

Financial Crisis, Monetary Policy, and Macroeconomic Performance*

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Outline

1. Some stylized facts.
2. Monetary policy, inflation targeting and the financial system.
3. Risk management, crisis and inflation target.
4. Latin America current economic developments.

1. Some stylized facts

- Costs of financial crisis:
In a five year-period the output loss of a currency-banking crisis is 16% of GDP (De Gregorio and Lee, 2004). Hutchison and Noy (2005) estimates duration about 3 years and losses about 10% of GDP. Demirguc-Kunt et al. (2001), about 8% in 3 years. The costs could rise much more than full GDP if out decline is permanent (Boyd et al. 2004).
- Determinants of financial crisis: poor policies and weak financial system.
- Worsening financial crisis: sudden stoops and contagion.

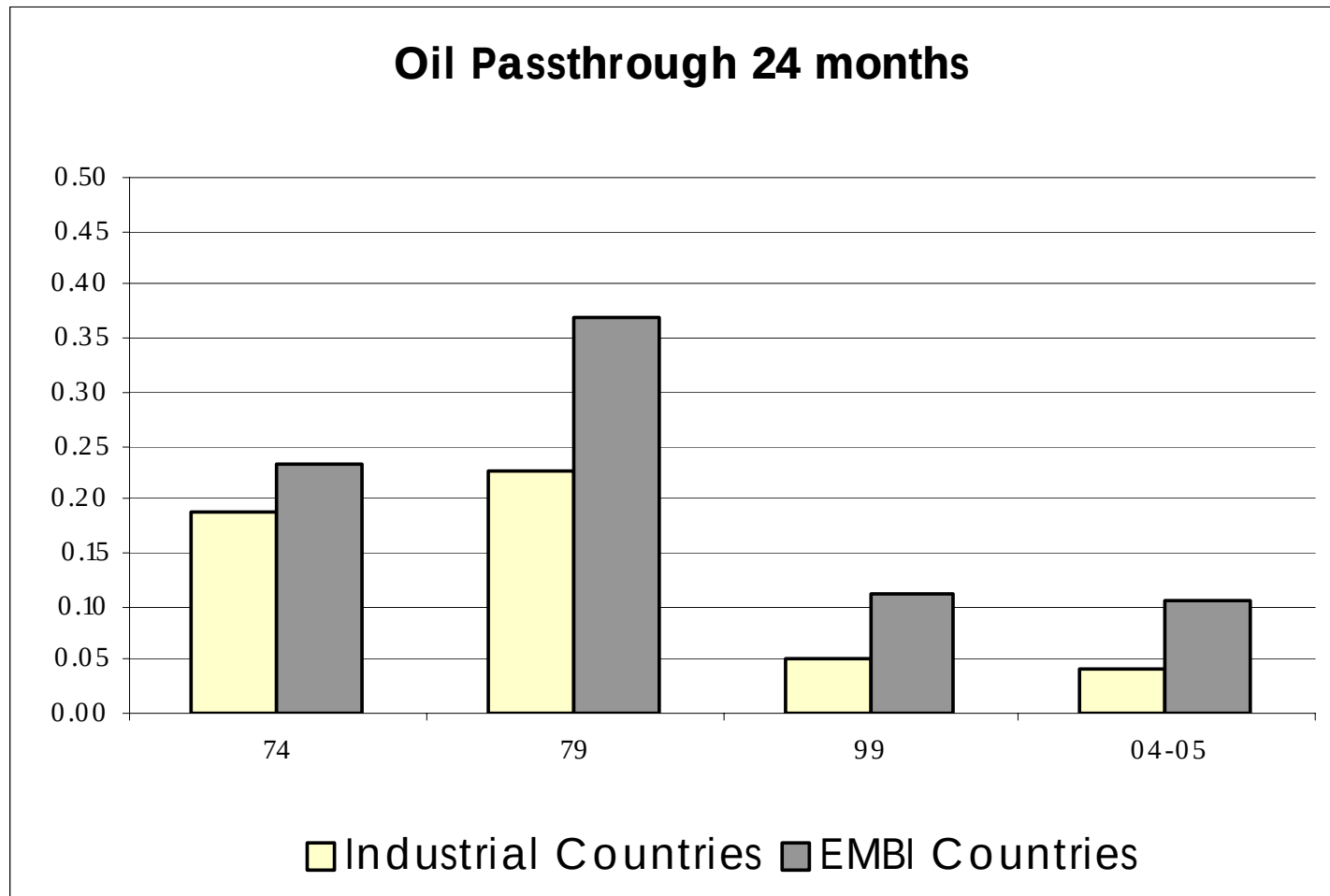
2. Monetary policy, inflation targeting and the financial system

