

## Box 3

**THE FINANCIAL SAFETY NET IN LATIN AMERICA IN TIMES OF GLOBAL UNCERTAINTY**

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In the face of challenges to its macro-financial stability, Latin America requires robust fiscal, monetary and financial policies, supplemented by a financial safety net capable of responding effectively to external shocks in an uncertain world. This box analyses recent developments in the financial safety net and its current state, along with its capacity to support national policies at critical moments. Understanding and strengthening the safety net is a strategic investment in the resilience and sustained development of the region, not only allowing Latin America to successfully handle shocks, but also to take advantage of the opportunities in the current global environment.

### A strong financial safety net for the region

The currency and financial crises in Latin America at the end of the last century had a significant impact on GDP

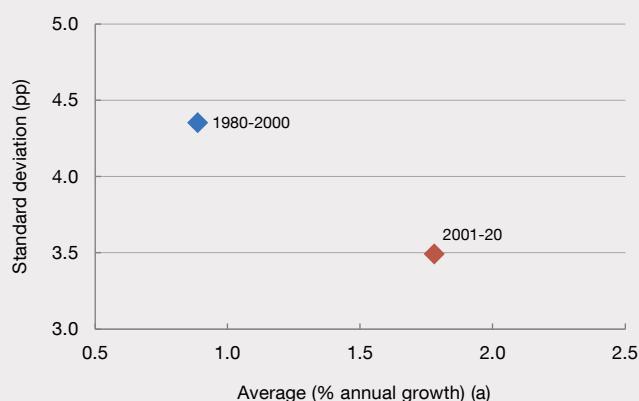
growth and inflation.<sup>2</sup> This prompted the development of institutions and macroeconomic policies focused on strengthening macroeconomic and financial resilience in many Latin American economies, through a framework of monetary,<sup>3</sup> fiscal,<sup>4</sup> macroprudential and microprudential policies.<sup>5,6</sup> Having reinforced these institutions and policies, the region saw an improvement in GDP per capita growth and inflation (Chart 1).

This new macro-financial framework was effective when facing external shocks, such as the global financial crisis, the episode of financial volatility in 2013 known as the taper tantrum, the negative shocks in the terms of trade in 2014-15, the COVID-19 pandemic (supply and demand shocks and financial shocks), the war in Ukraine (terms of trade shocks and supply shocks), the unexpected surge in inflation and the rapid rise in external interest rates.

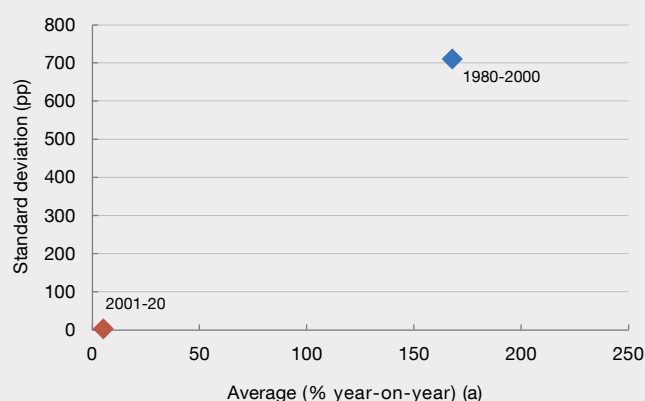
Chart 1

Latin America: change in and volatility of GDP per capita growth and inflation

1.a GDP per capita



1.b Inflation



**SOURCE:** IMF (World Economic Outlook). Authors' calculations.

**a** Simple average: Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Peru and Uruguay.

- 1 Carlos Giraldo is Chief Economist at the Latin American Reserve Fund (FLAR by its Spanish acronym). He thanks Valeria Saldaña, adviser at FLAR, for her excellent assistance. The opinions and observations of the authors do not necessarily reflect the position of FLAR or its governing bodies.
- 2 Among the forces behind these crises were the terms of trade shocks, outflows or abrupt reversals of capital flows, unsustainable fiscal policies and exchange rate regimes and fiscal dominance of monetary policy.
- 3 Central bank independence, flexible inflation target, (managed) exchange rate regimes, better communication, transparency and accountability and restrictions on direct financing of governments.
- 4 Adoption of fiscal rules and independent fiscal councils, medium-term fiscal frameworks and laws governing fiscal responsibility.
- 5 Measures to manage capital flows, countercyclical capital requirements, limits to the foreign currency position, limits to leverage and the liquidity coverage ratio.
- 6 José Uribe. (2025). "Seeking Stability and Responses to Shocks in Latin America". Presentation for the SARB Biennial Conference: 25 Years of Inflation Targeting: Lessons for the Future.

