

# 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!**)

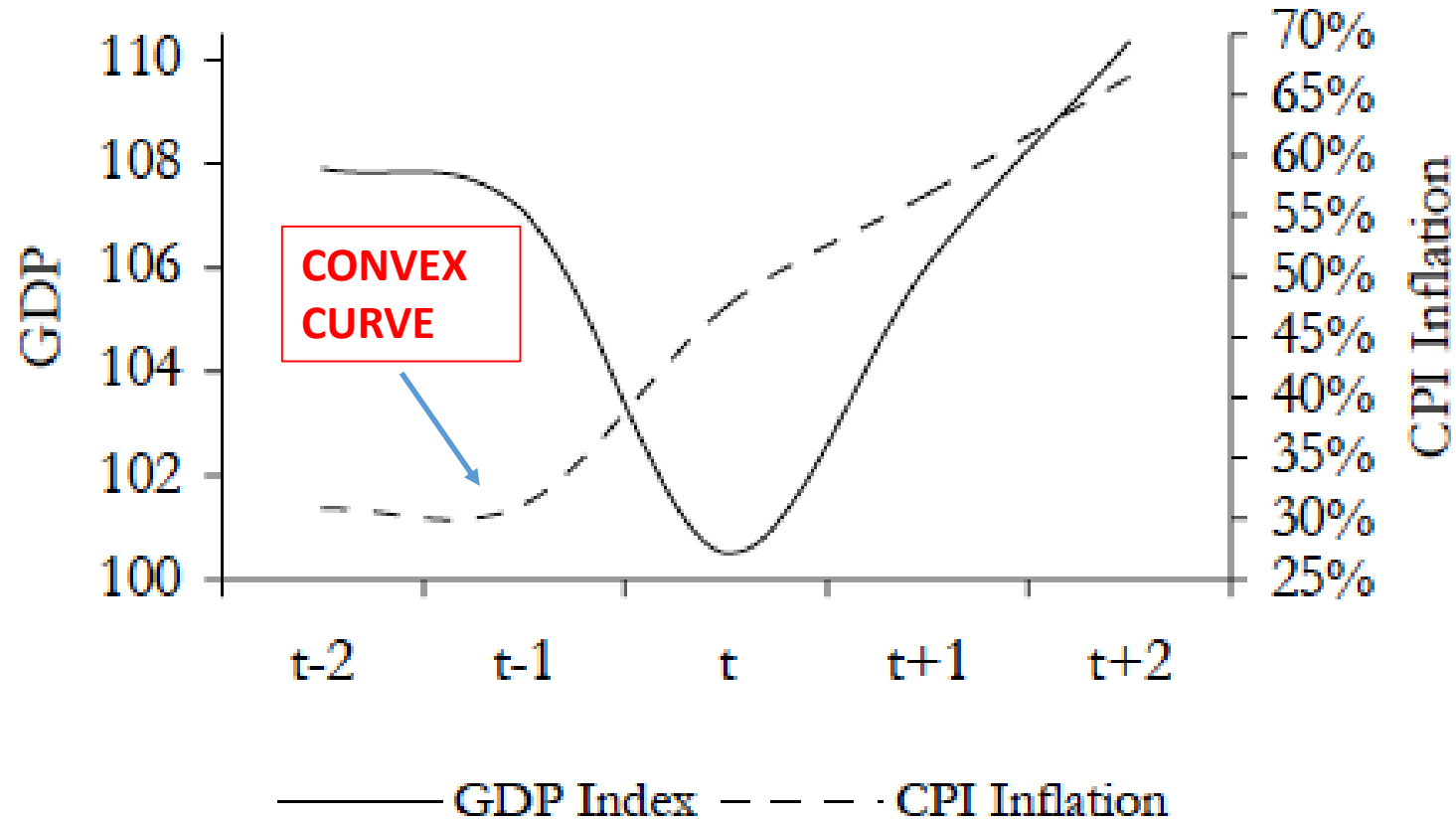
*In Contrast*

### EMERGING MARKETS

- Face Higher Interest Rates.
- May Have to Resort to **Inflation Tax...**

# FLIGHT TO QUALITY

## *EM Systemic Sudden Stop and Inflation*



Source: G. Calvo, A. Izquierdo, E. Talvi, "Phoenix Miracles in Emerging Markets: Recovering without Credit from Systemic Financial Crises," NBER WP 12101, March 2006

# 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 THE 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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