INTERNATIONAL MONETARY FUND

WESTERN HEMISPHERE DEPARTMENT

Fiscal and Monetary Challenges in Latin America

XVIII CONFERENCIA ANUAL DEL FONDO LATINOAMERICANO DE RESERVAS

AUGUST 11, 2023

Rodrigo Valdes
Director of IMF Western Hemisphere Department

Key issues in the current juncture

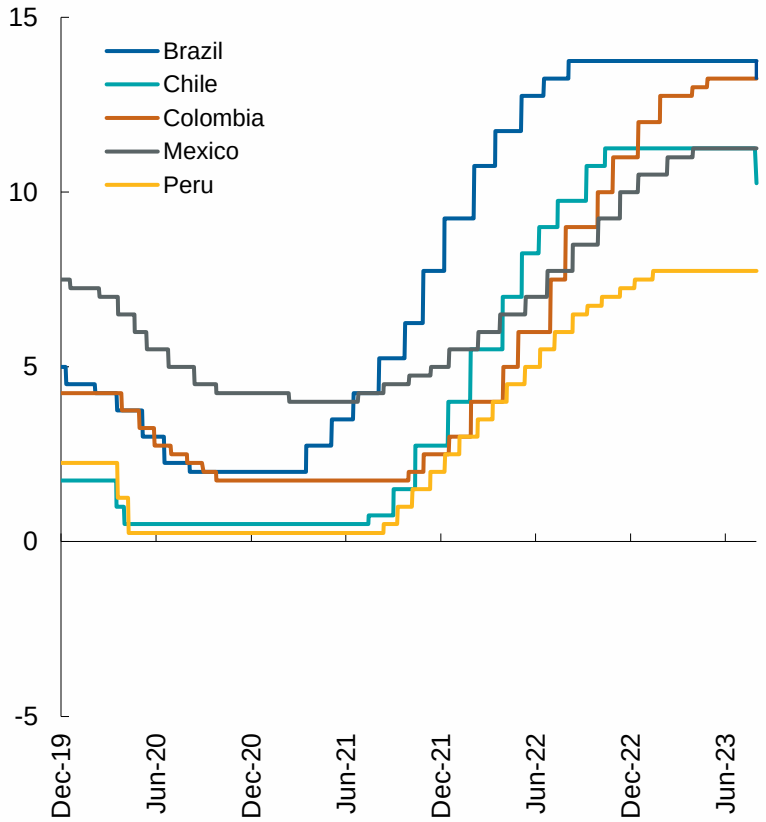
- **Monetary policy**
  1. **A steadfast reaction to a huge shock**
  2. **Is inflation receding?**
  3. **How to calibrate monetary policy as conditions shift?**

- **Fiscal policy**
  1. **Exemplary "in and out" during pandemic**
  2. **Role of fiscal policy in the current juncture?**
  3. **How to balance competing fiscal policy objectives?**

A steadfast reaction to a huge shock

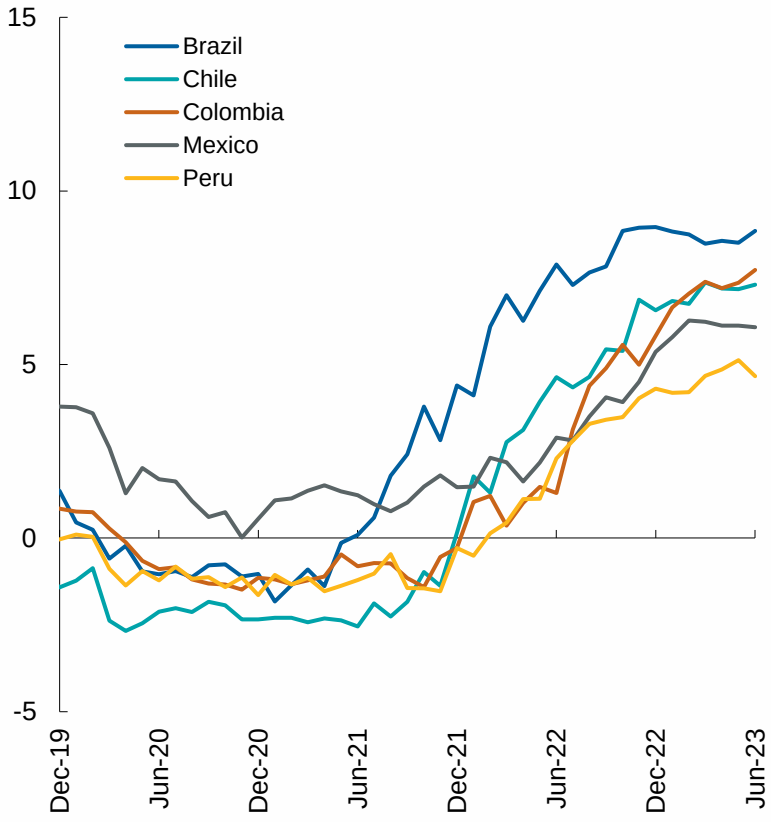
LATAM central banks' response has been remarkable

LA5: Nominal Monetary Policy Rates
(Percent)



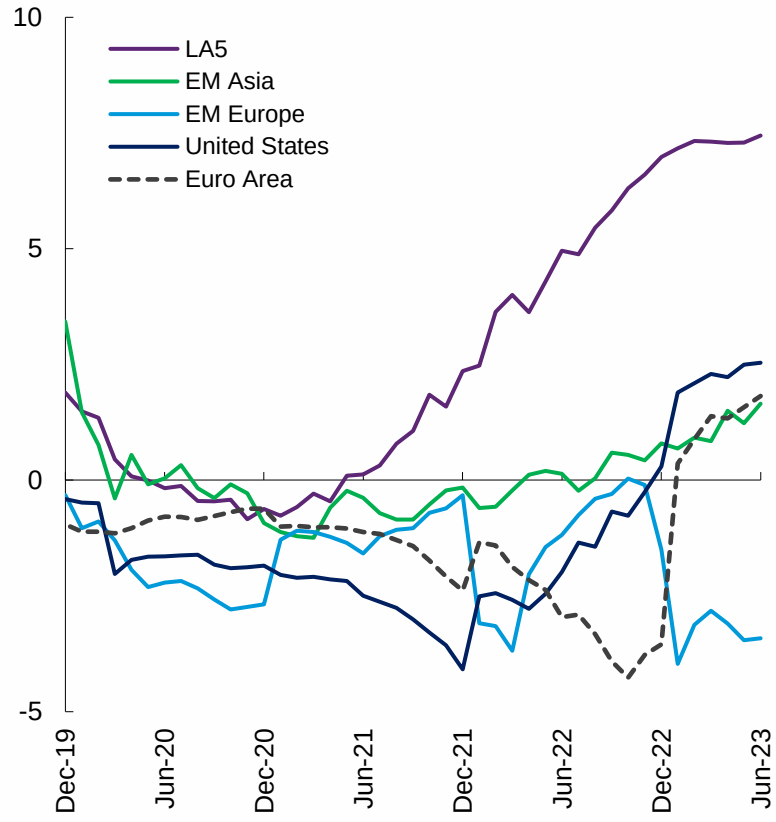
Sources: Haver Analytics; national authorities; and IMF staff calculations.

LA5: Ex-Ante Real Monetary Policy Rates
(Percent)



Sources: Consensus Economics; Haver Analytics; national authorities; and IMF staff calculations.
Note: Ex-ante real policy rate is the difference between nominal policy rate and one-year ahead inflation expectation.

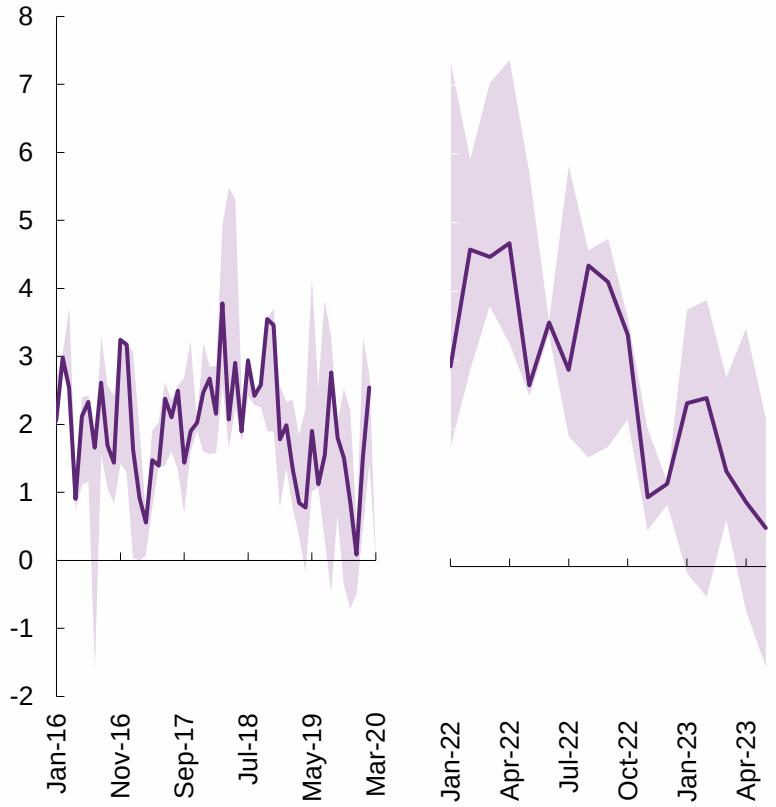
Ex-Ante Real Monetary Policy Rates
(Percent)



Sources: Consensus Economics; Haver Analytics; national authorities; and IMF staff calculations.
Note: Ex-ante real policy rate is the difference between nominal policy rate and one-year ahead inflation expectations. Aggregates are purchasing-power-parity GDP-weighted averages. EM = emerging markets; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).

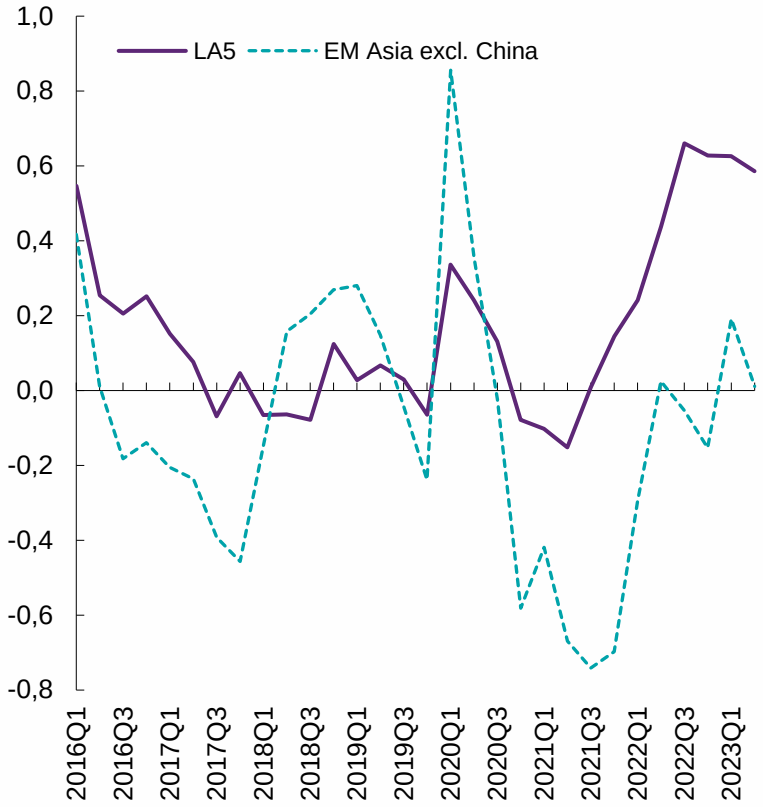
Responding to tighter policies, growth is slowing, financial conditions have tightened, and exchange rates have appreciated

LA5: Economic Activity Index
(year-over-year percent change)



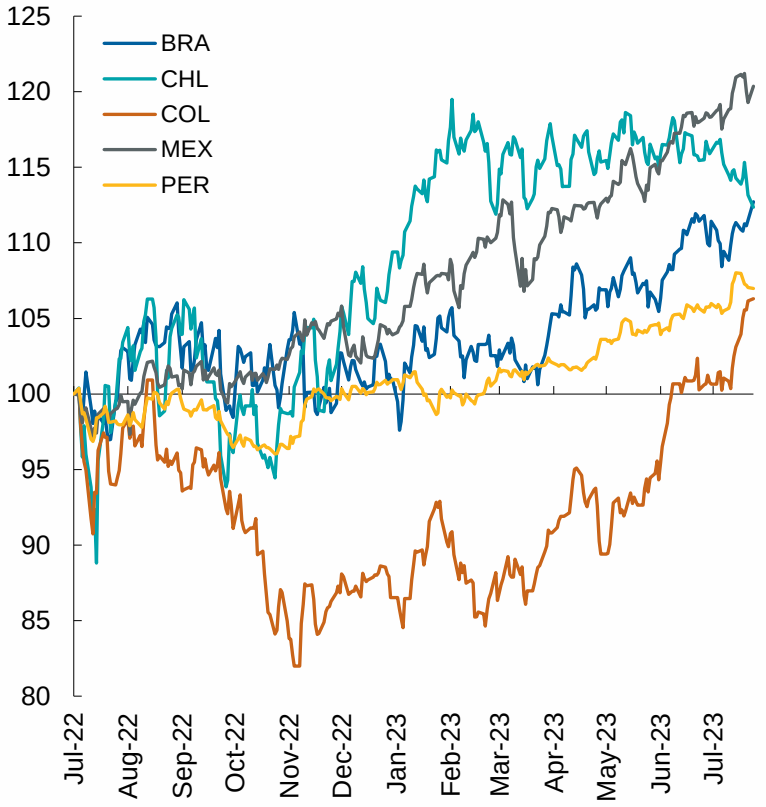
Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Median and 25th-75th interquartile range (shaded area) for LA5 countries are reported. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Financial Conditions Index
(0 = neutral; +/– = tight/loose)