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However, these developments should not be cause for complacency. It is essential to make an additional effort to improve the quality of the macro-financial institutions and policies, especially in economies with large budget deficits or unsustainable current accounts, elevated levels of inflation, excessive public or external debt, or where a significant part of the financial sector is not subject to adequate prudential regulation or supervision.<sup>7</sup>

Though sound macroeconomic and financial policies are essential, they do not always suffice to prevent external liquidity crises. These tend to stem from elevated volatility in global financial markets, including significant fluctuations in capital flows. Developments in global financial markets are amplified by market failings – such as information asymmetry – and by deficiencies in international coordination, making episodes of sudden stops or reversals in capital flows more likely. This environment can even affect solvent and well-managed economies, underscoring the need for a financial safety net that complements national policies.

The financial safety net should be strengthened in light of growing risks, such as fiscal vulnerability due to high levels of debt or external trade uncertainty caused by US economic policy. Recent research<sup>8</sup> shows that the Latin American region is vulnerable to uncertainty from the United States, which is mainly transmitted to the real sector through trade and investment. The impact on GDP growth is negative and uneven across Latin American economies, particularly in the quarter after the shock.

Likewise, the increasing use of unilateral financial and trade policies may reduce the likelihood of multilateral support and assistance from developed countries to emerging and developing economies. Moreover, this likelihood could also decrease if a fresh crisis started in emerging market countries, insofar as the sequence of events is nothing like the global financial crisis and the pandemic, to which the US Federal Reserve System responded rapidly and comprehensively, alleviating international liquidity problems for the emerging economies.

For these reasons, countries need to have sound macro-financial policies and establish a robust financial safety net.

**Latin America's financial safety net: developments and current state**

The financial safety net has four layers:

- *Global layer*: the International Monetary Fund (IMF);
- *Regional layer*: FLAR;
- *Bilateral layer*: swap lines arranged between central banks issuing reserve currency;
- *Local or domestic layer*: central banks' international reserves.

Each layer has its strengths and drawbacks. Accordingly, countries find it advisable to be a member of the IMF and regional funds (FLAR) and have an appropriate level of international reserves. Swap lines arranged with central banks from outside the region are less predictable, particularly amid global geopolitical tensions. Under certain circumstances, multilateral development banks, such as the World Bank, Inter-American Development Bank and CAF -Development Bank of Latin America and the Caribbean-, could supplement the supply of external liquidity to the economies.

The financial safety net's coverage levels vary and, in some cases, are insufficient (Chart 2, where each dot represents a country). In addition, the layers' coverage is fragmented: not all countries have swap lines with central banks from outside the region or are party to regional financing arrangements (RFAs) (Chart 3). At present, Argentina, Brazil and Chile have active swap lines arranged with the People's Bank of China. During the pandemic, Brazil and Mexico had access to temporary US dollar liquidity swap lines granted by the Federal Reserve System that are not currently active. Meanwhile, Brazil and Mexico are parties to regional or interregional integration frameworks (the BRICS Contingent Reserve Arrangement (CRA) and the United States–Mexico–Canada Agreement (USMCA) respectively), which also function as liquidity arrangements. The USMCA envisages a formal swap line between Mexico and the United States that can be activated by the US Department of the Treasury, with the Federal Reserve providing the liquidity. The BRICS CRA is an RFA between Brazil, Russia, India, China and South Africa.

<sup>7</sup> Working Group on Regional Financial Stability. (2019). "Toward a FLAR with a regional outreach". Fondo Latinoamericano de Reservas.

<sup>8</sup> Carlos Giraldo, Iader Giraldo, Jose E. Gomez-Gonzalez and Jorge M. Uribe. (2025). "US uncertainty shocks, credit, production, and prices: The case of fourteen Latin American countries". *Research in International Business and Finance*, 78, 103003.

