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The IMPACTS of the GLOBAL FINANCIAL CRISIS on LATIN AMERICAN COUNTRIES

Selçuk BALI,* Mete GÜLER **
* Giresun Üniversitesi, **University of Illinois at Urbana-Champaign
E-mail: selcuk.bali@giresun.edu.tr, mete.guler@hotmail.com

ABSTRACT
The global financial crisis is the most important capitalist crisis since World War II. However, the impacts of the global crisis on Latin America have in some respects been less severe than in previous crises. Because Latin American countries have experienced several important crises in the past, the crisis did not have severe impacts on Latin American region/economies. The aim of this article is to analyze the impacts of the global crisis on Latin America. Since the effects of the crisis on Latin American countries are generally heterogeneous, we will only mention the countries have different cases rather than all of them. We will also argue how Latin American countries are affected less severe from the crisis. We conclude that good and powerful macroeconomic frameworks and strong fiscal and monetary policies applied since 1990s played an important role to decline the impact of the crisis on Latin American countries.

Keywords: Global financial crisis, Latin American economies, Economic growth, International trade

JEL-Clasification: E44, G 01

KÜRESEL FİNANSAL KRİZİN LATİN AMERİKA ÜLKELERİNE ETKİLERİ[1]

ÖZET
Küresel finansal kriz kapitalizmin İkinci Dünya Savaşı'ndan bu yana yaşadığı en önemli krizdir. Ancak, küresel krizin etkileri daha önce Latin Amerika ülkelerinde yaşanmış olan krizlerden çeşitli açılardan daha az şiddetli ortaya çıkmıştır. Geçmişte Latin Amerika ülkelerinde önemli birçok finansal kriz yaşanmış olması nedeniyle bu krizin krizin Latin Amerika bölgesine/ekonomilerine ciddi etkileri olmamıştır. Bu çalışmanın amacı küresel krizin Latin Amerika'ya etkilerini analiz edebilmektir. Krizin etkilerinin Latin Amerika ülkelerinde genel olarak heterojen olması nedeniyle ülkeler farklı durumlardan ziyada bir bütün olarak ele alınacaktır. Aynı zamanda Latin Amerika ülkelerinin krizden daha az şiddetli bir şekilde nasıl etkilendiği irdelenecektir. Sonuç olarak iyi ve güçlü makroekonomik çerçeve ve 1990'lardan itibaren uygulanan güçlü maliye ve para politikaları Latin Amerika ülkelerinin krizden daha az etkilenmelerinde önemli bir rol oynamıştır

[1] The views expressed in this paper are those of the author and do not represent the official views of the Republic of Turkey Prime Ministry Undersecretariat of Treasury

Anahtar Kelimeler: Küresel Finansal Kriz, Latin Amerika ekonomileri, Ekonomik büyüme, Uluslararası ticaret

1. INTRODUCTION

Latin American economies felt deeply several economic crises in the past. But, although the global financial crisis of 2008-2009, as named of mortgage crisis, was also the worst economic crisis since Great Depression, Latin American economies have been surprisingly resilient from the crisis. Gregorio (2014) points out that Latin American Economies showed a strong performance unexpectedly comparing with other emerging market economies around the world. In this perspective, the damage of global financial crisis affected limited to Latin American countries since they performed better than other crises such as Latin American debt crisis of 1980s and the 1997-98 Asian financial crisis.

In this paper, we will analyze the effects of the global financial crisis and factors underlying Latin America's effective economic performance during the crisis. We will evaluate the impacts of the crisis as overall conditions about Latin America countries methodologically and, we will argues why Latin American Countries resilient from the global financial crisis.

2. the GLOBAL FINANCIAL CRISIS

The global economy is widely acknowledged to be going through the worst financial crisis since the Great Depression of the 1930s (Ocampo, 2009). The history of the global financial crisis erupted in 2008 already separates two stages. The first stage should between August 2007 and September 2008. The first stage corresponds when the subprime mortgage crisis broke out, with its gradual but inevitable collapse of the bond and mortgage-based derivatives market. Because the whole financial system was established on a foundation of indebtedness, credits started to decrease at this stage. The impact on stock markets was limited in the central countries, but they maintained to increase in many emerging countries. The stock market fall began in July and August 2008 when turbulence on the bonds market stepped. During that stage, the effects of this decreasing was also limited on the real economy. The second stage has lasted roughly from September 2008 until today and is characterized by a sharp contraction of credit in all markets. It caused banking crisis, deepening deflationary trends in central economies and dropping stock markets, and therefore; began a generalized recession and deflationary trends around the world (Guillen, 2011).