Source: IMF staff calculations.
Note: For methodology, see online annex of the October 2018 *Global Financial Stability Report.* LA5 is PPP-weighted average. EM = emerging markets; LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Exchange Rates Against US Dollar
(Index: 7/1/2022 = 100; increase = appreciation)

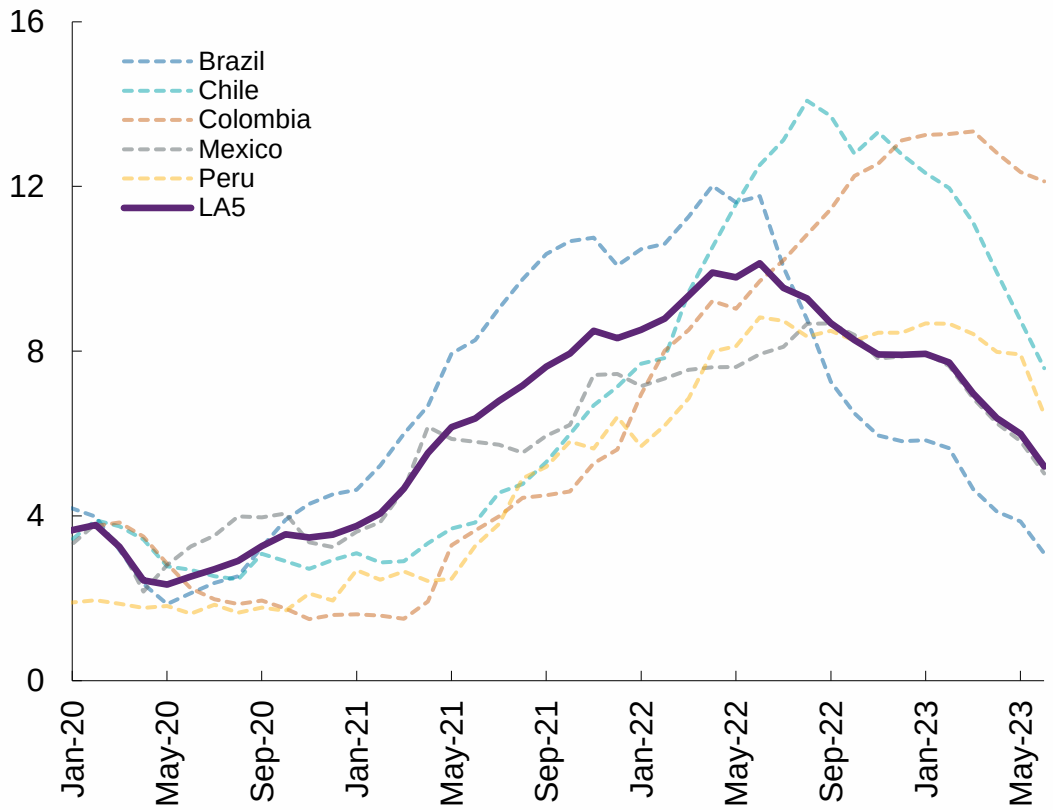


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Is inflation receding?

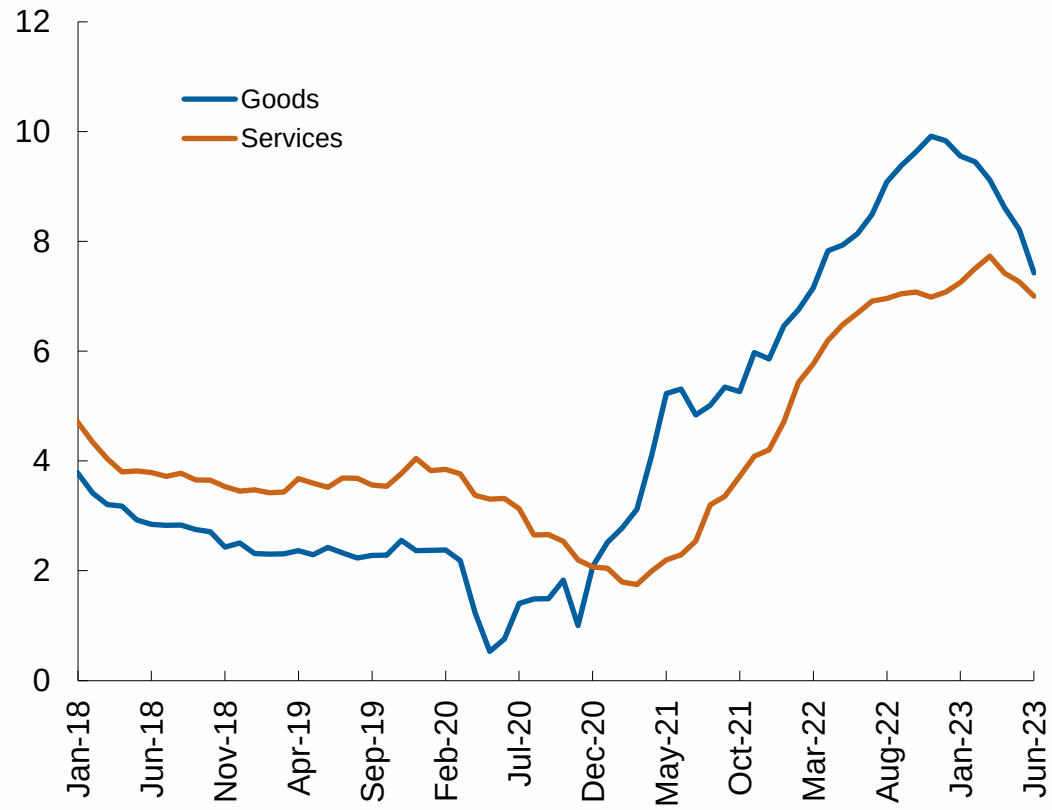
Headline inflation is now declining, and core inflation shows signs of having peaked …

LA5: Headline Consumer Price Inflation
(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: LA5 is purchasing-power-parity GDP-weighted average. Peru refers to Lima. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

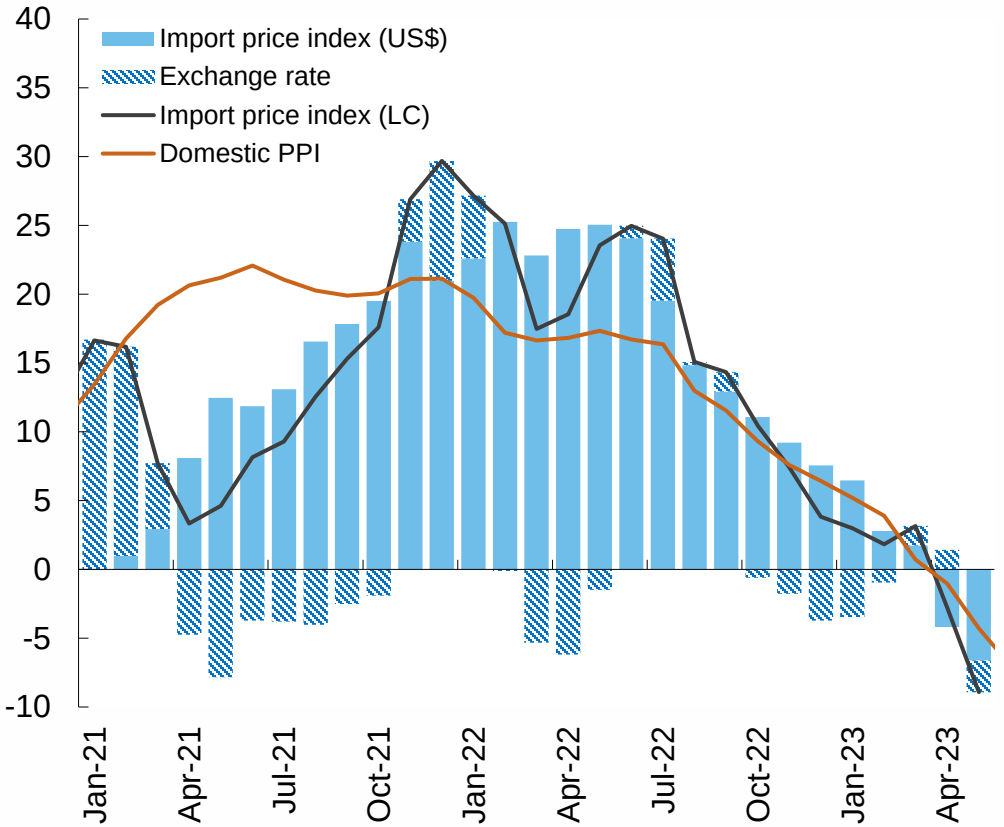
LA4: Core Goods and Core Services Inflation
(Year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Core goods exclude food, transport, and housing items. Core services exclude transport and housing items. LA4 is purchasing-power-parity GDP-weighted average. LA4 = Latin America 4 (Brazil, Chile, Colombia, Mexico).

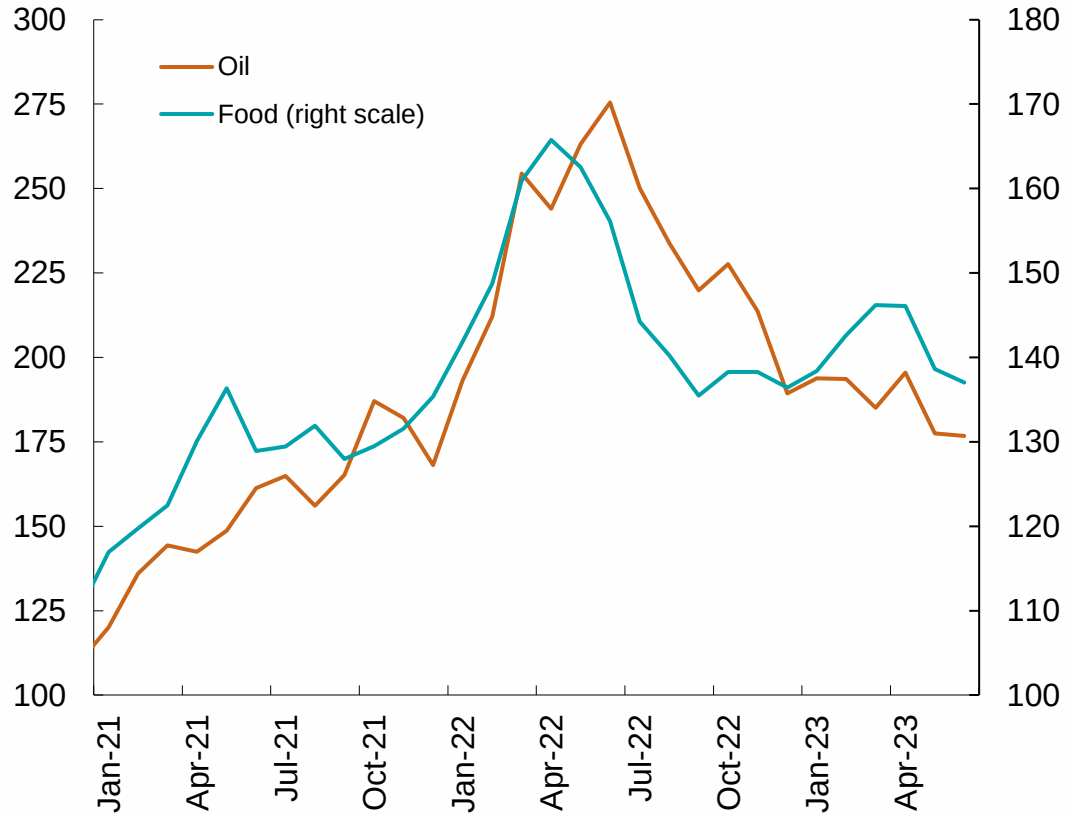
External inflation pressures are receding

LA4: Import Price Inflation
(Year-over-year percent change)



Sources: Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: Aggregates are purchasing-power-parity GDP-weighted average. CPI = consumer price index; LA4 = Brazil, Colombia, Mexico, Peru; LC = local currency; PPI = producer price index.