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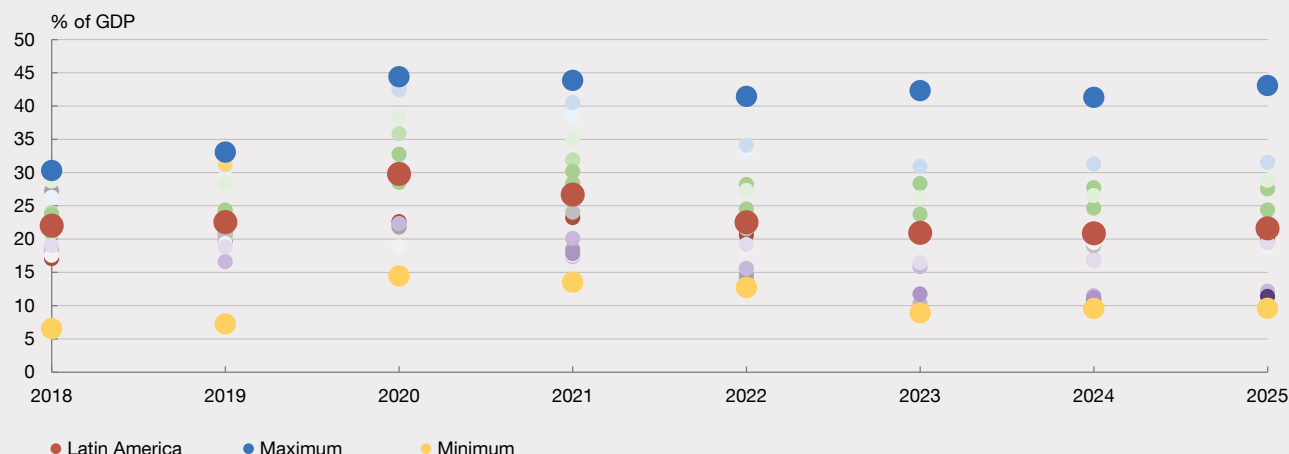
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In Latin America, the safety net largely depends on international reserves and the IMF (Chart 4). Reserves are the largest layer, although they incur costs for the countries and are unevenly distributed and low in some economies.

In addition, there is also a risk that a fear of losing reserves may arise during episodes of stress in international markets, underscoring the need for supplementary international liquidity arrangements.

Chart 2

Access to the financial safety net, by country (2018-25) (a)



**SOURCES:** IMF, BRICS CRA, FLAR and central banks. Authors' calculations.

a Denotes the access limit per safety net layer. For the IMF, a quota limit for conditional support lines over a three-year period equal to 4.35 times each country's quota for 2018-19 and 6 times the country's quota for 2020-25 is assumed. While these limits are not strict ceilings, any application that exceeds them is subject to the IMF's exceptional access policy. Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay were the countries considered for the estimation. "Latin America" refers to a simple average of the aforementioned countries.

Chart 3

Number of financial safety net layers, by country (2025)



**SOURCES:** IMF, BRICS CRA, FLAR and central banks. Authors' calculations.

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The IMF is the second most important layer for emergency financing in the event of balance of payments problems. However, it has its drawbacks, such as the stigma associated with seeking IMF assistance and protracted negotiations in some countries.

In response to these weaknesses, central bank swaps and RFAs have grown in importance since the global financial crisis, although swaps can still only be accessed by some countries and their future availability is uncertain. RFAs have come to the fore more significantly in the euro area, with the European Stability Mechanism (ESM), and in Asia, with the Chiang Mai Initiative Multilateralisation/ASEAN+3 Macroeconomic Research Office (CMIM/AMRO) (Charts 5 and 6).<sup>9</sup>

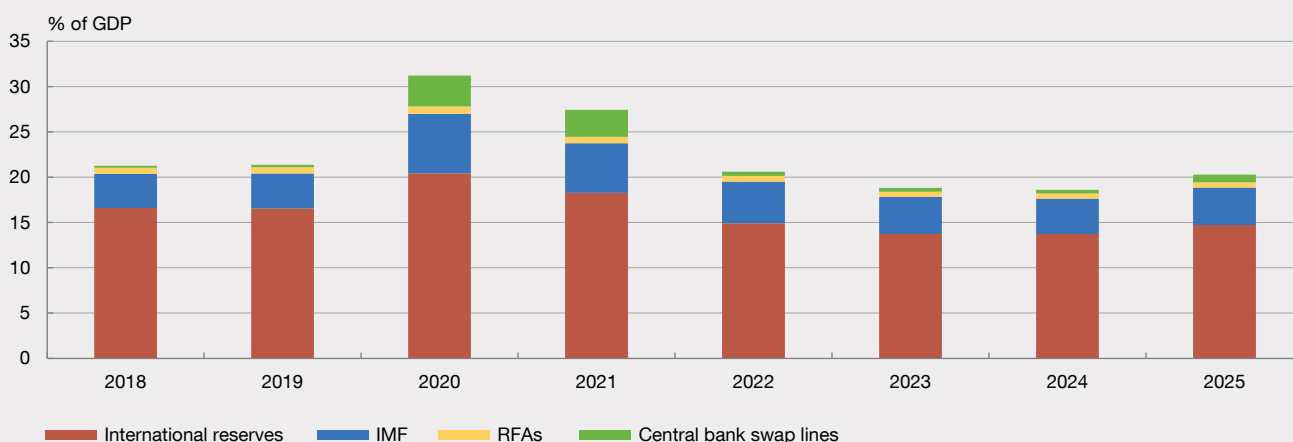
FLAR has proven effective in providing financial support to Latin American countries. Created in 1978, its main objective is to support its members' balance of payments. Its initial members were Bolivia, Colombia, Ecuador, Peru