Two pillars:

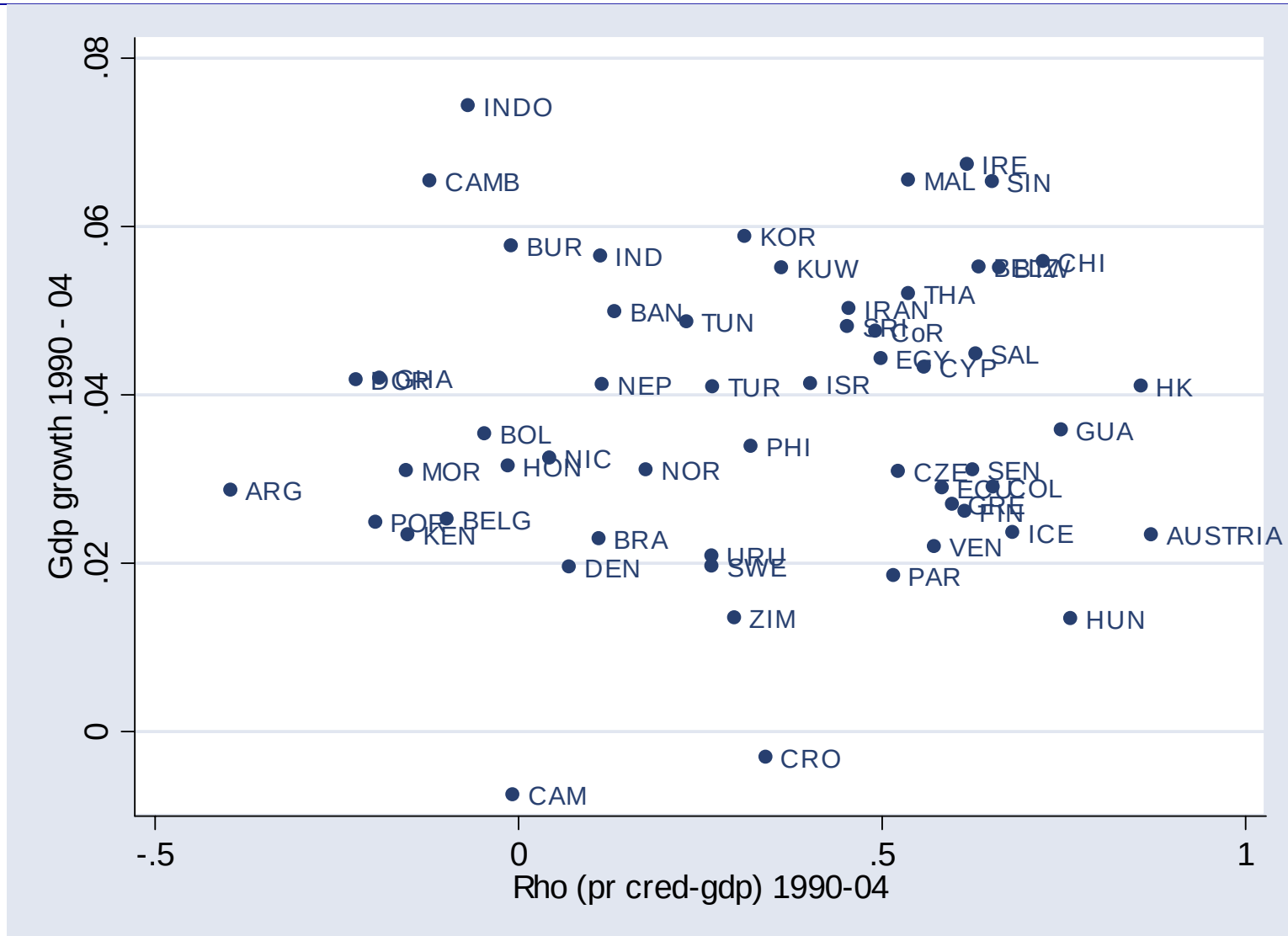
Many central banks have a dual objective of price stability and financial stability (normal functioning of domestic and foreign payments).