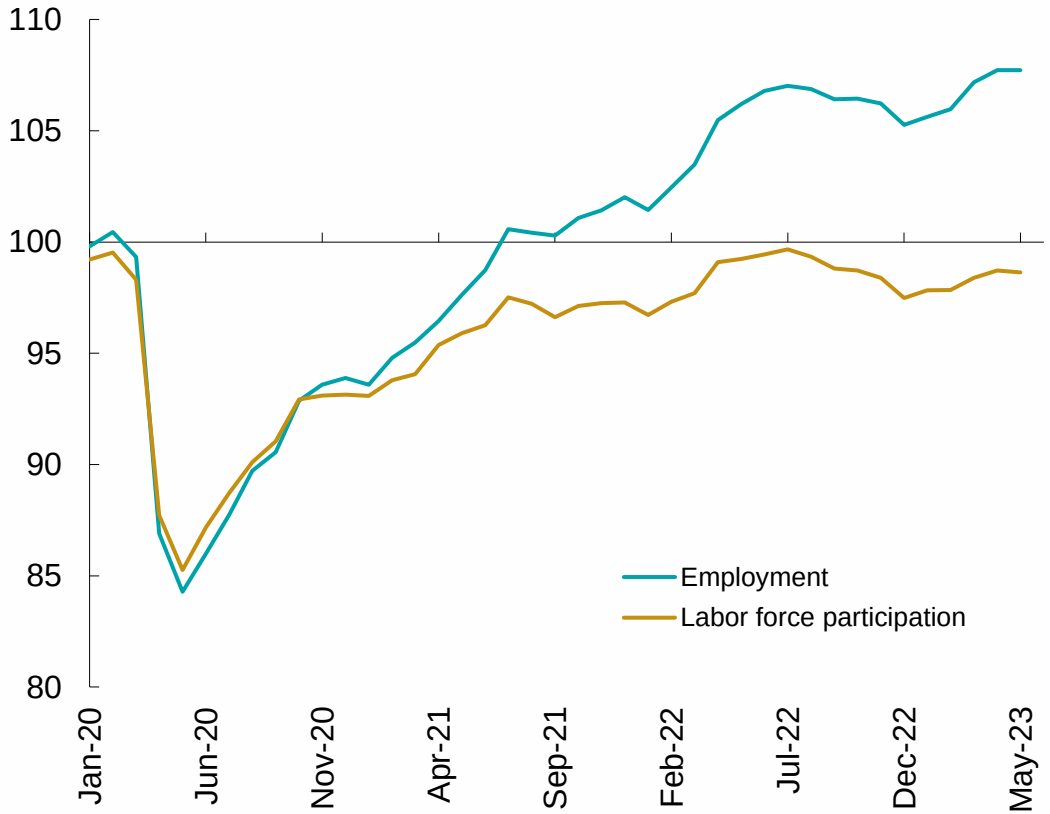
Global Oil and Food Prices
(Index: 2016 = 100)



Source: IMF, World Economic Outlook database.
Note: Oil price is crude oil (petroleum) price index, which is a simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh. Food price is commodity food price index, which includes bananas, cereal, citrus fruit, dairy products, legumes, meat, non-citrus fruit, seafood, sugar, vegetables, and vegetable oils.

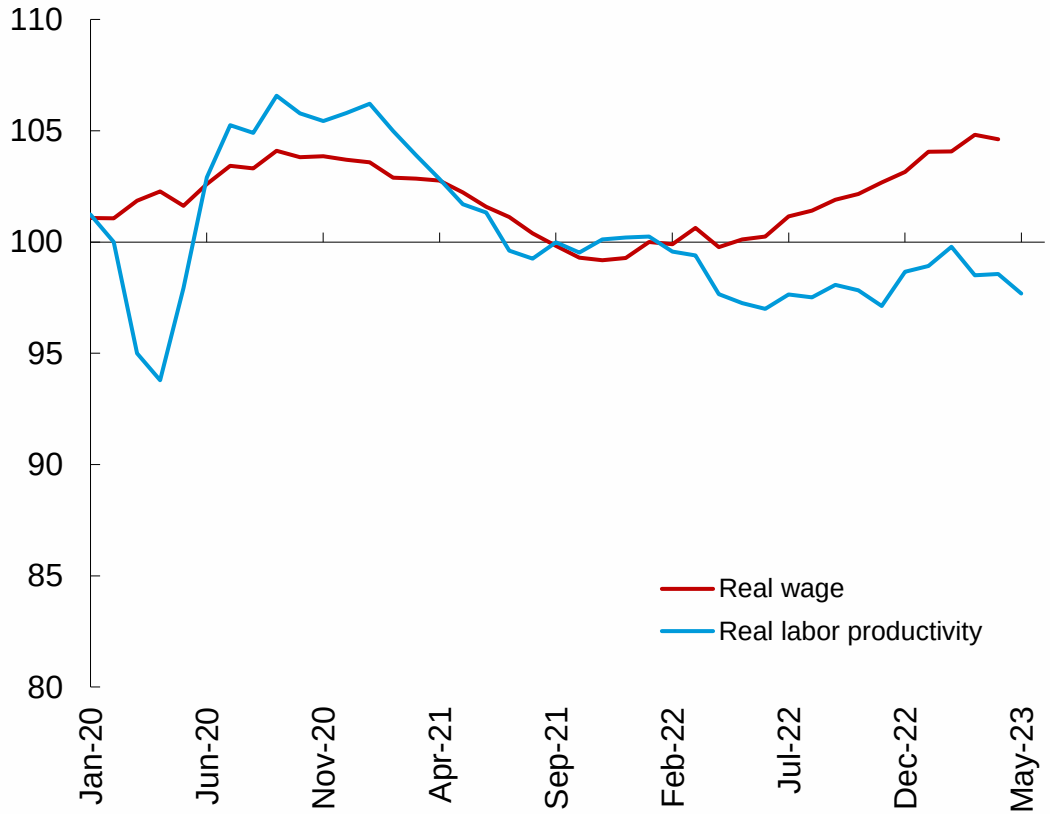
While economies are close to full employment, wages outpacing inflation and productivity…

LA5: Employment and Labor Force Participation
(Index: 2019 = 100)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Aggregates are purchasing-power-parity GDP-weighted averages. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

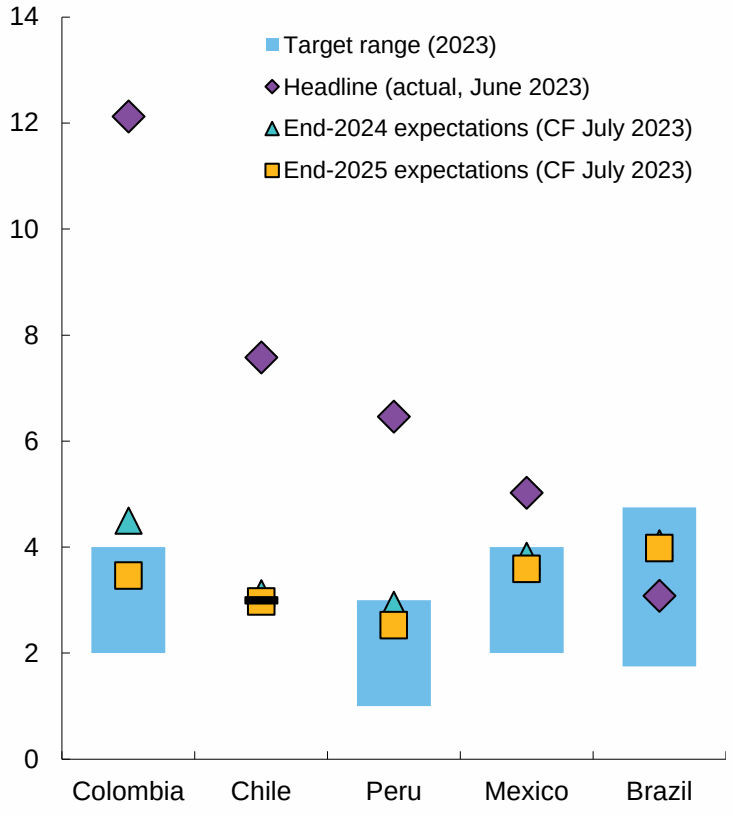
LA5: Real Wages and Real Labor Productivity
(Index: 2019 = 100)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Aggregates are purchasing-power-parity GDP-weighted averages. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

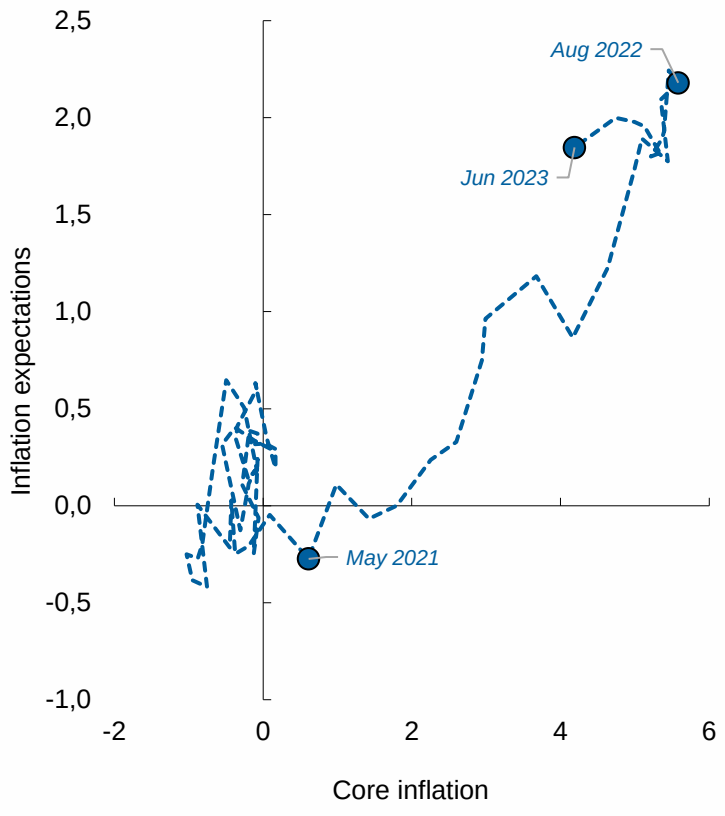
… and short-term inflation expectations still elevated

LA5 Headline Inflation and Inflation Expectations
(Percent)



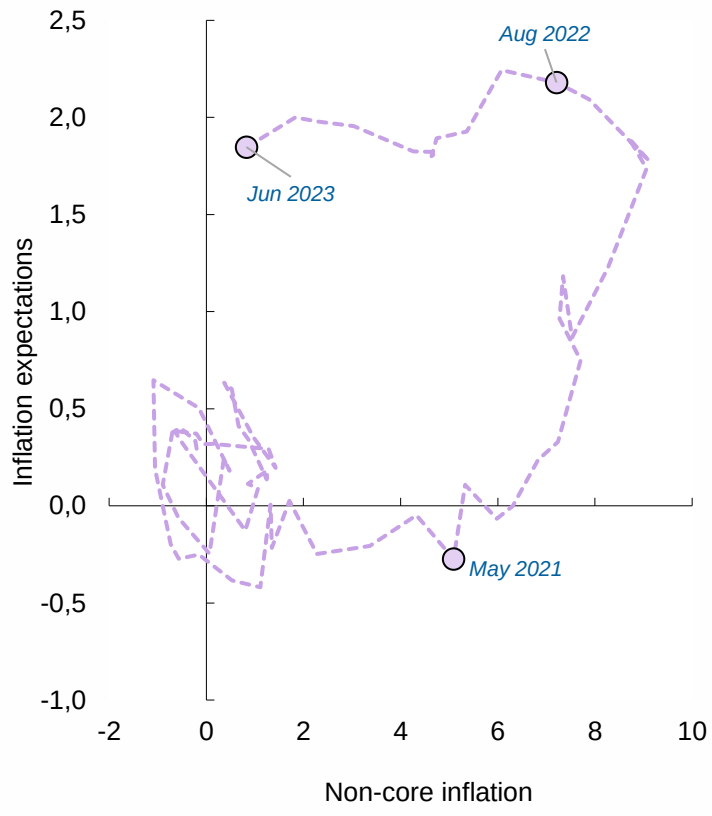
Sources: Consensus Economics; Haver Analytics; and national authorities.
Note: Brazil inflation target is set to decline over time from 3.25 percent in 2023 to 3 percent in 2025. Chile does not have tolerance bands; midpoint target is shown.

LA5: Core Inflation and Inflation Expectations
(Deviation from inflation target; ppts.)



Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.
Note: Core inflation and inflation expectations are measured as deviations from the inflation target midpoint. Aggregates are purchasing power-parity GDP-weighted averages. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Non-core Inflation and Inflation Expectations
(Deviation from inflation target; ppts.)



