
Currency Unification and Exchange Rate Policy in Cuba

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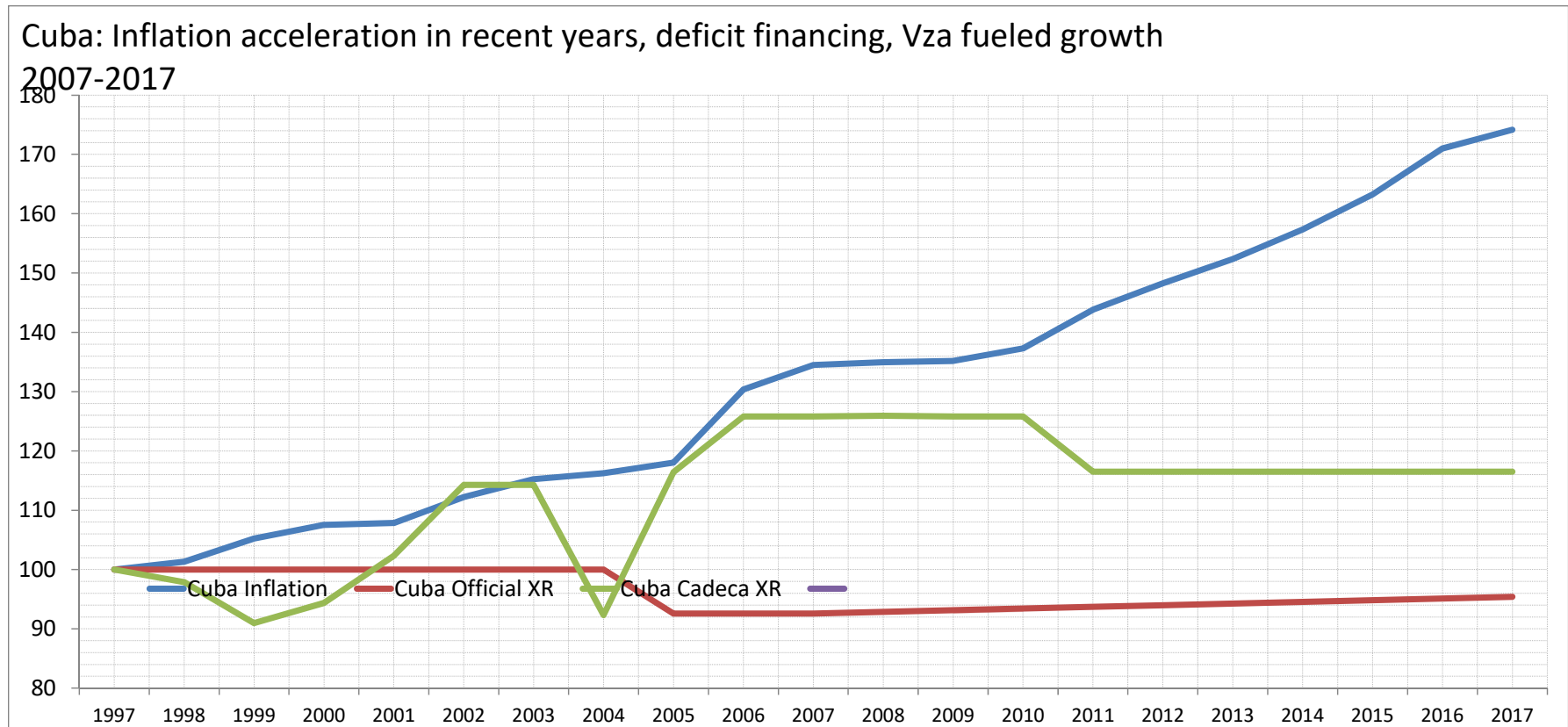
Today's talk

- Full dollarization risks
- Fixing exchange rates also a mistake.
- Let the exchange rate to float.
- Dollarization will be a problem in any case.



Full dollarization a mistake

- Dollarizing not in line with the country's competitiveness.



