Seminário Internacional

Desafios e Oportunidades para a Integração Financeira e Monetária na Região

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Financial Integration in Latin America: *A New Strategy for a New Normal*

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Outline

- Section I: Motivation - What are the main issues?
  - Historical context
  - Current juncture
- Section II: What to do? “Regionalization as a first step towards globalization”
  - Benefits of integration
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Section I: What Are The Main Issues?

Historical Context

- Following the financial crises in the 1980s-1990s, Latin American countries opened up their financial markets to foreign participation
- North American and European banks entered these markets
- Global banks were seen as a source of stability, bringing know how and best practices into the region…

Historical Context: Entrance of Global Banks

Current Juncture: Challenges to the "Global Bank" Model

- Changes in global regulatory frameworks…
  - 'Extreme subsidiarization' model (ring fencing of both liquidity and capital)
  - Tightening of AML/CFT rules; FATCA; issues with correspondent banking
- …have increased costs in some business areas
  - E.g. derivatives trading moving to Chicago exchange

➡ Global banks are retrenching from non-core business areas and regions

Current Juncture: Departing Global Banks

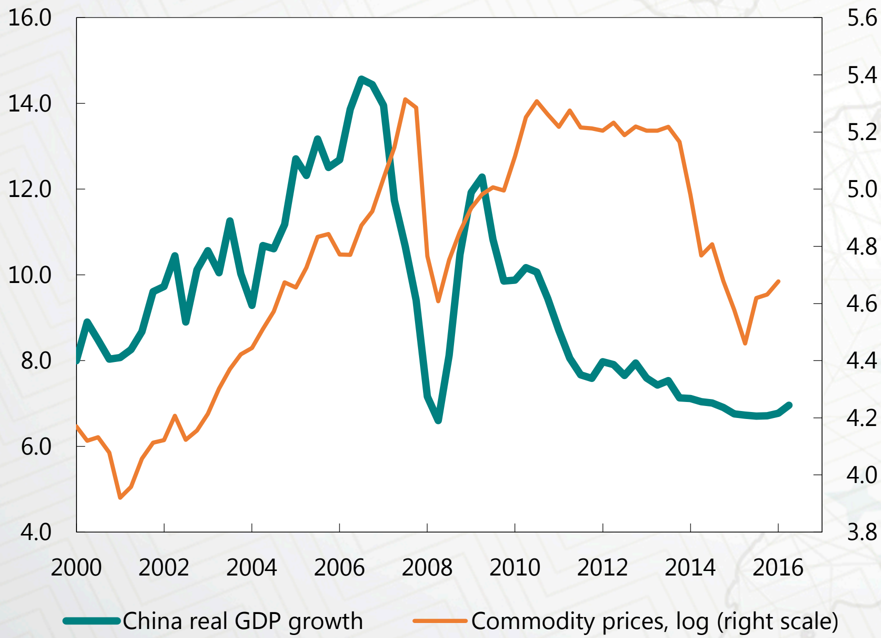
	Sold operation in: Global Bank	BRA	CHL	COL	MEX	PAN	PER	URY	OTH
	Banco Santander (ESP)		2009	2012					2009
	BNP Paribas (FRA)					2009			
	Citigroup (USA)	2013				2015	2015	2013	2009
	Commerzbank AG (DEU)	2009-10							
	Credit Agricole (FRA)	2009-10							
	HSBC Holding PLC (GBR)		2011		2011	2013			2012
	Lloyds Banking Group (GBR)							2012	2010
	Royal Bank of Scotland (GBR)		2010	2010					2011
	Standard Bank Group (ZAF)	2015							

Source: Bloomberg, LLP.

