

An Unintended Consequence of Uncoordinated International Monetary Policy on Central America

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Purpose:

To examine whether the foreign bond market became an important source of funding for countries in Central America (during the second phase of global liquidity that took place with the rounds of QE policies)

To consider the implications (e.g., **financial fragility**)

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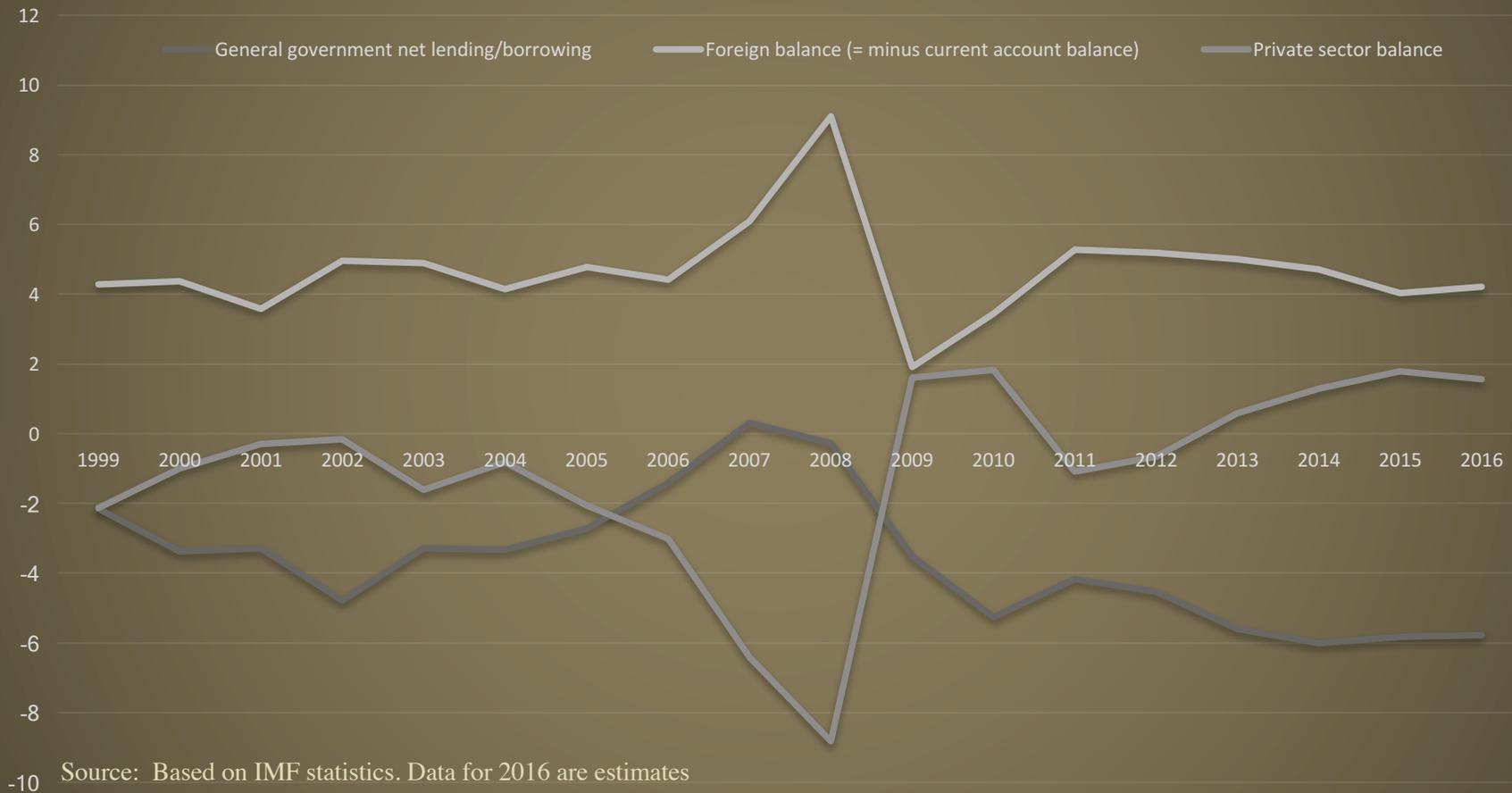
1. What I've done so far (analysis of sectoral financial balances; dependence on bank lending and evolution of external debt; analysis of evolution of IDS outstanding –also by residence and nationality)
2. The results that I've gotten so far (two types of different consequences in CA with respect to bigger emerging economies)

