

García Herrero, Alicia

**Working Paper**

## Why are Latin American crises deeper than those in Emerging Asia, including that of COVID-19?

ADB Working Paper Series, No. 1221

**Provided in Cooperation with:**

Asian Development Bank Institute (ADBI), Tokyo

*Suggested Citation:* García Herrero, Alicia (2021) : Why are Latin American crises deeper than those in Emerging Asia, including that of COVID-19?, ADB Working Paper Series, No. 1221, Asian Development Bank Institute (ADBI), Tokyo

This Version is available at:

<https://hdl.handle.net/10419/238578>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*



<https://creativecommons.org/licenses/by-nc-nd/3.0/igo/>



**ADB Working Paper Series**

**WHY ARE LATIN AMERICAN CRISES  
DEEPER THAN THOSE IN EMERGING  
ASIA, INCLUDING THAT OF COVID-19?**

---

Alicia Garcia Herrero

No. 1221  
March 2021

**Asian Development Bank Institute**

Alicia Garcia Herrero is an adjunct professor at the Hong Kong University of Science and Technology, a senior fellow at Bruegel, and chief economist for Asia Pacific at Natixis.

The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of ADBI, ADB, its Board of Directors, or the governments they represent. ADBI does not guarantee the accuracy of the data included in this paper and accepts no responsibility for any consequences of their use. Terminology used may not necessarily be consistent with ADB official terms.

Working papers are subject to formal revision and correction before they are finalized and considered published.

The Working Paper series is a continuation of the formerly named Discussion Paper series; the numbering of the papers continued without interruption or change. ADBI's working papers reflect initial ideas on a topic and are posted online for discussion. Some working papers may develop into other forms of publication.

The Asian Development Bank refers to "China" as the People's Republic of China.

Suggested citation:

Herrero, A. G. 2021. Why Are Latin American Crises Deeper Than Those in Emerging Asia, Including That of COVID-19? ADBI Working Paper 1221. Tokyo: Asian Development Bank Institute. Available: <https://www.adb.org/publications/why-latin-american-crises-deeper-than-those-emerging-asia-covid-19>

Please contact the authors for information about this paper.

Email: [alicia.garcia-herrero@bruegel.org](mailto:alicia.garcia-herrero@bruegel.org)

Asian Development Bank Institute  
Kasumigaseki Building, 8th Floor  
3-2-5 Kasumigaseki, Chiyoda-ku  
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500  
Fax: +81-3-3593-5571  
URL: [www.adbi.org](http://www.adbi.org)  
E-mail: [info@adbi.org](mailto:info@adbi.org)

© 2021 Asian Development Bank Institute

**Abstract**

The COVID-19 pandemic has challenged global economies with unparalleled negative shock. Asia and Latin America have gone through a number of financial crises in the last few decades but they have addressed those crises rather differently, leading to different growth trajectories after the shocks.

In this paper, we take a closer look at the past crises in Latin America and Asia, such as the Latin American balance-of-payment crisis in the 1980s and a number of Latin American banking crises in the 1990s and compare them with the Asian financial crisis in 1997 and draw lessons on their differences and the policy responses to shed some light on the situation today with the pandemic. All in all, Latin American countries are challenged with worse debt dynamics and more limited access to dollar liquidity. Asia, instead, seems to have developed a much more resilient macroeconomic framework as well as larger self- and regional insurance.

**Keywords:** Latin America, emerging Asia, external funding, international crisis

**JEL Classification:** F32, F33, F34

## Contents

1.	INTRODUCTION.....	1
2.	A HISTORICAL ACCOUNT OF LATIN AMERICAN CRISES.....	1
3.	THE ASIAN FINANCIAL CRISIS NOT SO DIFFERENT FROM THE LATIN AMERICAN CRISES OF THE 1980s .....	4
4.	WHY WERE BOTH REGIONS RELATIVELY SHIELDED FROM THE 2008 GLOBAL FINANCIAL CRISIS? .....	4
5.	COVID19: STARTING IN ASIA BUT BEING MORE SERIOUS AND DETRIMENTAL IN LATIN AMERICA.....	7
6.	LESSONS FOR LATIN AMERICA AND ASIA .....	15
	REFERENCES .....	17

## 1. INTRODUCTION

COVID-19 is arguably the largest crisis in this century, challenging global economies with unparalleled magnitude of shock on growth momentum, policy dynamics, and liquidity constraint. At the center of the epidemic are Asia and Latin America, two regions that have happened to be the most crisis-prone regions in the world in the face of international shocks over the past decades. In the past, the two regions have dealt with crises in very different manners, leading to varied growth trajectories after the shocks. This article reviews their experiences in dealing with financial crises of different natures with the hope of generating useful guidance on how to deal with the economic consequences of the pandemic and recover from the economic impacts, and provides potentially helpful policy tools to reduce the shock.

While crises are hard to classify, this paper will first deliver a brief summary on two main waves of events during two particularly volatile periods for Latin America, i.e., the 1970s–80s and the 1990s, when a large number of countries in the region were hit by balance of payment crises and banking crises. Within the second period, Mexico in 1994–1995 and Argentina in 2001 even experienced extreme cases when twin crises haunted the economy. This paper also reviews the different nature of the crises and what has changed since, in order to shed some light on why Latin America has recently been less crisis prone than in the past, and lessons will be drawn for Asia.

This paper is divided into the following sections. The first categorizes past Latin American crises, focusing on their different origins. The second section compares those Latin American crises with the Asian financial crisis in 1997–1998. The third section discusses why both Latin America and Asia were relatively shielded from the 2008 global financial crisis and the key risks that could potentially come from the Federal Reserve (FED) monetary policy normalization. In the fourth section, the focus is on the current economic shock from the pandemic, both in Latin America and Asia. To that end, attention is paid to the different size of the shock but also to the policy responses and economic resilience. The last section offers some conclusions and policy implications.

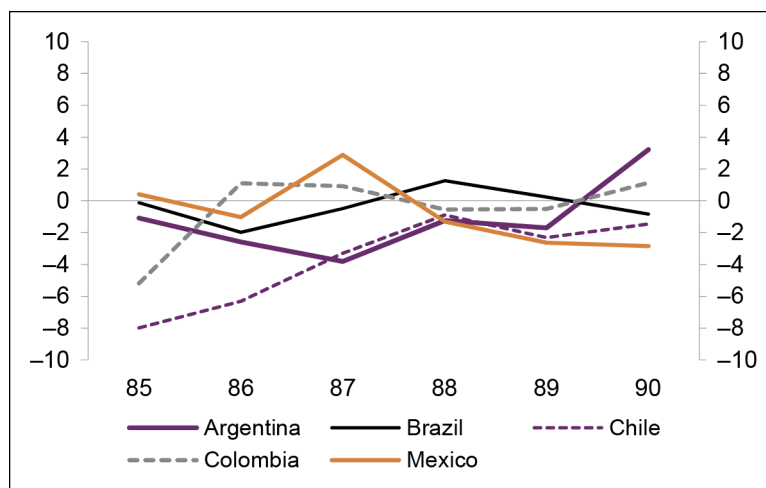
## 2. A HISTORICAL ACCOUNT OF LATIN AMERICAN CRISES

Financial crises in Latin America can be divided into three types. The first type is the balance of payment crises in the 1980s and exemplified by the Mexican crisis. Second, banking crises intensively hit the region in the 1990s. Last, twin crises were triggered in extreme cases throughout the period, for example, Mexico in 1994–1995 and Argentina in 2001.