The main crisis erupted by the subprime mortgage securitization crisis in the United States at September, 2008 with the bankruptcy of Lehman Brothers, one of the big five investment banks in United States. A number of important events were encountered at the beginning of the crisis such as rescue of Merrill Lynch, bailing out of Bear Stearns which began the process of merging with J.P. Morgan Chase, also rescue of American Insurance Group (AIG), the country's leading insurance firm, and the sale of Washington Mutual Bank which is a leading savings and loan bank and Wachovia which is one of the largest commercial banks. At the same time, the financial system in US was on the edge of total breakdown, which is called as credit crunch. This situation caused paralyzing for interbank transactions. On the other hand, a number of bankruptcies occurred in European banks and some of active banks in British in advance due to the global crisis (Ocampo, 2009).

Economic activity was made impossible in practically the entire world with unprecedented synchronicity. According to the Bureau of Economic Analysis (BEA), the U.S. recession lasted from December 2007 to the third quarter of 2009, namely 17 months and this was the longest depression period since World War II.

Private consumption and investments rate in all fields significantly declined. And then, the crisis were not confined with US and started to influence all over the world later. Guillen (2011) argues this point that some economies like China or India might be able to counteract the severity of the crisis and keep their growing but most of countries have gone into recession. The recession was generalized and deep and it eventually involved the European Union and a lot of countries on the periphery as well as the United States.

The impact on global economic activity was severe. Global gross domestic product (GDP) declined 2.2% in 2009. Economic activity in developed countries including the US decreased 3.5%, while growth in developing countries slowed from 5.8% to 1.9% based on the last year. Total output in the developing world contracted 1.6% other than China and India. The global crisis hit harder to the majority of European Union and Central Asian countries with GDP declining 6.5%. As will mention below, the Latin America and the Caribbean (LAC) region was the second-worst affected from the crisis with output declining 1.9%. By contrast, no countries in the Middle East and North Africa (MNA) or South Asia (SAR) regions recorded negative growth in 2009 excluding one of the Sub-Saharan Africa (Grosh, Bussolo & Freije, 2014).

Global trade was affected even more severely. Particularly, this crisis was distinctive in terms of the collapse in world trade (10.5%) comparing with previous global recessions. Because, global trade expanded by 1.2% during the 1982 recession, also it grew in the 1998 and 2001 crises by 5.4% and 0.6%, respectively. The results show that they reflect the importance of global supply chains (Freund, 2009).

3. the IMPACT of the FINANCIAL CRISIS on LATIN AMERICA

Despite the positive period of growth between 2002 and 2008, the Latin American countries nevertheless felt the global financial crisis that erupted in the fall of 2008 with the collapse of Lehman Brothers. While a credit squeeze quickly spread to European and Asian markets, it was less evident in Latin America because the financial sector of Latin American countries was less developed. Particularly, Latin American countries was affected by external factors such as international trade, capital inflows remittances because the crisis was not originate from the region.

In this part, we will examine the effects of the global financial crisis on Latin America in terms of based on economic growth, international trade, foreign direct investment, remittances, and private consumption.

3.1. Economic Growth

Latin American countries succeeded effective growing rates from 2003 to 2008. According to ECLAC (2008), regional GDP grew an annual average of 5% between 2003 and 2008. Especially, Argentina and Venezuela also managed better with growth rates of more than 8% for several consecutive years. Guillen (2011) states that Latin America's good economic performance in this period was related a substantial improvement in the terms of exchange, growing exports, and high prices for primary products.