Sectoral Balances (Godley 1999)

$$(S - I) + (T - G) + (M - X) = 0$$

The sectoral financial balances summed over all sectors must equal zero. With a surplus in the foreign sector ($M - X > 0$), there is a deficit either in the public sector ($T - G < 0$) or in the private ($S - I < 0$) or in both

Costa Rica Sectoral Balances as percentage of GDP, (1999-2016)



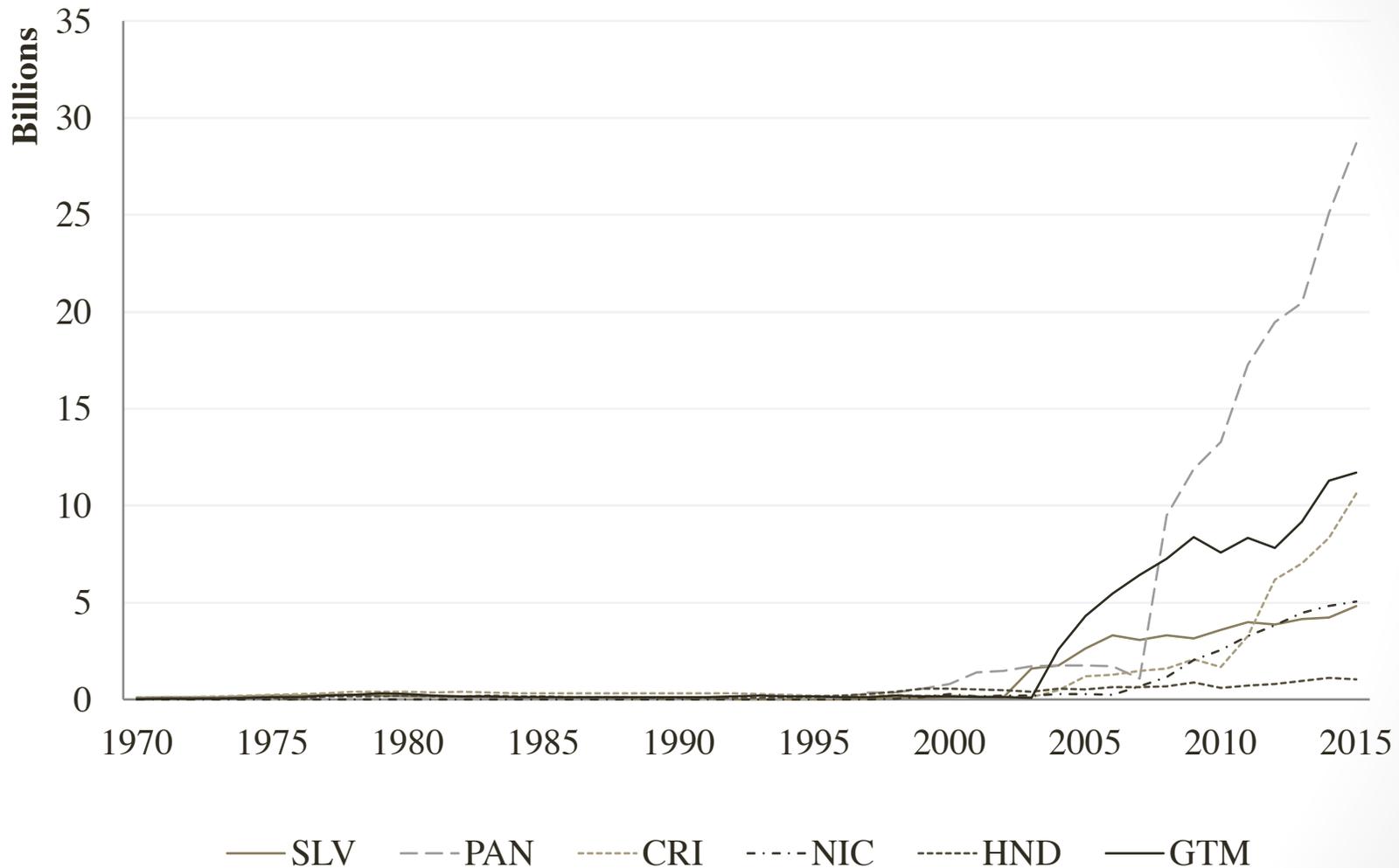
Overall, the data shows that, in all Central American countries, the external sector financed the deficit of the public and/or private sector during almost the whole period considered

- All countries in Central America are dependent on capital inflows and have been **structurally in a position of borrowing from abroad** (even before the onset of QE policies)
- They are prone to use new sources of funding

