DOWNLOAD PDF STRUCTURAL VOLATILITY IN ARGENTINA

Chapter 1 : Structural Volatility in Argentina: A Policy Report - CORE

The author identifies sources of volatility in Argentina that include weak international financial links, a recurrent credit crunch and financial underdevelopment problem, a fragile fiscal situation, and a pervasive profit and collateral squeeze mechanism brought about by a rigid labor market and.

Rao, and Mark Gertler. Bernanke, Ben, and Mark Gertler. National Bureau of Economic Research. Bulow, Jeremy, and Kenneth Rogoff. Is to Forgive to Forget? An Asset Markets Perspective. Sterilization with Illiquid Financial Markets. When Wall Street Is a Carrier. Dornbusch, Rudiger, and Alejandro Werner. Stabilization, Reform and No Growth. Eaton, Jonathan, and Mark Gerosvitz. Theoretical and Empirical Analysis. Elements of the East Asian Crisis. Frankel, Jeffrey, and Sergio Schmukler. Effects on East Asia and Latin America. Lessons from the Pacific Rim, edited by Reuven Glick. National Bureau of Economic Research June. Gaston, and Alejandro M. Guerra de Luna, Alfonso. The Case of Mexico. Kiyotaki, Nobuhiro, and John Moore. Lessard, Donald, and John Williamson. Schneider, Martin, and Aaron Tornell. Fred Bergsten, Special Reports 4, Institute for International Economics. However, the country fund statistics suggest that the subsequent contagion to the rest of Latin America does indeed come via New York. See Frankel and Schmukler , In countries with a flexible exchange rate, such as Mexico more recently, interest rates can actually be even more sensitive to the U. Federal Reserve funds rate than they are in countries that use currency boards or dollarization to tie their monetary fates rigidly to the United States, as do Argentina and Panama Frankel, , table 1. For example, Lessard and Williamson See Calvo and Mendoza Caballero and Krishnamurthy Eaton and Gersovitz Calvo ; Dornbusch and Werner See Kiyotaki and Moore Aiyagari and Gertler See Mendoza for details. Martin Wolf, editorial, Financial Times, 8 August Guerra de Luna , provides data that illustrate this relation dramatically, both in Latin America and elsewhere. Calvo and Mendoza Calvo and Reinhart Paasche also supports this conclusion. See Caballero and Krishnamurthy and Aghion, Benerjee, and Piketty for models in which the correlation between financial development and economic stability is nonmonotonic. However, welfare is monotonically increasing with respect to institutional and financial development. The rewards of successful reforms apparently come in the form of high average growth, a decline in the frequency of crises although these can be deep , and an increase in the speed at which the economy recovers from such crises. However, the lack of precautionary options is clearly demonstrated by the serious decline in electricity provision in Chile during , which resulted primarily from a severe drought. Shocks that involve the only existing pipeline, be it electricity distribution, financial services, or a road, have a deep impact. While precautionary options and the ability to handle complex scenarios are luxury goods, their rewards come precisely in the form of tamed volatility. The essence of the conceptual framework is an adaptation of that presented in Caballero and Krishnamurthy , All of these papers can be downloaded from web. On the other hand, as financial development rises so does leverage, and as a result, the vulnerability of the financial system to shocks also increases. Many Latin American economies have suffered at both ends: I return to this issue in the next section. See Caballero and Krishnamurthy for a fully fleshed model along these lines. In addition to binding microeconomic incentive problems, sovereign risk may be associated with many of these assets, especially in the event of crises. These abrupt changes in slopes are only meant to capture as clearly as possible the fact that there are regions where most firms can satisfy their financial needs and the cost of credit is determined by international conditions, and others where it is the domestic availability of international assets that determines such cost. Foreigners or nonspecialists are unable to capture these high returns because at times of crises they only hold and arbitrage claims backed by international collateral. While their arbitrage during normal times keeps the international spread at zero, it is immaterial when the international collateral constraint binds. That is, the interest parity condition shifts until domestic equilibrium, rather than international arbitrage, holds. Formal models of sovereign debt renegotiation are built around the question of what international lenders can threaten sovereign countries with in the event of default. In this literature, international collateral is typically taken to be some fraction of exports see Bulow and Rogoff, Cash revenues from exports can be seized before they make it back into the country. This feature was used by Mexico during the crisis, when its oil revenues were made part of the collateral backing the liquidity package it received. Note that a lower L does not necessarily mean that the explicit domestic rate is lower than in the case with well developed financial markets for a given supply of international collateral. It essentially means that a lower fraction of investments and loans can be collateralized and is likely to be recouped by the lender. This does not mean that international liquidity is valued less than in the first best. The claim is that it is valued less than the second best indicates. See Caballero and Krishnamurthy Another interpretation is that the finding is spurious, as the more comprehensive series is polluted by too many no-trades. Although this remains a possibility, aggregate volume data for both indexes do not reveal a pronounced relative decline of transactions in the IGPSA. It is also important to realize what the relative-volatility claim in the text is not about: Indeed, the reality is quite the opposite, as concerned local banks reallocate their loans toward larger companies. It just says that an important segment of the demand for the shares of prime companies fluctuates with international sentiment about emerging markets. See Caballero a for details on the bonds included in each sample. Government notes in the BCRA rose by about 25 percent from to and then declined sharply. The interquartile range between 25 and 75 percent of a cross section of nominal interest rates on day peso loans averaged less than 2 percent in the months before the tequila crisis, but it then jumped to more than 16 percent in March Similarly, the same measure jumped from less than 2 percent to more than 6 percent during the Russian financial crisis. See figure 3 in Powell for clear evidence on the improved systemic liquidity of the Argentine financial system. As described in that figure, starting in January , liquidity requirements increased steadily from 10 percent of deposits to over 15 percent by March Excess reserves added a fairly constant 10 percent, and the repo program added yet another 10 percent starting in January The industries correspond to the stock market subsectors at level of disaggregation 5 of the Datastream classification, which includes potential entries. For Argentina, Chile, Australia, and Mexico, 26, 20, 25, and 24 sectors respectively were represented during the period considered. Similar results were obtained when different measures of dispersion were used. Ideally, these comparisons should be made with ex ante rather than ex post returns. Of course, it would have been better had the government borrowed those resources not to solve its own fiscal imbalances, but to support a financially distressed private sector. The share of loans made by large banks increased from 36 percent in late to 42 percent at the end of and 48 percent a year later. Despite the conventional wisdom on the matter, this decline is not purely due to the sharp decline in the prices of primary goods. Outliers not in the sense of measurement error, but in that nominal rigidities are not very relevant for sectors in deep distress and with high turnover rates, such as construction. It is certainly inaccurate to blame foreigners exclusively for the outflows. These activities inflated capital inflows before the crisis and automatically reversed them after the crisis. Much has been said about the positive role the U. By the same token, it seems unreasonable to solely blame Mexico for its poor growth performanceâ€"particularly of exportsâ€"in the early s since the United States was not growing much either. See Caballero c for the details of this analysis and further discussion. Of course, this is not to deny that Mexican banks were vulnerable and had already shown an increasing trend of nonperforming loans before the crisis. See Caballero c for further detail. Firms with price-earnings ratios greater than 11 at the end of more than doubled their debt over the next three years, while firms with price-earnings ratios less than 11 increased their debt by less than 50 percent. The proportion of loans over 20 million pesos that were collateralized right after the crisis was around 70 percent of the total for most banks. In the literature, the latter factor seems to have been underplayed relative to the exchange rate overvaluation as an explanation of depressed growth in Mexico. The overvaluation, the argument goes, was primarily due to the exchange rate-based stabilization program.

