FLIGHT TO QUALITY:
A Serious Amplifier

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FLIGHT TO QUALITY
Advanced vs Emerging Markets

ADVANCED MARKETS
• Finance Fiscal Deficit at Lower Interest Rates, and Issue Money without Triggering Inflation (the problem may rather be stopping deflation!)

In Contrast

EMERGING MARKETS
• Face Higher Interest Rates.
• May Have to Resort to Inflation Tax...
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EM Systemic Sudden Stop and Inflation

CONVEX CURVE

TRANSFER CHALLENGES IN EMERGING MARKETS

Large SMEs Sector. Two relevant financing options:

- Reprofiling International Debt
- Inflation Tax that may help to lower real government expenditure, but risks evolving into
  - Creation of quasi-monies (*patacones*)
  - Financial repression
  - Paying interest directly or indirectly on money, like in Hungary 1946, Argentina 1989.

ALL OF WHICH MAY SERIOUSLY HAMPER THE DOMESTIC PAYMENTS SYSTEM

Kiss of Death
WARNING: ACCESS TO INTERNATIONAL CREDIT MAY NOT BE A SILVER BULLET

- Several countries in LAC have been able to float government bond obligations at low interest rates. e.g., Mexico, Peru.

- However, complacency may be risky, because this does not rule out that the private sector undergoes severe credit shortage, as shown in previous Sudden Stops in the region, and in the US during the Lehman crisis.
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