On the transmission of external shocks to Latin America
or
Has Latin America Truly changed?

By

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For many years Latin America was one of the most unstable regions in the world. Inflation was high, currency crises were frequent, and financial markets were extremely volatile. Moreover, most Latin American countries were prone to suffering contagion: instability in the rest of the world was rapidly transmitted into the region.

In recent years, however, things have changed. Indeed, most of the countries in Latin America have been able to whether the global financial crisis. For the first time in decades the word “crisis” is not automatically associated with the region. In some quarters it has even become fashionable to say: “This time Latin America is not part of the problem; it is part of the solution.”

From an econometric point of view, the idea that (most) Latin American countries have not been seriously affected by the crisis can be represented as structural breaks in a series of equations that capture the behavior of key macroeconomic variables. The purpose of this paper is to analyze the nature of these structural breaks. In particular, we use weekly and monthly data to investigate the following issues for a group of 10 to 12 Latin American nations: (1) To what extent has macroeconomic instability declined during the last 10 years. (2) Is this change generalized, or is it confined to a (small) group of countries. (3) Has the transmission mechanism of external shocks – both real and financial -- into Latin America experienced structural breaks? (4) When are these brakes dated? (5) Are the dates of structural breaks similar across countries? (6) Is it possible to associate those structural breaks with policy changes, such as the accumulation of reserves passed a certain threshold, the adoption of inflation targeting, the adoption of flexible exchange rates, and so on.

The analysis focuses on the following macroeconomic variables in Latin America: (a) domestic interest rates; (b) the (short end) of the yield curve; (c) sovereign debt spreads; and (d) exchange rates. The following external shocks are considered: (i) changes in the Fed’s policy rate (Fed Funds’ rate); (ii) changes in the Ted Spread in the US; (iii) changes in the USD/Euro rate; (iv) changes in the steepness of the US yield curve; (v) country risk spreads in other countries and regions; (vi) changes in several commodity prices indexes. We will use (relatively) new econometric techniques – Smooth Transition Autoregressions, and Threshold VARs, among others – to investigate these issues.

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