and Venezuela. Costa Rica, Uruguay and Paraguay joined as member countries in 2001, 2008 and 2015 respectively, and in 2022 the Chilean central bank became a FLAR member as an Associate Central Bank. FLAR has played a key role during episodes such as the crises of the 1980s, the Asian crisis and, more recently, the pandemic and other idiosyncratic shocks affecting its members.

FLAR has contributed to its members' macroeconomic and financial stability, providing financial support more than 50 times since it was created. One recent example is a balance of payments support loan to the Banco Central de Costa Rica (BCCR) amounting to \$1.1 billion (18% of its net international reserves) in August 2022.<sup>10</sup>

The loan was granted amid adverse shocks stemming from the pandemic, the war in Ukraine and the rise in interest rates around the world, which exerted considerable pressure on the foreign exchange market. At that time, the local currency, the Costa Rican colón, was depreciating

Chart 4  
Financial safety net, by layer (2018-25) (a)



SOURCES: IMF, BRICS CRA, FLAR and central banks. Authors' calculations.

a Denotes the access limit per safety net layer. For the IMF, a quota limit over a three-year period equal to 4.35 times each country's quota for 2018-19 and 6 times the country's quota for 2020-25 is assumed. While these limits are not strict ceilings, any application that exceeds them is subject to the IMF's exceptional access policy. Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay were considered for the international reserves and IMF estimations. Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru and Uruguay were considered for the RFA estimation. Argentina, Brazil, Chile and Mexico were considered for the central bank swap line estimation.

9 Arab Monetary Fund, ASEAN+3 Macroeconomic Research Office, European Commission, Eurasian Fund for Stabilization and Development, European Stability Mechanism and Fondo Latinoamericano de Reservas. (2018). "Working together with the IMF: enhancing financial safety nets in emerging markets". Discussion Paper Series, 4, European Stability Mechanism.

10 The loan was disbursed in a lump sum on 19 August 2022.

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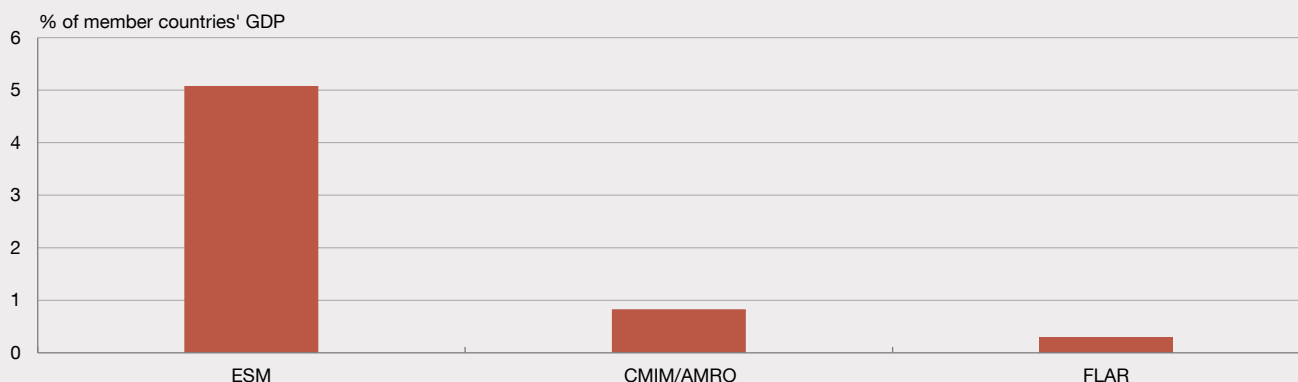
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significantly and the central bank had lost close to a quarter of its international reserves over the previous two years.<sup>11</sup>

