The Roles of the Euro and Dollar: A Latin American Update

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Dollarization in Latin America then

- Ten years ago dollarization in full swing in Latina America:
  - Dollar as common currency for the Americas seen as natural next step in currency unification drive inspired by the euro.
  - A year later, El Salvador dollarized and Guatemala authorized the use of the US dollar in its financial system.
- Dollarization of the Americas seemed unstoppable.
Dollarization in Latin America now

• Dollarization out, “De-dollarization” in.
• Negative developments behind mood change:
  – Economic performance of Ecuador far from stellar after dollarization. (Adoption of the currency of a low inflation country doesn’t import the institutions behind that currency’s reputation. Ask Greece.)
  – Economic meltdown of Argentina after collapse of its currency-board arrangement.
• Positive developments behind mood change:
  – Sovereign debt of major countries in the region elevated to the investment grade status previously enjoyed only by Chile: Mexico (in 2003), Brazil and Peru (in 2008).
  – Confidence on viability of domestic currencies restored in most of Latin America.
Financial Dollarization in Steady or Declining Pattern in South America...

...but still advancing in Central America
Foreign Currency Penetration Retreating in Government Financing

- Downward trend in foreign currency denomination of government debt both in South and Central America
- Domestic currencies gaining ground, especially in debt sold in domestic markets.
  
  — Caution:
  - Information limited to a small set of countries.
  - Government debt not comparable across countries due to methodological differences in definitions and coverage.
Government Debt
% of GDP

<table>
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<th>Year</th>
<th>Argentina</th>
<th>Brazil</th>
<th>Colombia</th>
<th>Venezuela</th>
<th>Peru</th>
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<td></td>
<td>In Foreign Currency</td>
<td>External (*)</td>
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</table>

(*) As classified by the source. A large fraction of debt in this category is typically issued under the jurisdiction of foreign courts.
Summary

- Prospects of widespread dollarization in Latin America have not materialized.
- But the goals behind the dollarization drive have:
  - With some exceptions, inflation rates in Latin America have converged to those of developed nations.
  - Fiscal accounts in much better shape than a decade ago and even than those of some developed nations.
- Incipient De-dollarization under way suggests dollar and euro will lose market share in Latin America.
- Reduced presence of foreign currencies in Latin America should not lead to overlook the role of the dollar and the euro as powerful off-the-equilibrium-path discipline devices:
  - Mismanage your monetary and fiscal affairs and your currency will follow the Ecuadorian Sucre path to extinction.