



The EU Debt Crisis

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Roadmap

- Growth—Global, EU, and Asia
- Global Financial Stability—Volatility and Risk Aversion
- The EU Debt Crisis
 - Sovereign debt
 - Banking sector stress
- Trade, Investment, and Financing
 - Trade—DOT and Commodity Composition
 - The Credit Cycle and the “Search for Yield”
 - Capital Flows to Emerging Markets

Growth

The Global Economy

- Global economy at dangerous stage
- G2 growth has slowed
- Downside risks

Eurozone

- Weak growth, risk of recession
- Banking and sovereign debt crisis
- Downside risks dominate

Emerging Asia

- Still healthy growth
- Domestic demand holding
- But downside risks dominate

Vietnam

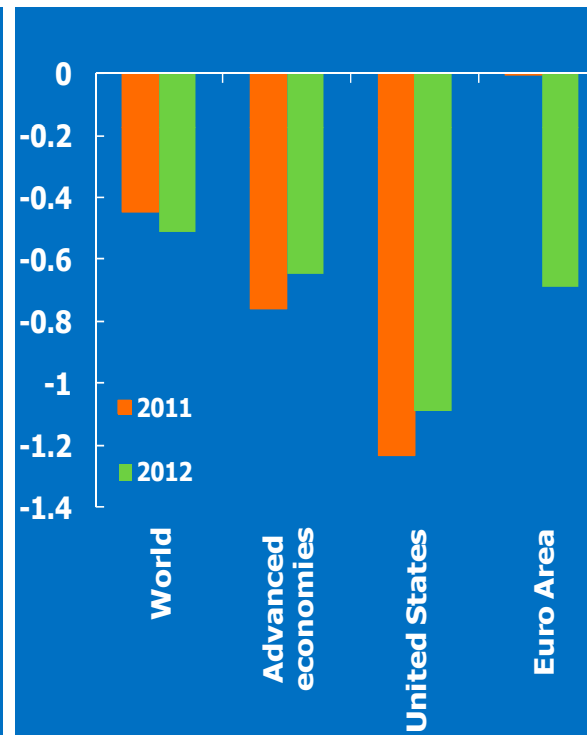
- Macroeconomic instability
- Macrofinancial linkages
- Need for structural reforms

The Global Economy

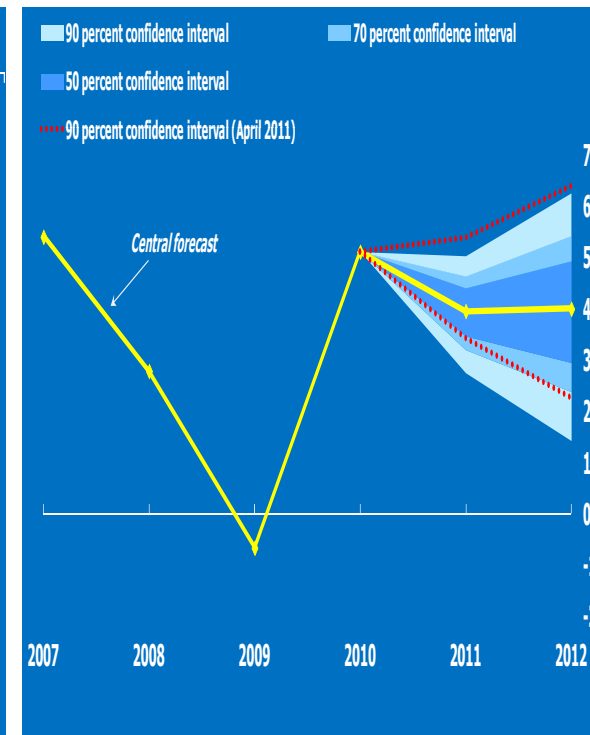
World GDP Growth
(y-o-y; in percent)

	2010	2011 (Proj.)	2012 (Proj.)
World	5.1	4.0	4.0
Advanced economies	3.1	1.6	1.9
USA	3.0	1.5	1.8
Euro area	1.8	1.6	1.1
United Kingdom	1.4	1.1	1.6
Japan	4.0	-0.5	2.3

Downward Revisions in Growth Forecasts since Apr-'11 WEO
(In percentage points)



Risks to the Global Outlook
(Baseline forecast and selected confidence bands)

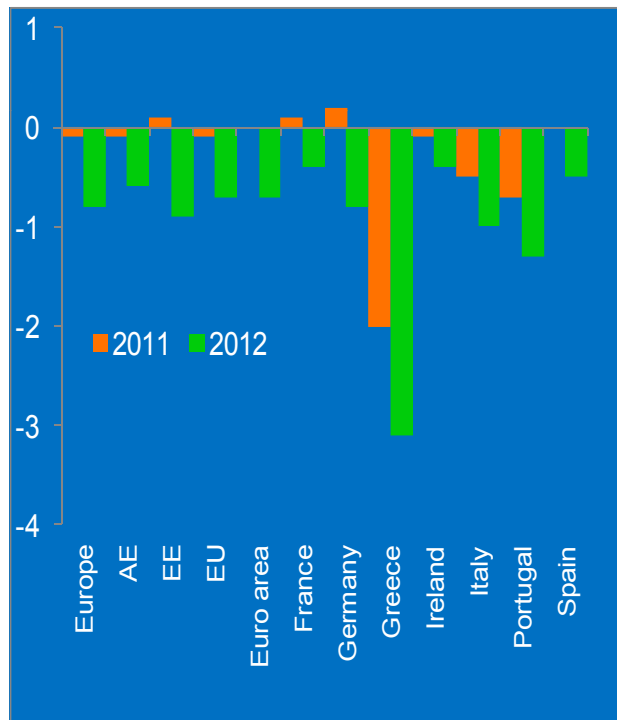


Europe

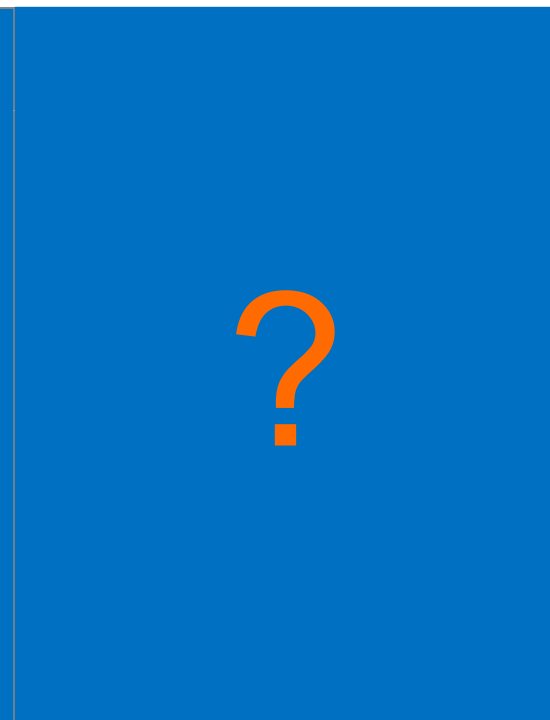
European countries: GDP growth (y-o-y, in percent)