The authorities had adopted measures to preserve macroeconomic and financial stability, including reducing the fiscal deficit and raising policy interest rates

Chart 5

Paid-in capital of the ESM, CMIM/AMRO and FLAR (a)



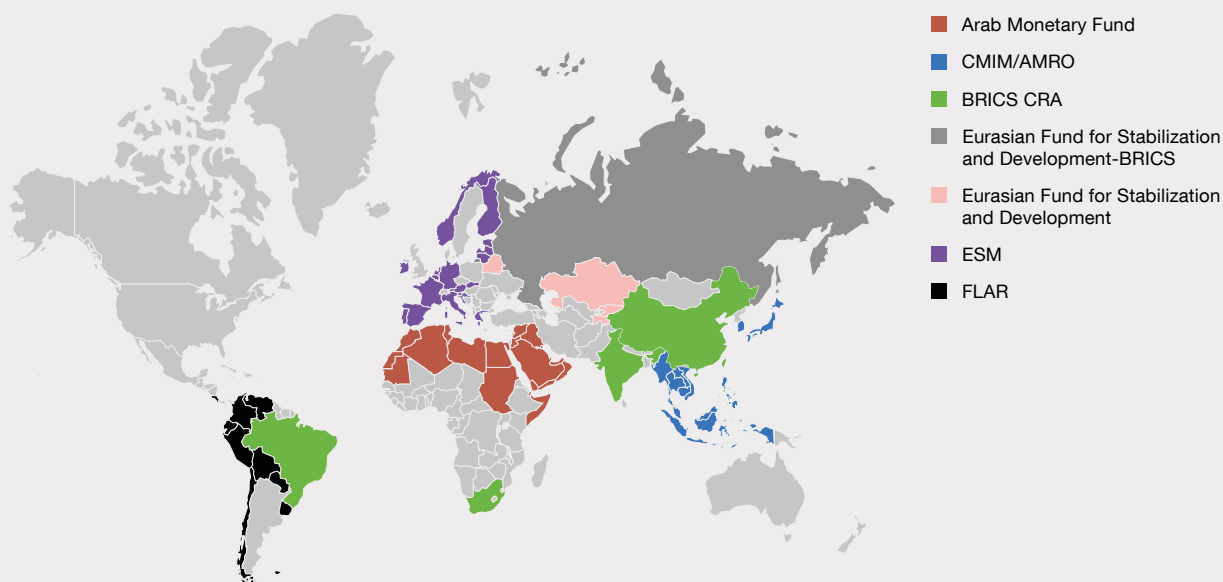
**SOURCES:** ESM, CMIM, FLAR and IMF (World Economic Outlook). Authors' calculations.

**NOTES:** For the ESM, Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland are considered. For the CMIM, Brunei, Cambodia, China, Hong Kong (China), Indonesia, Japan, Laos, Malaysia, Myanmar, the Philippines, Singapore, South Korea, Thailand and Vietnam. For FLAR, Bolivia, Chile, Colombia, Costa Rica, Ecuador, Paraguay, Peru, Uruguay and Venezuela.

**a** The latest available figure for total paid-in capital is considered, while for CMIM/AMRO the total value of the arrangement is taken into account. Reference GDP: 2024.

Chart 6

Parties to RFAs around the world



**SOURCES:** RFAs and FLAR staff calculations.

<sup>11</sup> Up to 24 July 2022.

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substantially to contain inflation and achieving the goals under the IMF Extended Fund Facility arrangement. However, the foreign exchange market remained under heavy pressure (Chart 7).

After the FLAR loan was approved (depicted by the vertical black lines in the panels of Chart 7), Costa Rica's exchange rate, net international reserves and sovereign spread performed positively: the colón appreciated steadily, the central bank's net international reserves increased to appropriate levels and the sovereign spread fell below the regional average, generating confidence in the economy and the macroeconomic policy implemented.