- Resources from the banking system have been an essential source of funding for countries in Central America. The share of domestic credit provided by the financial sector with respect to GDP has continued increasing (but still low)

- High and increasing external debt

External Debt Stocks, private non-guaranteed (DOD, current US\$)



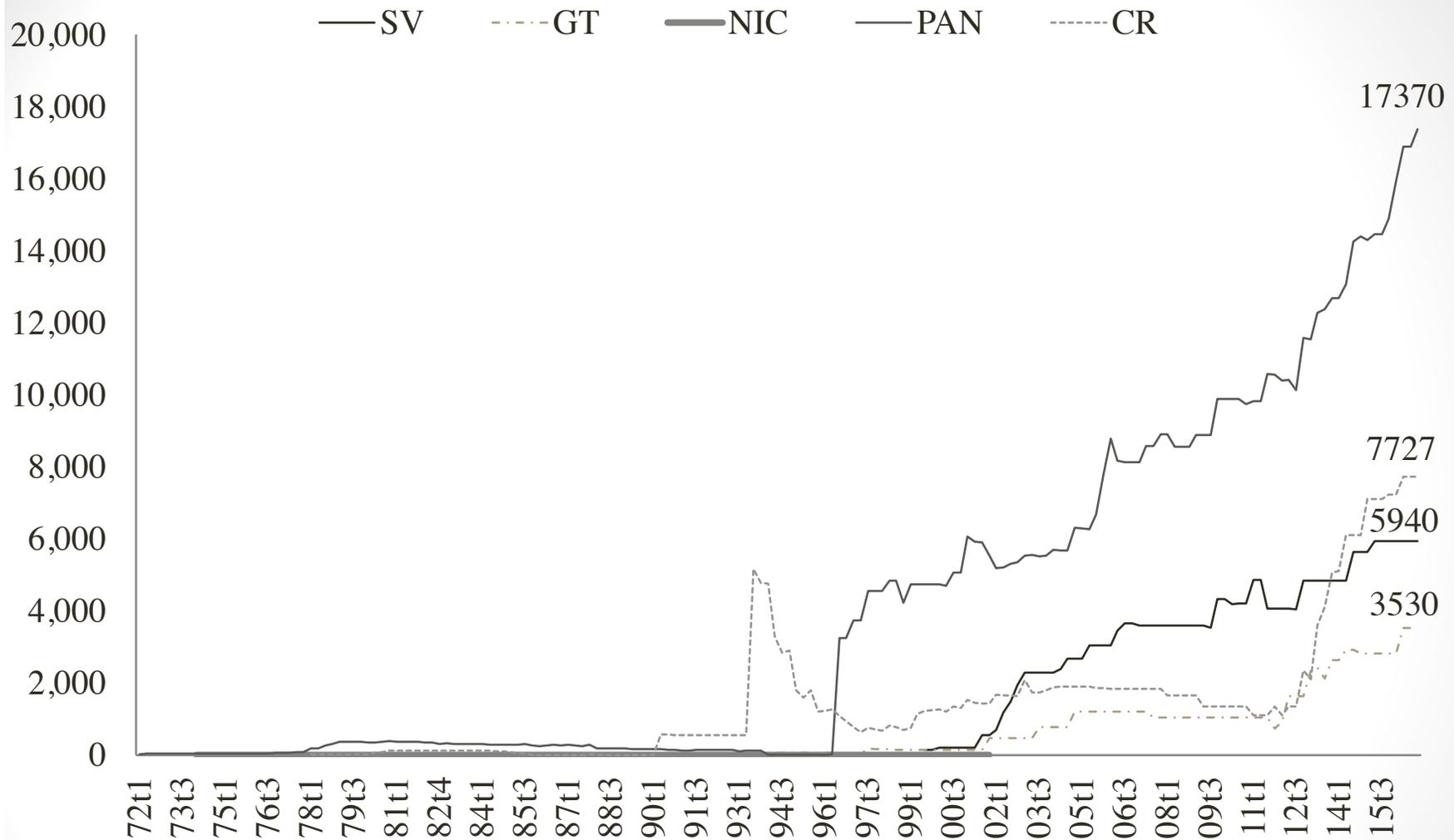
Sources: World Development Indicators

International Debt Securities evolution

Findings:

1. By indirectly providing a new, low cost, source of funding in the foreign bond market, QE impacted the financial structure of countries in Central America by facilitating the increase in the use of international debt securities (all sectors and mainly general government)

Total IDS Outstanding 1972Q1-2016Q4 (mill US\$)