	2010	2011 (Proj.)	2012 (Proj.)
Europe	2.4	2.3	1.8
Advanced economies	1.7	1.6	1.3
Emerging economies	4.4	4.4	3.4
European Union	1.8	1.7	1.4
Euro area	1.8	1.6	1.1
France	1.4	1.7	1.4
Germany	3.6	2.7	1.3
Greece	-4.4	-5.0	-2.0
Ireland	-0.4	0.4	1.5
Italy	1.3	0.6	0.3
Portugal	1.3	-2.2	-1.8
Spain	-0.1	0.8	1.1

Downward Revisions in Growth Forecasts since Apr-'11 WEO (In percentage points)



Risks to the Euro zone's Outlook



Note: AE: Advanced European economies
EE: Emerging European economies

Emerging Asia

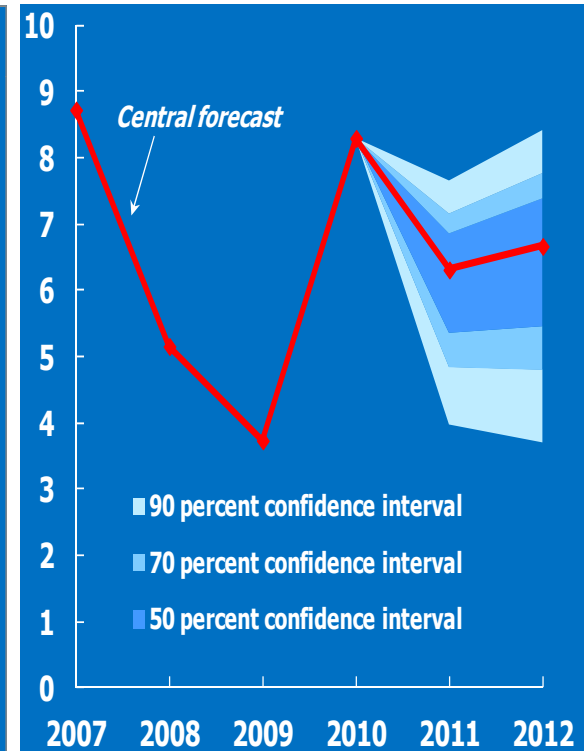
Asia: GDP growth
(y-o-y, in percent)

	2010	2011 (Proj.)	2012 (Proj.)
Emerging Asia	9.5	7.9	7.7
China	10.3	9.5	9
Hong kong SAR	7	6	4.3
Korea	6.2	4.0	4.4
Taiwan PoC	10.9	5.2	5.0
India	10.1	7.8	7.5
Indonesia	6.1	6.4	6.3
Malaysia	7.2	5.2	5.1
Philippines	7.6	4.7	4.9
Singapore	14.5	5.3	4.3
Thailand	7.8	3.5	4.8
Vietnam	6.8	5.8	6.3

Downward Revisions in Growth Forecasts since Apr-'11 WEO
(In percentage points)

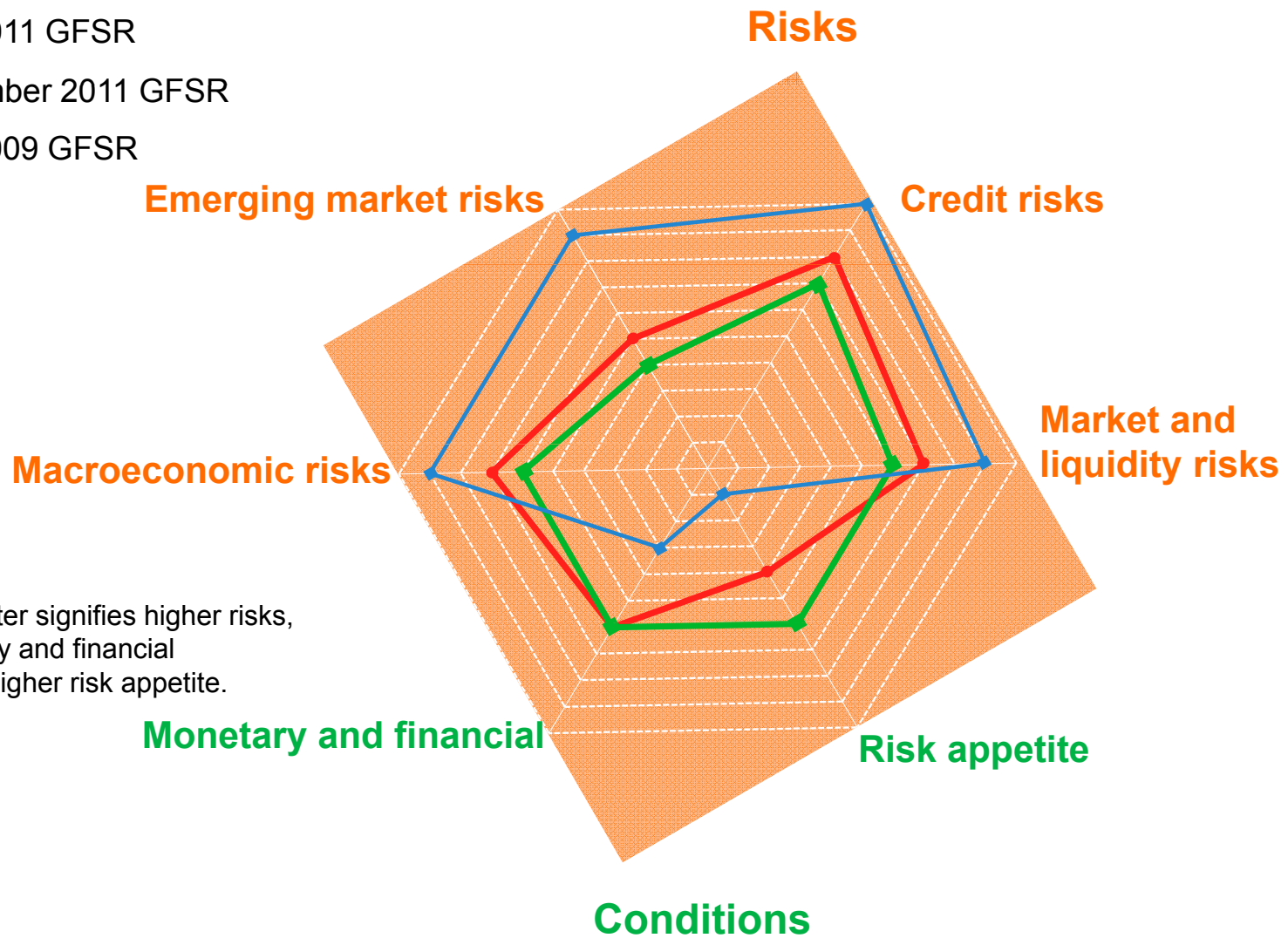


Risks to Asian Outlook
(Central forecast and selected confidence intervals; in percent)

