How Latin America Weathered the Global Financial Crisis

WASHINGTON—While Europe and the United States have suffered their worst economic downturns in 75 years, most major Latin American economies weathered the crisis with limited damage before embarking on strong recoveries. An important new book published by the Peterson Institute for International Economics explains why countries that were once the cautionary examples of high inflation, financial crises, and macroeconomic mismanagement have fared so well, so far. The book, How Latin America Weathered the Global Financial Crisis, by José De Gregorio, former governor of the Central Bank of Chile and nonresident senior fellow at the Peterson Institute, also discusses the lessons that can be learned by the rest of the world in the years ahead.

Four years after the crisis, Latin America’s GDP is expected to be about 25 percent higher than the pre-crisis level, twice the growth achieved five years after the Latin American financial crisis and the Asian financial crisis, De Gregorio notes. De Gregorio explains in the book that during the most recent crisis the Latin American nations under study were able to maintain flexible inflation targeting regimes and utilize exchange rate flexibility. Fiscal expansions were also important, and unprecedented. Their banking systems were strong, well regulated, and fairly simple to understand. These countries also held high levels of international reserves, which helped make up for any shortages of international financing. Economic reforms, some of which were adopted after the Asian financial crisis, created the policy space that helped the region respond to the global financial crisis.

The study focuses on Latin America’s seven largest economies (Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela), which together account for 91 percent of the region’s economy.

De Gregorio acknowledges that there was also an element of luck. Latin America’s terms of trade were improving over this period and investors remained confident in the region, but De Gregorio shows the positive environment is a function of domestic economic policies. In the study he compares the success of countries that had good economic policies to countries such as Argentina and Venezuela which simply benefited from high commodity prices, warning the latter remain particularly vulnerable to external factors and the commodities markets.

“The most important lesson José draws from recent Latin American experience is the simplest,” said Adam S. Posen, president of the Peterson Institute. “Good macroeconomic management and strong financial systems can mitigate a large
shock caused by external factors. This study takes us far in understanding what has worked better than in the past, so that emerging markets can draw on their own successes in meeting future challenges.”

The Peterson Institute is pleased to note that Prof. De Gregorio has joined as a nonresident senior fellow at the Institute effective today. He will remain a full professor at the Department of Economics of the Universidad de Chile, but will more regularly contribute research and participate in PIIE programs. “In 2012 José delivered the inaugural Sunrise Foundation Lecture at the Peterson Institute, which features leading economists from emerging market countries,” said Posen. “We are excited that he will continue to increase his involvement with the Institute.”

How Latin America Weathered the Global Financial Crisis
José De Gregorio
ISBN paper 978-0-88132-678-9
January 2014 • 166pp. • $21.95

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