The reasons why Latin American countries, especially Mexico, Brazil, Argentina, and Peru, went down to a series of crises have long been a topic in academic debate. Some scholars, including Sachs and Williamson (1985), Banuri (1991), and Lustig and Ros (1986), argue that the region suffered heavily from crises due to internal vulnerabilities, such as hasty liberalization, commodity overdependence, and inconsistent macroeconomic policies. Others, however, put forward that the fundamental reason lies in the magnitude of international shocks beyond the control of the region (Singh 1993). Our stance, on the other hand, is that Latin American crises arise from both crippled fundamentals and regulations together with bad luck in the international tides.

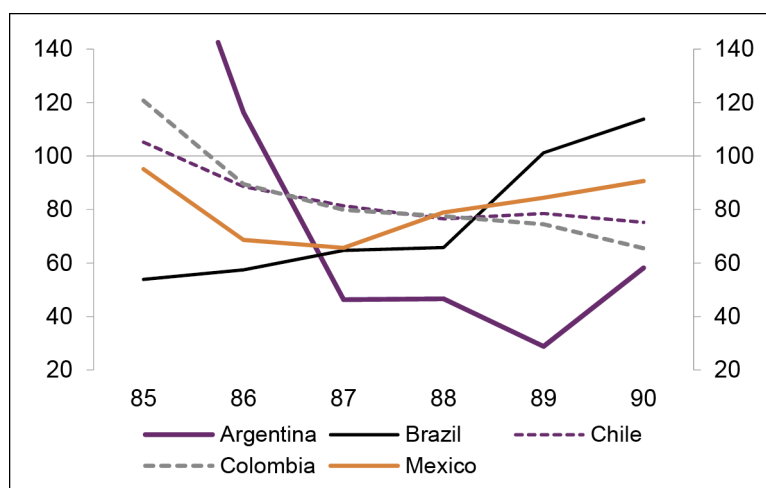
In the 1980s a balance of payment crisis broke out in Latin American countries with a profound impact on various aspects of the region. Excess demand for foreign goods aggravated trade deficits. High interest rates promised on debts attracted foreign capitals into the economies and cross-border loans in the 1980s surged. As a result, current account deficits as a share of GDP reached  $-3.81\%$  in Argentina, when it peaked in 1987 (Figure 1). On the other hand, supply bottlenecks pushed prices up and pegged exchange regimes led to exchange rate appreciation (Figure 2). The situation was worse in economies where the tradable part was small.

**Figure 1: Latin America: Current Account Balance (% of GDP)**



Source: WB, Thomson Reuters Datastream, Natixis.

**Figure 2: Latin America: Real Effective Exchange Rate (base 1997=100)**

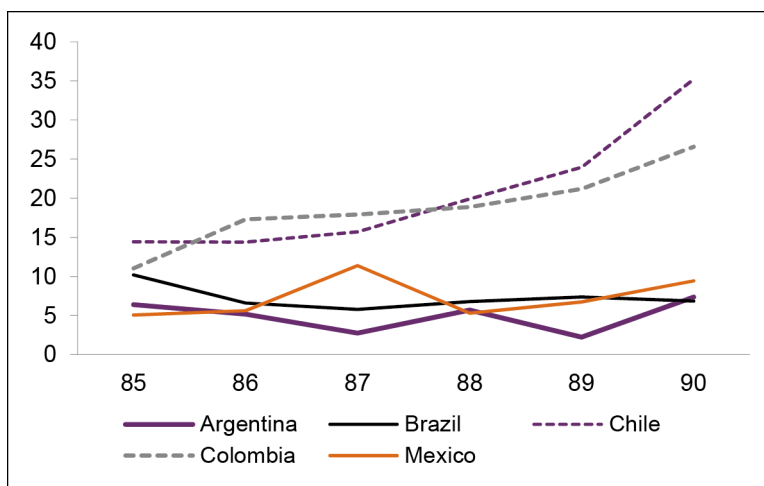


Source: EIU, Thomson Reuters Datastream, Natixis.

At the same time, lax fiscal policy intended for economic renaissance created excessive demand. In the 1960s and 1970s, for the purpose of infrastructure development and industrialization, many Latin American countries like Mexico, Brazil, and Argentina borrowed huge amounts of money externally (Figure 3). The boom in commodity prices was no answer to the mounting external debt but increased commodity dependence. So, followed by sudden changes in terms of trade and the

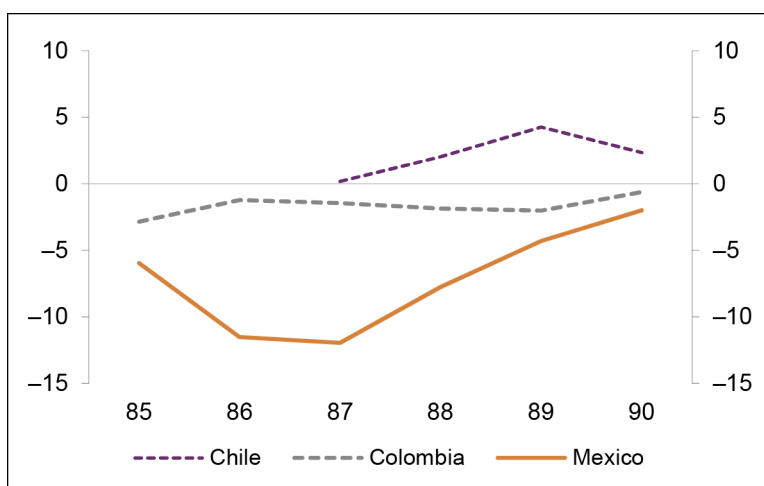
FED hikes, crises were triggered in the 1980s and 1990s. A low level of public and private savings implied that there was no cushion for capital outflows. Consequently, fiscal and current account deficits were heightened (Figures 1 and 4). Banks and non-financial institutions that were key in intermediating capital inflows could not withstand sudden changes in financial conditions and the balance of payment crises arose.

**Figure 3: Latin America: Reserves (% of External Debt)**



Source: WB, Thomson Reuters Datastream, Natixis.

**Figure 4: Latin America: Fiscal Balance (% of GDP)**



Source: EIU, Thomson Reuters Datastream, Natixis.

As for banking crises, Garcia-Herrero (1997) reviewed three banking crises in Latin America in the 1990s and concluded that the exchange rate regime, the degree of dollarization, and the structure of the banking system significantly influenced the actual impact of the crises. A fixed exchange rate regime and high level of foreign currency indebtedness make it more difficult to use inflation to reduce banks' balance sheets. Furthermore, a high degree of dollarization and foreign and government-owned banks with implicit government guarantee can only mitigate deposit runs at the beginning of the crises. But as people lost faith in the banking system and the macroeconomic situation, there was a substantial capital flight. In addition, a well-funded deposit



insurance scheme and responsive authorities helped to reduce the negative impact of a banking crisis while a poorly regulated banking system and substantial off-balance-sheet operations increase the cost of a crisis.

