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ABSTRACT

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This study examines a troubling phenomenon occurring in several Latin American economies in the last few years: a marked slowdown in bank credit to the private sector. Since the late 1980s, the “credit channel” literature has made a case that fluctuations in bank credit may have a significant impact on the real economy, thus policymakers’ concerns about the credit slowdown appear to be well founded, as this phenomenon could have serious implications for present and future growth of these economies.

Based on the study of five Latin American countries (Argentina, Bolivia, Colombia, Peru, and Mexico), the first task is to document and measure the magnitude of the problem, using a similar framework to that of the Bernanke & Lown (1991) for the U.S. in the early 1990s. Two main questions are addressed. How severe and prolonged has the slowdown been? How does this recent behavior compare with the past? The second question specifically addresses the issue of whether the slowdown was preceded by a boom in private sector credit, which on first examination, appears to be the case in some of the countries studied. This is especially relevant since credit booms have been cited as factors increasing financial sector vulnerability, and have been used as early warning indicators for financial and currency crises (for example, Kaminsky, Lizondo and Reinhart (1998); Gourinchas, Valdés, and Landerretche (2000)). Thus, it may be the case that the slowdown is at least partly due to some corrective action aimed at reducing financial sector vulnerability, perhaps also following a period of banking system distress.

The second task will be to explore how commercial bank balance sheets have changed, addressing several questions. Is the credit slowdown merely a reflection of a slowdown in bank deposits (i.e., loanable funds), or has the asset side changed? If the latter is the case, then into what assets have banks shifted? Are banks holding more central bank or government securities? Are they holding more excess reserves or have they increased their net foreign position? Has monetary policy contributed to or attenuated the slowdown? Has the monetary policy stance changed with respect to the previous period?

The third and final task will be to use econometric analysis to investigate possible causes for the slowdown. Drawing on a disequilibrium approach used in recent studies of credit slowdowns in the aftermath of financial crises in East Asia (Ghosh & Ghosh, 1999) and in Finland (Pazarbasioğlu, 1997), we will estimate demand and supply functions for bank credit, thus, we will test whether the slowdown is due to supply or demand factors. Among supply factors, we will explore whether banks have experienced a squeeze in loanable funds, greater financing pressure from the public sector, tighter monetary policy, or simply have become more cautious in their lending (reflected by a structural shift in the supply curve) in response to tightened regulation. Likewise, demand for credit may have contracted as a result
of slowing economic activity or the emergence of substitutes for bank credit. Finally, the
disequilibrium approach will allow us to test whether a “crunch” has occurred, i.e., a
voluntary rationing of credit, perhaps also reflecting greater caution on the part of banks.