Full dollarization a mistake

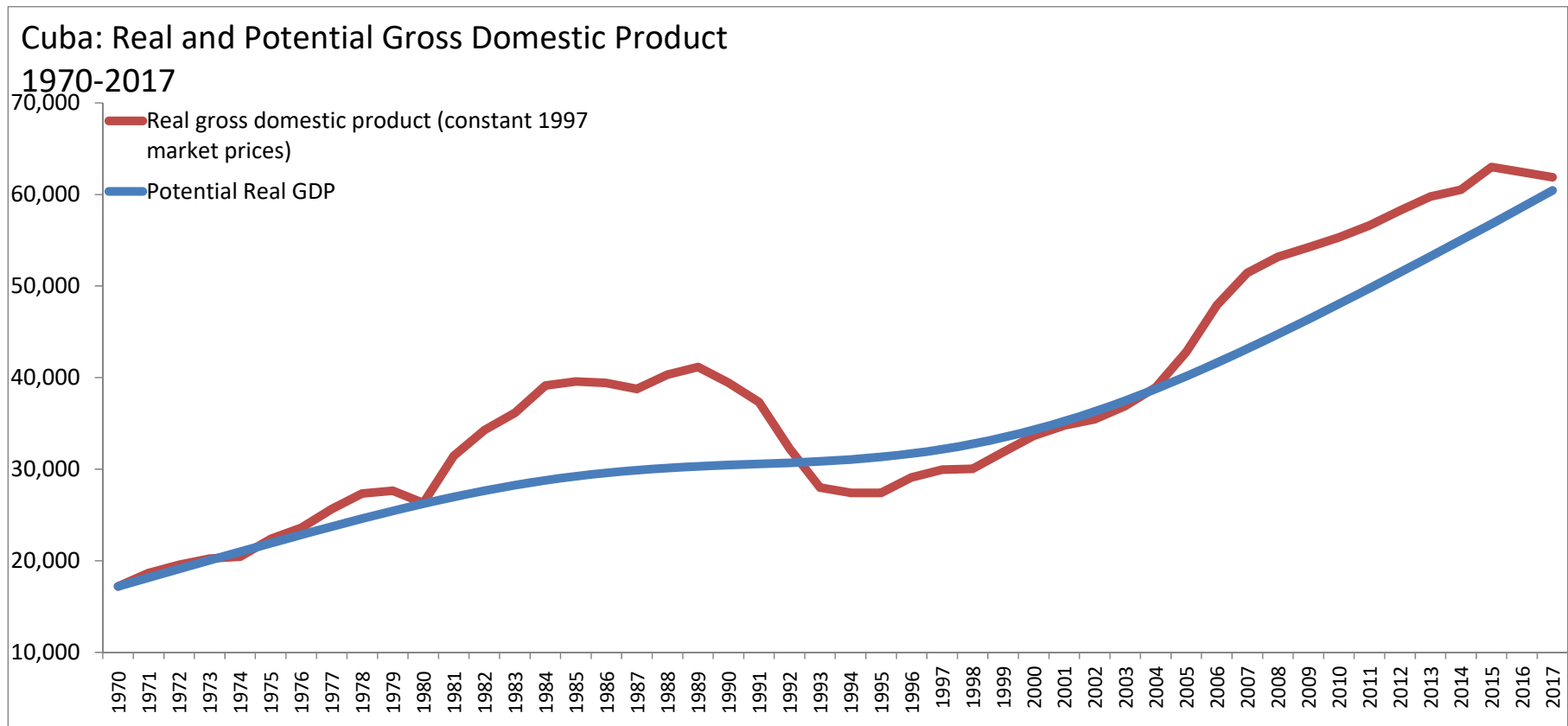
- ER regime depends on the type of external shock.
 - In Cuba today shocks come from the current account.
 - In a more integrated Cuba, we don't know.
- An inflexible ER in a first stage of liberalization would bring challenges
 - Relative prices need to reach equilibrium without output and employment costs.
 - External shocks in a liberalized Cuba come from terms of trade, financial flows.
 - Domestic shocks from inconsistency in fiscal and monetary policies.
- Inflexible ER can leave the economy at a wrong set of relative prices
 - Creates unemployment and ends in costly devaluations.