### **3. THE ASIAN FINANCIAL CRISIS NOT SO DIFFERENT FROM THE LATIN AMERICAN CRISES OF THE 1980s**

In both regions, international liquidity played an important role, from excessive credit lent to the emerging economies to capital outflows triggered by the FED hikes. Furthermore, pegged exchange regimes created discontinuities in financial conditions that hit the financial and nonfinancial intermediators of capital flows. In comparison, dollarization and capital account openness were much more of a problem in Latin America.

### **4. WHY WERE BOTH REGIONS RELATIVELY SHIELDED FROM THE 2008 GLOBAL FINANCIAL CRISIS?**

In 2008, an international financial crisis, later seen as the most dangerous crisis since the Great Depression, broke out. Also known as the subprime mortgage crisis, the 2008 global financial crisis was rooted in excessive profit chasing, whereby a large proportion of sophisticated financial institutions crammed their balance sheets with securitized structured products linked to subprime mortgages, which later were seen as toxic and thus trapped plenty of market players in the mire. The subprime crisis originated in the US, where it was found accountable for ever-dropping house prices, consumption and investment contraction, and deteriorating labor market employment (Du and Chu 2008). Unfortunately, the crisis soon infected all of the major regions, including Europe, East Asia, and Latin America.

Surprisingly, researchers also observed that the 2008 mortgage crisis left a relatively shorter-lasting dent on Latin America and the emerging Asia economy, except for the painful turmoil at the beginning: for instance, most of the Latin American economies rebounded swiftly with above-trend growth rate by 3Q09 (Resende and Goldfajn 2013). What is more, the People's Republic of China (PRC) managed to go through the global panic with a minimum growth rate of 6.4% in 1Q09 and soon emerged with a 12% growth rate in 4Q19. This leads us to a natural question: Why were emerging economies in these regions relatively "sheltered" from the crisis?

We believe the reasons for both regions' success in navigating through the 2008 crisis are twofold: Healthy fundamentals and adequate economic policies, representing why they "deserve" to be the victors, and a beneficial external environment, i.e., good "luck". Take Latin American countries as an example; major countries in the region had built up buffers in three aspects since the 1980s' and 1990s' crises, including more resilient balance of payment, responsive inflation-targeting regimes and downsized public debt (Resende and Goldfajn 2013). According to Resende and Goldfajn (2013), the trend to switch from a fixed exchange rate regime to an inflation targeting regime since the 1990s in this region contributed to a benign expectation on inflation and a limited exchange rate influence on inflation. Furthermore, new fiscal rules in Latin America improved the public debt profile, with lower public deficits and a healthy debt cycle. On top of these factors, a timely and appropriate policy response, such as cutting policy

rates, prudent liquidity provision, and a foreign exchange stabilization package all helped this region to rise above the meltdown in the 2008 global crisis.

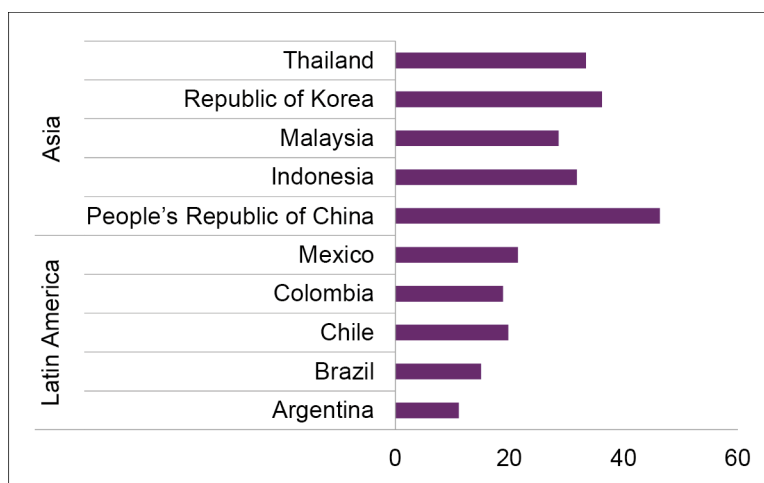
The exposures to external demand shocks were limited as larger countries in both regions were able to rely more on domestic demand when the crisis hit. Local financial markets had also grown to have less dependence on foreign capital and increased domestic bond issuance. In addition, improved regulation, especially on open forex positions, helped countries to curb the losses. Admittedly, there were some cases at corporate level in Mexico and Brazil where forex positions were still severely hit, but they did not lead to systemic risks. Ironically, one important advantage of emerging markets in the face of the 2008 global financial crisis lies in less financial deepening. In fact, De Gregorio (2013) found that during the 1980s, Latin American countries with a more developed financial system tended to have slower growth due to a more severe collapse and an enlarged banking crisis. It is argued that financial institutions in this region tended to be relatively small and less sophisticated in their exposure and services, which limited their involvement in toxic assets, and the central and decisive role of banks in the financial system was seen as a strength from the regulatory point of view (Bleger 2011). The same case also applied in Asia; for example, banks in emerging Asian markets tended to be simpler, bearing less securitized subprime mortgage products on the balance sheet.

The international tailwind also contributed to sheltering Latin American and emerging Asian countries from a downward spiral. As the Chinese economy picked up quickly with the help of an economic stimulus package, its import demand for commodities also persisted. As studied by Garcia-Herrero, Ferchen, and Nigrinis (2013), the PRC has become the number one or two trading partner and export market for plenty of countries in this region and “the biggest contributor to global commodity demand and to global commodity prices” for commodities including iron ore, soy, copper, and ores of nonferrous metals. Not only did this export channel progressively tie Latin American and emerging Asian countries’ development and stability into the fate of the Chinese economy, which helped the recovery of regional markets in the case of the PRC’s strong performance, but the massive saving and thus capital export from the PRC also provided liquidity in the Latin and emerging Asian market.

What is more, going beyond the PRC, the demands for commodities were also relatively robust given the nature of the underlying transactions. Commodities, including raw materials such as soybean, copper, iron ore, and non-ferrous ores are intensively demanded in various manufacturing and production processes. Although in the first phase of crisis commodity markets were also hit to great extent, major commodity markets displayed great resilience and recovered shortly after. Such steady demand also helped Latin American and Asian economies emerge out of the mire of the 2008 global financial crisis.

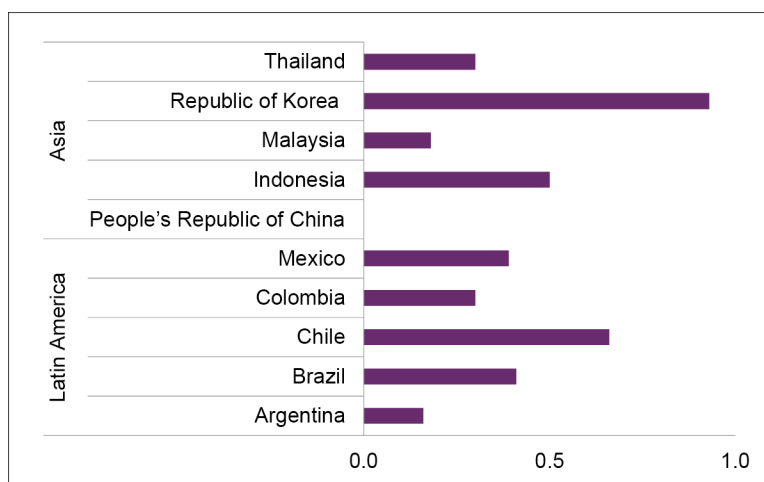
In comparison, Asian countries were better positioned to shield from the global financial crisis compared to Latin American countries thanks to several factors. First, domestic savings helped by current account surplus are clearly a plus for Asia (Figure 5). Prudent fiscal policies also provided space to absorb external shocks. Furthermore, capital controls are still more pervasive in Asia (Figure 6). In terms of tradable economy, Asian countries, with the exception of more developed countries like the Republic of Korea, are generally less dependent on commodity exports compared to Latin American countries.