Chapter 2 : CiteSeerX â€” Comment on Caballero, `Structural Volatility in Latin America'

2 Cataloging-in-Publication data provided by the Inter-American Development Bank Felipe Herrera Library Caballero, Ricardo J. Structural volatility in Argentina: policy report / Ricardo J. Caballero.

Summary and General Recommendations The Argentine economy has experienced a dramatic transformation during the s. Signs of success abound. An important exception to this rosy scenario is the untamed, or even increased, volatility of output and employment. The shocks behind this volatility have changed over time. During the s their source was mostly domesticâ€”e. As with many other emerging economies, a weak international financial links have played a central role in the two crises faced by Argentina during the post-convertibility era. While external factors seem to have started recent crises, their impact has been magnified and, at times fostered, by deficiencies on the domestic front. There are at least three strongly complementary domestic amplification mechanisms in modern Argentina: These domestic deficiencies, which are tested and stressed by external shocks, are at the same time likely factors behind the weak international financial links. This complementarity creates a harmful process of volatility-feedback, but it also hints at the potential synergies of a multidimensional policy package aimed at these problems simultaneously. Since there are very good reasons, rooted in the stability of the payments system, not to abandon such a system in the near future, policy reforms must work within its constraints. Argentina has made substantial progress, especially on item b and some aspects of both c and d over the last five years. In a nutshell, and in accordance with the deficiencies highlighted above, this report contains policy recommendations on four general items: With this goal in mind, there are at least four slightly more specific recommendations and considerations: This poses a delicate tradeoff. To this effect, there are two type of measures which, while clearly sub-optimal in the long run, may prove helpful in the short and medium run: While the availability of counter-cyclical fiscal policies is a blessing in normal OECD-like circumstances, it is not of much use when the nature of the crises is mostly one of loss of confidence by international financial markets. Thus the cost of losing this policy tool during the typical Argentine recession may not be large relative to the gains associated with a healthy fiscal stance during good times. Although this report endorses the idea of dealing with the former, while postponing any potential flexibilization of the latter, I briefly surmise concerns about dollarization as well. On the labor market side, several issues should be considered: The tension between structural damage and cyclical benefits can be dealt 7 with by making temporary contracts contingent on aggregate conditions i. While both forms of rigidity feed into each other, their solutions are quite different. Given the current exchange rate system, nominal rigidities will largely fade away with the passage of time, and with sustained low inflation, rather than through deregulation. At this time, supply incentives should have a higher payoff than demand incentives, justifying the tradeoff. On dollarization, and at an even more conjectural level than the discussion above, I surmise that: Given the near irreversibility of the dollarization decision, it does not seem sound to adopt it unless long-run considerations support it, and this is highly unlikely at least as a unilateral action. The rest of this report supports these diagnoses and recommendations when possible, given the data available. Elsewhere this report highlights their conjectural nature in some instances, and in others suggests further research needed to make these conjectures more precise. The Facts and Mechanisms 2. While panels a and b in Figure 1 highlight the clear success in terms of increased growth and dramatic inflation stabilization attained during the post-convertibility period delimited by a vertical line in the figures , panel c shows that output volatility has not been tamed. The last panel portrays the rate of GDP growth minus the average growth rate for the corresponding period pre- and post-convertibility. Not only has volatility remained high, but the relative contribution of deep crises skewness , as opposed to a regular business cycle, has risen.

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Ricardo Caballero. Working Papers. Structural Volatility in Argentina: A Policy Report[policy paper], IADB Working Paper # August SSRN.

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Chapter 9 : Structural Volatility in Chile: A Policy Report - CORE

We don't expect the problems emerging in places like Argentina and Turkey to be representative of broader EM equities. The EM weakness we have seen in the past two weeks is centered on countries with structural funding problems, i.e. current account deficits.