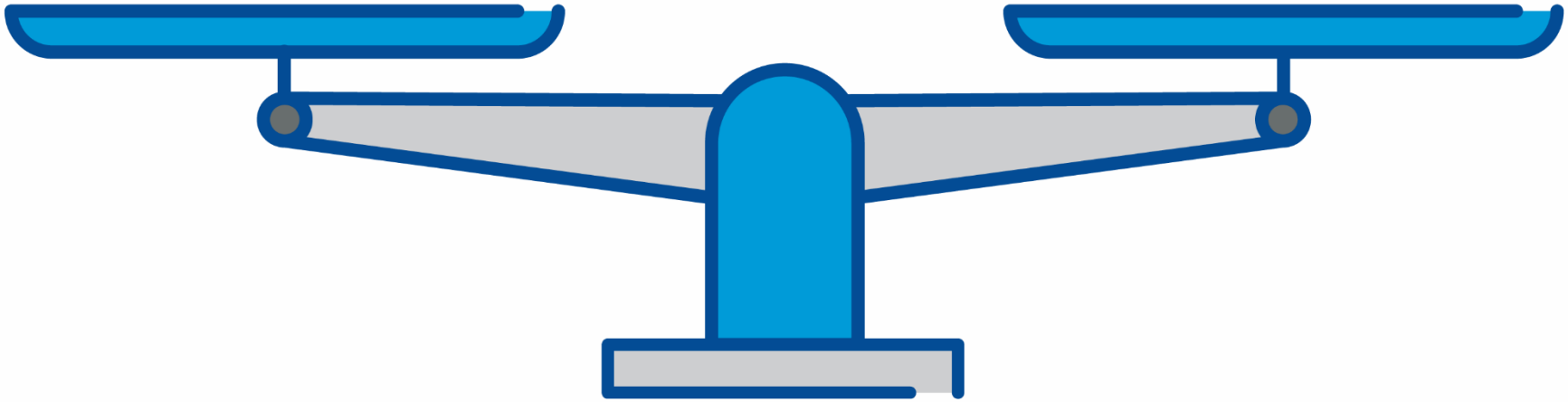
Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.
Note: Non-core inflation and inflation expectations are measured as deviations from the inflation target midpoint. Aggregates are purchasing power-parity GDP-weighted averages. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Calibrating monetary policy amid shifting conditions

Balancing risks

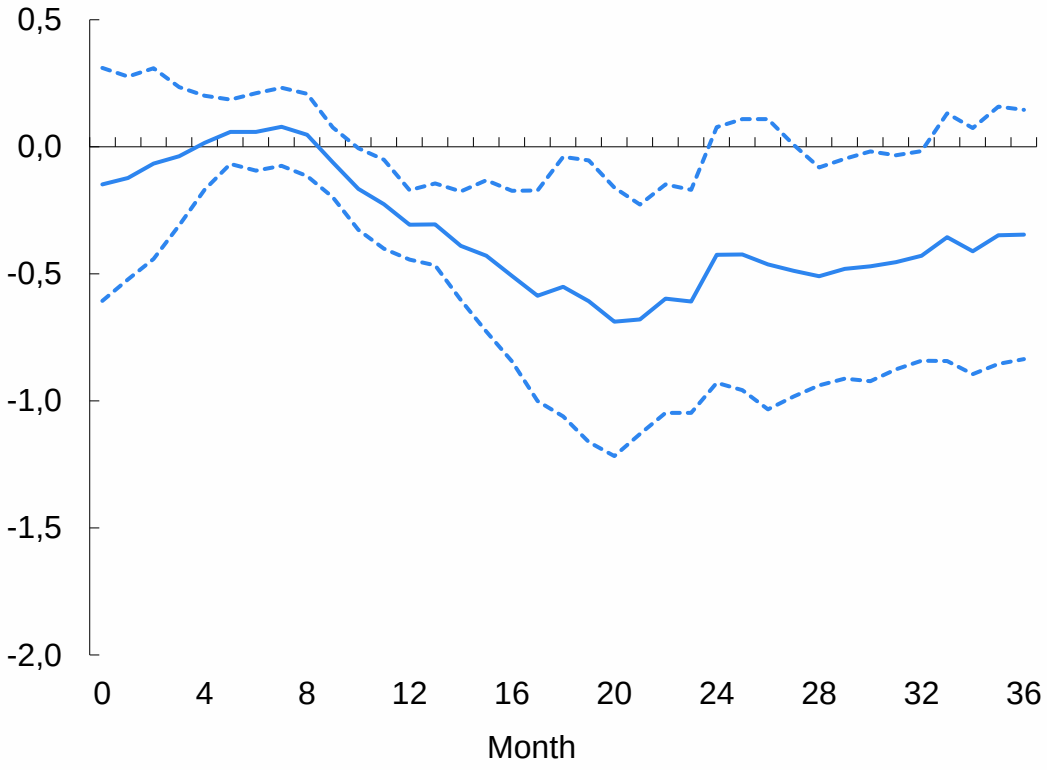
Risk of Delayed Easing
(lower inflation but lower growth)

Risk of Premature Easing
(stronger growth but persistent inflation)



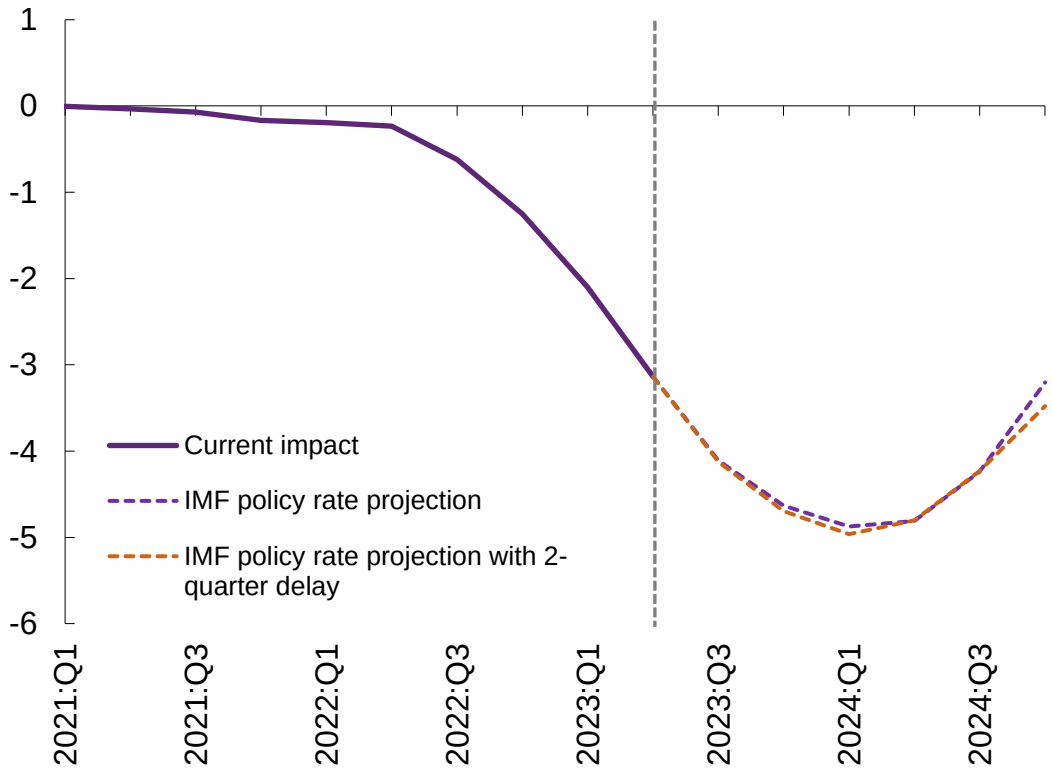
Significant policy-induced disinflation in the pipeline…

LA5: Year-over-Year Inflation Response to Monetary Policy Shocks
(Percentage points; 90 percent confidence interval)



Source: IMF staff calculations.
Note: Line shows the estimated impact of a 1 percentage point shock to the policy rate estimated. For methodological details, see Annex 5 of 2022 Regional Economic Outlook Background Note "The Inflation Surge: Policy Trade-offs amid Uncertainty". LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).

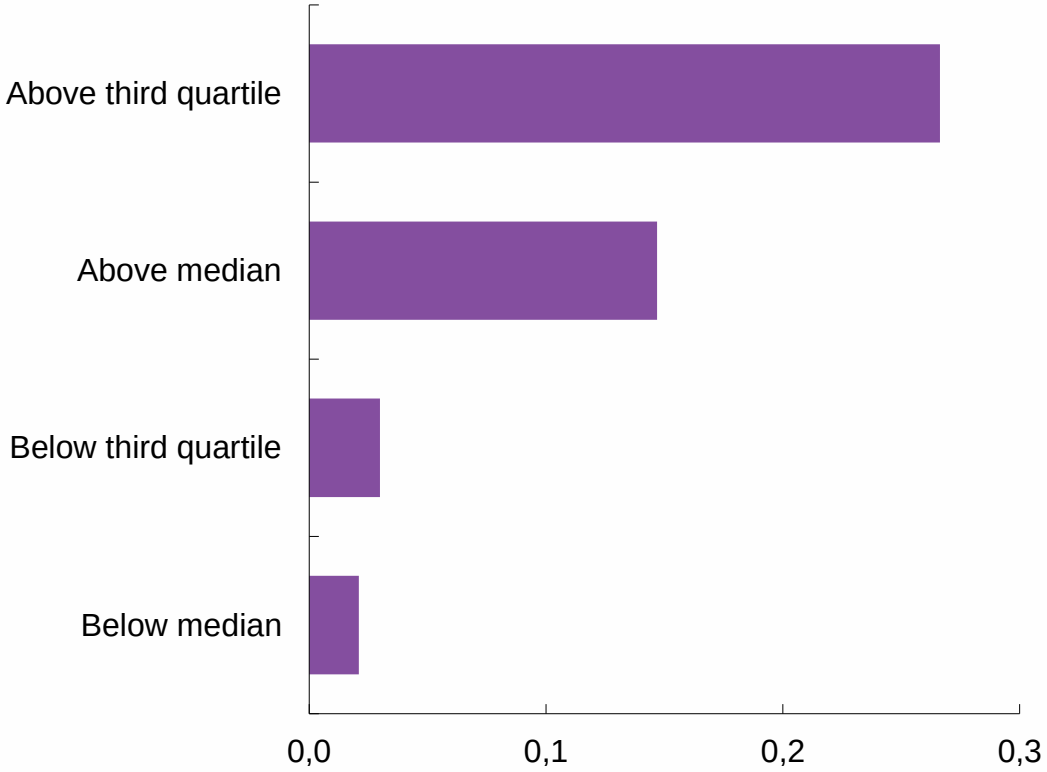
LA5: Current Monetary Impulse
(Percentage points contribution to inflation)



Source: IMF staff calculations. Estimated impact of monetary policy on inflation.

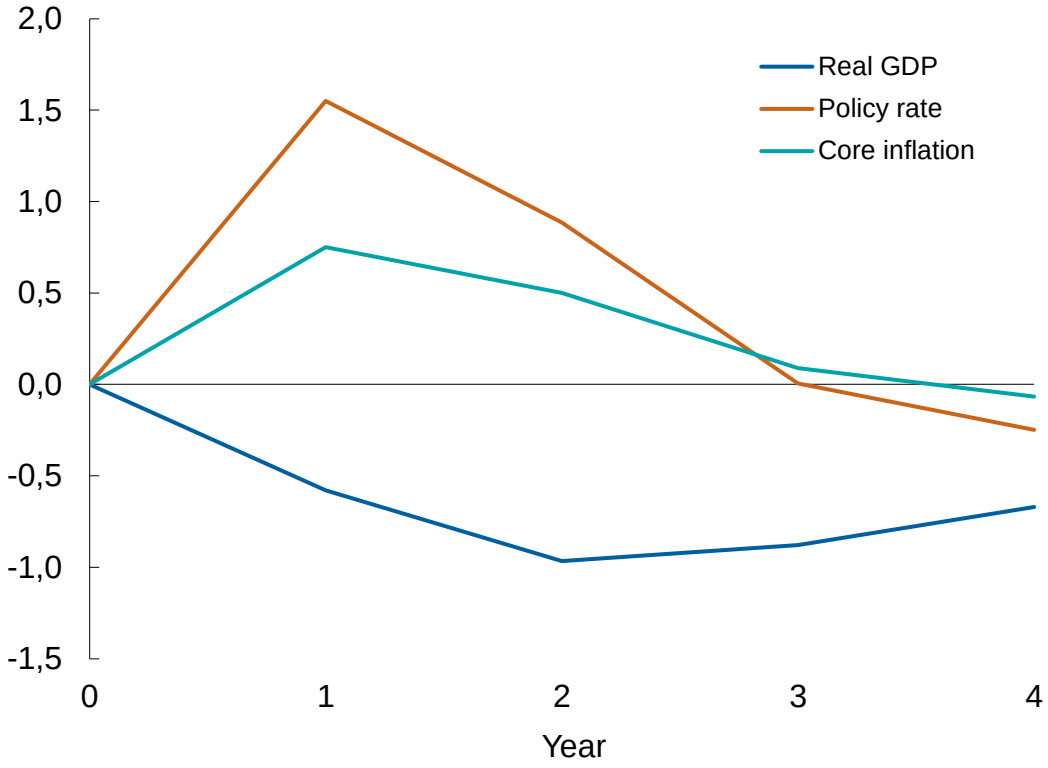
… but the cost of premature easing can be high

Sensitivity of Inflation Expectations to Inflation Surprise, Across the Distribution of Inflation Expectations
(Index)



Sources: For methodological details, see 2022 Regional Economic Outlook Background Note "The Inflation Surge: Policy Trade-offs amid Uncertainty".

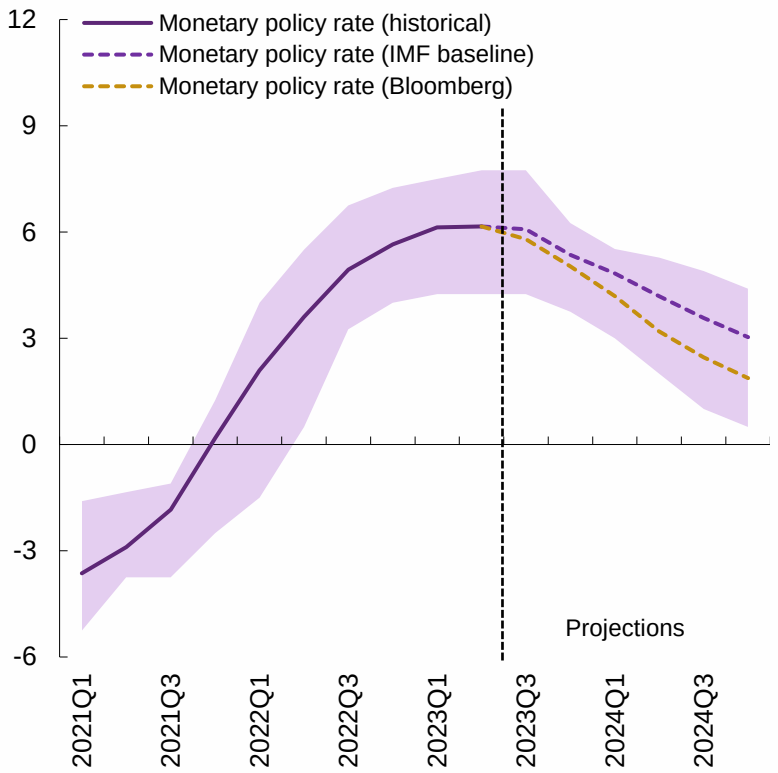
LA5: Inflation Expectations Shock
(Percentage points; deviation from baseline)



Sources:: IMF staff calculations based on IMF's WHDMOD general equilibrium model.
Note: Inflation expectation shock of 75 and 50 basis points in year 1 and 2 respectively. Results shown as simple average of LA5 (Brazil, Colombia, Chile, Mexico, Peru). For methodological details, see Annex 5 of 2022 Regional Economic Outlook Background Note "The Inflation Surge: Policy Trade-offs amid Uncertainty".