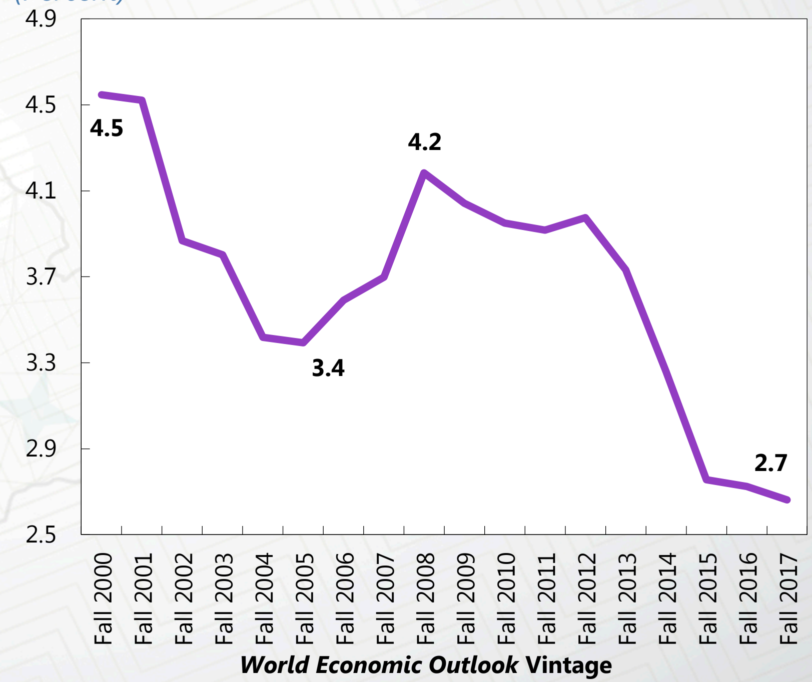
Current Juncture: Challenging External and Domestic Environment

Less support from growth engines of the past decade.

Growth in China and Global Commodity Prices
(percent change, index)



Estimates of Medium-Term Growth in LAC by Forecast Vintage, 2000–16
(Percent)



LAC needs to find new sources of growth!

Current Juncture: Need for Financial Market Development

➡ The void left by departing global banks needs to be filled, to avoid a large fall in both financial intermediation and/or competition.

➡ New avenues for growth in LA will require fresh investment and deep financial markets.

Section II: “Regionalization towards Globalization”

The qualitative benefits from financial integration at large are many…

Qualitatively, financial integration can expand financing and savings options, enhancing financial development, and resource allocation

- ***Enhance efficiency***: the infusion of foreign capital can enhance competition and economies of scale in the financial sector, reducing costs and spreads, and thus stimulating investment.
- ***Know-how transfer:*** better resource allocation and the importation of technology and know-how can boost productivity.
- ***Best practices:*** exposure of policymakers and companies to international scrutiny and standards can improve the investment climate by "raising the bar."

Integration can also reduce growth volatility, enhancing stability

- Increasing the ***depth and liquidity*** of markets creates new instruments and players.
- ***Portfolio diversification***: new opportunities for risk-sharing and inter-temporal consumption smoothing.

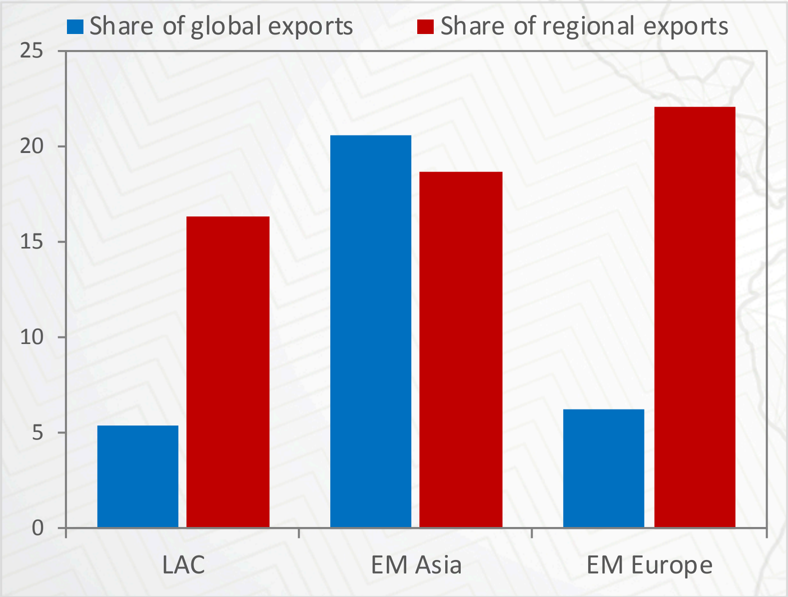
...and increased *regional* integration would help reap these

As global banks depart, higher regional integration in LA may bring several benefits:

- ***Regional trade***: greater cross-border financial activity could trigger greater cross-border trade.
- ***"Local expertise"***: regional banks may have greater expertise in specific regional needs for trade and industrial credit, for example, as well as business culture and institutions.
- ***"Fill the void"***: regional banks could help fill the void left by departing global banks.
  - Consolidation of domestic financial sectors and reduced competition could be avoided by introducing regional players.
  - Assimilation of technical know-how, regulatory and operational best practices from regional leaders could raise standards across the region, facilitating broader integration.
- ***Regional infrastructure***: regional integration of capital markets could provide economies of scale and facilitate the financing of large regional projects (e.g. cross-border highways), currently pending due to small domestic markets.
- ***Further risk diversification****:* regional portfolio diversification and investments could mitigate the risk of both domestic bubbles and extra-regional spillovers.

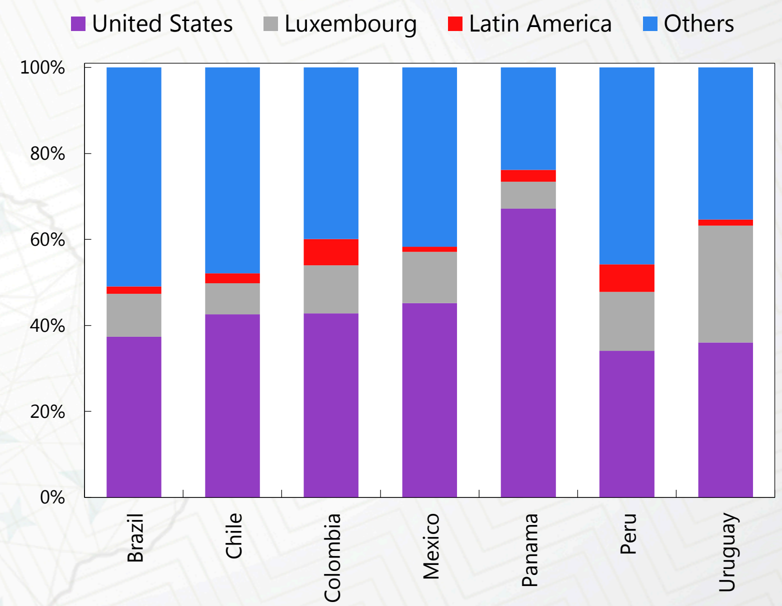
State of Play: Limited trade and financial linkages within LA

Share of Global and Regional Trade, 2016
(Percent of total)



Sources: Haver Analytics; and IMF staff calculations.

Total Portfolio Investment, 2015
(Percent share)



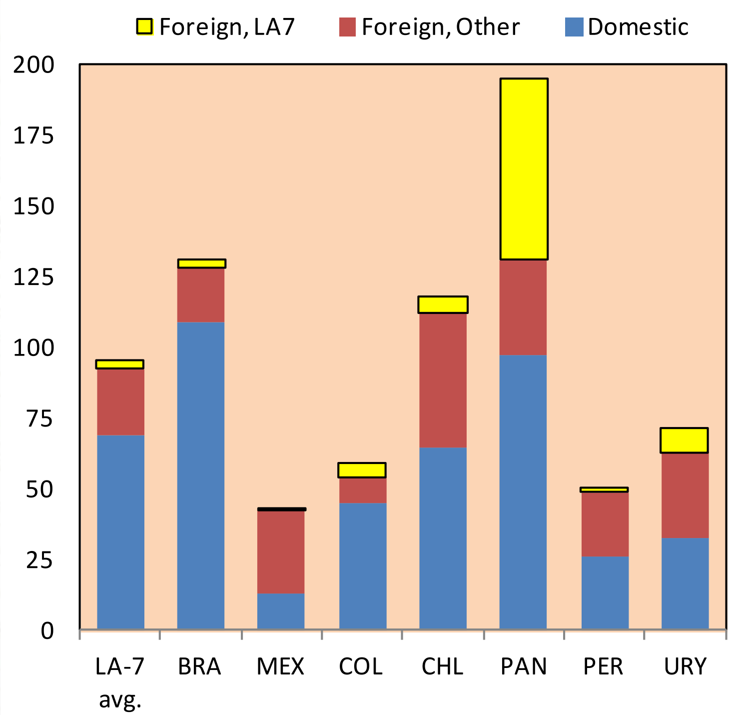
Sources: Coordinated Portfolio Investment Survey; and IMF staff calculations.
Note: Latin America = Argentina, Brazil, Chile, Colombia, Mexico, Panama, Peru, Uruguay.