- Strong macroeconomic policy: monetary policy conducted by a credibly independent central bank with an inflation objective, and based-rule fiscal policy. It reduces the costs of achieving low inflation.
- Sound financial regulation. Pro-cyclicality of lending and stabilization during the business cycle. The evidence.

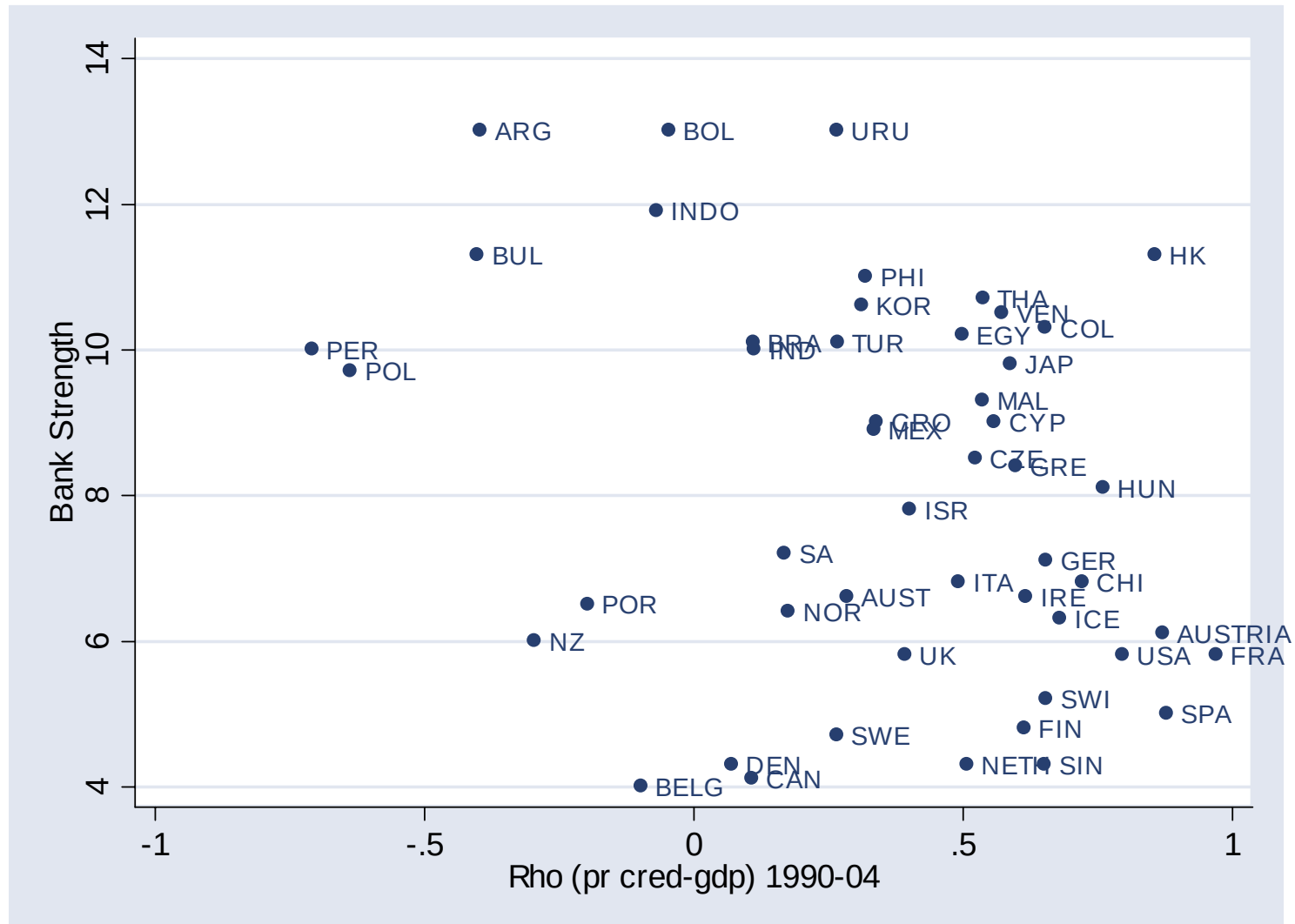
2. Passthrough Oil prices -inflation