**Figure 5: Asia versus Latin America: Gross Saving Rate (%)**



Source: EIU, Natixis N.B. data as of 2017.

**Figure 6: Capital Account Openness Index (1 = fully liberalized)**



Source: IMF, Natixis N.B. data as of 2013.

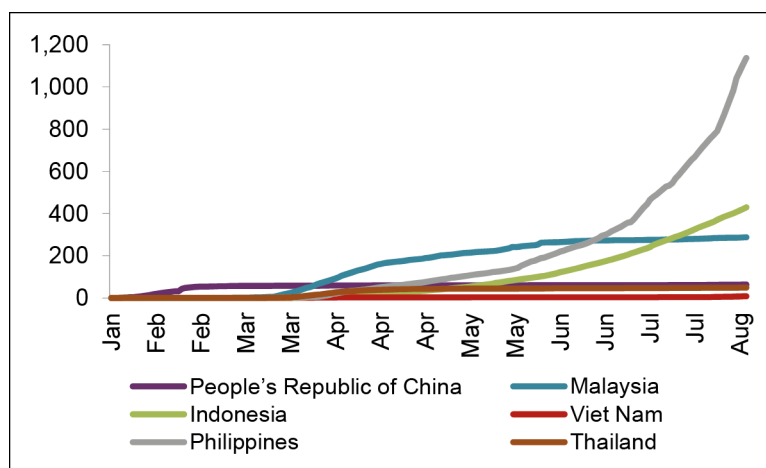
Another key difference between emerging Asia and Latin America lies in their approach to exchange regimes. Most Asian countries managed to avoid appreciation as they are more dependent on export. On the contrary, as a flexible inflation-targeting exchange policy prevailed in Latin America, currency appreciation was not observed during the crisis but it was in good times. Thus, as commodity prices increased, current account deficits were reduced.

However, both Latin America and Asia face key risks that could potentially drag them into the mire. Both Latin America and Asia are still USD regions and USD liquidity could be aggravated by the pandemic-related risk aversion. Corporate indebtedness is also one of the potential risks, though some may argue the situation is overstated. In addition, the slowdown of the Chinese economy makes the external tailwinds less favorable for both of the regions, especially Asian countries.

## 5. COVID19: STARTING IN ASIA BUT BEING MORE SERIOUS AND DETRIMENTAL IN LATIN AMERICA

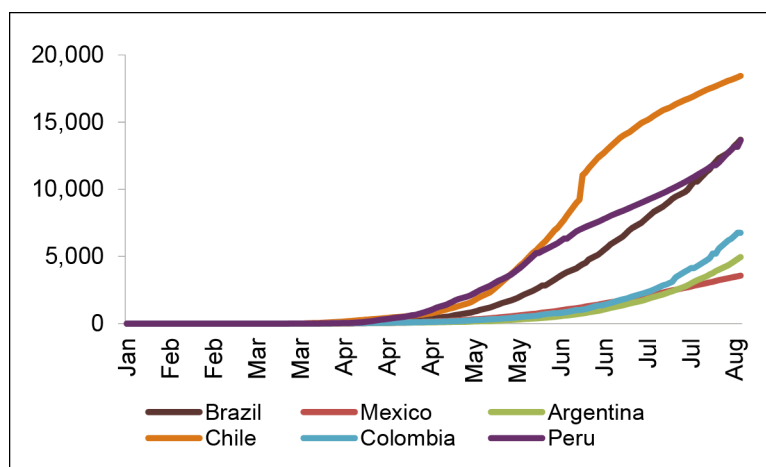
COVID-19 is having a massively negative impact on the global economy and emerging economies are not exempted from it. While Asia has been at the center of the epidemic of this shock since its outbreak in February, the blow soon transmitted globally, with Latin America among the most impacted regions. In terms of confirmed cases, Chile is burdened with 18,334 cases and Brazil with 13,451 cases per million population, which draws a drastic comparison to under 1,200 cases per million people in Asian countries as of August 7 (Figures 7 and 8). The larger size of the pandemic shock for Latin American countries is even more salient if we take into account the reduced mobility stemming from lockdowns and social distancing measures (Figures 9 and 10). In addition, the sharper decline in mobilities in Latin American countries since the outbreak of pandemic has put a halt on economic activities, leading to slower recovery in business confidence (Figure 11).

**Figure 7: Asia Confirmed Cases by Million Population**



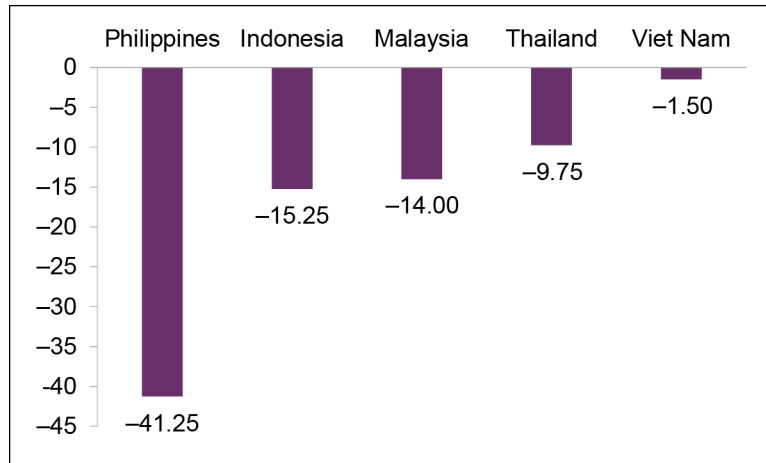
Source: Natixis, Bloomberg N.B, Data as of Aug 2020.

**Figure 8: Latin America Confirmed Cases by Million Population**



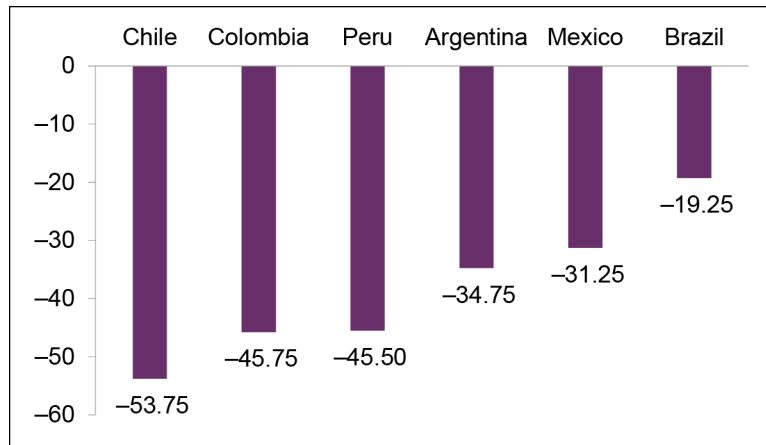
Source: Natixis, Bloomberg N.B, Data as of Aug 2020.

