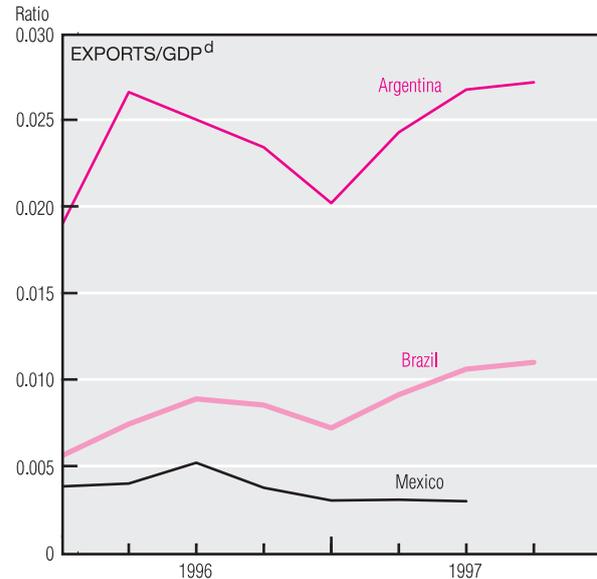
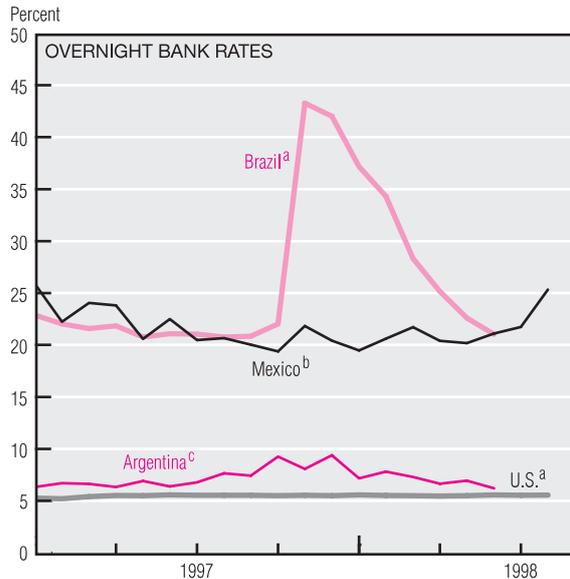
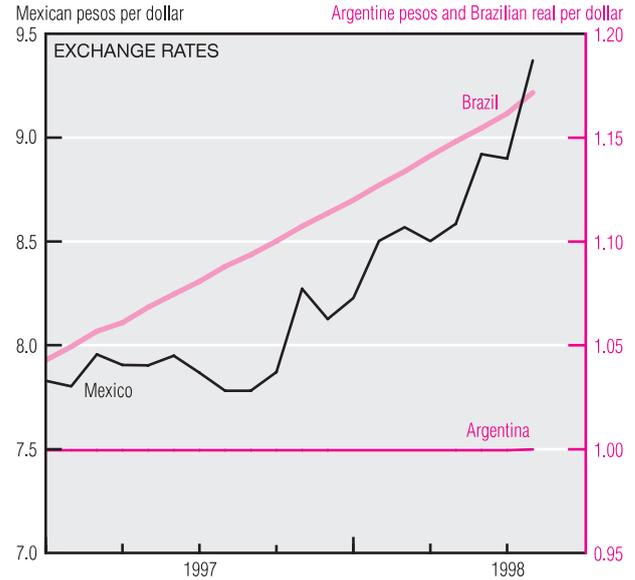
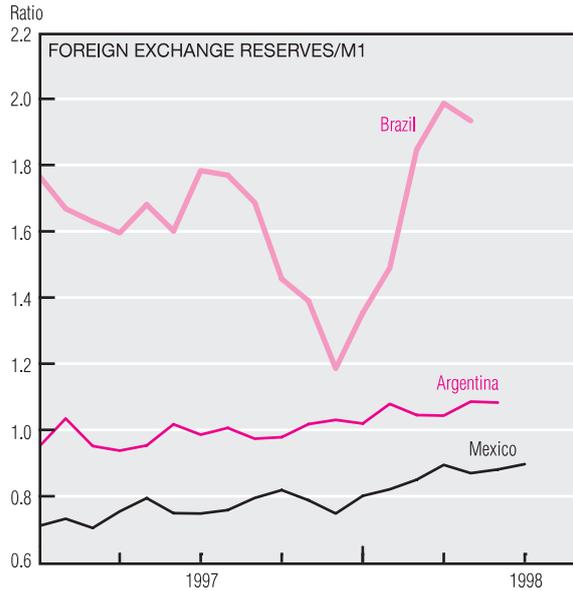


Latin American Economies



a. Federal funds rate.

b. Interbank interest rate.

c. Call money, private banks.

d. Data include only exports to each of the other two countries shown in the chart.

NOTE: Different end dates reflect differences in data availability among countries.

SOURCES: Board of Governors of the Federal Reserve System; Banco Central de la Republica Argentina; Banco Central do Brasil; Banco de Mexico; and International Monetary Fund, *Direction of Trade Statistics and International Financial Statistics*, various issues.

Successive Asian and Russian crises have focused attention on the economies of Latin America. Brazil, the largest of these, has experienced capital outflows that reached almost \$2 billion (U.S.) on September 11. To some extent, this represents “contagion”—investors’ presumption that all emerging markets are shaky. However, recent data have revealed that Brazil’s public-sector deficit is larger than previously thought.

The impact of having a central-government deficit depends partly on the exchange-rate regime. Brazil utilizes a “crawling peg” that allows

the dollar value of its currency, the *real*, to decline gradually (at 7% per year); Argentina has adopted a currency board that fixes the dollar value of its peso; and Mexico has allowed its currency to float, albeit with occasional interventions.

Although Brazil’s decision to adopt a crawling peg against the dollar initially reduced its inflation rate, lack of progress in reducing the public-sector deficit has hurt investors’ confidence in the real, necessitating higher domestic interest rates to defend the peg. This in turn has raised the cost of financing the deficit and increased the stock of government debt. The im-

mediate alternative to higher rates is devaluation.

The three economies are linked financially because the U.S. dollar is used as an alternative to the currency of each. Even in Argentina’s banking system, which permits clients to use either dollars or pesos, interest rates on pesos have recently risen along with Brazilian rates. Export dependence among the three countries appears limited. Trade between Brazil and Argentina constitutes a significant proportion of each country’s exports, but not of their GDPs. Mexican trade is heavily weighted toward the U.S.