	1998	2007	2016
GDP deflator index	1.3	3.2	4.8
Official Exchange rate (average)	1.0	0.9	1.0
PPP exchange rate (Pesos per 1 international USD)	0.4	0.5	0.5
Real exchange rate valuation (+) overvaluation	99.8	119.5	117.6
Parallel exchange rate	22.3	28.6	26.5



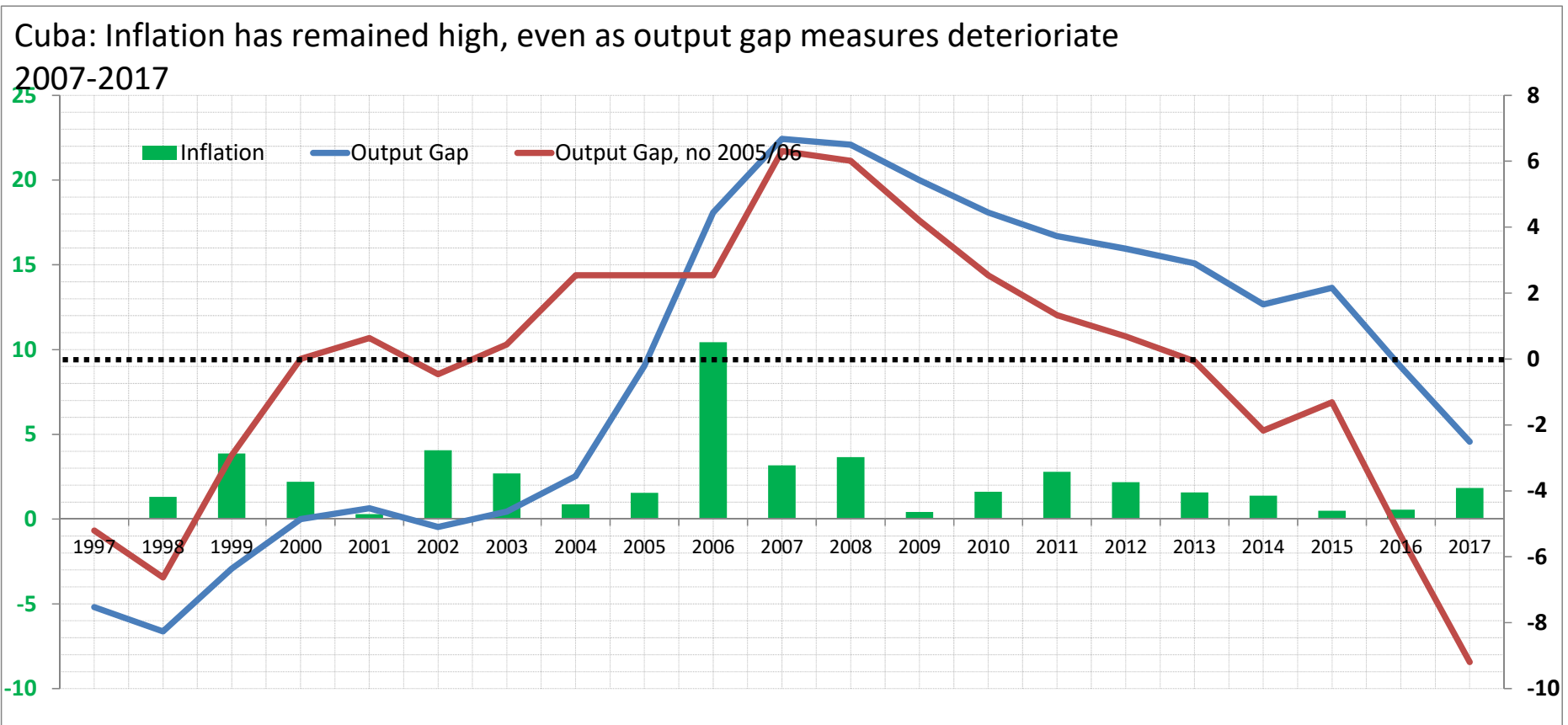
Full dollarization a mistake

- Once relative prices are set in hard currency, changing them would require deflation and structural reforms and they would be slow and painful.
 - The experience of hard pegs in LAC in the 1990s is telling in this regard



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Fixing exchange rates brings risks, fiscal numbers looking bad