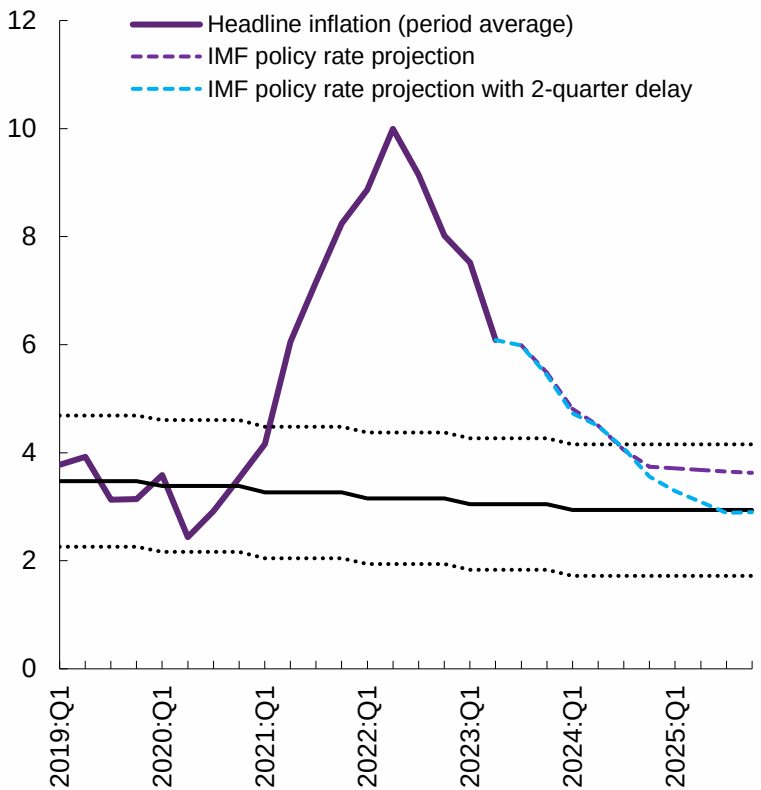
Mind country heterogeneity: early hikers already easing

LA5: Monetary Policy Rate
(Deviation from neutral rate; percent)



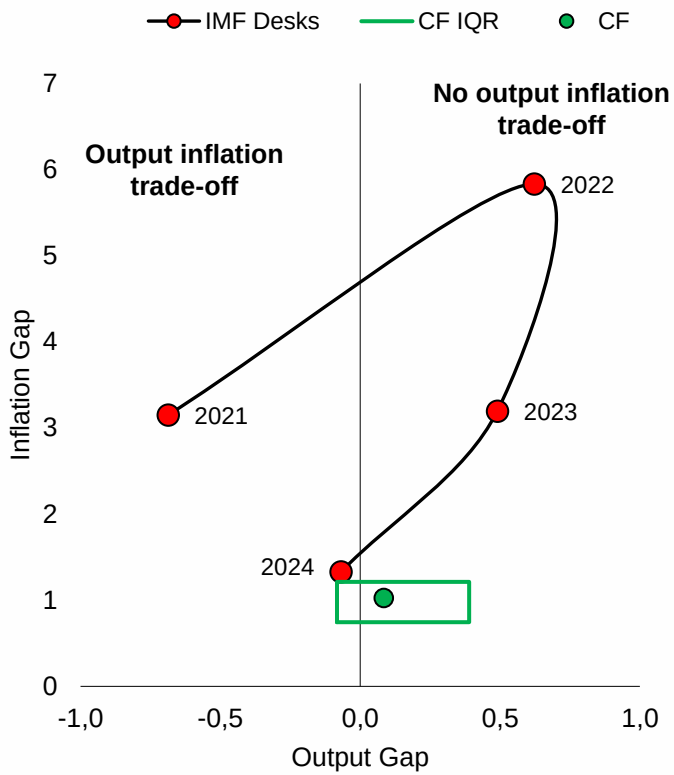
Sources: Bloomberg Finance L.P.; Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: LA5 is purchasing-power-parity GDP-weighted average. Monetary policy rates are in deviation from trend. Inflation is in deviation from target. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Inflation Simulations
(Percent)



Sources: Haver Analytics; and IMF staff calculations. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Inflation and Output Gap
(Percentage points)

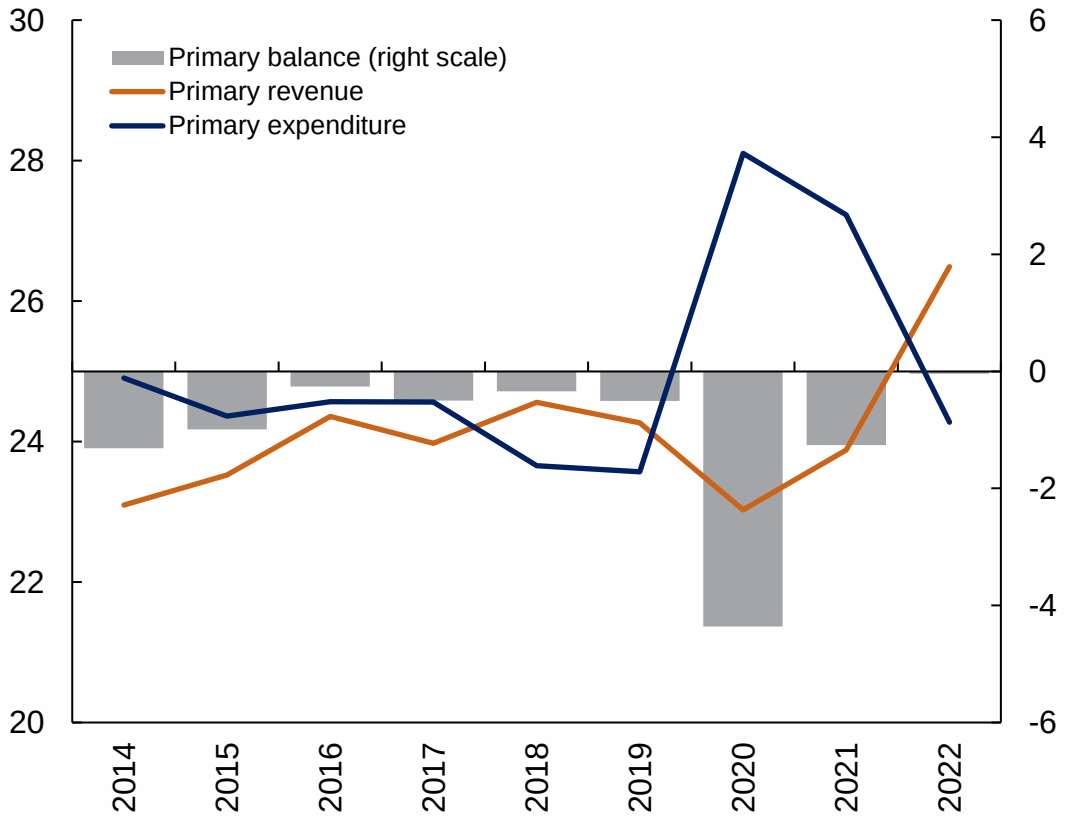


Source: IMF staff calculations. CF indicates the median projection from Consensus Economics. CF IQR indicates the interquartile range of different forecaster projections from the Consensus Economics sample.

Exemplary “in and out” fiscal policy during the pandemic

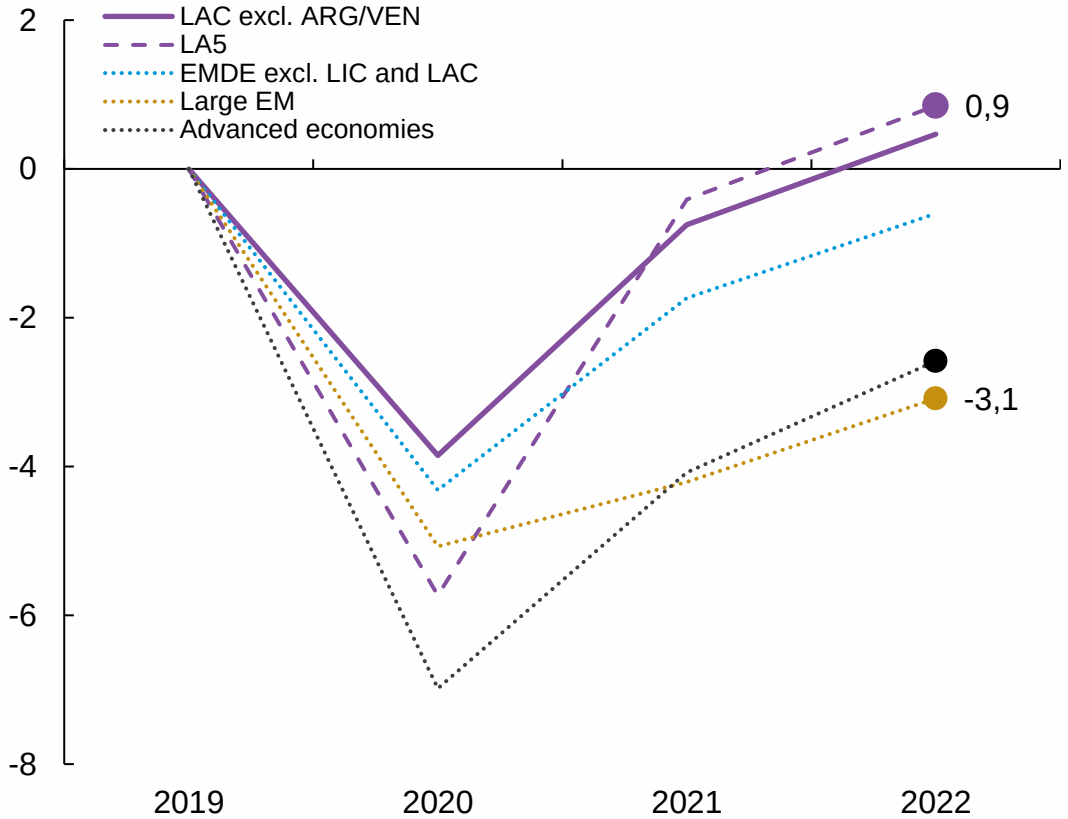
The response of fiscal policy during the pandemic has been remarkable, with COVID stimulus quickly unwound

LAC: Primary Balance, Revenue and Expenditure
(Percent of GDP, median)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are medians. LAC = Latin America and the Caribbean (excluding Argentina and Venezuela).

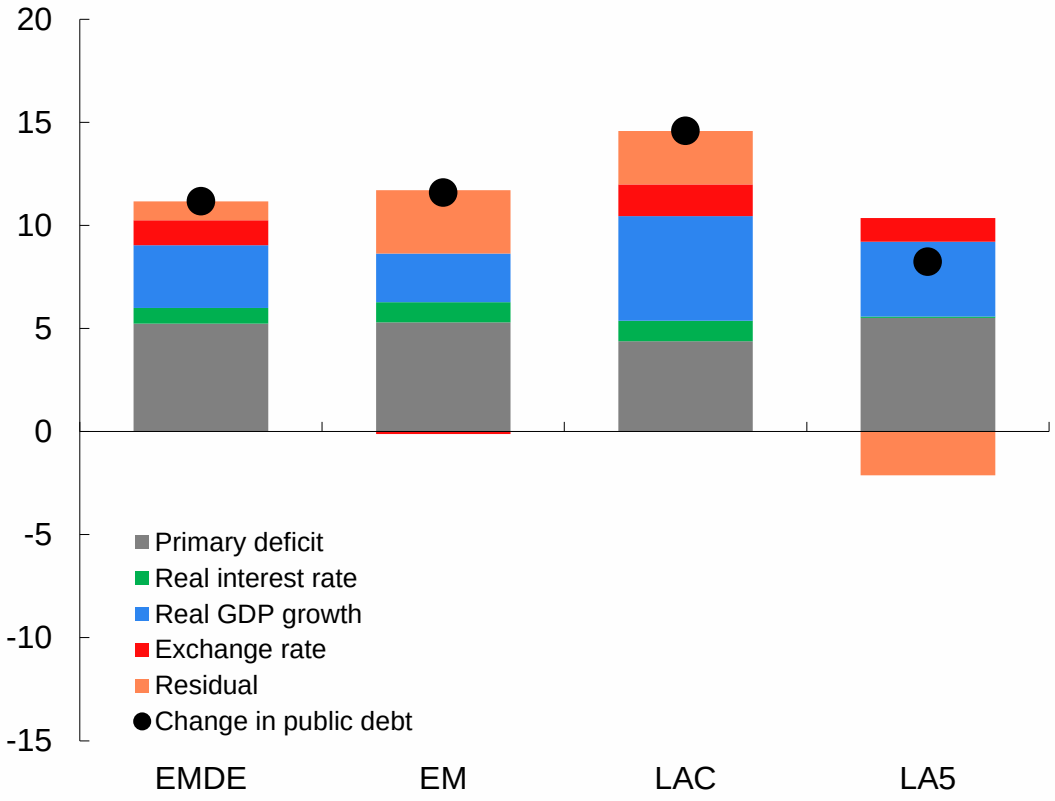
LAC and Other Economies: Primary Balance
(Cumulative median changes; percentage points of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are medians. EMDE = emerging market and developing economies; LAC = Latin America and the Caribbean; Large EM = emerging markets (CHN, HUN, IND, IDN, MYS, PHL, POL, ZAF, THA); LIC = low-income countries.