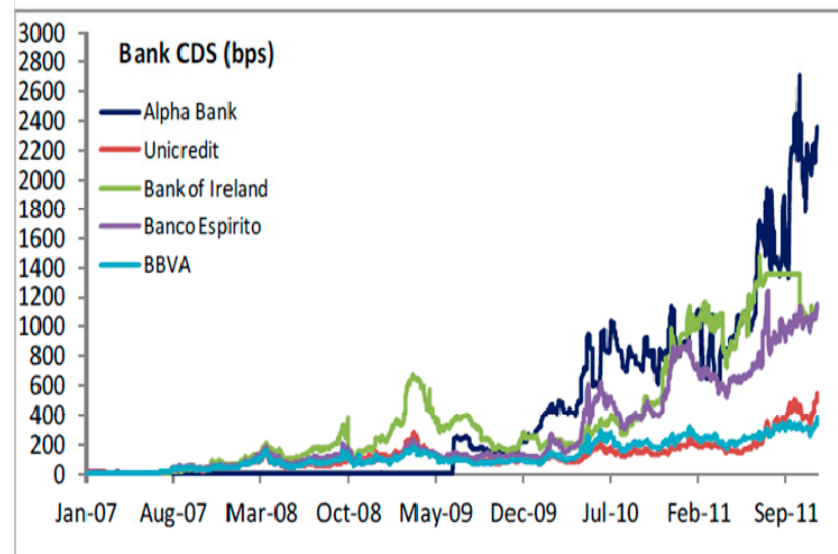
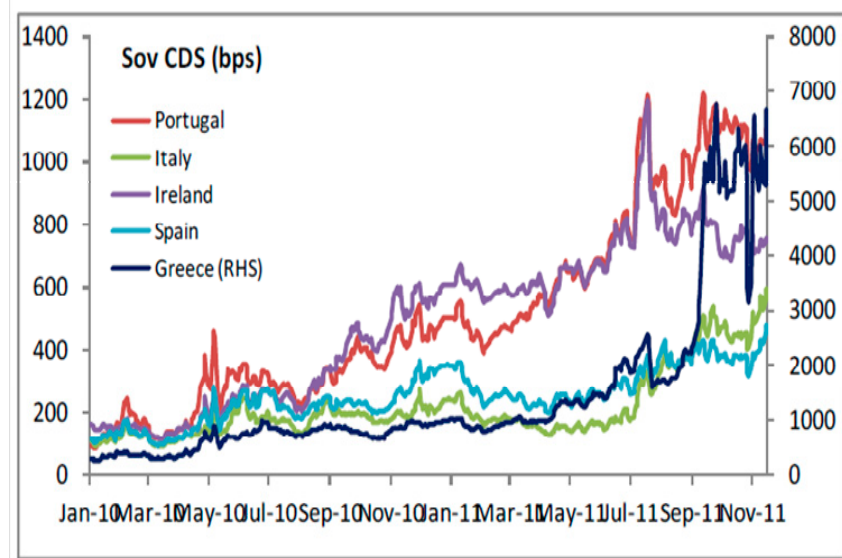
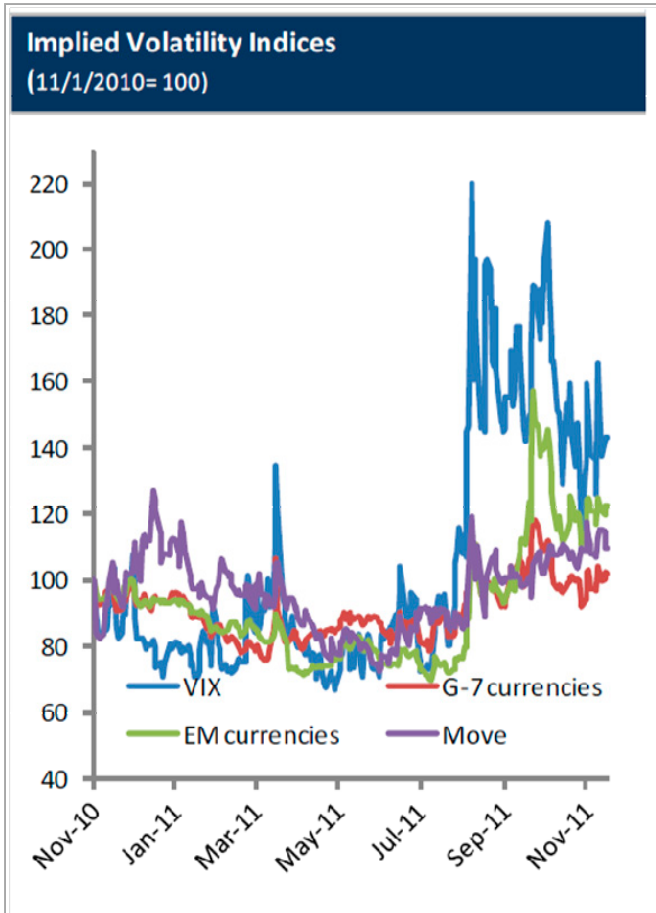


