World Economic Situation and Prospects

Weekly Highlight

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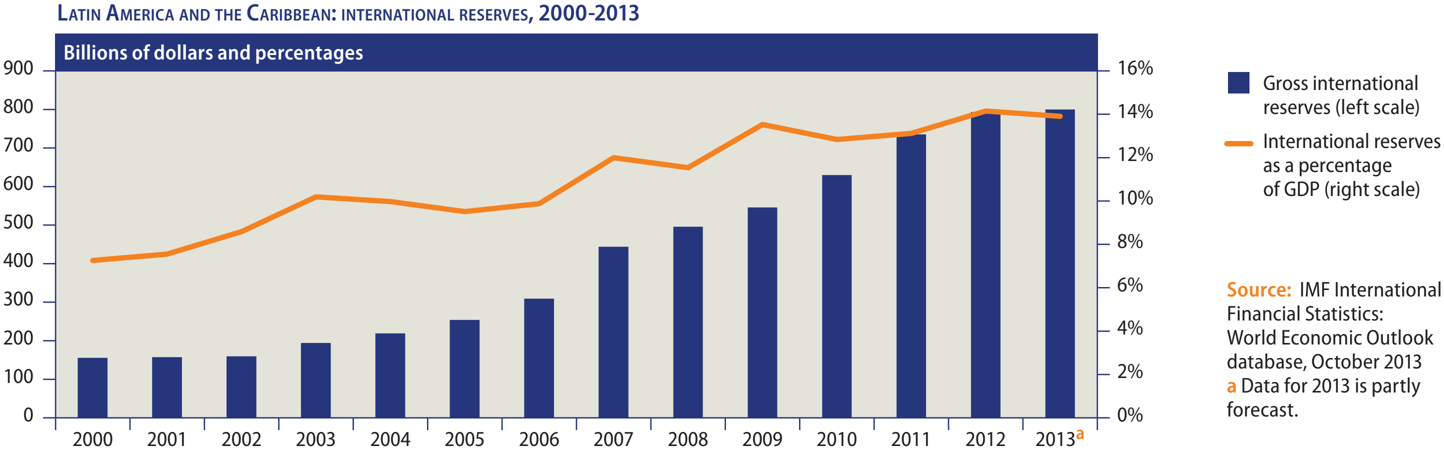
Is Latin America and the Caribbean at the turning point of international reserves?

During the last decade, Latin America and the Caribbean noticeably increased the level of international reserves, similarly to other developing regions. International reserves increased from $157 billion in 2000 to almost $800 billion in 2012, and reserves in terms of GDP doubled from 7 per cent to 14 per cent (see figure). The accumulation of reserves was related to several factors, such as a "self-insurance" strategy against potential external shocks, or resulted as a by-product of interventions by central banks in foreign-exchange markets, especially in the context of some recent surges of capital inflows. However, the pace of accumulation has sharply decreased in 2013, especially in the second half of the year, keeping the total absolute level of reserves for the region unchanged compared to 2012, although they might even have decreased in terms of GDP. Figures through November 2013 show that Argentina and Venezuela experienced a reduction in reserves by almost 20 per cent year on year,[1] while Brazil saw a reduction by almost 4 per cent. In addition, Peru saw a sharp reduction in the pace of accumulation of reserves, from $15 billion in 2012 to $2.5 billion in 2013. Several Caribbean countries, such as Barbados, Guyana and Jamaica are also expected to experience a reduction in their international reserves during 2013.

This recent development is explained by two major factors. First, current-account deficits are continuing to increase and are expected to expand from 1.8 per cent in 2012 to 2.5 per cent in 2013 for the region as a whole. In the context of relatively lower capital inflows, larger current-account deficits imply lower rates of accumulation of international reserves. Second, policy interventions in the foreign-exchange market have had significant impacts, particularly by selling international reserves to contain the volatility and depreciation pressures on exchange rates arising from the upcoming normalization of monetary conditions in the United States. For instance, Brazil launched a $60 billion intervention programme in foreign-exchange markets last August to contain the depreciation pressures on the real. This programme consisted of foreign exchange swap auctions and U.S. dollar sales auctions with repurchase agreements. In Caribbean countries, however, the lower accumulation of reserves is related to the declining performance of tourism and lower levels of capital inflows.

In 2014-2015, the normalization of monetary conditions in developed countries involves significant risks for the region, such as a retrenchment of capital inflows, volatility in exchange rates and tighter financing conditions. This might sharply increase the pressure on international reserves, particularly if current accounts continue to deteriorate, but the effects will depend on country specific circumstances. If the pressure on international reserves mounts, policymakers will have to evaluate alternative measures to confront the potential effects of adverse international conditions.

Figure
Latin America and the Caribbean: international reserves, 2000-2013



Source: IMF International Financial Statistics: World Economic Outlook database, October 2013
a Data for 2013 is partly forecast.

1 ECLAC/UN (2013), "Balance Preliminar de las Economías de América Latina y el Caribe". December.