Latin America less integrated relative to other regions.

State of Play: Regional banks have thus far played a limited role...

- Banks dominate the financial sector in LA.
- Non-LA foreign banks still hold an important market share in the LA-7.
- Despite recent acquisitions and moves by Colombian and Brazilian banks, regional banks have played a limited role so far...

LA-7: Commercial Bank Ownership, 2014[1]
(Bank assets in percent of GDP)

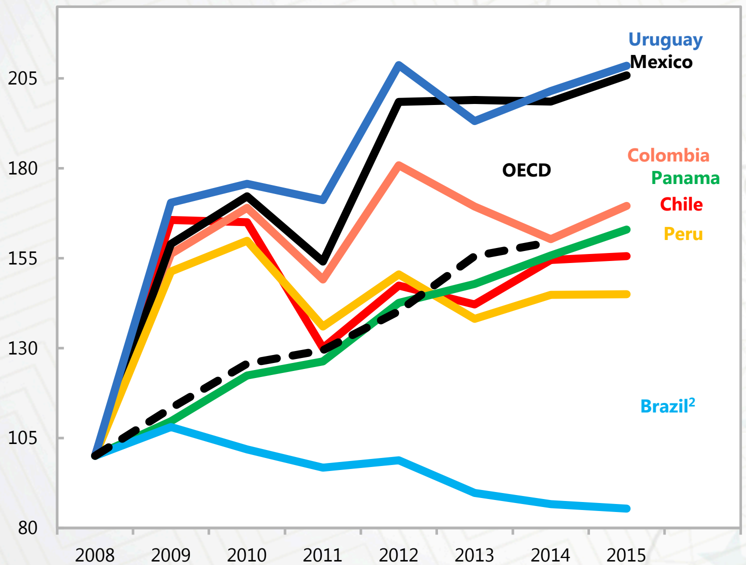


Sources: National authorities; Bureau van Dijk; and IMF staff calculations.
[1] Year-end 2014 or latest available.

…with just a few regional players…

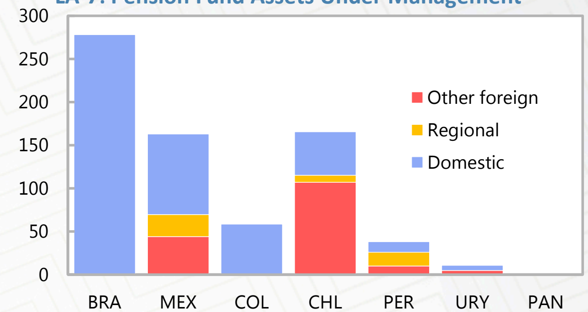
State of Play: Pension funds have grown rapidly, but invest in relatively shallow domestic capital markets

Pension Fund Assets
(Index, 2008=100, in percent of GDP in USD[1])



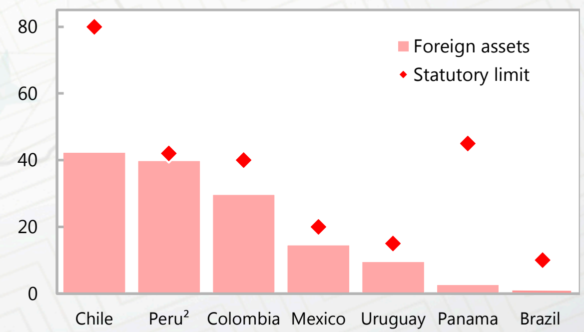
Sources: International Association of Bodies Supervision of Pension Funds (AIOS); Brazilian Association of Closed Pension Funds (ABRAPP); Brazilian National Superintendent of Pension Funds (PREVIC); OECD; and IMF staff estimates and calculations.
[1] Data for some countries may include partial estimates depending on availability. Data for Panama cover SMV. [2] Estimates for Brazil reflect total assets of the Brazilian closed pension funds system.