Global Financial Stability

- April 2011 GFSR
- September 2011 GFSR
- ◆ April 2009 GFSR

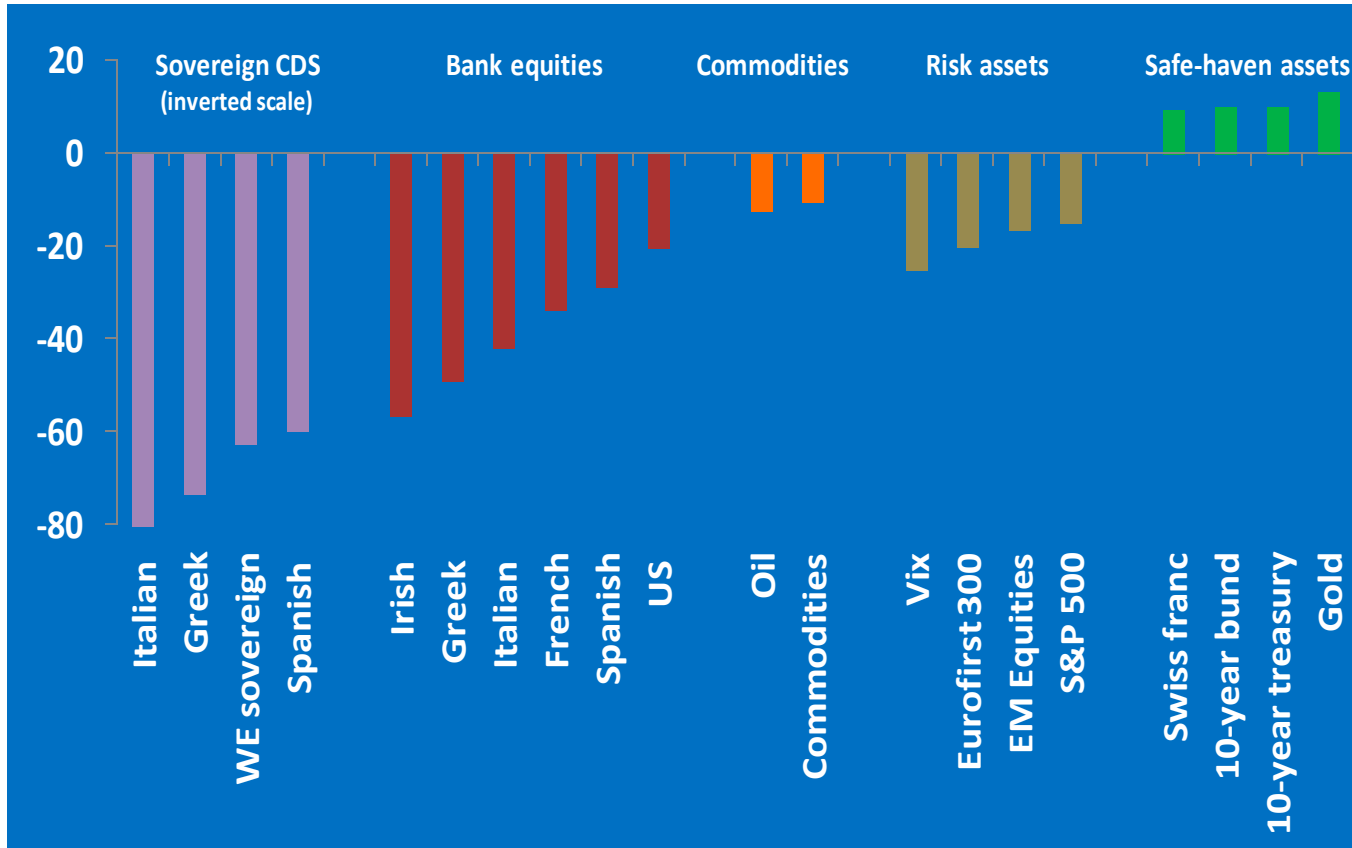


Volatility and Risk Aversion

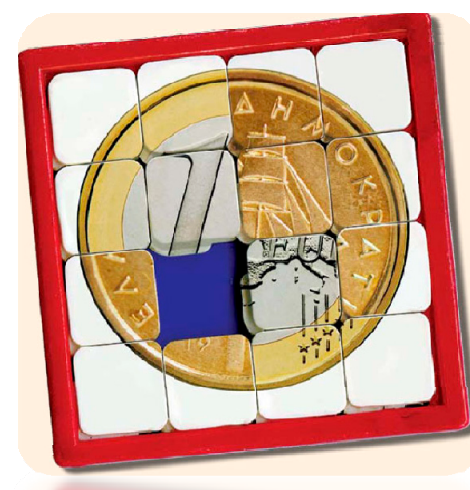
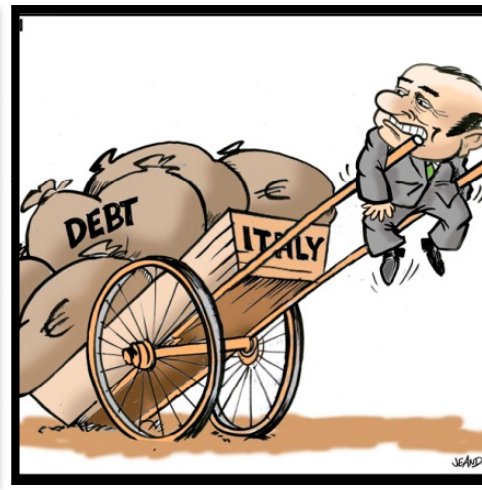


Flight to “Safe Havens”””

Asset Price Performance since April GFSR
(percent)



The EU Debt Crisis



Growth/Recession
Banking stress/Recapitalization
Productivity
Market Confidence

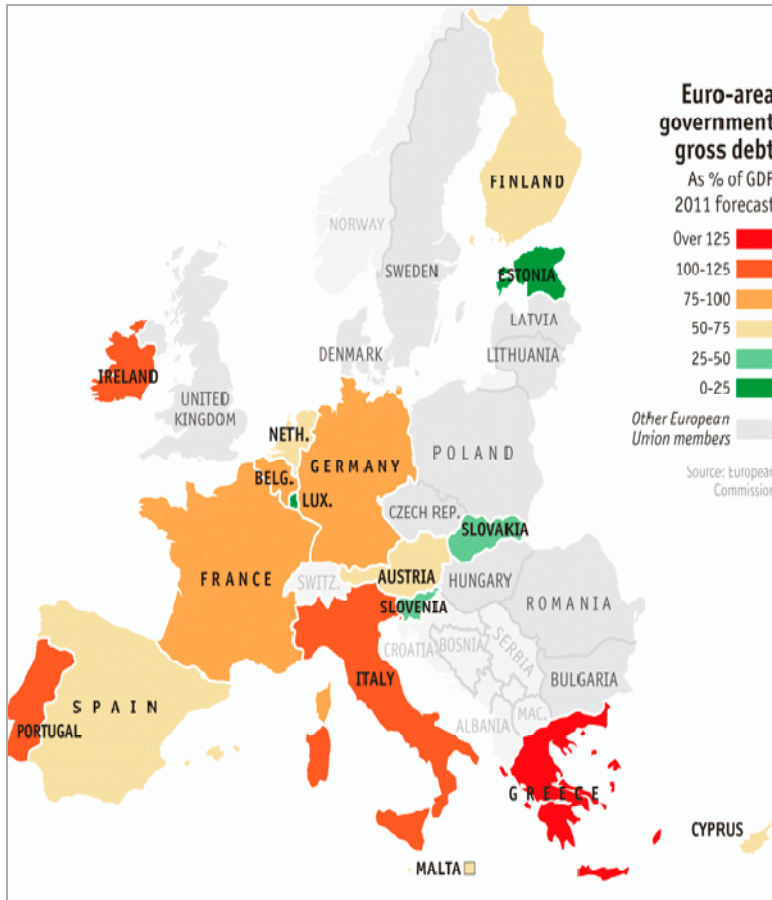
Sovereign debt/Fiscal reforms
Structural Reforms