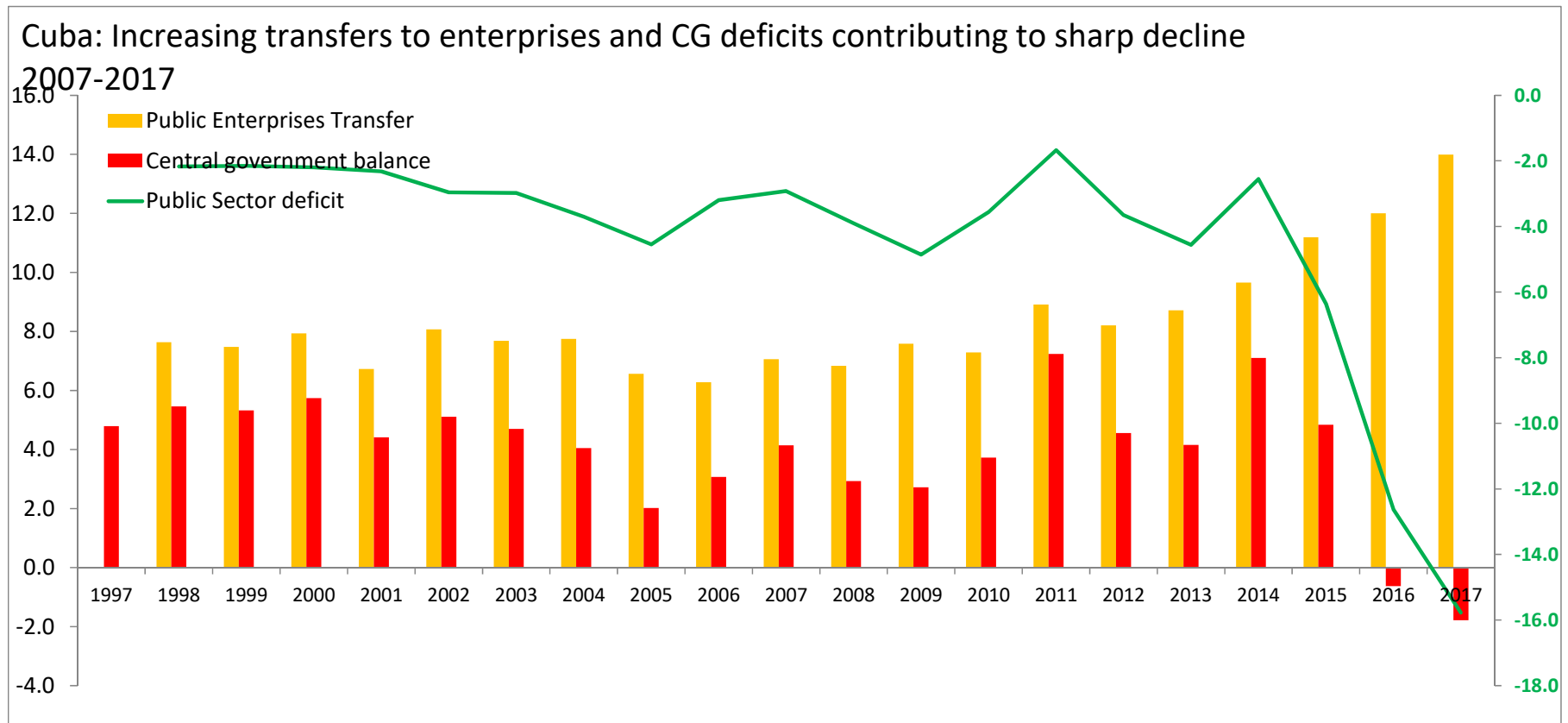
- Our research done suggests that productivity has not increased in the last few decades.
- Demographic trends are extremely negative (the worst in Latam and one of the worst in the world)
- The budget was left afloat thanks to Venezuela but it has deteriorated recent years

	1998	2007	2016	2017
Total revenue	36.4	41.2	28.0	24.9
Central government expenditure	30.9	37.1	28.6	26.7
<i>Current expenditure</i>	26.6	33.2	28.6	26.7
Interest	1.1	1.6	0.6	0.5
Social expenditure	14.3	19.5	13.8	10.9
Defense	1.4	1.7	0.0	0.0
Other	9.9	10.4	14.3	15.3
<i>Capital expenditure</i>	4.3	3.9	0.0	0.0
Public Enterprises Transfer	7.6	7.1	12.0	14.0
Total Expenditure	38.5	44.1	40.6	40.6
Public Sector deficit	-2.2	-2.9	-12.6	-15.8