LA-7: Pension Fund Assets Under Management



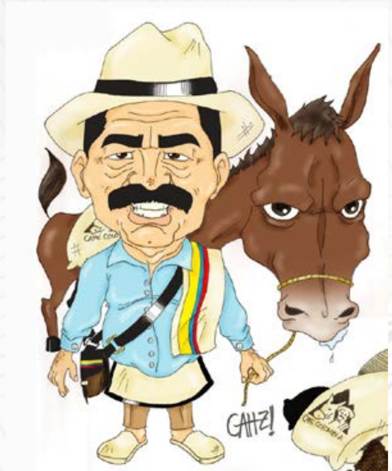
Sources: National authorities; Bureau van Dijk; and IMF staff calculations.
[1] Year-end 2014 or latest available. Data for some countries may include partial estimates depending on availability.
Data for Panama cover SMV. Estimates for Brazil reflect total assets of the

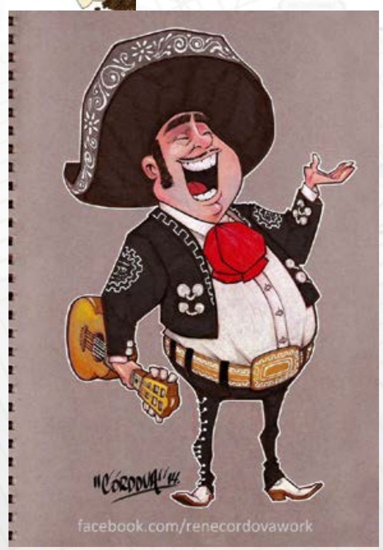
Pension Funds Investment: Foreign Assets[1]
(Percent of total investment)



Sources: AIOS; PREVIC; and IMF staff estimates and calculations.
[1] Data as of March 2016. Data for some countries may include partial estimates depending on availability.
[2] While the statutory limit on foreign assets in Peru is 50 percent, the pension fund supervisor raises the effective limit over a period of time; at the time of discussions it was set at 42 percent.