Capital markets
the Euro

Sovereign Debt

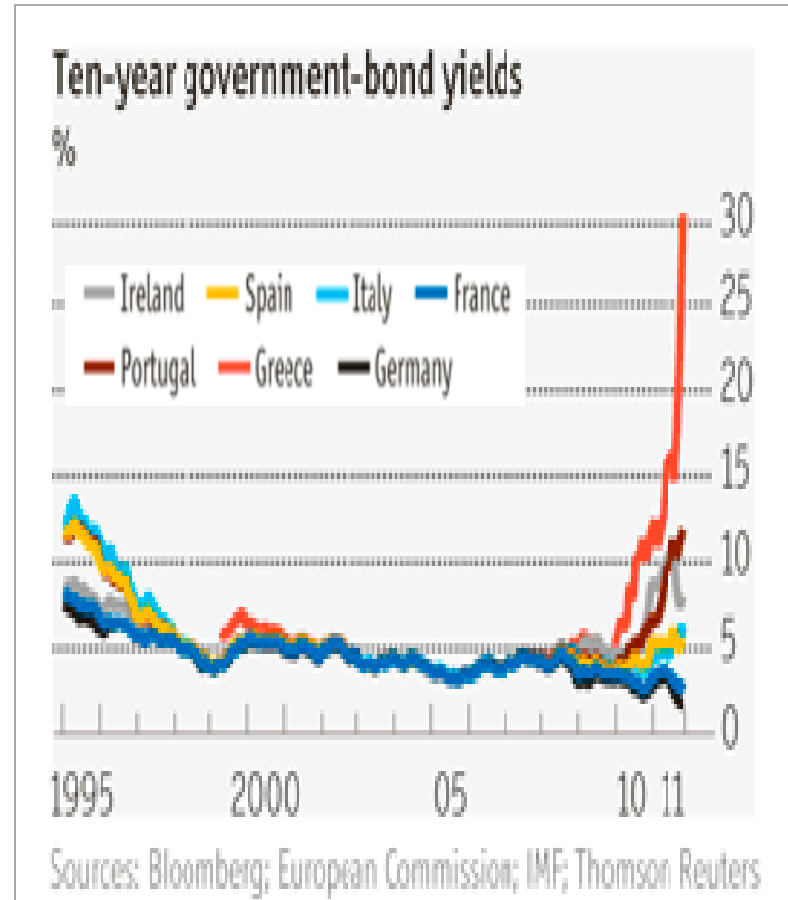
Public Debt

(in percent of GDP)



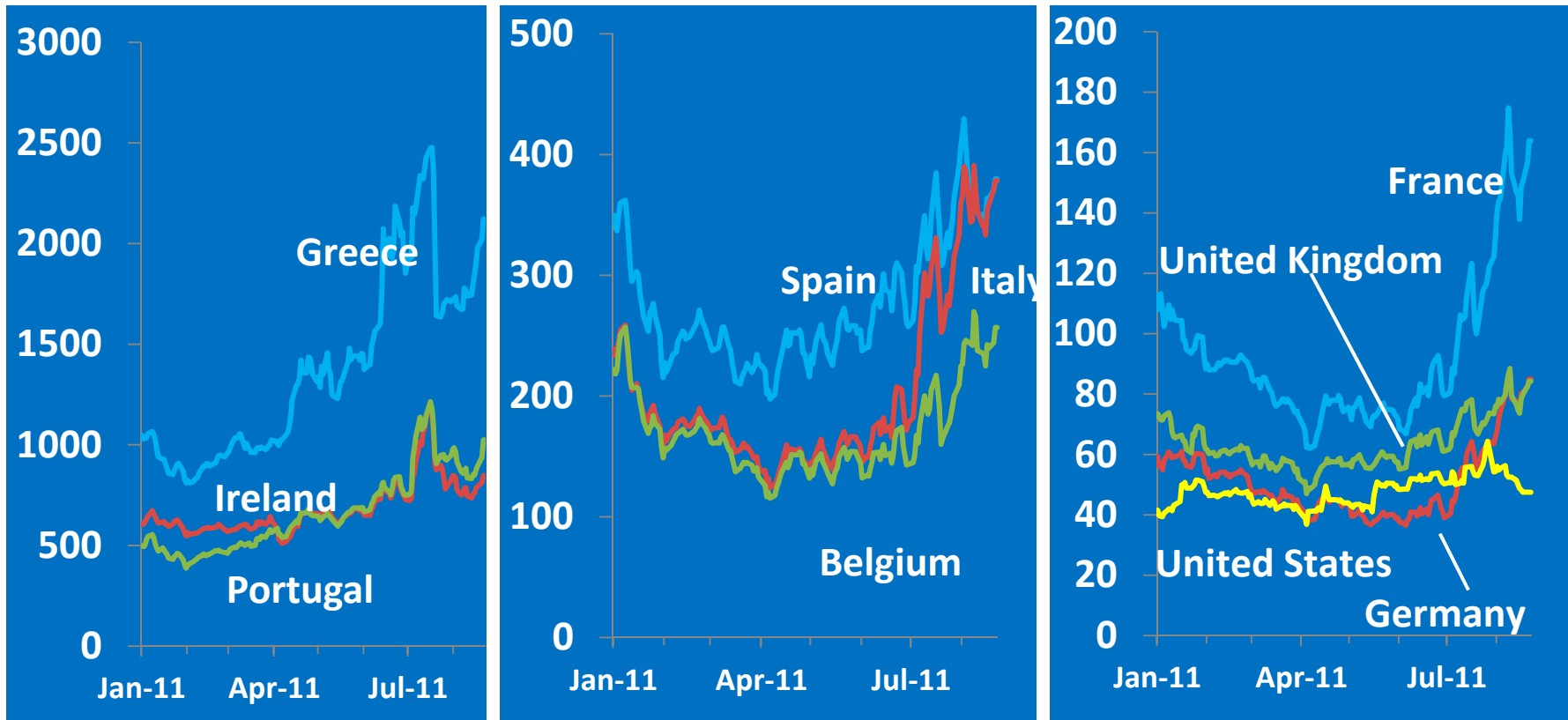
Bond Yields

(in percent)