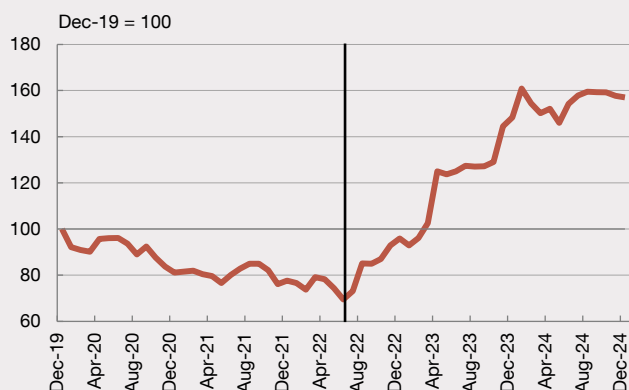
## Conclusion

Stronger macro-financial policies have made Latin America more resilient to external shocks. Nonetheless, international capital market failings highlight the need for a strong financial safety net comprising the IMF, RFAs such as FLAR, swap lines with central banks from outside the region and international reserves. FLAR's recent track record, including the loan granted to Costa Rica in 2022, shows that this regional arrangement mitigates the impacts on the real economy and the financial markets, builds confidence in economic policy and facilitates productive investment. Consolidating and expanding the

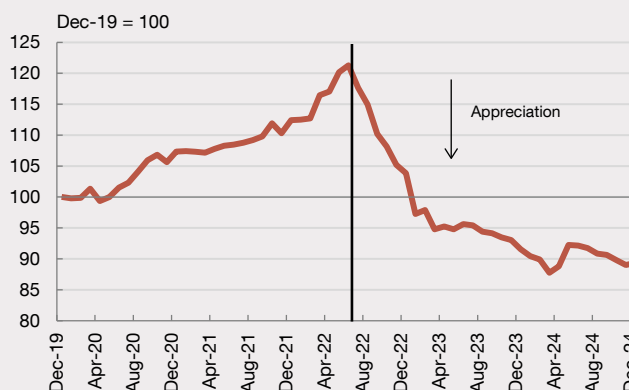
Chart 7

Costa Rica: international reserves, nominal exchange rate and EMBIG spread (a)

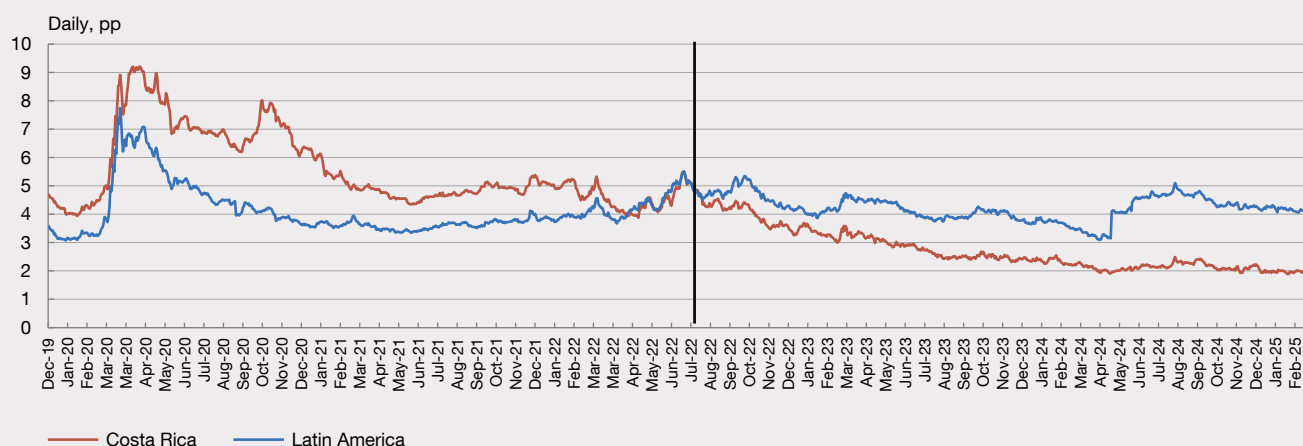
7.a BCCR: international reserves



7.b Costa Rica: nominal exchange rate



7.c Costa Rica and Latin America: EMBIG spread



**SOURCES:** BCCR, Bloomberg and FLAR staff calculations.

**a** The vertical black line denotes the disbursement date of the FLAR loan to Costa Rica.

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regional layer of the financial safety net is a strategic imperative for Latin America to preserve stability and seize opportunities in an uncertain global environment. Lastly, a high reliance on a single currency for debt

issuance and exports invoicing limits options and entails vulnerabilities. In light of this, the region's countries could assess the possibility of expanding the range of reference currencies used to gain access to international markets.<sup>12</sup>

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12 José Luis Escrivá. (2025). *The future of payments and the international role of the euro*. 52nd Annual Meeting of the Federación Iberoamericana de Bolsas.