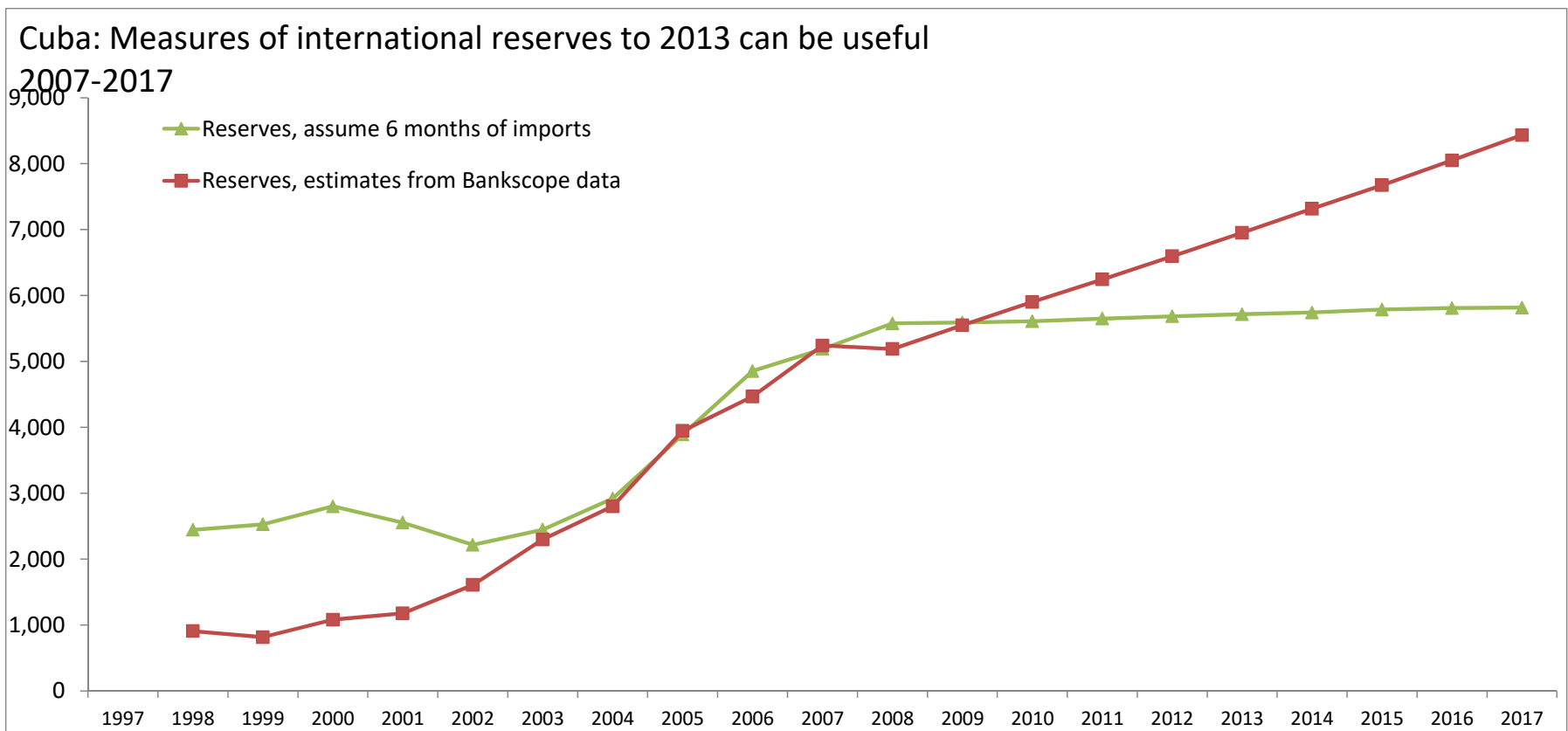
Fixing exchange rates brings risks, fiscal numbers looking bad

- At most, if expectations are to be anchored, a crawling peg could be announced,
- Should be backed with credible fiscal policy.