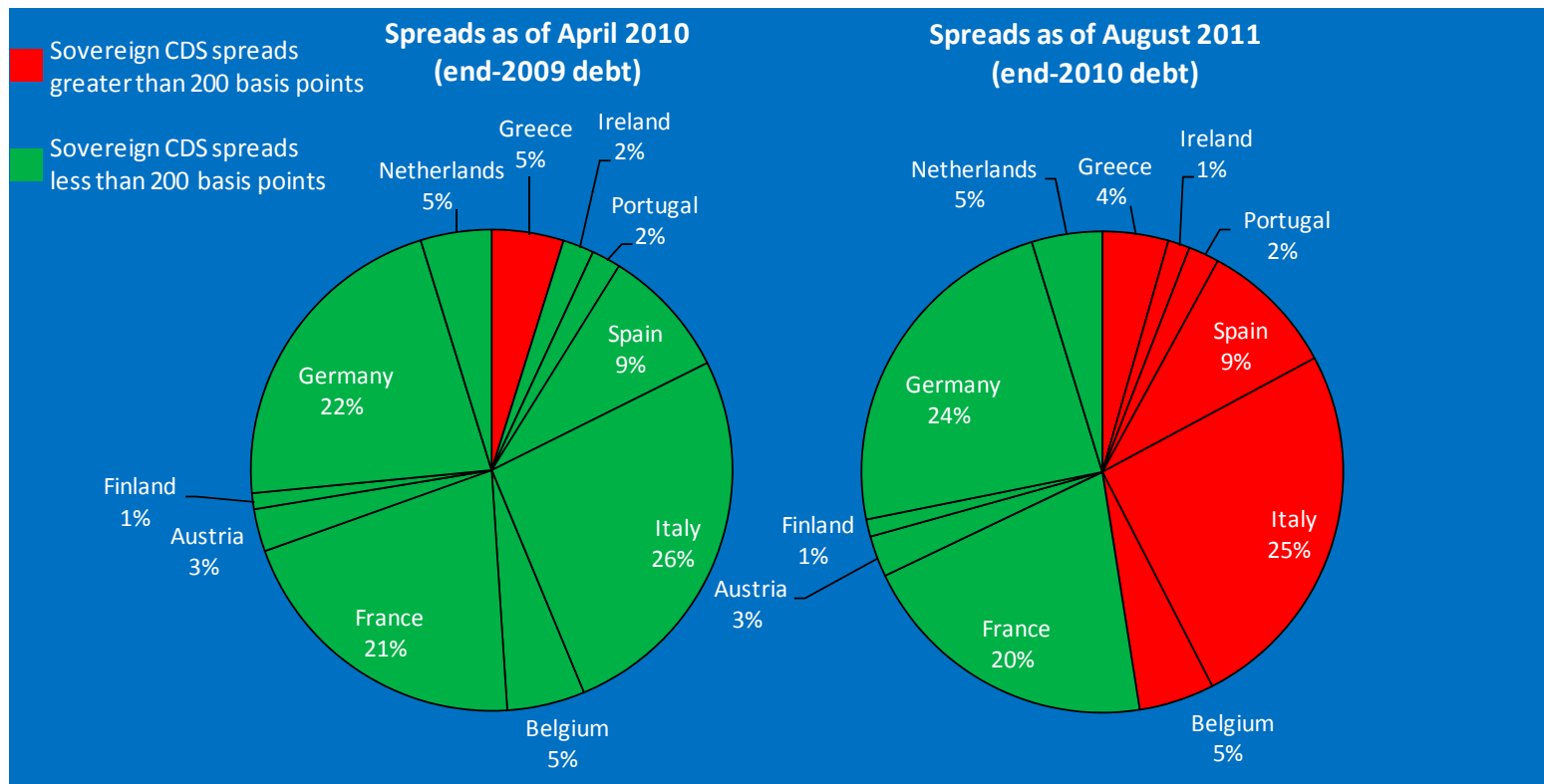
Sovereign strains in the Euro area

Credit Default Swap Spreads
(basis points)



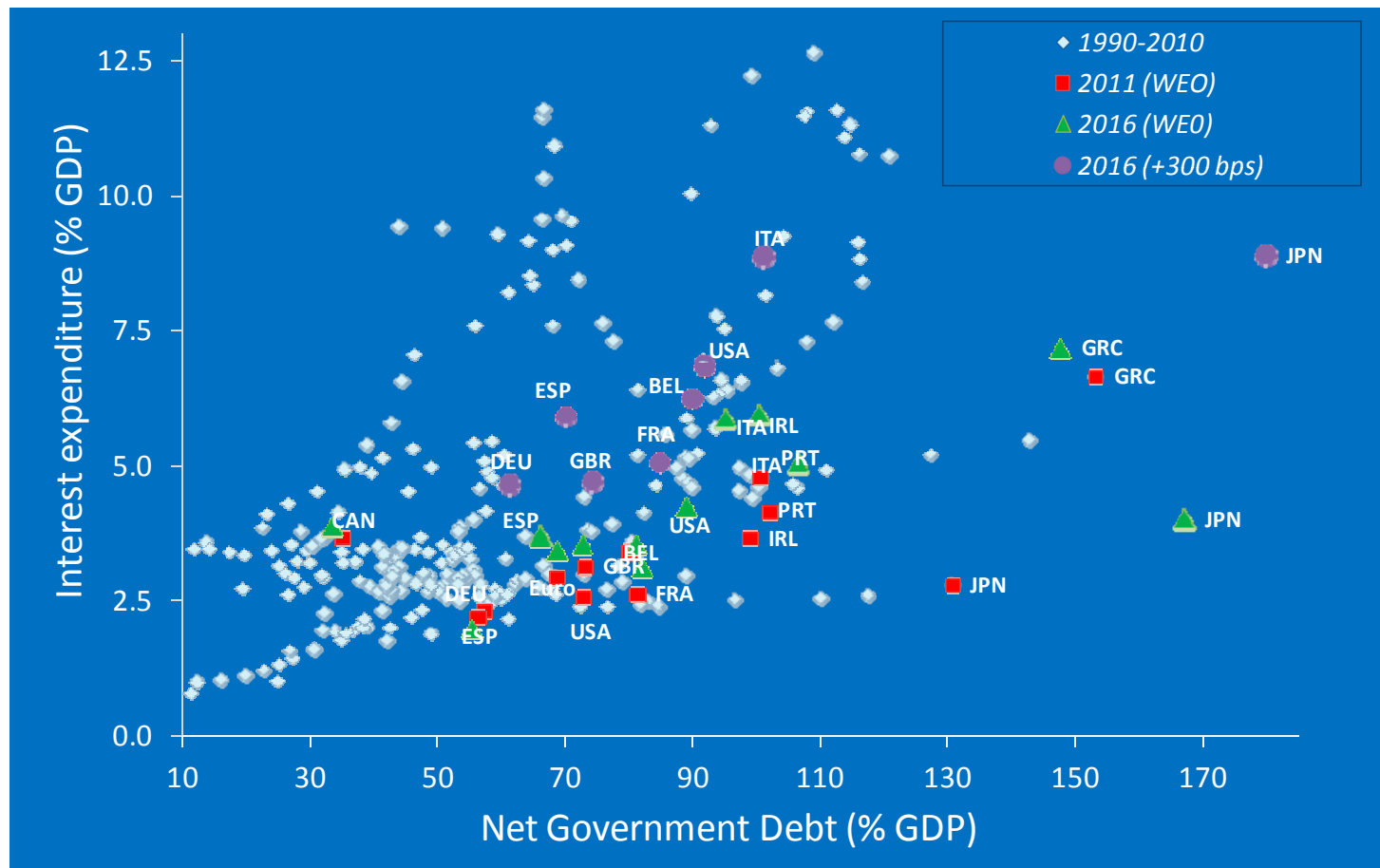
... spread and intensification ...