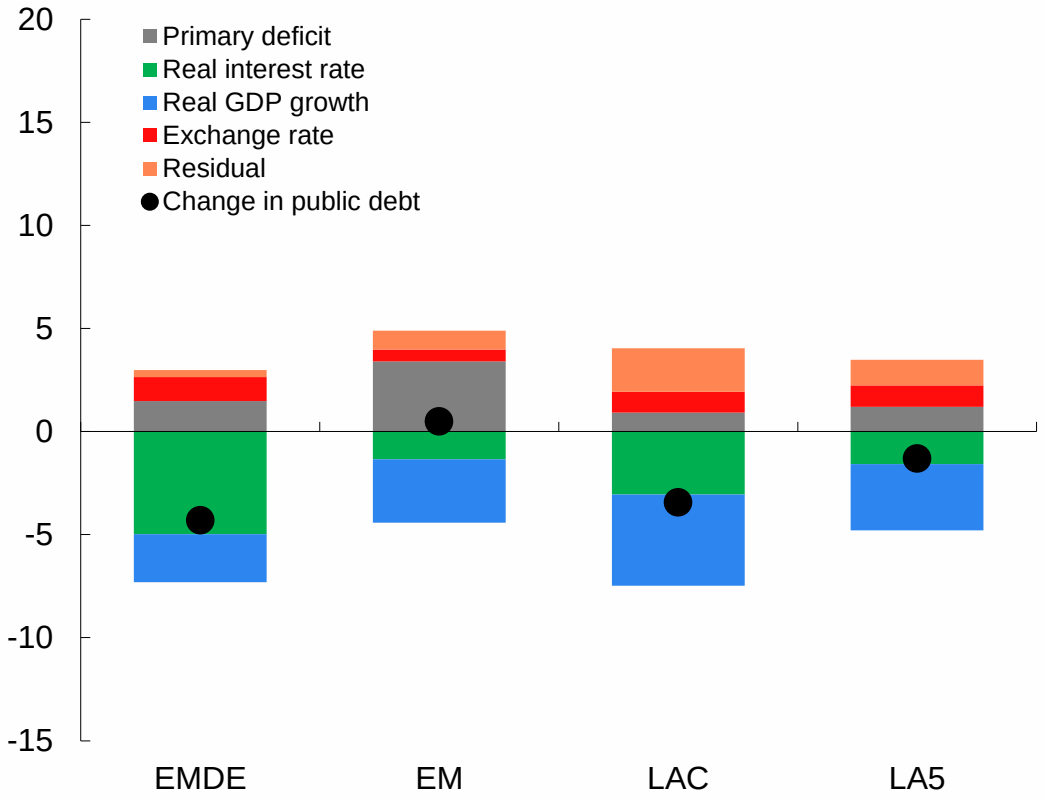
Prudent policies limited the worsening public debt ratios, helped by economic resilience and inflation…

Decomposition of Public Debt Changes, 2020
(percentage points of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are simple averages. EM = large emerging markets (CHN, HUN, IND, IDN, MYS, PHL, POL, ZAF, THA); EMDE = emerging market and developing economies (excl. LIC/LAC); LAC = Latin America and the Caribbean (excl. ARG/VEN); LA5 = BRA, CHL, COL, MEX, PER; LIC = low-income countries.

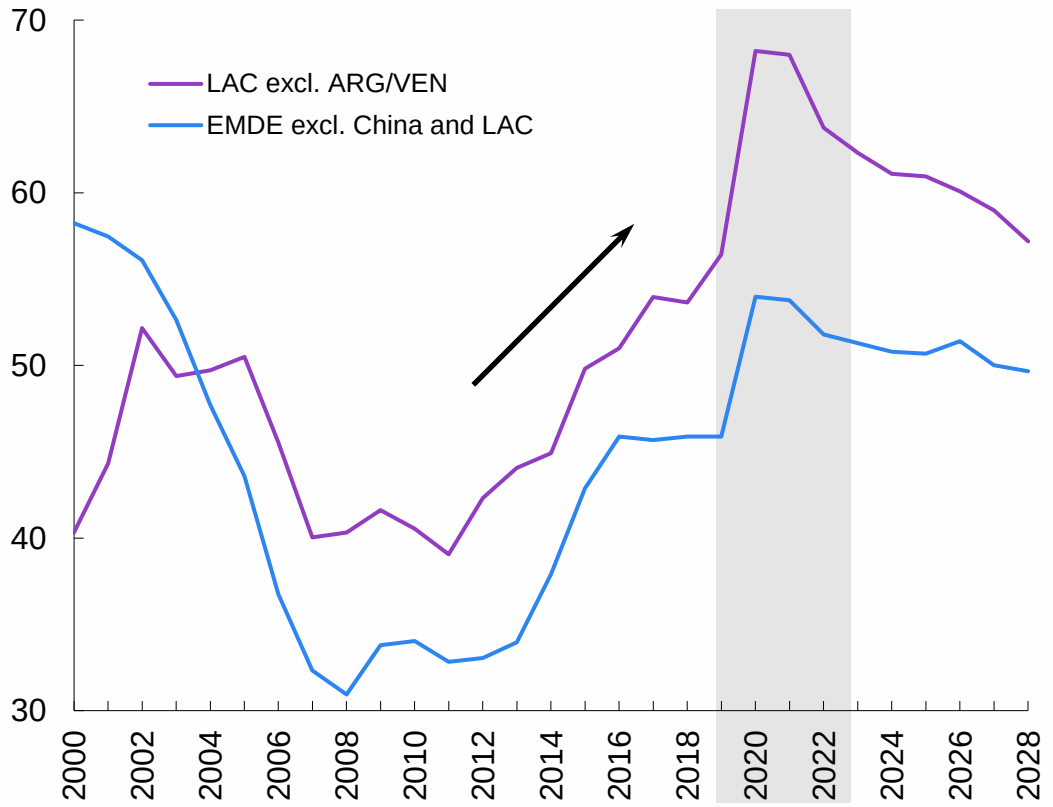
Decomposition of Public Debt Changes 2021–22
(percentage points of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Average for 2021-22 is reported. Aggregates are simple averages across countries. EM = large emerging markets (CHN, HUN, IND, IDN, MYS, PHL, POL, ZAF, THA); EMDE = emerging market and developing economies (excl. LIC/LAC); LAC = Latin America and the Caribbean (excl. ARG/VEN); LA5 = BRA, CHL, COL, MEX, PER; LIC = low-income countries.

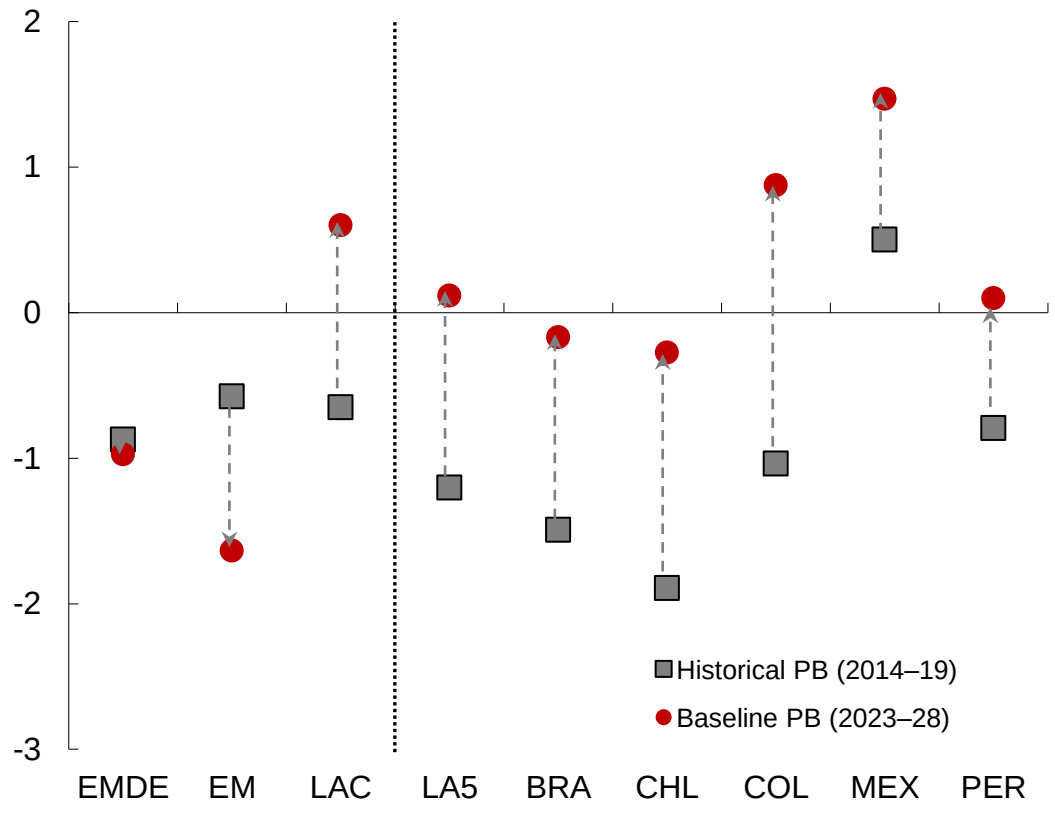
… but current (more ambitious) fiscal plans could prove insufficient in some countries

General Government Gross Debt
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are medians. EMDE = emerging market and developing economies; LAC = Latin America and the Caribbean; LIC = low-income countries.

General Government Primary Balance
(Percent of GDP)

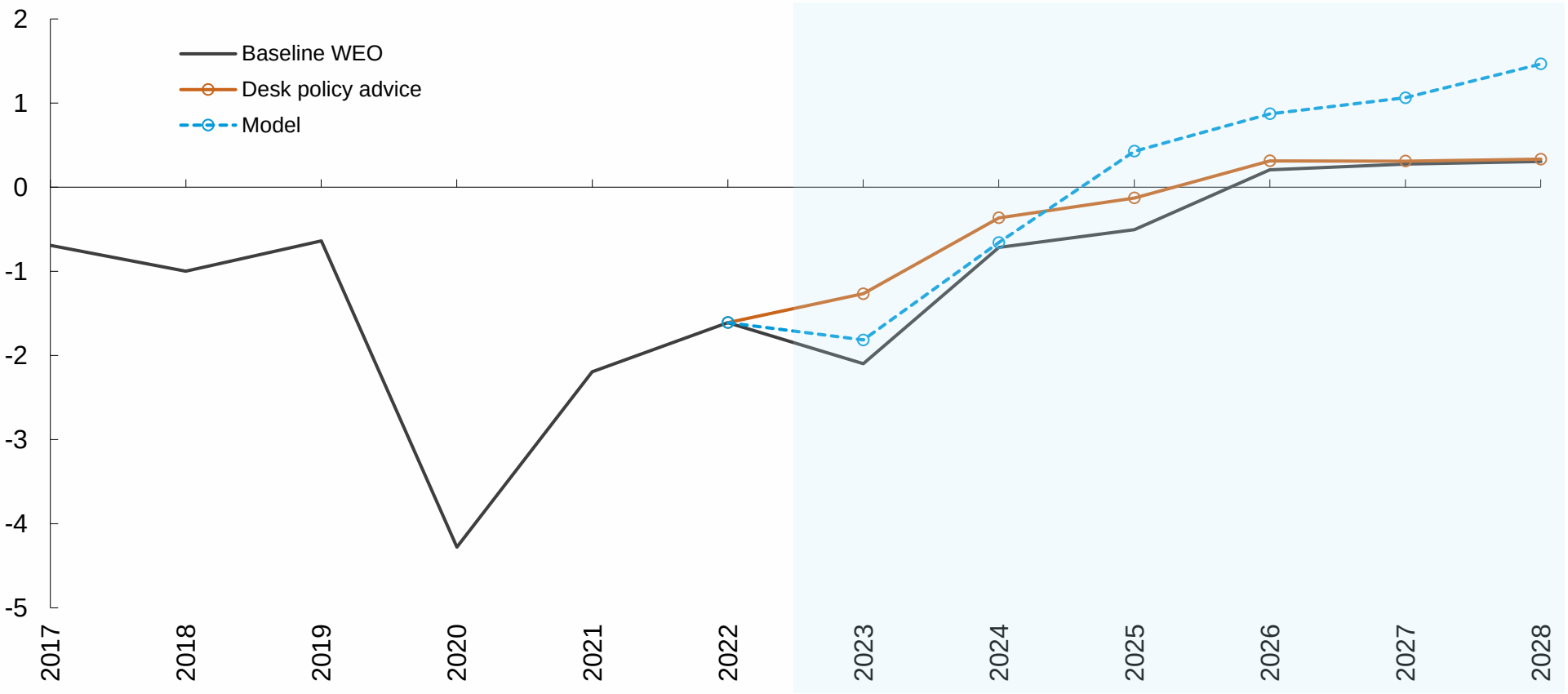


Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are medians. EM = large emerging markets (CHN, HUN, IND, IDN, MYS, PHL, POL, ZAF, THA); EMDE = emerging market and developing economies (excl. LIC/LAC); LAC = Latin America and the Caribbean (excl. ARG/VEN); LA5 = BRA, CHL, COL, MEX, PER; LIC = low-income countries.

What is the role of fiscal policy in the current juncture? Rules or discretion?