Source: Bank of International Settlements

International Debt Securities evolution

2. In contrast to big emerging economies, the role of non-financial corporations' bond issuance is not relevant for countries in Central America

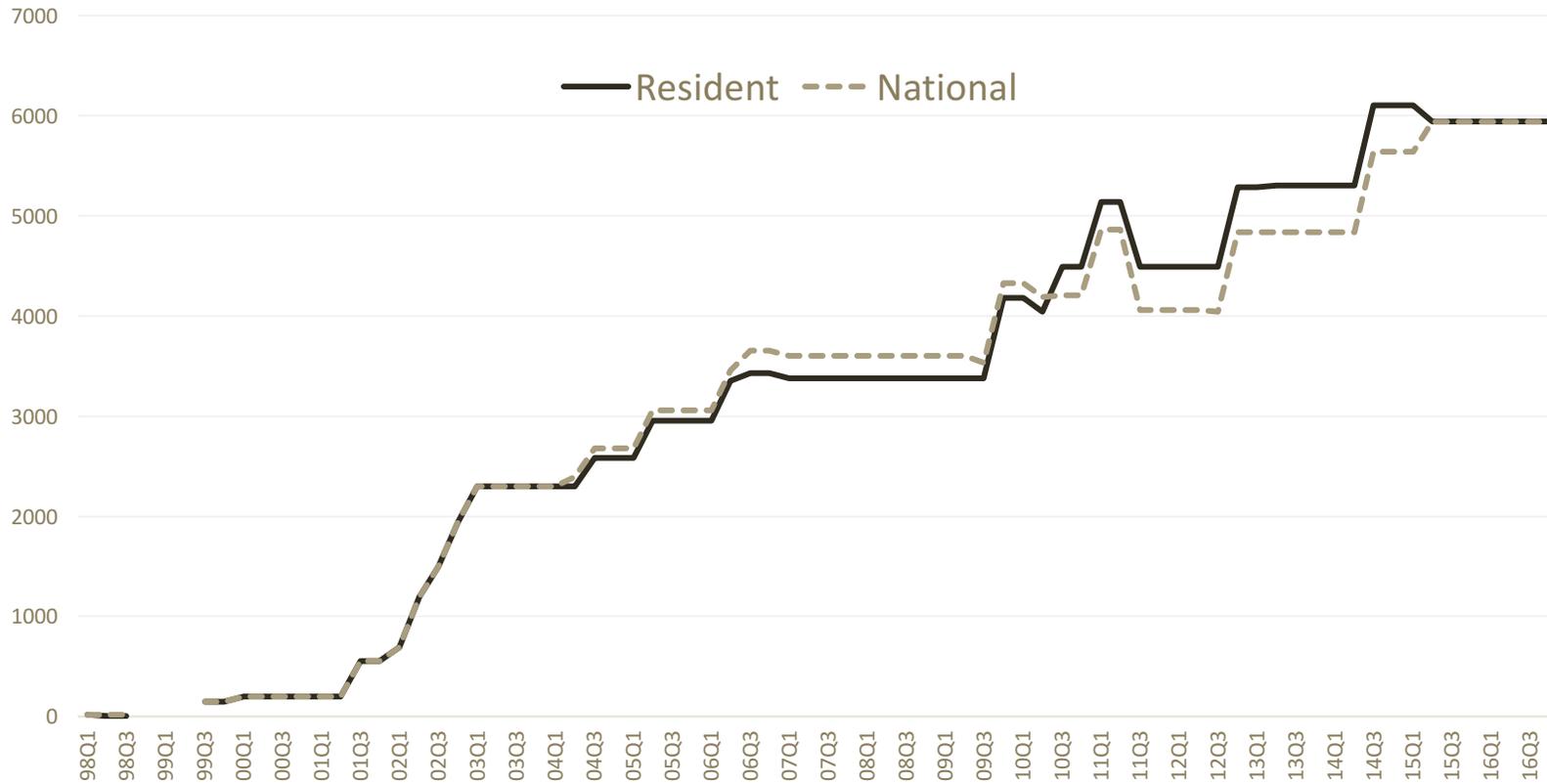
General government

IDS by residence and nationality (implications)

- Another general pattern identified for big emerging economies around the world-- that the debt issued by nationality was higher than by residence during the second phase of global liquidity -- is not representative of countries in Central America