Size of High-Spread Euro Area Government Bond Markets
(percent of total euro area government debt)



... with spotlight on some sovereigns' vulnerability to higher funding costs

Sensitivity to an Interest Rate Shock
(percent of GDP)

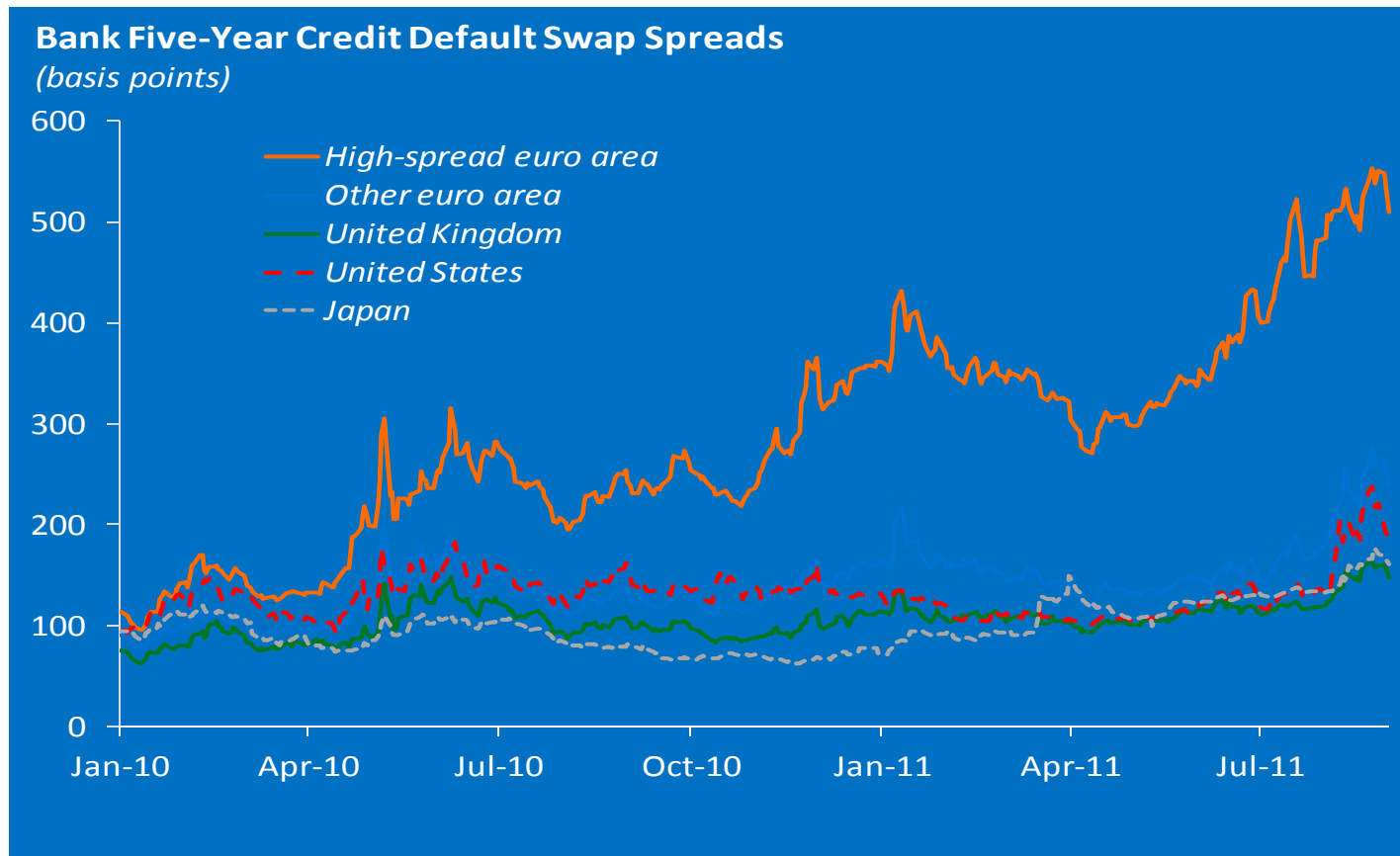


Concerns about U.S. sovereign risk

- Debt ceiling stalemate in July/August has weakened confidence
- Doubts about capacity of the political process to achieve necessary consensus on fiscal strategy
- Some investor nervousness apparent from market indicators...
... but treasuries have retained safe-haven status for now
- Continued investor confidence is good news...
... but must not lead to complacency

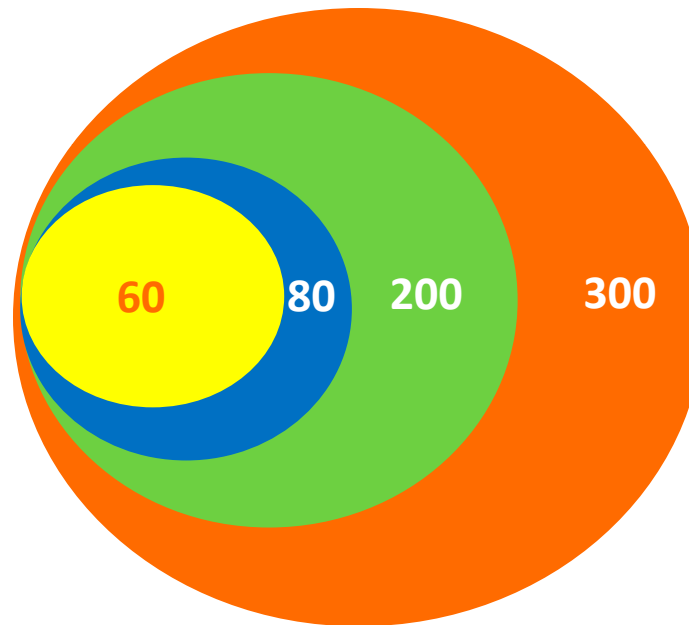
Banking Sector Stress

Spillover of Euro area sovereign risks to the European banking system ...



... with a significant impact of higher sovereign risk premia on banks' bond portfolios ...