Greater efforts to rebuild policy space (frontload consolidation) are desirable while activity remains healthy

LA5: Structural Primary Balance
(Percent of potential GDP)



Sources: Fournier, J.M., 2019, "A Buffer-Stock Model for the Government: Balancing Stability and Sustainability ," IMF Working Paper No. 19/159; IMF, World Economic Outlook database; and IMF staff calculations.
Note: Aggregates are medians. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

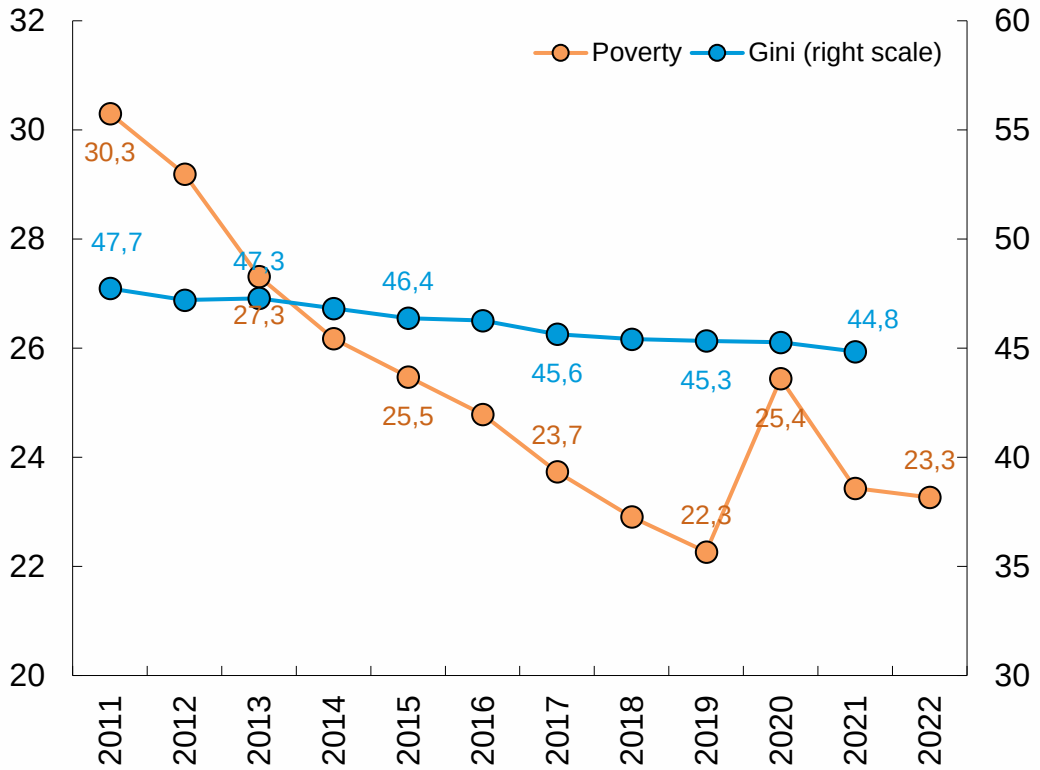
Well-designed fiscal rules have a key role in anchoring credibility and strengthening public finances

- **Fiscal rules have become useful devices**
  - Clear guiding post for budget discussions and DSA
  - Summary of government plans
- **Opportunity to improve their design**
  - Ensure fiscal discipline with flexibility to deal with large shocks (escape clauses + return)
  - Protection of quality of spending
- **Note fiscal-monetary policy interactions**
  - Active fiscal policy as a countercyclical tool (inc. to fight inflation)?
  - Predictability of fiscal policy helps the calibration of monetary policy

How to balance competing fiscal policy objectives?

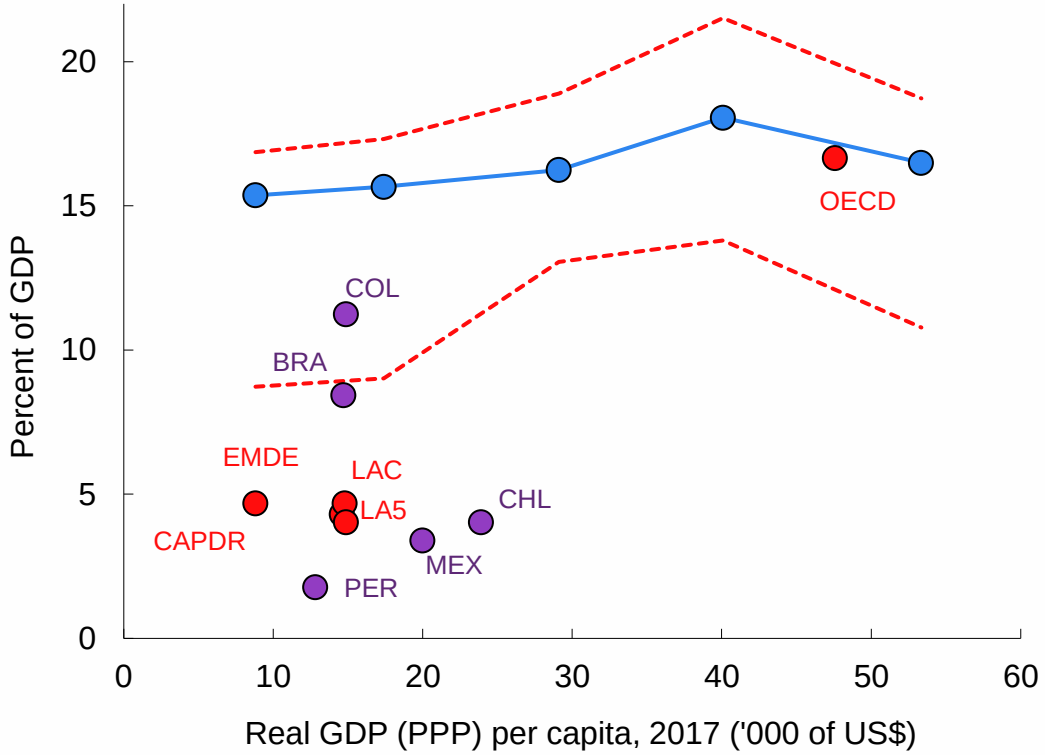
With sizable gaps in social spending…

LAC: Poverty Ratio and Gini Index
(Poverty: share of population; $6.85 threshold; Gini: index)



Sources: IMF, World Economic Outlook database; World Bank, Macro Poverty Outlook for Latin America and the Caribbean; World Bank, World Development Indicators database; and IMF staff calculations.
Note: Aggregates are simple averages. LAC = Latin America and the Caribbean (ARG, BOL, BRA, CHL, COL, CRI, DOM, ECU, SLV, HND, MEX, PAN, PRY, PER, URY).

Social Benefits and Income Level

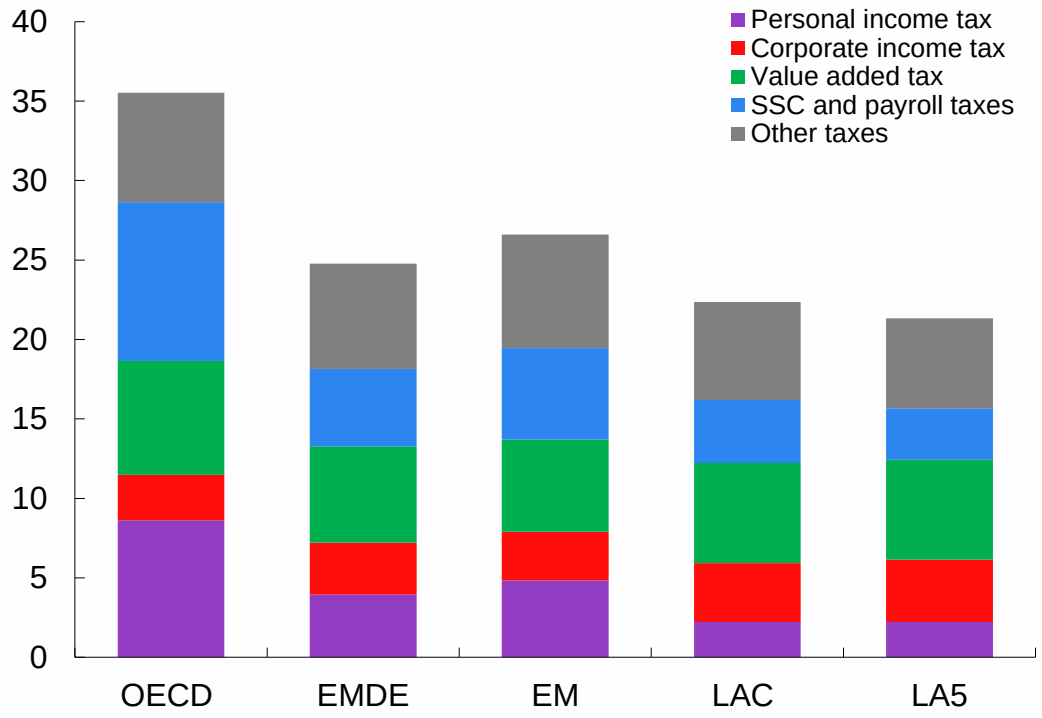


Sources: Methodology builds on Acosta-Ormaechea, Sola, and Yoo (2019); IMF, World Economic Outlook database; and IMF staff calculations.
Note: Blue round markers: Median values for each income quintile according to a sample of OECD countries (period 1971–2019), where the lowest income quintile is constructed by extrapolation of the relevant revenues variable from the OECD sample to be consistent with LAC countries' income levels; dotted lines: 75th and 25th percentiles of the OECD distribution; region (red) dots: Medians of average spending in 2017-2019; country (purple) markers: Averages of 2017-2019.

… mobilizing revenues will be key to achieve the dual objective of rebuilding policy space and increasing social spending

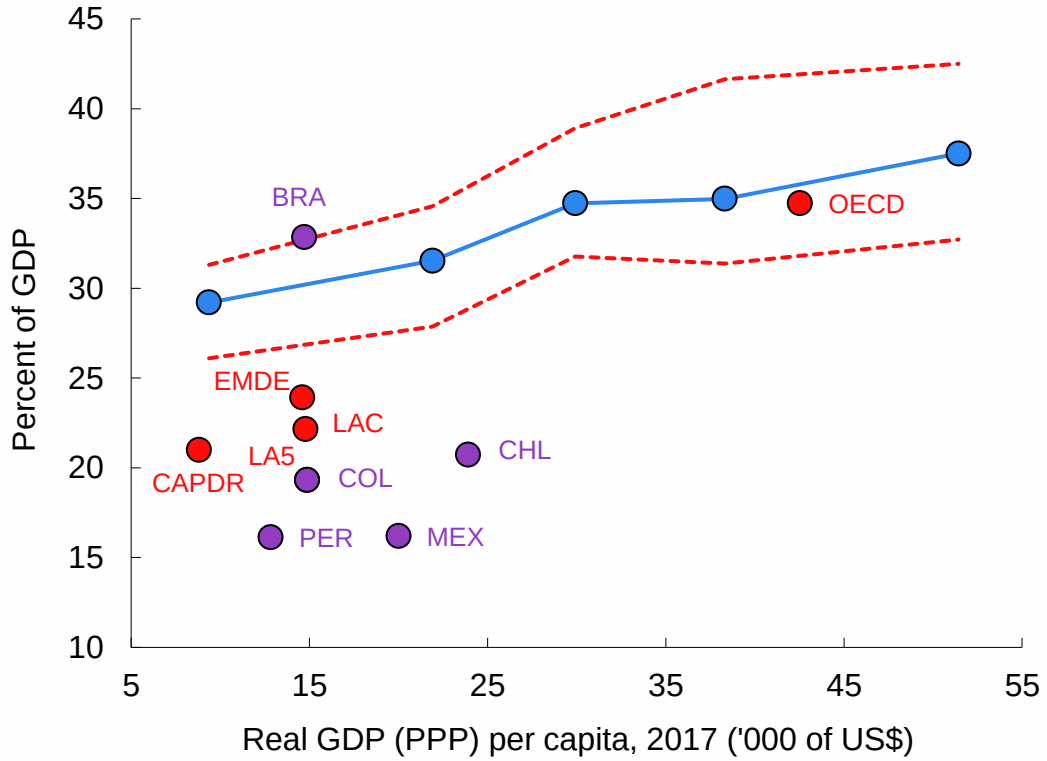
Tax Revenue Collection Composition, 2019

(Percent of GDP)



Sources: OECD Tax Revenue Statistics database; and IMF staff calculations.
Note: Aggregates are simple averages. Sample of 19 LAC, 32 OECD countries, 13 EMDE countries, 5 EM countries. OECD (members as of end-2019) average excludes Chile, Colombia, Costa Rica, and Mexico. LA5 = BRA, CHL, COL, MEX, PER; LAC = BLZ, BOL, BRA, BRB, CHL, COL, CRI, DOM, GTM, HND, JAM, MEX, NIC, PAN, PER, PRY, SLV, TTO, URY; EMDE = BGR, CPV, EGY, HUN, KAZ, MAR, MUS, PHL, POL, THA, TUN, TUR, ZAF ; EM= HUN, PHL, POL, THA, ZAF.

