

Warning indicators of crisis of exchange rate for the Bolivian case

Gabriel Loza Tellería

ABSTRACT

The paper proposes that both in Mexico as in Thailand there are both a component of announced crisis as of sudden crisis. That is to say, there is a set of factors which are cumulative that provokes an exchange rate crisis. The announced crisis is expressed in misalignment, not of the classical indicators used by IMF, such as fiscal deficit and inflation, but of current account deficit and the overvalued exchange rate in a context of high and free entry of short term capitals along with a fragility of the banking system. The external shocks generally accentuate the misalignment or disequilibria; wrong policies of response, and the overreaction of intermediaries, amplify disequilibria, and then, lastly, there is the component of sudden crisis, based on self-accomplished expectations, which trigger the exchange rate crisis, by foreseeing that exchange rate regime is not going to be sustainable.

Bolivia shows restrictive monetary and fiscal policies, capital flows are mostly direct investment flows, and even though there is a low inflation target function, the exchange rate has moved through mini-devaluations which kept the export competitiveness. Capital runs, within the traditional sense of deposits retirement to be exchanged by financial assets in foreign currency, are difficult in an economy with almost all of its deposits expressed in foreign currency.

However, there arises another kind of concerns. Firstly, limits in the function of Central Bank of Bolivia as last resort lender and the implicit collateral of deposits, may cause that the rescue of banks results in a loss of reserves. In second place, it is worrying a strong fall or sustained spread of interest rates between Libor and passive interest rates simultaneously with high active interest rates, all of which increase the risk of banking credits.

The fragility of the banking system may drive to deposit runs if arises any detonator, as an external shock or a change of the expectations of the agents. In third place, trade deficits and current account deficits are relevant to influence the expectations of economic agents in face of signals of crisis, and these deficits may be unsustainable in case of external shocks.

The following indicators of early warning are proposed:

- Index of external pressures 1 that measures the relationship between loss of reserves and exchange rate, which is complemented by the analysis of exchange rate balance.
- Ratio of money supply/international reserves and ratio of deposits/international reserves.
- The indicator of external pressure 2 that measures the relationship between loss of deposits and decrease of the spread of interest rates. This indicator would be supplemented by the analysis of liquidity and soundness of the banking system.