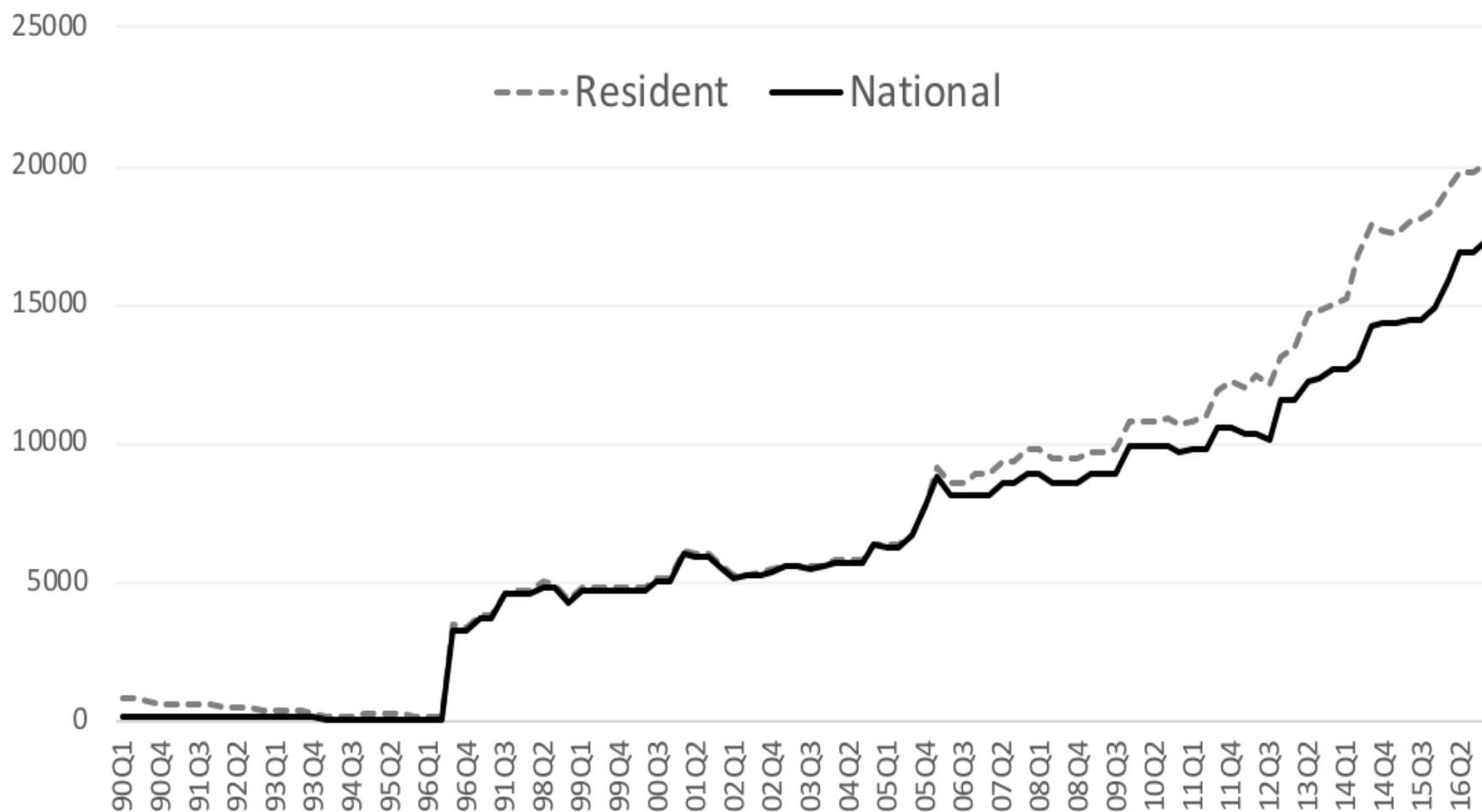
IDS by residence and nationality (implications)

El Salvador's IDS Outstanding (all borrowers) by Resident and Nationality of Issuer (USD mn)



Source: BIS Statistics

Panama's IDS Outstanding (all borrowers) by Resident and Nationality of Issuer (USD mn)



Source: BIS Statistics

Based on the sectoral financial balances analysis, the examination of the historic dependence of bank lending and of the evolution of foreign debt, including IDS, I arrive to the conclusion that the unintended outcomes of uncoordinated QE (e.g., a new source of funding) contributes to the financial vulnerability of these countries in a different way than the big EE):

Financial corporations are not the most active issuers of debt, but the general government;

The debt by residence is bigger than that by nationality (or they overlap);

Consequences for general government are critical given the other characteristics of the countries in CA

These countries have public finance issues of different types; they are highly vulnerable to international macroeconomic shocks and natural disasters that also impact their public finance; they have shown difficulties to face the repayment of their financial obligations in recent years

Thank you!

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