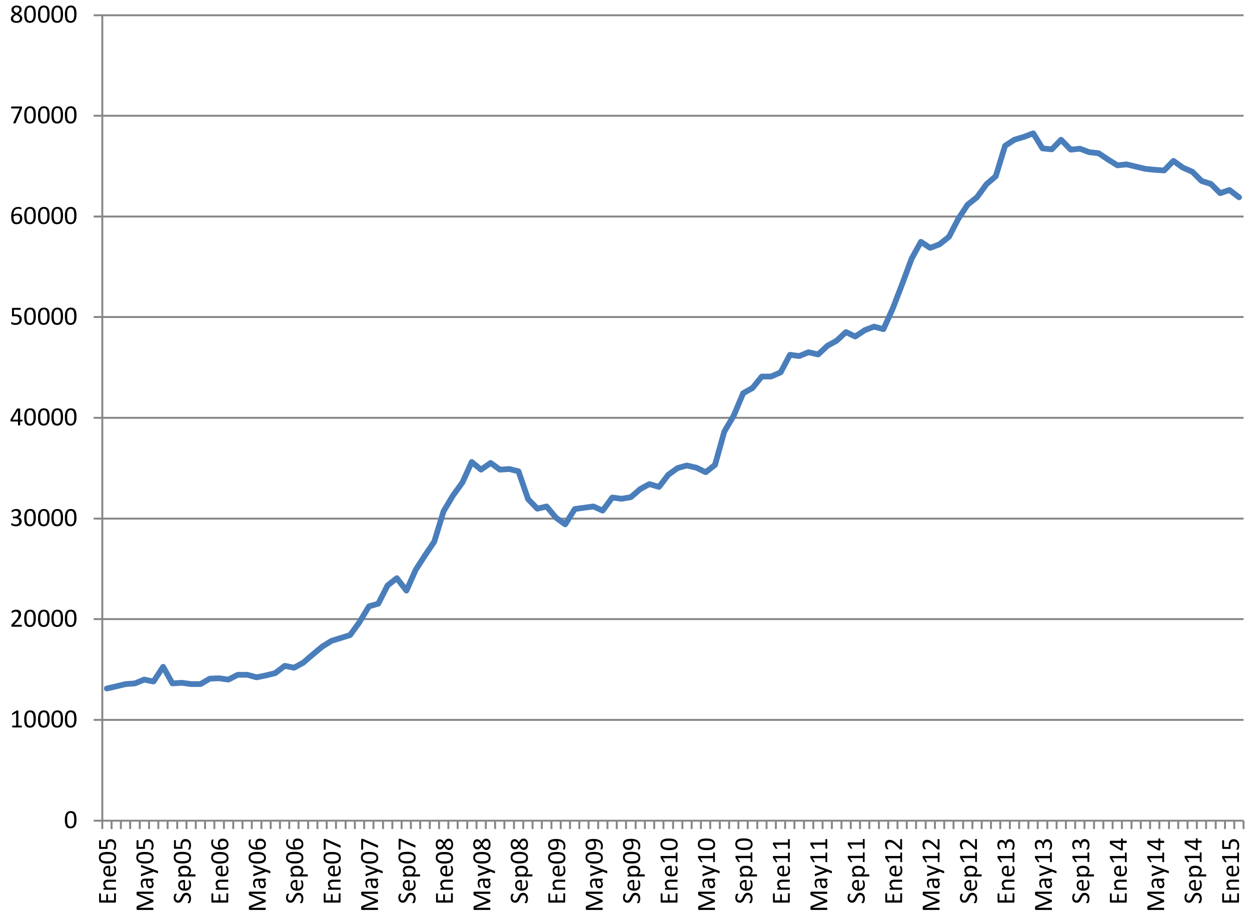

Peru: Foreign Exchange Reserves

Source: Central Bank of Peru

AndMarkets Do Notice…

The Sol is fighting an increasingly fierce battle against local and foreign banks [that are] assaulting Peru's foreign exchange markets…As of March 10, the Central Bank of Peru had had to sell US$ 2.58 bn to prevent the Sol from breaking the 3.10 level. At this rate the BCR will have sold before Semana Santa the same amount of dollars as in all of 2014: US$ 4 billion

Caretas, "O Sole Mio", March 12 2015 (My Translation)

Was the Recent Peru Defense Sound?

While waiting for the actual change in Fed policy, and perhaps further weakness in commodity prices, the right policy may have been not to spend foreign exchange reserves to prop up currencies, but actually the opposite.

- At least three advantages:

1. Consistency with overall monetary stance
2. Reserves Accumulation
3. Discouraging further currency mismatches