**Figure 9: Asia Mobility Decline Since Feb 2020 (%)**



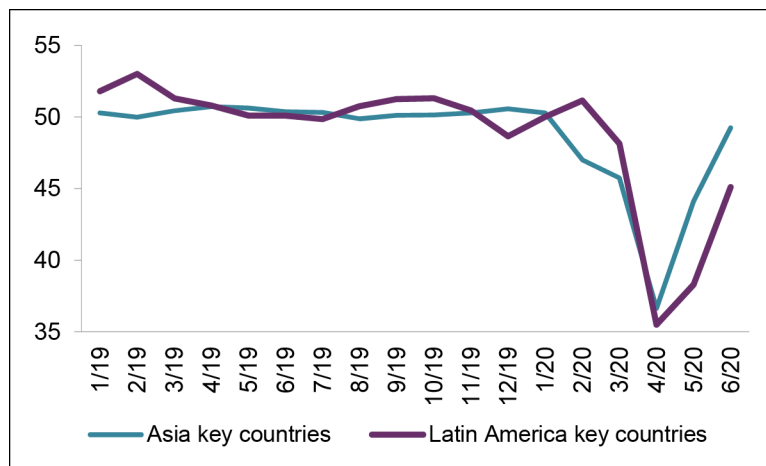
Source: Natixis, Google N.B, Data as of Aug 2020.

**Figure 10: Latin America Mobility Decline Since Feb 2020 (%)**



Source: Natixis, Google N.B, Data as of Aug 2020.

**Figure 11: PMI for Asia and Latam Key Countries**

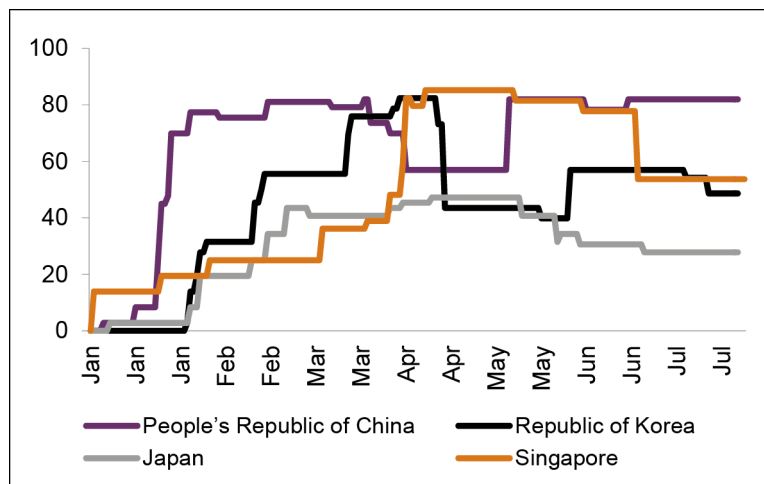


Note: Asia key countries include the PRC, Malaysia, Thailand, Philippines and Viet Nam, Latam key countries include Brazil and Mexico.

Source: Natixis, Bloomberg N.B, Data as of Jul 2020.

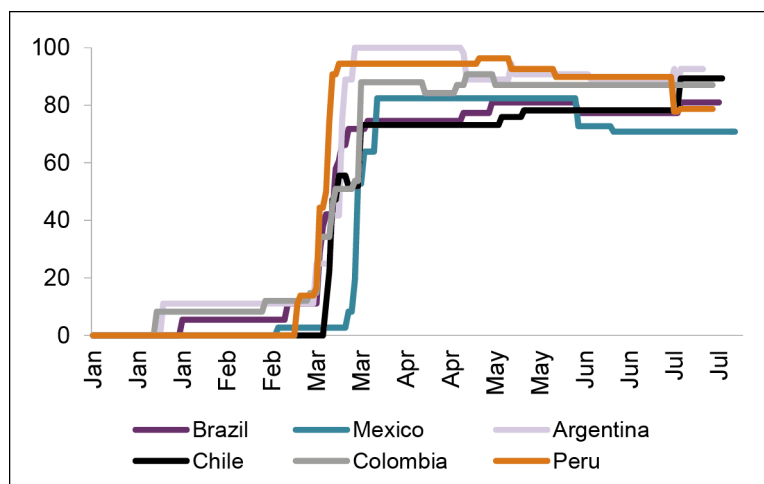
Higher confirmed cases and faster contagion has prompted Latin America to put in place a stricter government response to contain the virus spread. According to the coronavirus government response tracker by the University of Oxford, while Asia also embraced lockdown and mobility containment starting from February, effective virus control soon helped Asian countries to normalize economic activities and thus led to a falling government response stringency index since May (Figure 12). On the contrary, Latin American countries joined lockdown in March but lengthy and tighter mobility containment dragged on (Figure 13). Despite Brazil and Mexico having eased the lockdown, the overshooting virus case numbers ever since not only point to Latin America’s failure to control the virus spread but also serve as a critical impediment to normalizing economic activities.

**Figure 12: Asia Government Response Stringency Index (0 to 100, 100 = strictest)**



Source: Natixis, Bloomberg N.B, Data as of Aug 2020.

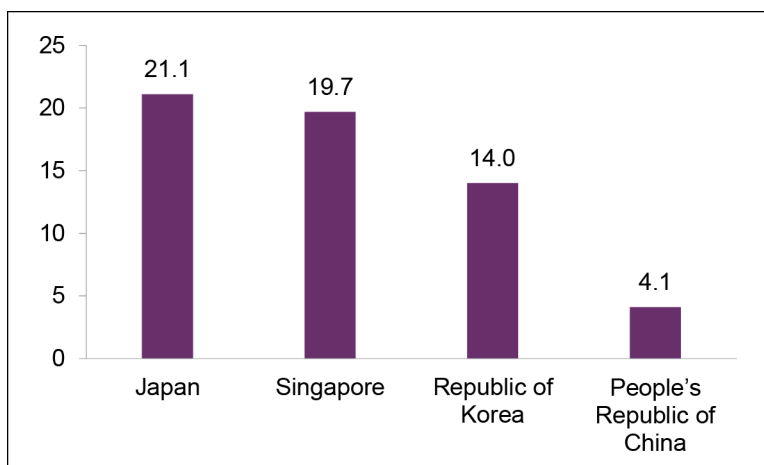
**Figure 13: Latin America Government Response Stringency Index (0 to 100, 100 = strictest)**



Source: Natixis, Bloomberg N.B, Data as of Aug 2020.

