



## Need to stay on course

### Success still depends on sound, stable policies

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**A** booming region is facing new challenges. Latin America, the region that for the best part of the last decade maintained relatively high levels of economic growth, financial resilience in the wake of a global financial crisis, and an increasing influx of both tourists and foreign investments, may be confronted with a scenario that isn't as rosy as it was.

So far, most Latin American policy-makers and private sector players complained about US monetary policy, arguing that interest rates kept artificially at near-zero levels for years as well as stagnant economies in the developed world contributed to unstoppable capital flows into the region, driving up demand for local currencies and affecting competitiveness of exports.

Countries responded differently to the same phenomenon; some fighting currency appreciation, others keeping their own interest rates low and fighting inflation by managing reserve requirements — thus, the widespread wish for quantitative easing to end. 'Be careful what you wish for,' a panelist said in Brasilia.

Timing couldn't have been better for an OMFIF Main Meeting in Brazil. Concerns about the unwinding of quantitative easing were evident during the meeting. Tapering off QE will happen sooner or later, but it won't be a walk in the park for emerging economies. Financial markets have shown this. Asset prices closely related to emerging markets sold off during the days preceding the meeting as a result of these concerns. Emerging markets currencies did so too, raising concerns that the unwinding of loose monetary policy in the US may not be so manageable after all.

This was probably not what was wished for, especially in Brazil, where controlling inflation has been tougher than expected while growth slowed almost to a halt. The change in US monetary policy is the culprit of a watershed event. Some countries' creativity to manage capital inflows may now have to match its creativity with the opposite scenario.

Even though questions remained about the specifics of each country's challenges, a common theme of discussion was how to cope with drastic changes in capital flows and interest rates, and the impact on exchange rates and, ultimately, growth.

A reversal in flows may present as big a challenge and this should not be underestimated. But countries in Latin America should note that their success so far has depended more on their own policy choices than on US monetary policy and euro area economic outcomes. The so-called 'Bolivarian' countries following large-scale state intervention and attacks on private property, have been struggling, with and without QE.

Notably, countries with sound macroeconomic policies, especially those comprising the newly-formed 'Pacific Alliance' (Peru, Chile, Mexico, Colombia) as well as Brazil and small economies with similar policies (Panama, Paraguay, etc.) have performed quite well before and after the financial crisis and zero-interest rates environments.

Latin America's progress in alleviating poverty and building a larger middle class through sound economic policies may come to a transitory halt if the impact of QE unwinding accelerates. But it's still a fertile ground for new businesses and social innovation models for sustainable development.

Its economic success in medium- and long-term horizons will largely depend on domestic policy decisions. It is very important for countries with sound policies to stay the course and avoid temptation for short term responses to counter US monetary policy changes. ☐

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