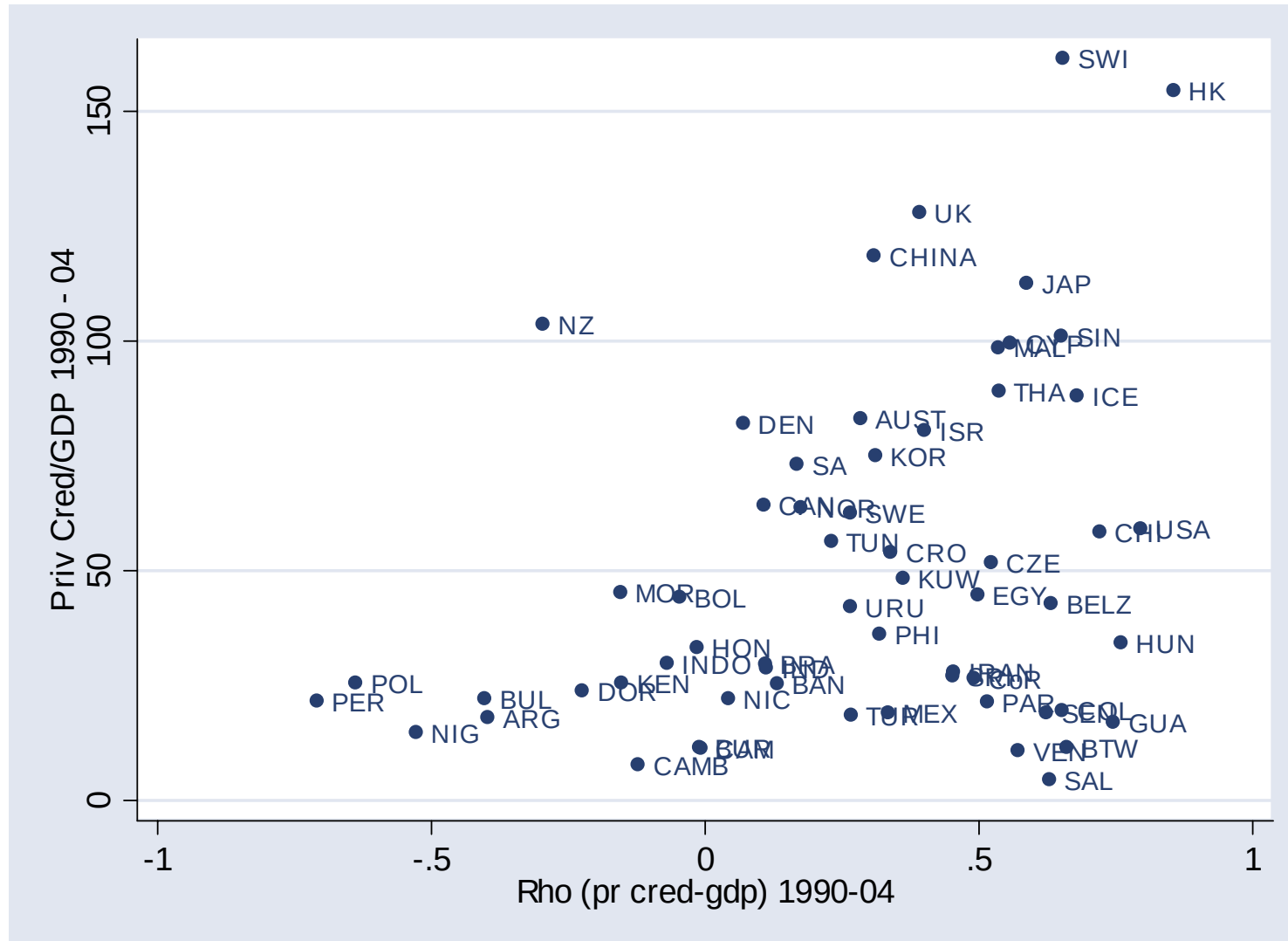
2. Pro-cyclicality and GDP growth



2. Pro-cyclicality and banking strength



2. Pro-cyclicality and banking development

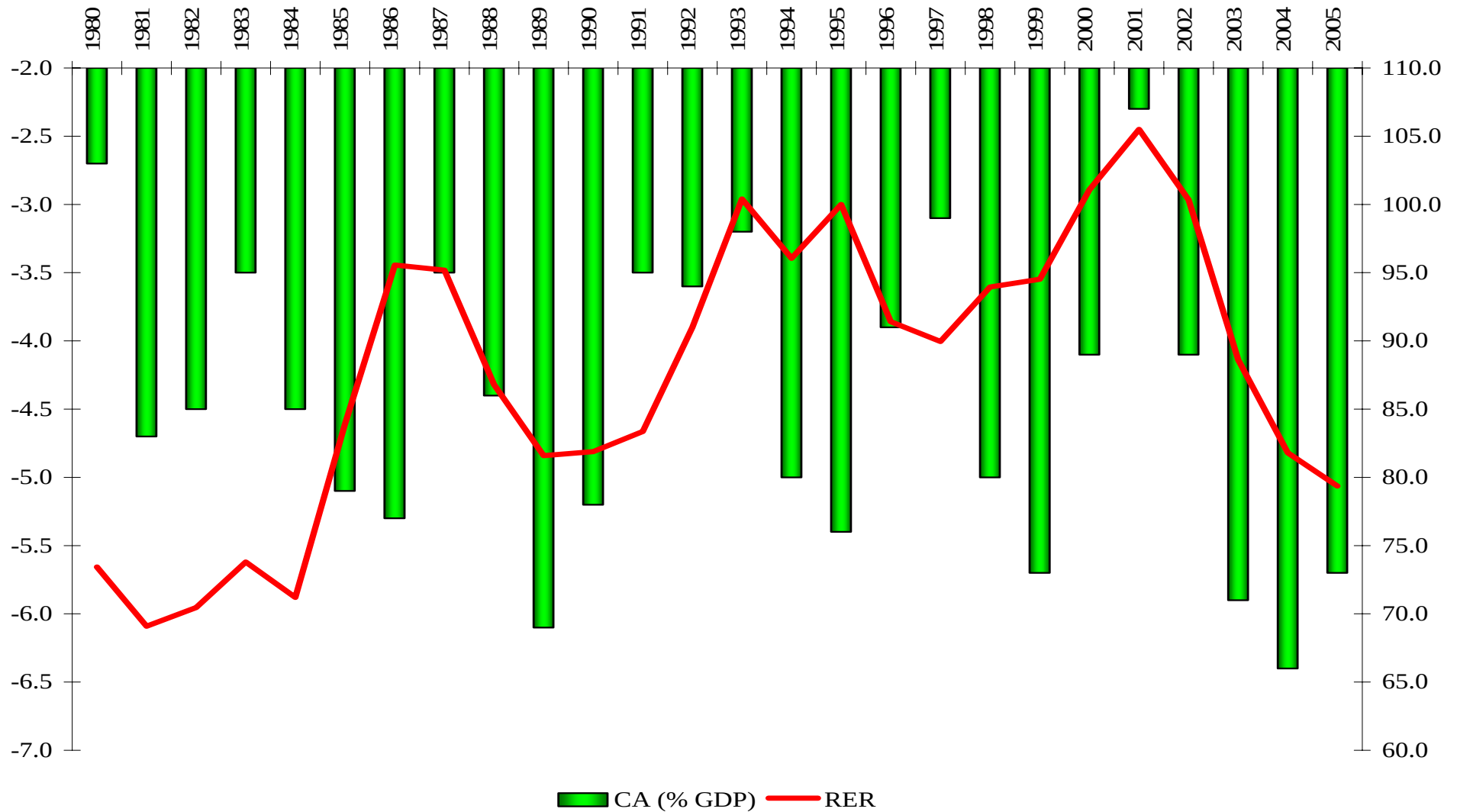