Against the background of faster coronavirus contagion, bigger immediate economic impact and tighter policy response, Latin America also falls shy of policy stimulus based on their limited room for fiscal and monetary stimulus. According to the International Monetary Fund policy tracker, Japan has announced 21.1% GDP worth of stimulus package and Singapore 19.7% while Brazil only 11.8% and Mexico 4.5% (Figures 14 and 15). The much smaller stimulus packages in Latin America stem from severely limited policy room. On the fiscal side, countries in this region face challenges from low tax bases, high public debt as well as rising costs of debt services. As for monetary policy, the room to cut rates is there, in principle, at least for countries with floating exchange regimes, but rapid currency depreciations in the region limit their space for further action.

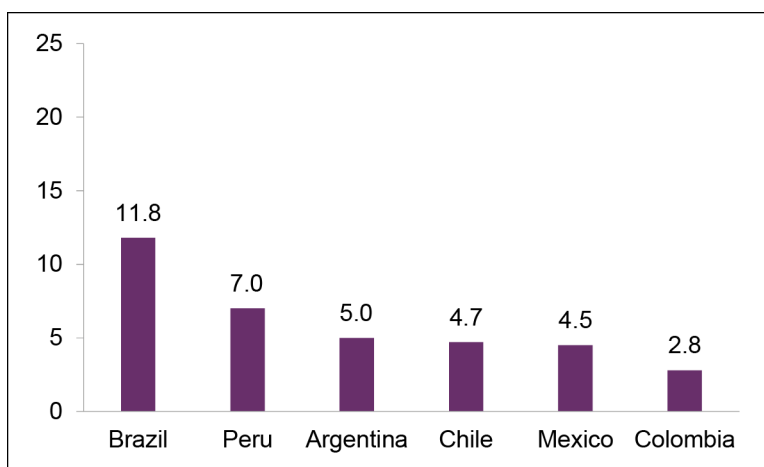
**Figure 14: Stimulus Package Announced as a Share of GDP (%)**



NB: The PRC announced RMB 4.2 trillion (or 4.1 percent of GDP) of discretionary fiscal measures by IMF estimate N.B, Data as of Aug 2020.

Source: Natixis, IMF.

**Figure 15: Stimulus Package Announced as a Share of GDP (%)**

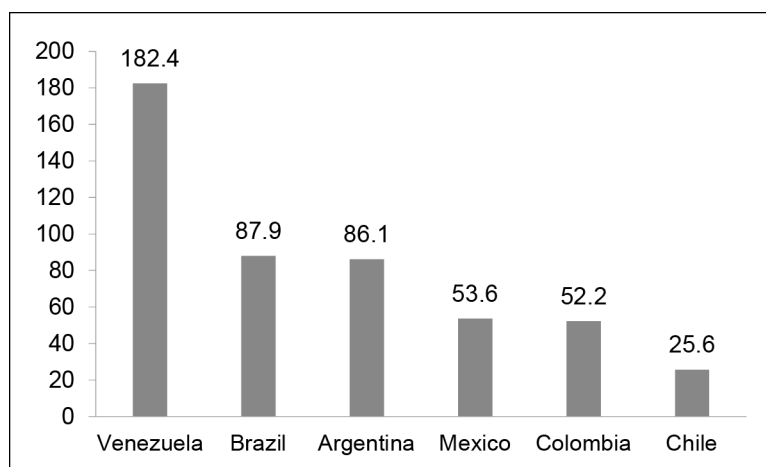


NB: The PRC announced RMB 4.2 trillion (or 4.1 percent of GDP) of discretionary fiscal measures by IMF estimate N.B, Data as of Aug 2020.

Source: Natixis, IMF.

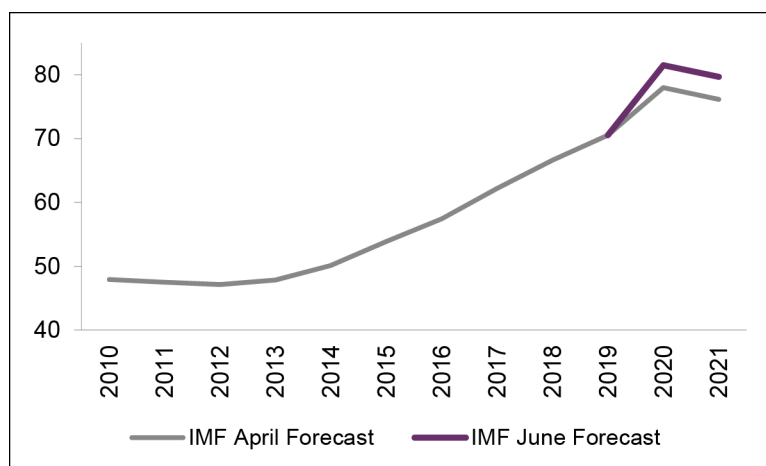
What is more, Latin America also lagged behind in terms of economic resilience to risks. Currently, both regions are faced with two key risks, namely rising public debt burden and liquidity shortage. In terms of the first risk, government debt across Latin America is skyrocketing owing to lower tax receipts, rapid currency depreciation, high costs of emergency health funding, and a rising need for income support and economic relief measures. As a result, IMF revised their forecast for public debt burden in 2020 of Latin America by 3.6% of GDP (Figure 16), a large rise compared to only a 0.8% increase in Asia. In the meantime, Argentina entered into its ninth default in May, raising fears over a mass debt crisis for the region. Such fragile public debt dynamics has led to a petition from leaders of this region to demand mass debt cancellation and relief for Latin American to IMF and other multilateral organizations. In comparison, Asia is much better-equipped to weather the storm as economies in the region saw their debt-to-GDP ratio rising but still manageable, implying the public sector still has room to lever up.

**Figure 16: Latin America Government Debt to GDP (2018, %)**



Source: Natixis, Datastream N.B, Data as of 2018.

**Figure 17: Gross Public Debt as a share of GDP (%)**

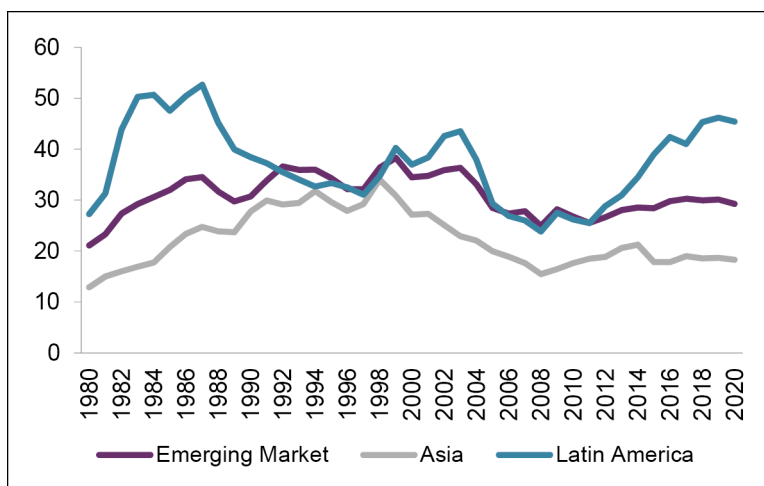


Source: Natixis, IMF.