Let it Float

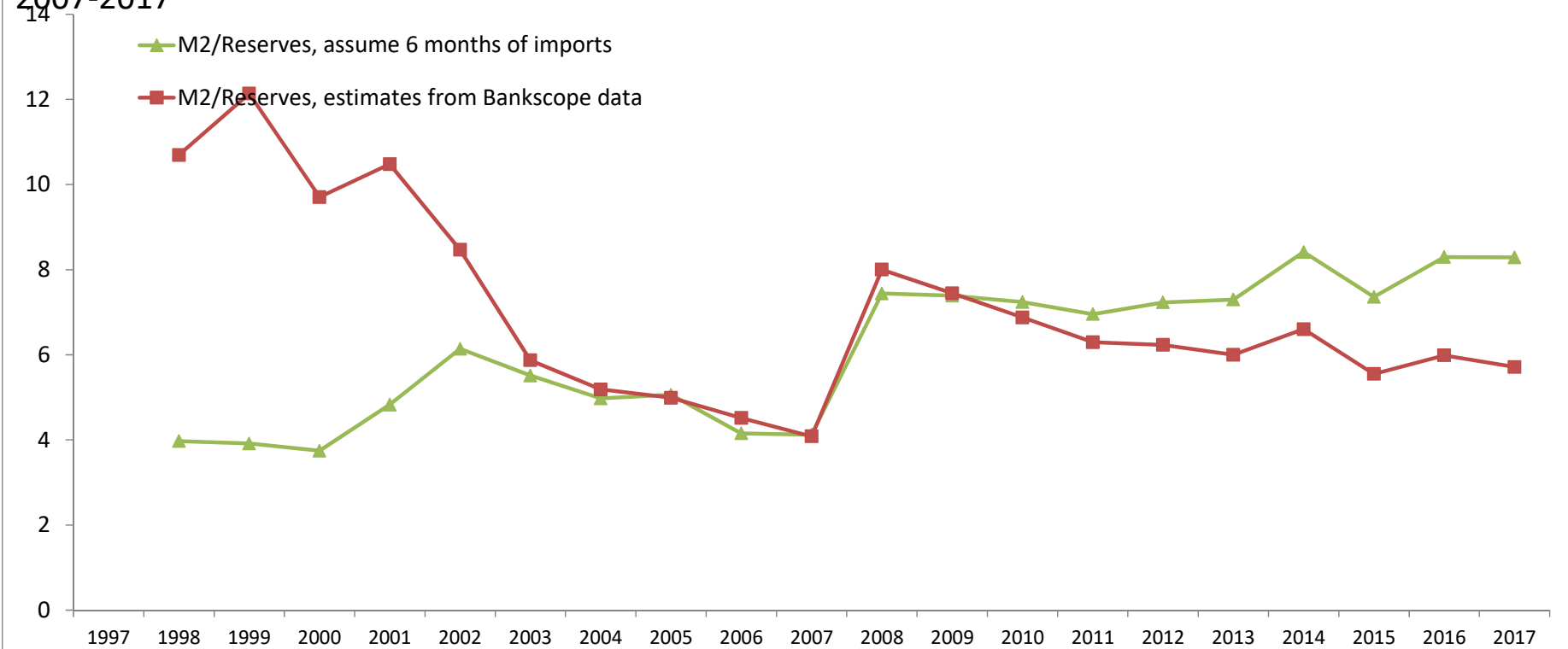
- The best option would be to let the exchange rate to float.
- At the beginning the float not necessarily need to be fully free,
 - The float at least would provide a buffer in the presence of unknown shocks.
- A credible and sustainable fiscal policy would be needed to avoid dollarization.



Dollarization will be a problem in any case.

- Float allows the Central Bank to keep a measure of control over monetary policy.
- Fiscal policy will have to be anchored and contracts/taxes/prices will need to be in Cuban pesos.

Cuba: M2/Reserves can serve to anchor expectations
2007-2017



Conclusions

- Dollarizing has some advantages, but would likely result in relative prices that are outside of equilibrium
 - Once prices are set, changing them requires deflation and structural reforms
 - They would be slow and painful.
- Fixing exchange rates without fiscal sustainability is a mistake.
 - At most, if expectations are to be anchored, a crawling peg could be announced,
 - Should be backed with credible fiscal policy.
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