Section III: Achieving Regional Integration in Practice

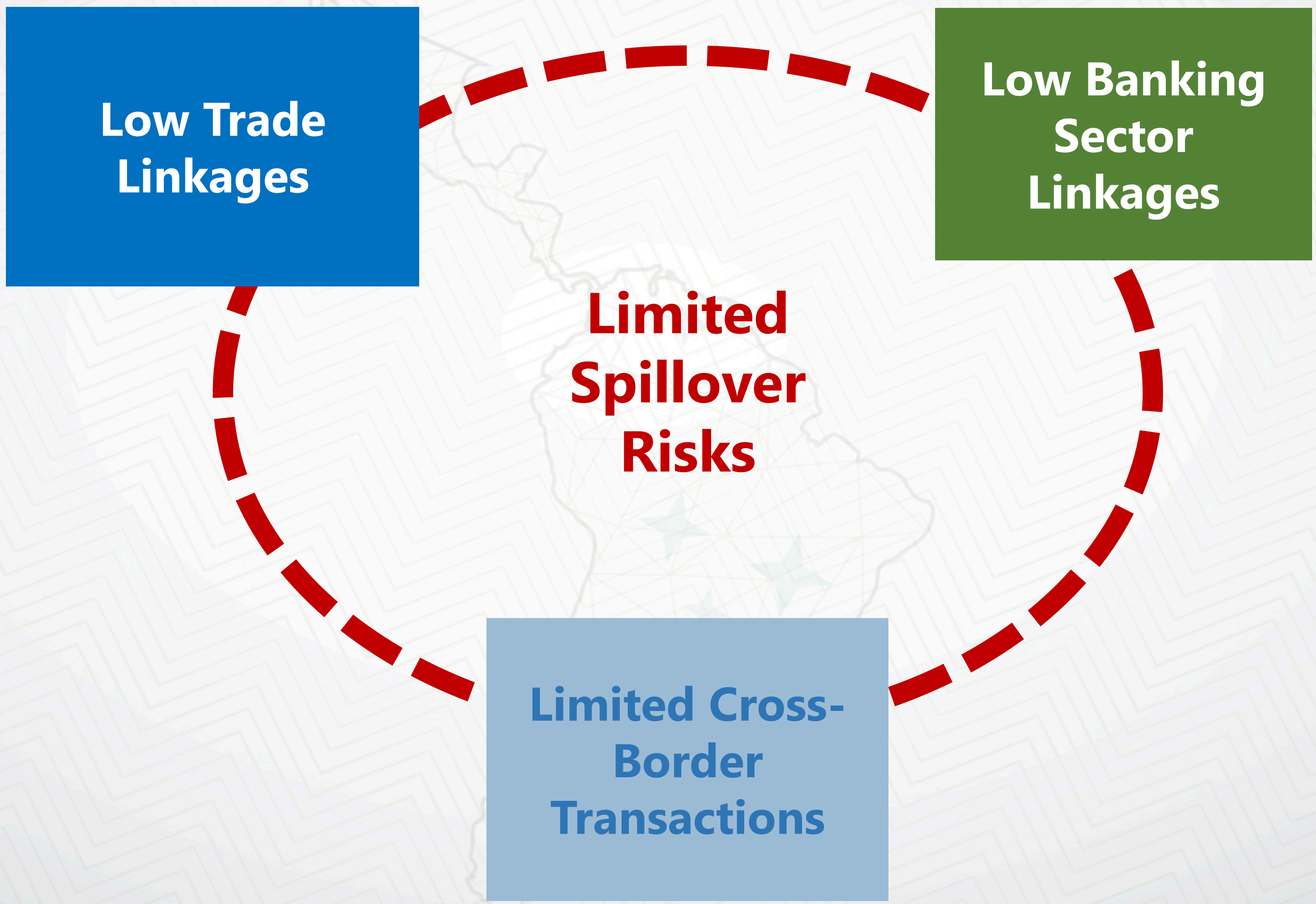




What are the risks?

- Trade diverting rather than trade creating.
  - Liberalization measures should be non-discriminatory.
- *Spillovers* across the region: financial stability concerns.
  - Integration through “ring fencing” national activities, including through subsidiarization and limits on cross-border transfers; very limited spillovers at present.
- Lack of adequate regulatory oversight.
  - Urgent need for consolidated and conglomerate supervision.

Currently low spillover risks…



…but increased integration MUST go hand-in-hand with enhanced supervision to mitigate potential risks.

Cooperation Across Regulators ⟷ **Enhanced Domestic Supervision** ⟷ **Prudential Tools**

Cooperation Across Regulators
- Reciprocity and coordination
- Joint Forum Principles Supervisory Colleges
- MoUs; Information Sharing

Enhanced Domestic Supervision
- Adoption of International Standards
- Consolidated and Conglomerate Supervision
- Cross-border risk monitoring

Prudential Tools
- Tackles Systemic Risks
- Additional Capital/Liquidity Requirements

→ Regulatory convergence towards international best practices!

Existing Initiatives: “Low-Hanging Fruits”

MERCOSUR

MILA
MERCADO INTEGRADO LATINOAMERICANO

The Pacific Alliance

Recommendations for enhancing regional financial integration

- Develop explicit, ***non-discriminatory*** statutory and regulatory ***framework*** for entry and functioning of cross-border financial institutions, ensuring level playing field.
- Harmonize ***regulatory and accounting frameworks*** following international "*best practices*": adopt Basel III (banks), Solvency-II type (insurance), and IFRS.
- Develop stable and transparent ***tax rules*** for domestic and cross-border financial activities, with agreements to avoid double taxation.
- Remove remaining ***exchange controls*** and revitalize regional currency settlement.
- Introduce/enhance ***consolidated supervision*** of banks and conglomerates, including limiting intra-group exposures. Harmonize legal frameworks for ***bank resolution and restructuring***.
- Increase maximum ***ratios for pension funds*** and NBFIs to invest regionally (if not more widely), ensuring safeguards are in place to manage cross-border risks, and allow them to invest in ***regional infrastructure projects***.

Section IV: Conclusions

Conclusions: “Food for Thought”

- Regional integration is not a panacea, but a first step towards global integration
- No “silver bullet”: regional integration a multi-faceted process
- ***Bottom line***: enhancing domestic financial regulatory institutions and infrastructure (following international “best practices”) in itself a good thing…
  - A “race to the top” in terms of regulatory and financial standards
  - Financial integration could be a positive by-product of it!
  - Alternatively, financial integration could be used as an “excuse” for the much needed reforms