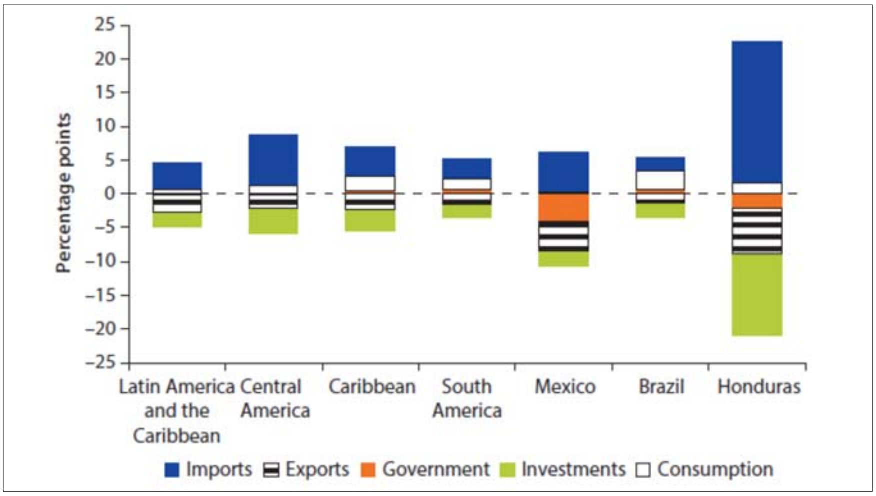
After the global financial crisis broke out, Latin America was certainly not the most affected ones from the global crisis comparing with other regions. Even though Latin America economies were affected from the global financial crisis, the damage was limited at the beginning of that and the vast majority of them have been resilient over time. Blanco (2010) points out that Western Europe's GDP contracted by 4.1%, Eastern Europe's by 5.4%, and Japan's by 5.7%, whereas the Latin American region and the US contracted around 3% during the crisis, several countries did not experience contractions (Bolivia, Panama, Peru, and Uruguay), some of them experienced little contractions (Brazil, Colombia, and the Dominican and others saw large contractions (Mexico). Mexico, with its strong economic ties to the U.S., was hit the hardest as real GDP growth dropped from 1.5% in 2008 to -6.5% in 2009, followed by Paraguay, El Salvador and Venezuela with growth rates between -5% and -3% at the same year. Conversely, Bolivia and Guyana reached the real GDP growth of almost 3.5% in 2009 (Leitner & Stehrer 2013).

During the 2008-2009 crisis, Latin American Countries felt the recession, especially 2009, but its severity was low and duration of it was short-lived in most countries. Economic activity in the Latin American region contracted 1.9% in 2009, compared with average annual growth of 4.5% over the 2003-2008 period (Grosh, Bussolo & Freije, 2014). Due to the measurements of the monetary and fiscal policies implemented to prevent negative effects of the crises encountered in the past, Latin American countries were less sensitive to external vulnerabilities. Therefore, the contraction in output remained limited at that period. As De la Torre (2010) states, the countries which are more open economies, a higher degree of financial openness, stronger commercial and financial connection to developing countries and a higher proportion of manufacturing exports to total exports were affected much more than others. Considering the decline of GDP growth shows differences based on the region, the most collapse in growth occurred in Central America by 6.8%, followed by South America by 5.6% and the Caribbean by 1.8%. In most countries, most of the slowdown in growth can be attributed to the crisis (Figure 1).

There was a reduction in a significant level in world trade during the crisis. This caused to decrease exports with high-income level countries, and therefore; it influenced Latin American Countries negatively, especially more open economies such as Brazil, Argentina. Blanco (2011) claims that reduction in world trade took effect the first quarter of 2009 but in the second quarter of 2009 began to stabilize. In other words, exports level increased from the second quarter of 2009 in the region.

Reduction in demand of United States is important factor for Latin American Countries because they export the most of their products to the US. The export of manufactured goods, raw materials, and to a lesser extent, commodities all experienced significant short term reductions (Ocampo, 2009). To illustrate, the import volume of the US fell by 28% from 2008 to 2009. However, Brazil started to increase its export level over time. Chile and Mexico also demonstrated the same picture. Indeed, it can be seen for majority of other Latin American countries in the region such rapid decline and the following stabilization period (Blanco, 2010).