3. Risk management, crisis and inflation target

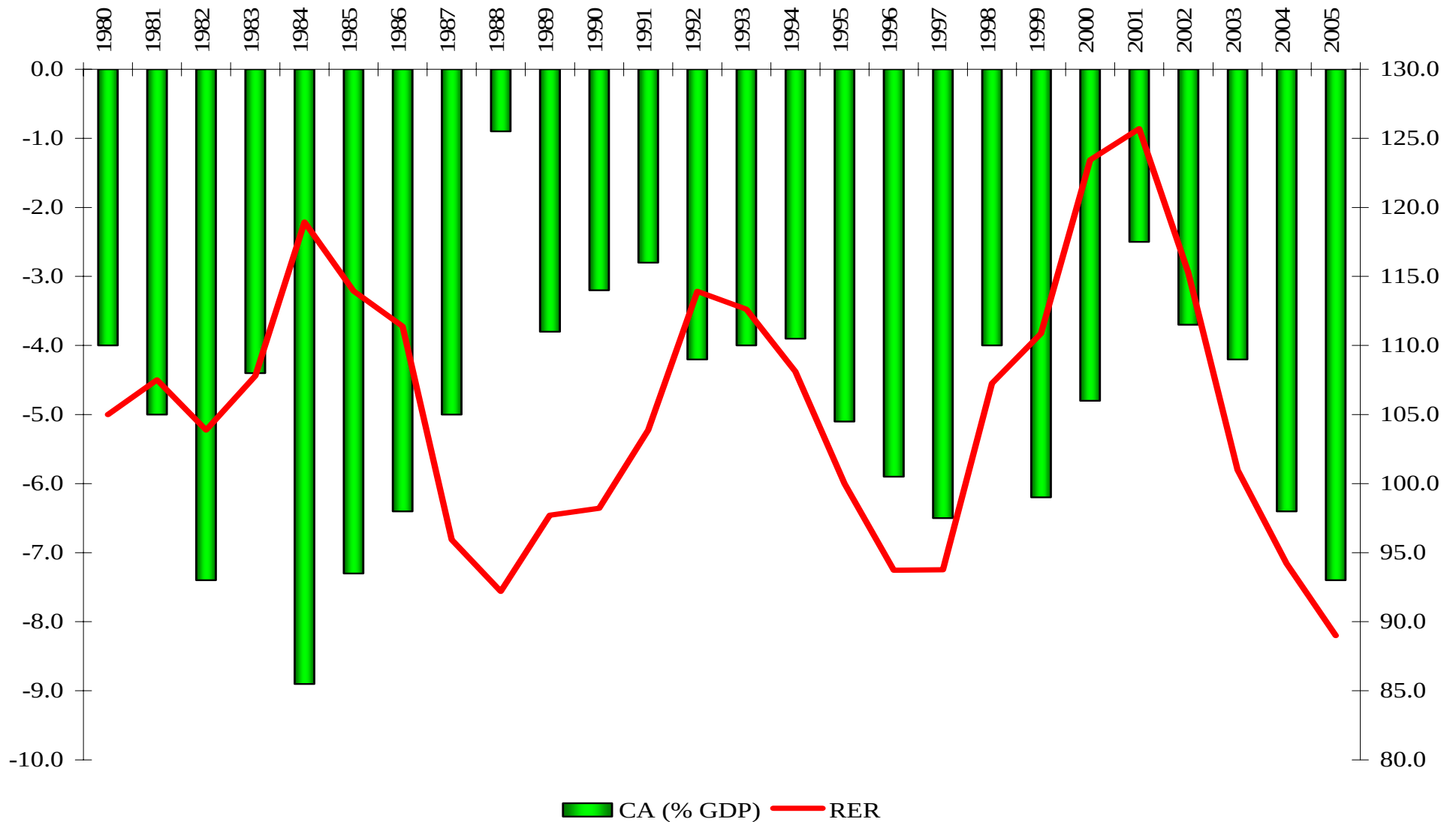
Central bank objectives: price and financial stability. Policy tensions in an environment where inflation is rising:

- The optimal response when the exchange rate has appreciated and there is a large current account deficit. Is enough with the interest rate?
- Financial crisis and the need for liquidity. How to trade-off tightening versus loosening.

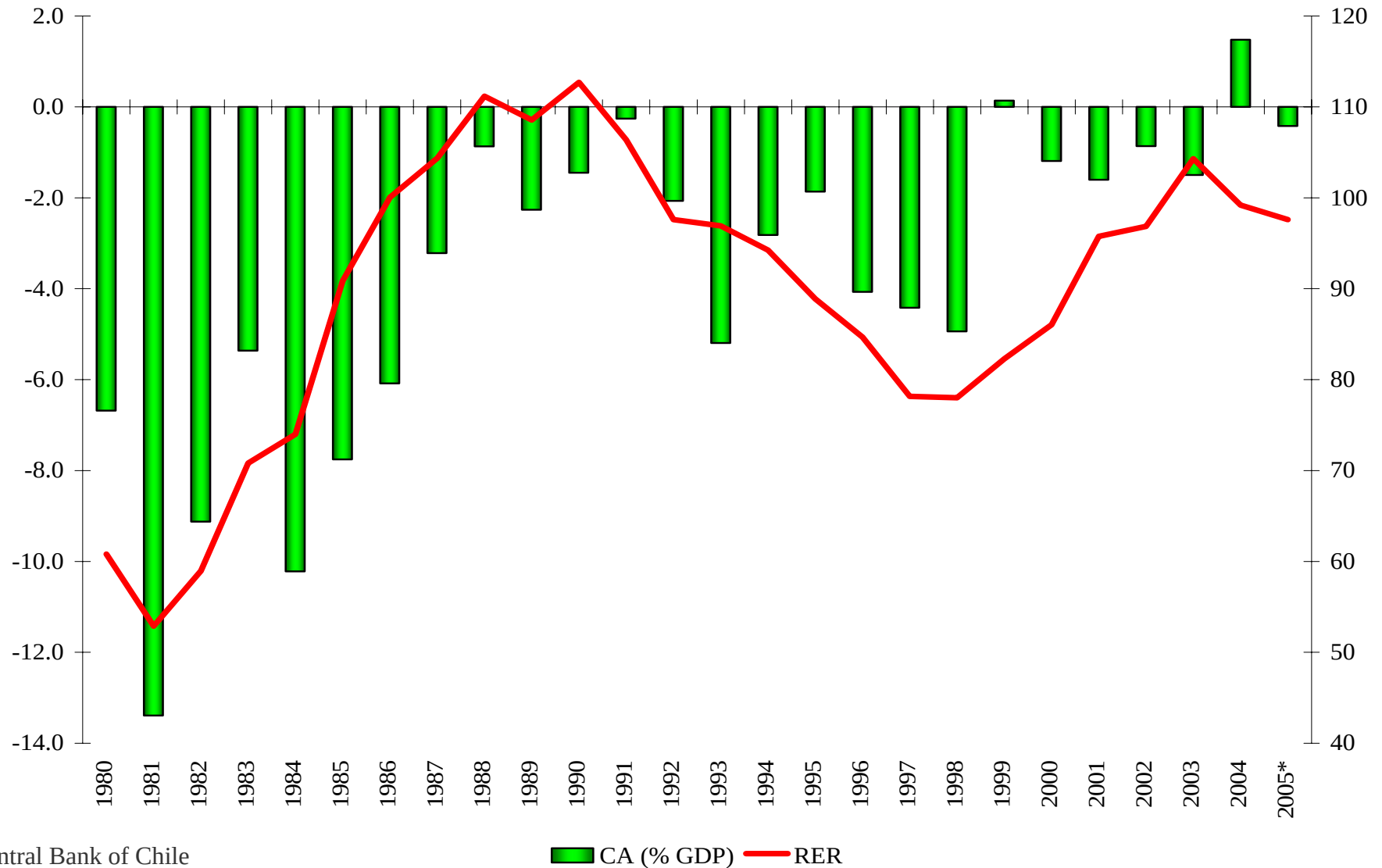
3. Australia: CA and RER



3. New Zealand: CA and RER



3. Chile: CA and RER



Source: Central Bank of Chile

* As of September 2005

3. Risk management, crisis and inflation target

There are special circumstances, in particular related to financial crisis, in which inflation target may give an incomplete policy framework to analyze the policy responses. In these cases there is a need for flexibility:

- Risk management and escape clauses to IT.
- Adjustments of the policy horizon of inflation target.

4. Latin America: Macroeconomic Performance

	GDP Growth (%)				Inflation (%)				Current Account (% GDP)			
	1993-2002	02-06(f)	2005(f)	2006(f)	1993-2002	02-06(f)	2005(f)	2006(f)	1993-2002	02-06(f)	2005(f)	2006(f)