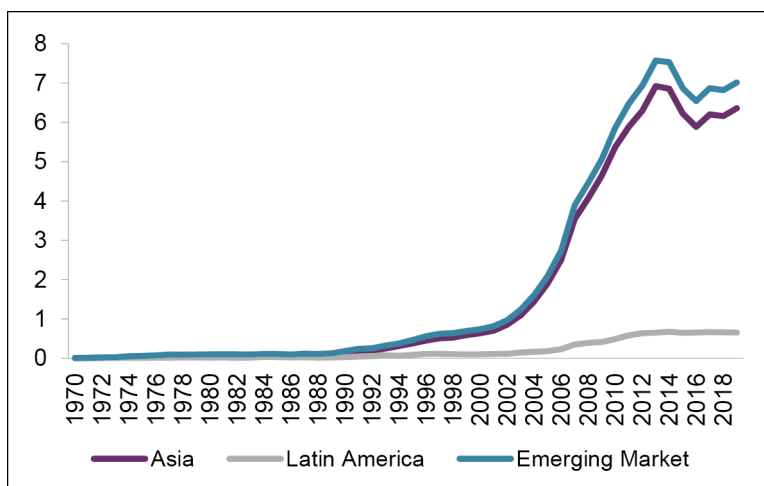
The second risk over liquidity stems from emerging economies' structural dependence on the dollar. Ever since the pandemic outbreak, the spike in global risk aversion has rushed investors to safe assets and to the dollar, away from no-reserve currencies, leading to dollar shortage for emerging regions, which further complicates their financing needs. This is especially concerning for regions with large external debts, such as Latin America (Figure 18).

**Figure 18: External Debt (%GDP)**



Sources: IMF, Natixis.

**Figure 19: Foreign Reserve (USD trillion)**

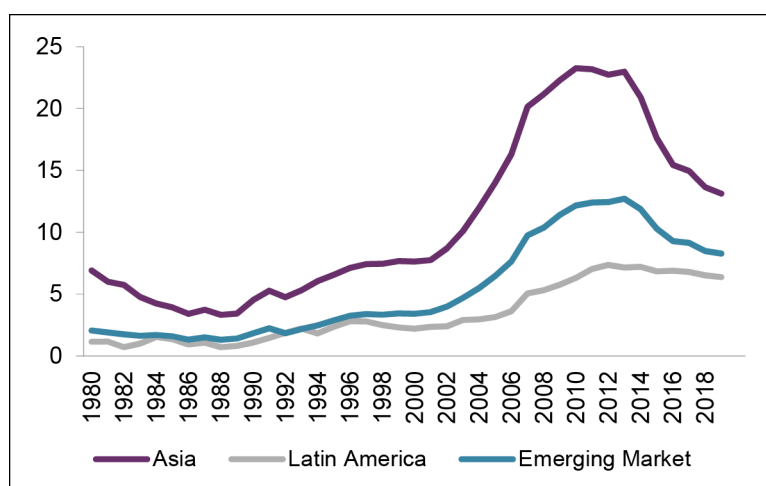


Sources: IMF, Natixis.

If we look at the tools that Latin American countries can count on to address this challenge, more weakness is revealed compared to their Asian peers. The first line of defense to address the negative impact of COVID-19 on external funding lies in self-insurance through the accumulation of forex reserves. In fact, few emerging economies can safely claim that their reserves are massive enough to deal with the shock. Most importantly, Asia possesses more than \$6 trillion in forex reserves or 27% of the forex reserve globally, held by central banks and sovereign wealth funds, while Latin America holds an aggressively lower amount of forex reserves. In other

words, Asia has accumulated significant buffers domestically for dollar liquidity shocks, but Latin America falls short of such self-insurance. However, even in Asia, current-account surpluses have been shrinking since 2011, meaning the role for self-insurance is more limited today. For Latin America or Africa, high dependence on external funding seems much harder to address because external debt is much larger, and the terms of trade more volatile.

**Figure 20: Foreign Reserve (% GDP)**



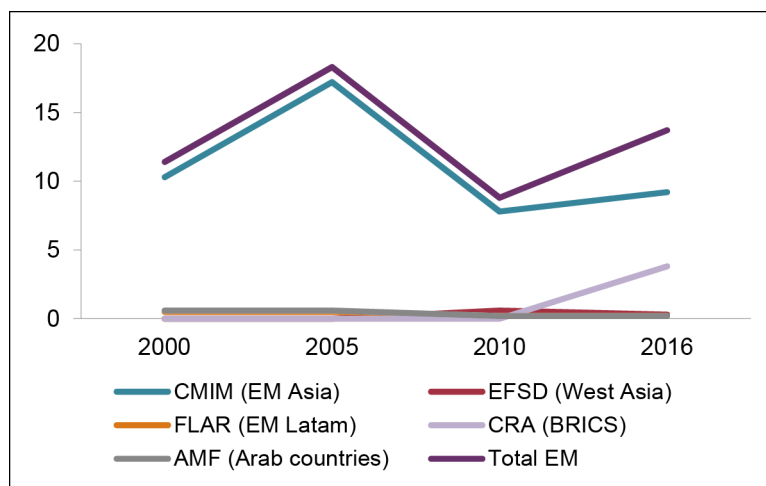
Sources: IMF, Natixis.

The second line of defense is regional insurance arrangements, where Asia also has built more buffer than Latin America. The most developed regional insurance scheme has also been created in Asia, called the Chiang Mai Initiative Multilateralization (CMIM), which started as a spaghetti bowl of bilateral swap lines built since the 1997 Asian financial crisis, but went multilateralized after the 2008 global financial crisis. So far, the amount of foreign reserves pooled has increased up to \$240 billion to address balance-of-payments and short-term liquidity difficulties. Beyond CMIM, very few regional mechanisms exist. The second most obvious is the Latin American Reserves Fund (FLAR), which started with reserve pooling for a number of Andean economies in 1991 but which has fallen short of expectations in terms of the size of the reserves pool and the number of countries included. A deeper multilateralization of FLAR is long overdue and certainly necessary for a region that has less self-insurance than Asia, in terms of forex reserves, but much greater external financial needs (Figure 21 and 22).

The third line of defense lies in central bank cross-border liquidity access. Both Latin America and Asia have access to the FED, but access to this safety net is rather limited to only a few countries. The sudden episode of global liquidity shortage in March 2020 as a consequence of the COVID-19 market collapse has pushed the Fed to re-activate its swap lines with large central banks with which it has had standing swap arrangements since the global financial crisis (Bank of Canada, Bank of England, Bank of Japan, European Central Bank and Swiss National Bank). While the Fed later extended swap lines further to include Brazil and Mexico, the Republic of Korea and Singapore, the countries with access to this channel remain short-listed. While the Fed's faster reaction this time has been welcomed by the market, its role in the provision of dollar global liquidity should not be overestimated. Bilateral swap lines are limited in size and withdrawals from the repo line hinge on US Treasuries as collateral and, therefore, are not a substitute for self-insurance mechanisms. A central bank

with limited forex reserves cannot really count on the Fed to solve its problems. Furthermore, the Fed is already having to deal with a rapidly expanding balance sheet for domestic reasons, which will further restrict it in expanding liquidity overseas. All in all, the Fed – the ultimate guarantor of the value of the reserve currency – currently risks being overburdened, meaning that it can be expected to play only a limited role in cross-border liquidity.