Figure 1. Components of Effects on Growth: Latin America, 2009



Source: World Bank

3.2. International Trade

The growth rate of trade volume was also affected negatively after the global financial crisis. Commodity prices boomed in the second half of 2007 and the first half of 2008, and the boom was much stronger for mining products, including energy commodities, than for agricultural products. Gregorio (2014) claims that high commodity prices are due to good economic performance in emerging markets, especially the striking growth in China. Just after the prices peaked, they started to retreat around mid-2008 and the prices of commodities, especially energy and mining commodities, declined significantly since global financial crisis broke out. Blanco (2010) states that Latin American countries show trade falling 31% from the first half of 2008 to the first half of 2009. Also, commodity prices declined by 29% in the same time and this affected Latin America's export market. Indeed, this fall in exports comparable to drop back 1930s.

After the crisis, the impact was felt primarily through sharp declines in commodity prices rather than volumes because the price inelasticity of commodities in the short term means that the adjustment to lower demand is through lower prices. Non-oil commodity prices declined by 22% in 2009 (Grosh, Bussolo & Freije, 2014).

Latin American countries had a favorable terms of trade during the crisis. With the rise in commodity prices, the region's economies enjoyed significant terms of trade (the ratio of export prices to import prices) gains before the global financial crisis. Terms of trade were perhaps the most obvious external development for emerging markets including Latin American countries. Latin American countries showed a strong performance during the crisis as a result of good macroeconomic and financial policies, which allowed for substantial monetary and fiscal expansion and a resilient financial system. It also the result of good international conditions, called as 'good luck" by Gregorio (2014). Specifically, the terms of trade have been very favorable for Latin America since mid-2000s, and overall global financial conditions have been positive for Latin American economies. Terms of trade was favorable when compared with the Latin American debt crisis and the Asian financial crisis, when terms of trade decreased and external conditions deteriorated for the region.

The decline in external demand also affected commodity exporters and this caused to export level in the region. Decline in export level led to contract Latin American region' output by 2.3% and this was the largest negative contribution to growth. Particularly, Mexican economy has tight link with US economy and it was the first country to feel the effect of the global crisis. Thus, its recession period was the deepest and longest (around five quarters) in Latin America region. The two-thirds of Mexico's merchandise exports consisted of exports of manufactured goods to the US. Therefore, output in Mexico contracted 6% in 2009. Services linked to the manufacturing industries also contracted sharply in Mexico. On the other hand, exports in Brazil, Argentina, and Chile dropped 9.1%, 6.4%, and 4.5%, respectively, in 2009, whereas the declines in export volumes in Colombia and Peru were relatively low. Peru and Chile weathered the crisis better since they exported to rapid growth markets in Asia. Ecuador which normally exports 35% of its exports to the United States exported 6.6% less in 2009 (Grosh, Bussolo & Freije, 2014).

The contraction in domestic demand caused a 15% contraction in import volumes. Thus, imports of goods and services contracted the most in Latin American countries. Honduras, Jamaica, El Salvador, Paraguay, and St. Lucia had the largest contraction in private consumption. In Honduras, the collapse of imports of goods and services was much bigger in magnitude than the collapse in exports, resulting in a staggering 14.1% percent positive contribution to growth of net exports. At the regional level, as a result of the compression in domestic demand and in imports, net exports level in St. Vincent and the Grenadines, Haiti, and Bolivia negatively affected the growth (Grosh, Bussolo & Freije, 2014).

3.2.1. Foreign Direct Investments

Another indicator related to the impacts of the global financial crisis in Latin America is foreign direct investment (FDI). FDI is an essential tool for Latin American countries since it ensures capital accumulation and higher technology opportunity that would not have them with their own facilities. After the crisis broke out, FDI started to decrease in Latin American countries. According to Blanco (2010), there was a drastic drop of 42% from the first quarter of 2008 to the first quarter of 2009. Although the drop was drastic, the experience of Latin American countries with FDI during the crisis has been different outcomes. For some countries, there was an increase in FDI, but for other countries there was a decrease. Grosh, Bussolo and Freije (2014) also claim that increased ambiguous environment about the economic expectations, greater risk aversion, difficulties in gaining capital, more expensive external financing, and sharply lower FDI inflows declined from double-digit levels in the previous years to single-digit levels (around 9%) in fixed investment in Latin America and the Caribbean in 2009. This caused to decline of overall GDP by 2% (Figure 1). Therefore, fixed investment declined in almost every country in the region, whether or not a country was financially integrated in the world economy, a commodity exporter, or an open economy. More than half of countries recorded double-digit declines. Honduras and Jamaica saw some of the most dramatic contractions in investment. In Argentina, FDI came back 63% in 2009 from the previous year. For the region as a whole, FDI amounted from $127.9 billion in the previous year to $73.6 billion in 2009. Consequently, the results showed that FDI level declined in most of Latin American countries in 2009 as a result of the global financial crisis.