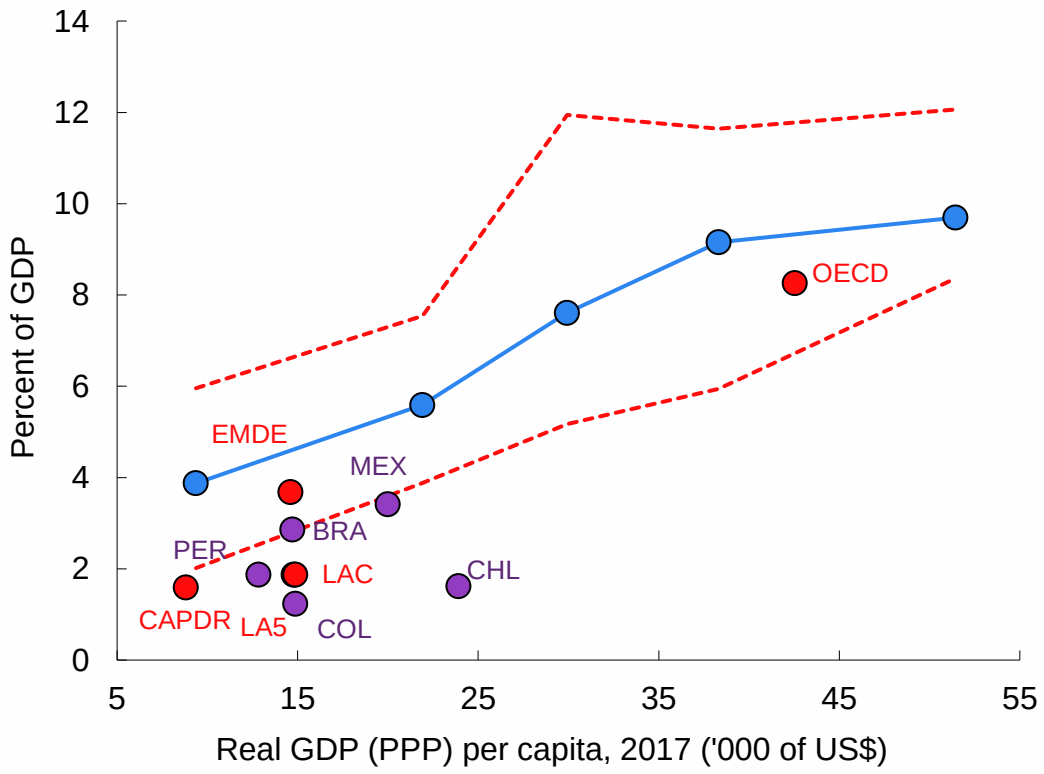
Tax Revenue Collection and Income Level



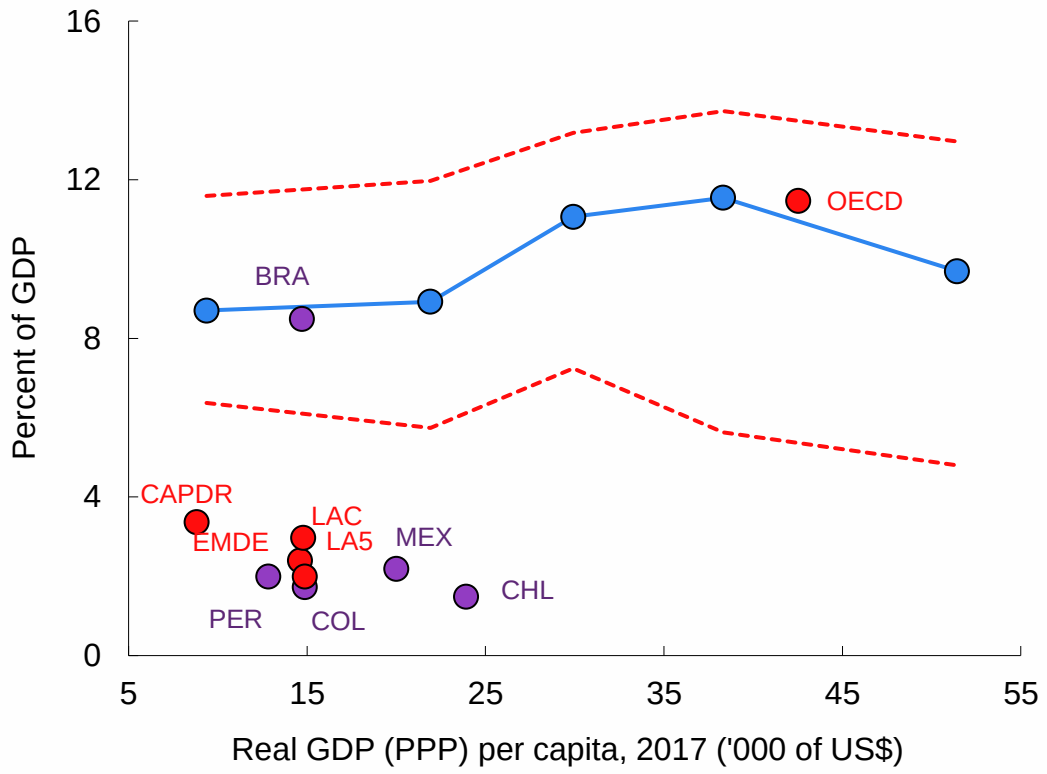
Sources: Methodology builds on Acosta-Ormaechea, Sola, and Yoo (2019); OECD Tax Revenue Statistics database; and IMF staff calculations.
Note: Blue round markers: Median values for each income quintile according to a sample of OECD countries (period 1971–2019), where the lowest income quintile is constructed by extrapolation of the relevant revenues variable from the OECD sample to be consistent with LAC countries' income levels; dotted lines: 75th and 25th percentiles of the OECD distribution; region (red) dots: Medians of average revenues in 2017-2019; country (purple) markers: Averages of 2017-2019.

Increase PIT collection (and SS Contribution through employment formalization) should be the focus of policy efforts

Personal Income Tax and Income Level
(Percent of GDP)



Social Security Contributions and Payroll Taxes
(Percent of GDP)



Sources: Methodology builds on Acosta-Ormaechea, Sola, and Yoo (2019); OECD Tax Revenue Statistics database; and IMF staff calculations.
Note: Blue round markers: Median values for each income quintile according to a sample of OECD countries (period 1971–2019), where the lowest income quintile is constructed by extrapolation of the relevant revenues variable from the OECD sample to be consistent with LAC countries' income levels; dotted lines: 75th and 25th percentiles of the OECD distribution; region (red) dots: Medians of average revenues in2017-2019; country (purple) markers: Averages of 2017-2019. OECD (members as of end-2019) average excludes Chile, Colombia, Costa Rica, and Mexico. LA5= BRA, CHL, COL, MEX, PER; LAC= BLZ, BOL, BRA, BRB, CHL, COL, CRI, DOM, GTM, HND, JAM, MEX, NIC, PAN, PER, PRY, SLV, TTO, URY; CAPDR = CRI DOM GTM HND NIC PAN SLV; EMDE = BGR, CPV, EGY, HUN, KAZ, MAR, MUS, PHL, POL, THA, TUN, TUR, ZAF.

Final remarks

- From “this time it was not us” to a (so far) close to state-of-the-art macroeconomic policy reaction to COVID and high inflation
- Tested with very large shocks, macroeconomic policy frameworks (CB independence + IT + quasi-float + Fiscal Rules with scape clauses) worked well.
- Average LA5 masks rich heterogeneity. Worth look at it.
- Fiscal policy needs to rebuild space and fine tune rules (and comply with).

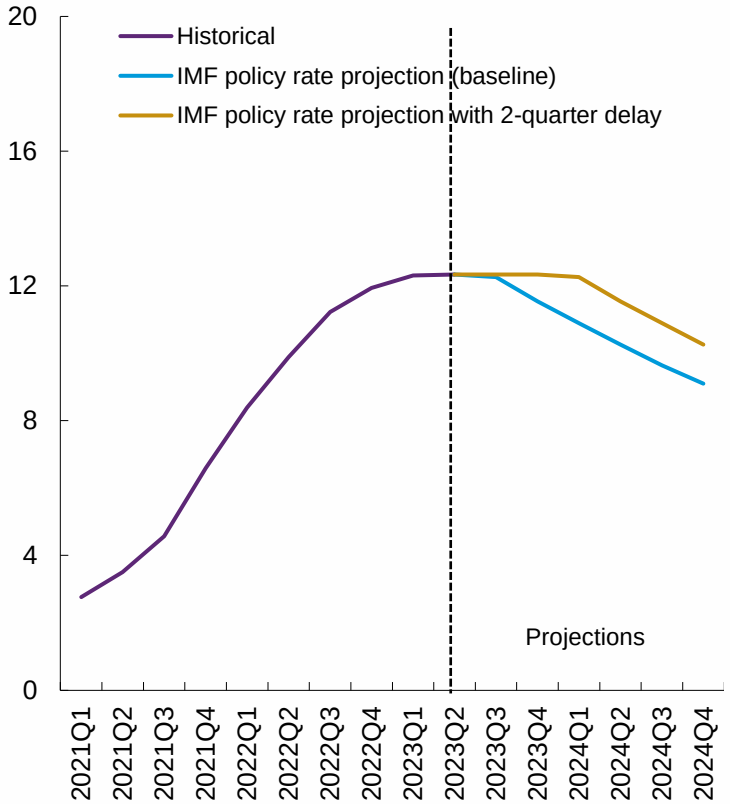
Thank You

LAC Groups

- LAC = Latin America and the Caribbean
- LA5 = Brazil, Chile, Colombia, Mexico, Peru
- Other South America = Bolivia, Ecuador, Paraguay, Uruguay
- CAPDR = Central America, Panama, and the Dominican Republic (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama)
- Caribbean = rest of LAC
- LAC Commodity exporters = Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Guyana, Honduras, Nicaragua, Paraguay, Peru, Trinidad and Tobago, Uruguay

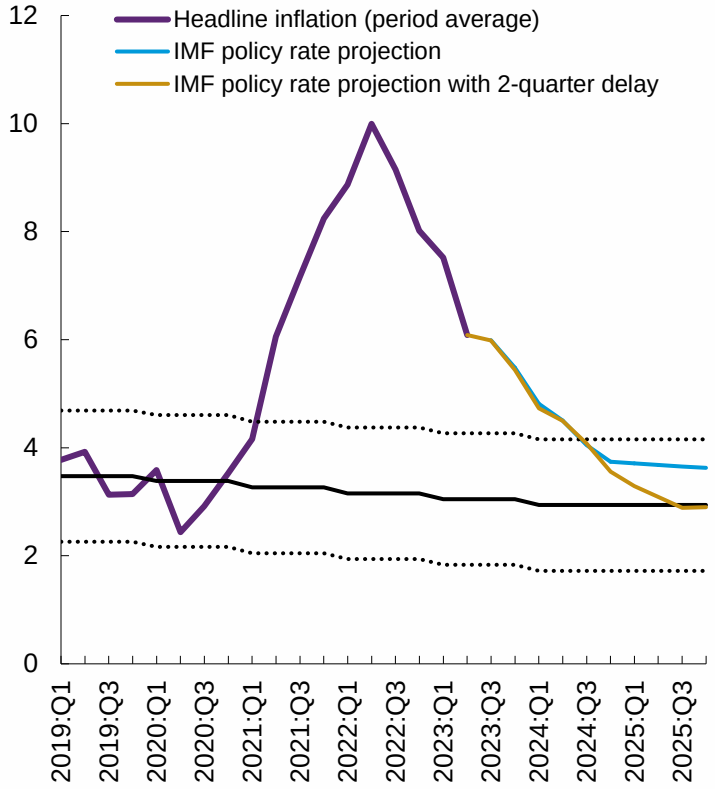
Mind country heterogeneity: early hikers already easing

LA5: Policy Rate
(Nominal; percent; PPP-weighted average)



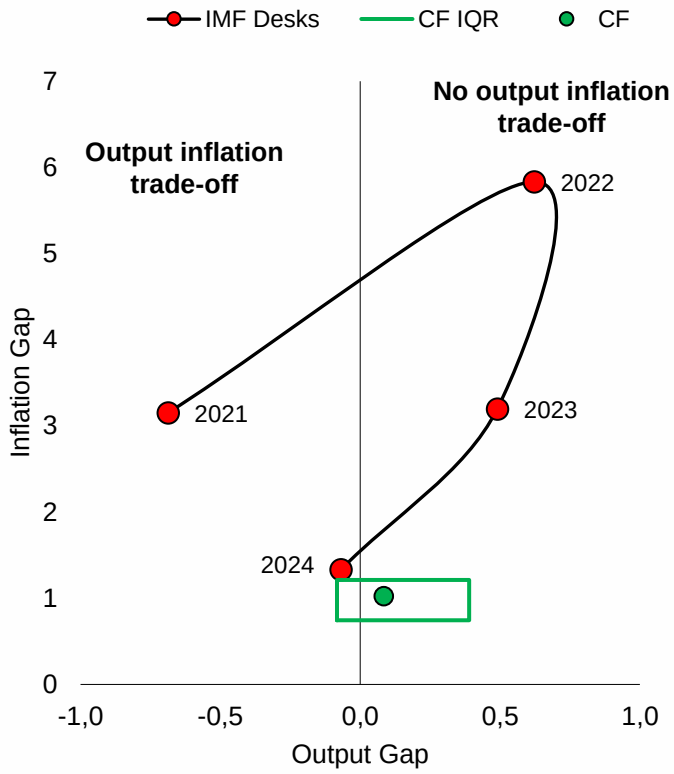
Sources: Bloomberg Finance L.P. (for forecasts); Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: LA5 is purchasing-power-parity GDP-weighted average. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Inflation Simulations
(Percent)



Sources: Haver Analytics; and IMF staff calculations. LA5 = Brazil, Chile, Colombia, Mexico, Peru.

LA5: Inflation and Output Gap
(Percentage points)



Source: IMF staff calculations. CF indicates the median projection from Consensus Economics. CF IQR indicates the interquartile range of different forecaster projections from the Consensus Economics sample.