World	3.5	4.1	4.3	4.3	11.4	3.7	3.9	3.7				
Argentina	0.7	3.7	7.5	4.2	4.2	12.7	9.5	10.4	-2.2	3.5	1.3	0.1
Bolivia	3.5	3.0	3.9	2.5	6.1	3.5	5.5	3.2	-5.4	1.0	2.6	2.9
Brazil	3.0	2.8	3.3	3.5	412.3	8.2	6.8	4.6	-2.9	0.7	1.7	0.7
Chile	5.0	4.7	5.9	5.8	6.4	2.5	2.9	3.3	-2.7	-0.3	0.3	-0.7
Colombia	2.4	3.6	4.0	4.0	15.9	5.9	5.2	4.8	-2.9	-1.5	-1.8	-1.5
Ecuador	2.2	3.7	2.7	2.8	38.4	5.4	2.0	2.0	-2.4	-0.8	0.2	2.4
El Salvador	3.9	1.9	2.0	2.0	6.4	3.7	4.0	4.0	-1.6	-4.3	-4.7	-5.5
Guatemala	3.7	2.7	3.2	3.2	8.8	6.8	7.6	5.3	-5.0	-4.7	-4.7	-4.5
Mexico	2.8	2.6	3.0	3.5	16.0	4.4	4.3	3.6	-3.1	-1.3	-1.1	-0.8
Peru	4.4	4.7	5.5	4.5	12.0	2.1	1.8	2.6	-5.0	-0.6	0.3	0.3
Uruguay	0.5	2.7	6.0	4.0	22.9	10.9	5.2	6.5	-1.5	-1.2	-2.8	-5.3
Venezuela	0.1	2.7	7.8	4.5	41.9	22.0	16.6	18.0	3.8	13.1	15.9	14.9
Average	2.7	3.3	4.6	3.7	49.3	7.3	6.0	5.7	-2.6	0.3	0.6	0.3

(f): Forecast.

Source: World Economic Outlook, September 2005.

4. Latin America: Improved Fiscal Balance