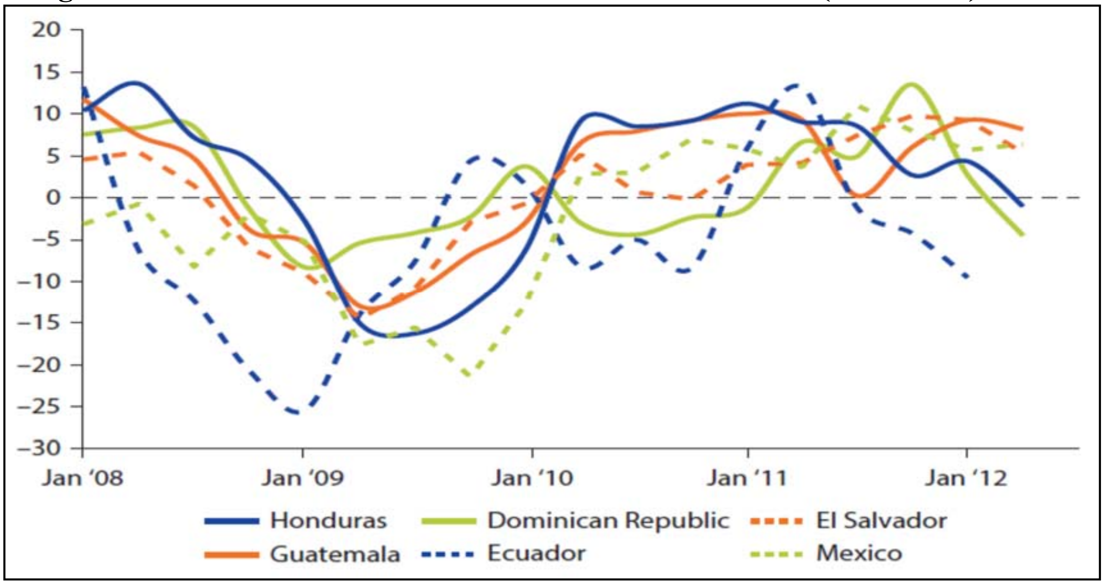
3.2.2. Remittances

Remittances are another significant indicator to show the impact of global financial crisis. Remittances stands for the money that immigrants transfer from foreign country to their own country. Remittances have increased significantly for many years in Latin American economies, especially in Mexico before the crisis. But, shortly after the crisis, the remittances started to decline in 2009. Blanco (2010) supports this point that in 2009, remittances bring down to 11% which is level of 2006. The one of the main reasons of this fall was because the

US unemployment level increased due to declining in United States construction activity. Because, Latin American immigrants have been influenced harder and they are less able to transfer money to their own countries. The average amount of remittances came back from $241 in 2009 to about $230 in 2010 (Blanco, 2010).

Remittances have enhanced more slowly by an average of 3% moderately between 2006 and 2008 in Mexico where is the one of the countries that receives the most remittances. Because the significant proportion of workers in the building sector in the US are Mexican migrants (around 13.8%), the declining in United States construction field caused the deterioration of transmission channel for Mexican migrant workers. Similarly, the decreasing of construction in Spain had a same impact for Colombian and Ecuadorian migrants. El Salvador Jamaica, and Honduras have remittances which contain over 15% of GDP because they have large migrant populations in United States before the crisis. During the crisis, their remittances dropped nearly 10% in 2009 (Figure 2). Adversely, remittances in Haiti which account for about 20% of GDP remaining relatively stable in 2009, although almost 75% of remittances receive from the United States (Grosh, Bussolo & Freije, 2014). Guillen (2011) states that the countries in Latin America most affected by the drop in migrant remittances will be Mexico, Bolivia, Ecuador, and most of Central America and the Caribbean. Consequently, decline of remittances cause to collapse in private consumption level in Latin American Countries. However, it might be say that it did not occur a large drop in remittances in general (Ocampo, 2009).