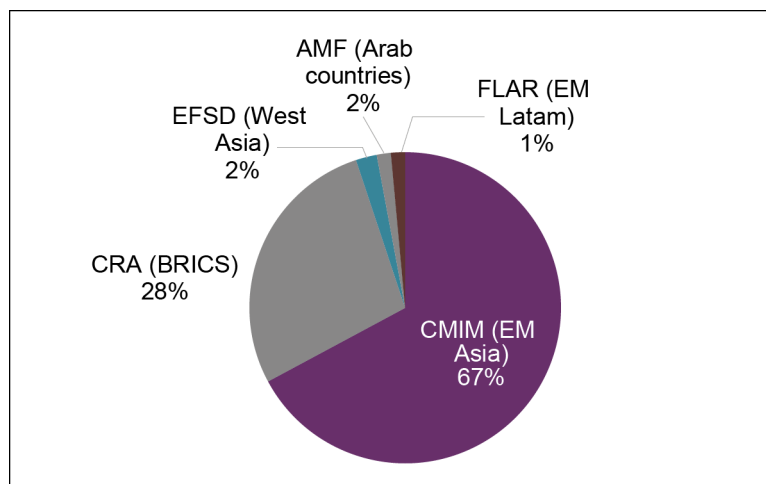
**Figure 21: Regional Financing Arrangement Capacity (USD bn)**



Note: The RFAs are: Chiang Mai Multilateral Initiative (CMIM), BRICS Contingent Reserve Arrangement (CRA), Eurasian Fund of Stabilisation and Development (EFSD), Fondo Latinoamericano de Reservas (FLAR), Arab Monetary Fund (AMF).

Sources: IMF, Natixis.

**Figure 22: Regional Financing Arrangement Capacity in Emerging Economies (%)**



Note: The RFAs are: Chiang Mai Multilateral Initiative (CMIM), BRICS Contingent Reserve Arrangement (CRA), Eurasian Fund of Stabilisation and Development (EFSD), Fondo Latinoamericano de Reservas (FLAR), Arab Monetary Fund (AMF).

Sources: IMF, Natixis N.B, Data as of Mar 2020.

The last line of defense lies in IMF financial assistance. While the IMF, long considered the indisputable lender of last resort for emerging markets, should indeed take center stage in helping emerging economies deal with a global dollar shortage, two key constraints are becoming increasingly obvious. First, IMF's limited programs fall short for responding, quickly and forcefully, to financing constraint in hard currency. The IMF currently provides three liquidity facilities, namely Flexible Credit Line, Precautionary Liquidity Line, and the new Short-Term Liquidity Facility. The first two facilities are based on stringent pre-qualification criteria, so the use is rather limited. In the same vein, the newly proposed facility, Short-Term Liquidity Facility (SLL) is also rather limited in size, especially for systemically important economies, whose access to international markets is so much bigger than their IMF quotas and could suddenly be curtailed. While the IMF is also ramping up the extension of its fast-disbursement support to deal with the impact of the COVID-19 crisis through the Rapid Financing Instrument (RFI) and the concessional Rapid Credit Facility (RCF), these rapid facilities also provide little real respite from external financing concerns. All in all, existing facilities – including the newly approved SLL – do not seem to fully cover the sudden increase in external financial needs of IMF members, especially for systemically important countries with access to international capital markets.

Second, the key outstanding question is whether the IMF has enough financial resources for the pressing needs of its members requiring financial assistance. The IMF's available resources are currently estimated at just under \$800 billion, as about one fifth of its total lending capacity of \$1 trillion is already committed to existing programs<sup>1</sup>. However, the IMF estimates that total gross financing need of emerging markets could be as much as 2.5 trillion dollars. In other words, the IMF is constrained in terms of both limited programs and resources to provide support to dollar liquidity shortage in either Latin America or Asia.

## **6. LESSONS FOR LATIN AMERICA AND ASIA**

In conclusion, in this paper we took a closer look at the historic crises in Latin America and Asia, including the balance-of-payment crisis in the 1980s, the banking crisis during the 1990s, and the twin crises that took place afterwards and compared the crises with the Asian financial crisis in order to borrow from the past. In addition to this, we examined the different responses for Latin American and Asian economies during the 2008 global financial crisis. In general, Latin American crises have left deeper economic wounds than those of Asia due to synchronizing banking, currency, and economic shocks.

In terms of COVID-19, a comprehensive comparison shows that Latin America has faced a bigger shock, with more constrained policy room, giving rise to its slower pace of recovery. In particular, Latin American countries are challenged with worse debt dynamics and more limited access to dollar liquidity. The region possesses far fewer forex reserves as self-insurance, with the regional insurance scheme FLAR being underdeveloped. Although both regions are entitled to Fed swap lines and IMF financial assistance, their constrained programs and resources are unlikely to be reliable for meeting the rising liquidity and financing demand for Asia and Latin America. As a result, Asia is much more resilient to the pandemic shock.

---

<sup>1</sup> See <https://www.imf.org/external/np/tre/activity/2020/041720.pdf>.

In contrast, Asia seems to have developed a much more resilient macroeconomic framework as well as self- and regional insurance. While this pandemic is clearly a huge shock for Asia as well, it remains much better shielded to a potential financial crisis than Latin America. Finally, although Latin America needs dollar liquidity much more than emerging Asia, it remains important for the region to increase regional insurance further and/or support the expansion of IMF financial resources to deal with financial crises in emerging markets. The risk of contagion is never fully eliminated, as the Asian and Latin American financial crises in the 1980s and 1990s have shown us.

## REFERENCES

- Banuri, Tariq. 1991. "Economic Liberalization: No Panacea." *The Experiences of Latin America and Asia*.
- Bleger, Leonardo. 2011. "Latin America in Better Conditions to Face the Global Crisis: Financial Regulations in Argentina, Brazil, Chile, Colombia, Mexico and Peru." *Iniciativa para la*, 21–27.
- De Gregorio, Jose. 2013. *Resilience in Latin America: Lessons from Macroeconomic Management and Financial Policies*. No. 13–259. International Monetary Fund.
- Du, Hou-wen, and Chun-li Chu. 2008. "The US Subprime Mortgage Crisis: Origin, Prospect and Impact [J]." *Journal of Renmin University of China* 1.010.
- García-Herrero, Alicia. 1997. *Banking Crises in Latin America in the 1990s: Lessons from Argentina, Paraguay, and Venezuela*. No. 97-140. International Monetary Fund.
- García-Herrero, Alicia, Matthew G. Ferchen, and Mario Nigrinis. 2013. "Evaluating Latin America's Commodity Dependence on China."
- Lustig, Nora, and Jaime Ros. 1986. *Stabilization and Adjustment in Mexico: 1982–1985*. ILET.
- Resende, João Pedro Bumachar, and Ilan Goldfajn. 2013. "Latin America During the Crisis: The Role of Fundamentals." *Monetaria, CEMLA* 1.1 (2013): 167–95.
- Sachs, Jeffrey D., and John Williamson. 1985. "External Debt and Macroeconomic Performance in Latin America and East Asia." *Brookings Papers on Economic Activity* 1985.2: 523–73.
- Singh, Ajit. 1993. "Asian Economic Success and Latin American Failure in the 1980s: New Analyses and Future Policy Implications." *International Review of Applied Economics* 7.3: 267–89.