Figure 2. Remittances: Latin America and the Caribbean (2008-2012**)**



Source: World Bank

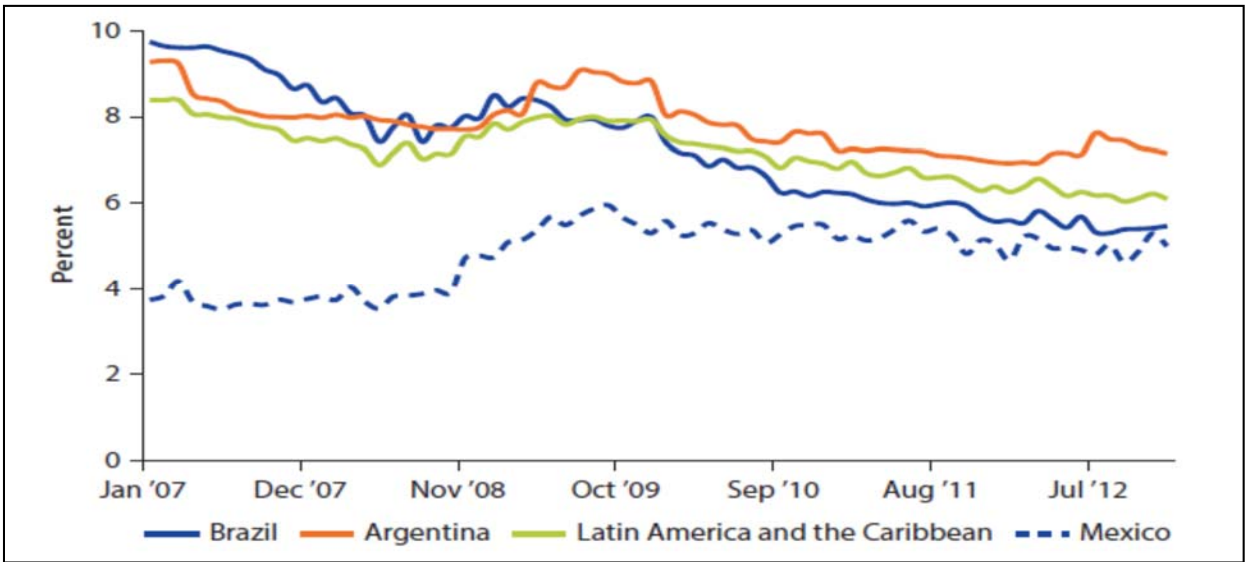
3.2.3. Private Consumption

After growing at a very robust rate during the commodity boom years (between 2000 – 2005) in the region, private consumption which is one of the most important contributors to growth collapsed in 2009 due to increased uncertainties about the economic outlook, rising unemployment rates, declined remittances. Private consumption declined 0.6% in 2009, which caused the largest negative contribution to overall growth in the region since 1960.

The decline in private consumption contributed 2% points or more to the contraction of GDP in Honduras, Paraguay, and República Bolivariana de Venezuela. The decline was felt in Mexico by 7.3% and this contributed 5.1% points to the decline in GDP. Because of lower remittances of Mexican migrants, private consumption was negatively affected for poorer households. On the other hand, private consumption in Paraguay (and other countries in the Southern Cone) was undermined by the severe drought that affected its agriculture sector, while in Honduras the uncertain political situation negatively affected consumer spending (Grosh, Bussolo & Freije, 2014).

Another reason of decreasing in private consumption was job losses. Unemployment rate increased during the global financial and economic crisis in many Latin American countries (Figure 3). The average unemployment rate (based on unemployment rates for Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay, and República Bolivariana de Venezuela, which account for more than 80% of the region's population) dropped in the second quarter of 2008 at 7.1%. During the most severe phase of the crisis, the average unemployment rate rose by 1.3% points relative to the pre-crisis low. The greater increase in the unemployment rate in the eight countries with available data ranged from 3.6 percentage points in Chile to 0.7% points in Uruguay. Mexico saw its unemployment rate increase 2.1% points from the second quarter of 2008 to the third quarter of 2009. It increased 1.4% points in Colombia at the same period. Also, unemployment rate in Brazil enhanced just by 0.6% (Grosh, Bussolo & Freije, 2014). The increase in unemployment rate in Mexico, Brazil, Peru and Argentina lasted for about two quarters.

Figure 3: Unemployment Rates: Latin America, 2007-2012



Source: World Bank

4. WHY HAVE BEEN LATIN AMERICA RESILIENT from GLOBAL CRISIS

Latin America countries responded differently to the crisis than other developed countries because the crisis did not originate in Latin America. They were affected by external factors rather than internal ones. It is noted that Latin American countries went through significant structural reforms since 1990s and these developments caused to enhance their ability to fight a crisis.

Despite of the fact that the global financial crisis was felt in the region, Latin America was resilience from global crisis due to good macroeconomic policies, stronger financial systems and the advantage of terms of trade.

Many Latin American countries used fiscal policies by greater government expenditure to address the crisis and, in contrast to previous experiences, this provided them to maneuver and to implement the fiscal policies. Improved macroeconomic policy frameworks and good initial conditions gave a good opportunity to allow the implementation of fiscal stimulus. On the other hand, the adaptation of flexible inflation targeting regimes made important contribution to gain the success of monetary policy.

Another keystone of improved macroeconomic framework is exchange rate flexibility. Flexible exchange rates have been allowed to float, and therefore; many countries responded strongly to negative external shocks.

Due to the well-regulated financial reforms, depreciations of exchange rates was prevented to cause a financial collapse. Also, stronger financial system played an important role to avoid the damages of capital inflows by deterring attacks on the region's currencies.

During the crisis, the level of international reserves in Latin American countries are good and this level of the reserves provided to compensate the negative effects of any shortages of foreign financing.

Commodity prices boomed during the second half of the 2000s and brought back to very high levels after the sharp decline experienced during the crisis. Thus, this was a bit of good luck for most Latin American countries which are exporters of primary commodities.

5. CONCLUSION

The fall of Lehman Brothers in September 2008 sent a shock all over the world; emerging markets were affected severely. However, Latin America was relatively unharmed by the global financial crisis compared with the previous crises. After global financial crisis broke out at September 2008, the crisis began to be felt by the transition of external factors such as capital inflows, remittances, and international trade in Latin American countries in 2009, especially the hardest hit to Mexico. Exchange rates depreciated by more than 40% (Mexico, Brazil) and share prices decreased by more than 50% (Argentina, Brazil). International trade was also severely affected, especially for countries with high trade and financial flows with the USA and countries with fiscal, trade or financing balances deficits. Economic growth in the region was affected negatively. Remittances, an important factor in terms of private consumption for the countries like households of Mexico and poorer countries, declined significantly. Decline in remittances contributed to decrease private consumption as well as job losses and also made a negative contribution to GDP level. Likewise, capital inflows, especially by decreasing foreign direct investments, dropped sharply and this is the one of the largest negative contribution on the Latin American economy. Decline in demand in US and other developing countries was also affected severely commodity exporters in Latin America. Decline in the export level made the greatest negative contribution to GDP level. The effects on poverty were heterogeneous within the region. Poverty increased mainly in Mexico and some Central American countries, whereas it actually declined in Brazil, Peru, and Uruguay. Nevertheless, the impact of the crisis on poverty was also less than in past economic downturns.

On the other hand, we see that Latin American countries have been resilience from the global financial crisis. With an improved institutional framework, a healthier financial system and lower the external vulnerabilities have created a better environment after the crisis. Good macroeconomic framework, strong financial systems and the advantage of terms of trade in the region played an important role that the crisis was less severity.

In summary, Latin America is better prepared for this economic downturn, and therefore; they weathered some of the effects of the worst crisis in the world economy experienced since the Great Depression compared with other region's countries.

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