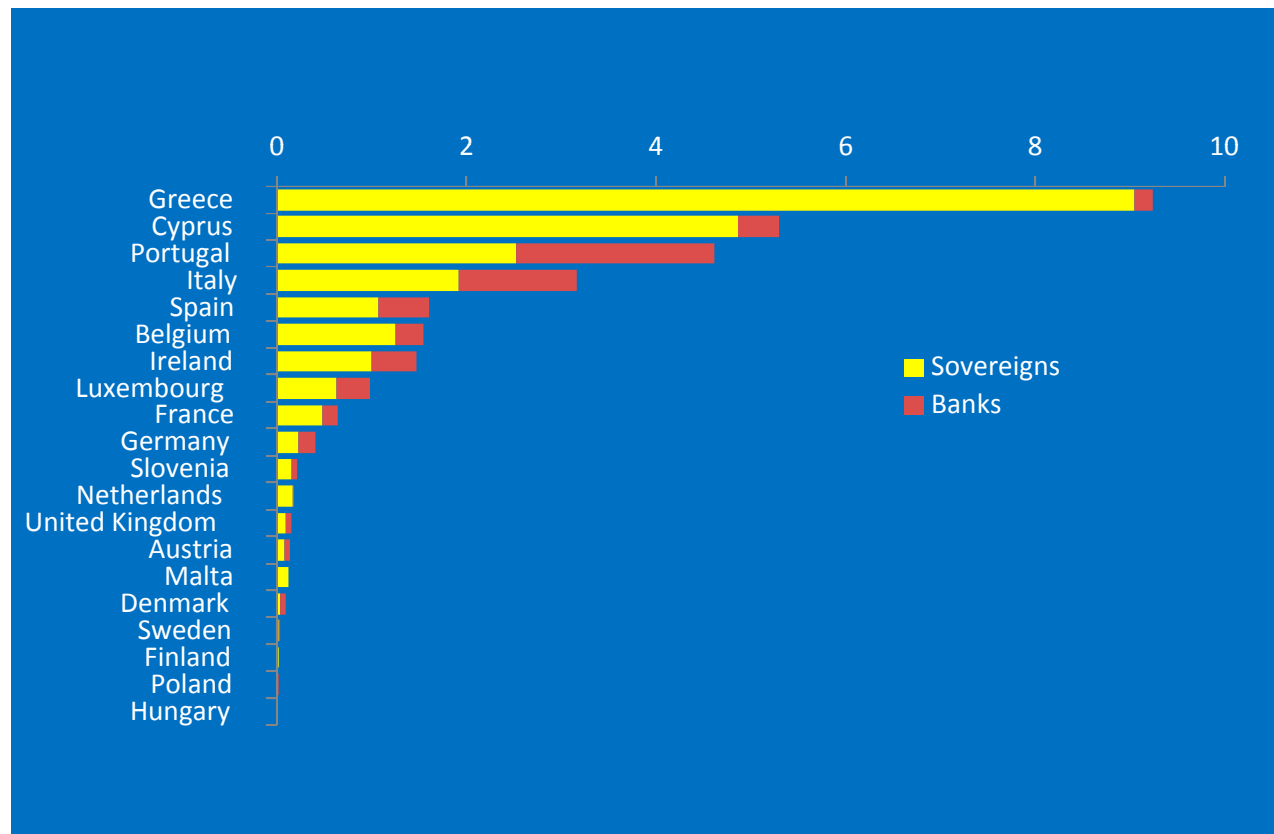
Cumulative Spillovers from High-Spread Euro Area Sovereigns to the EU Banking System
(Billions of Euros)



- Greek sovereign
- Irish & Portuguese sovereigns
- Belgian, Spanish & Italian sovereigns
- High-spread euro area banking sector

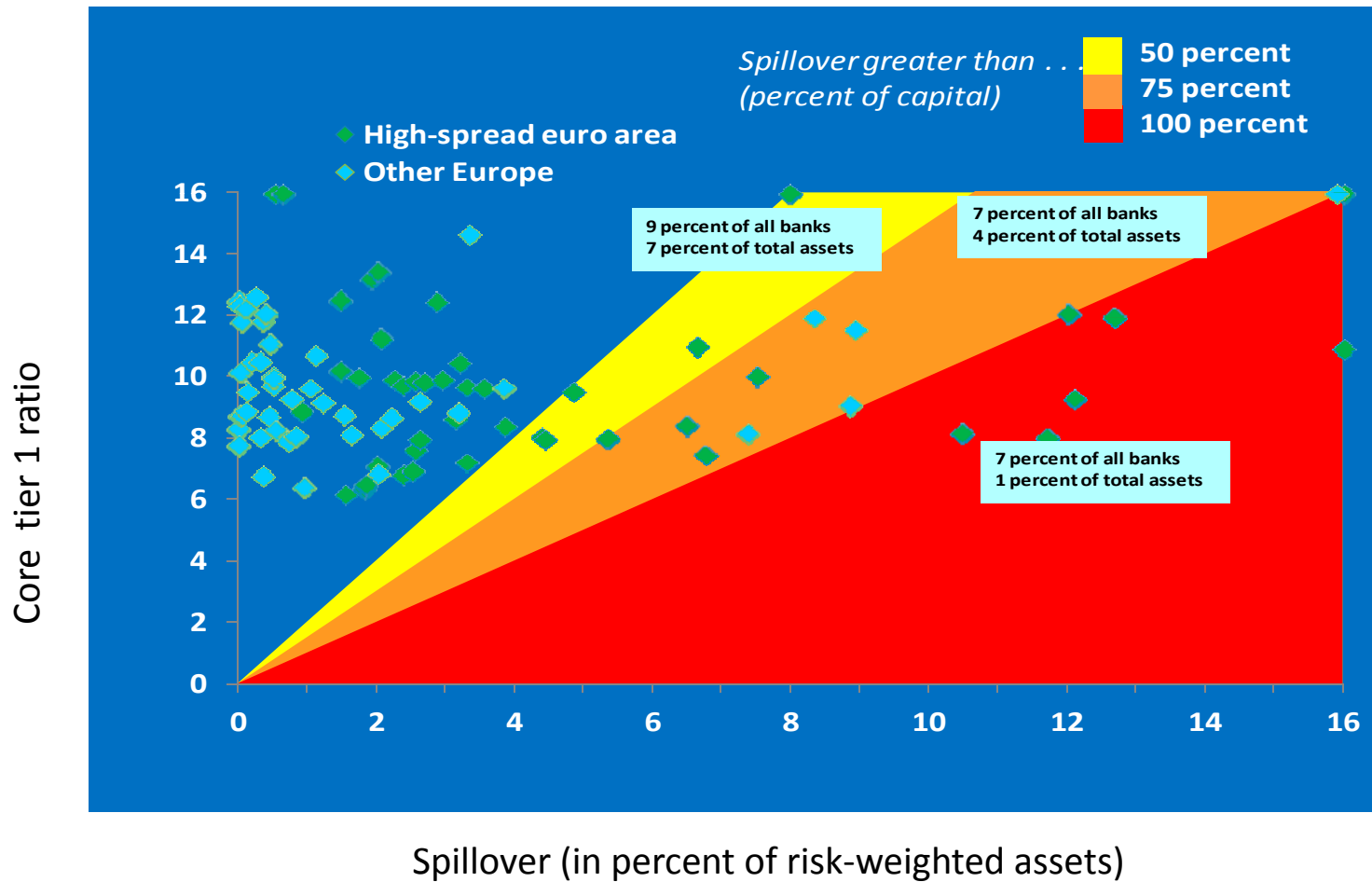
... but with considerable variation across countries ...

**Spillovers from High-Spread Euro Area Sovereigns
to Country Banking Systems**
(percent of assets)



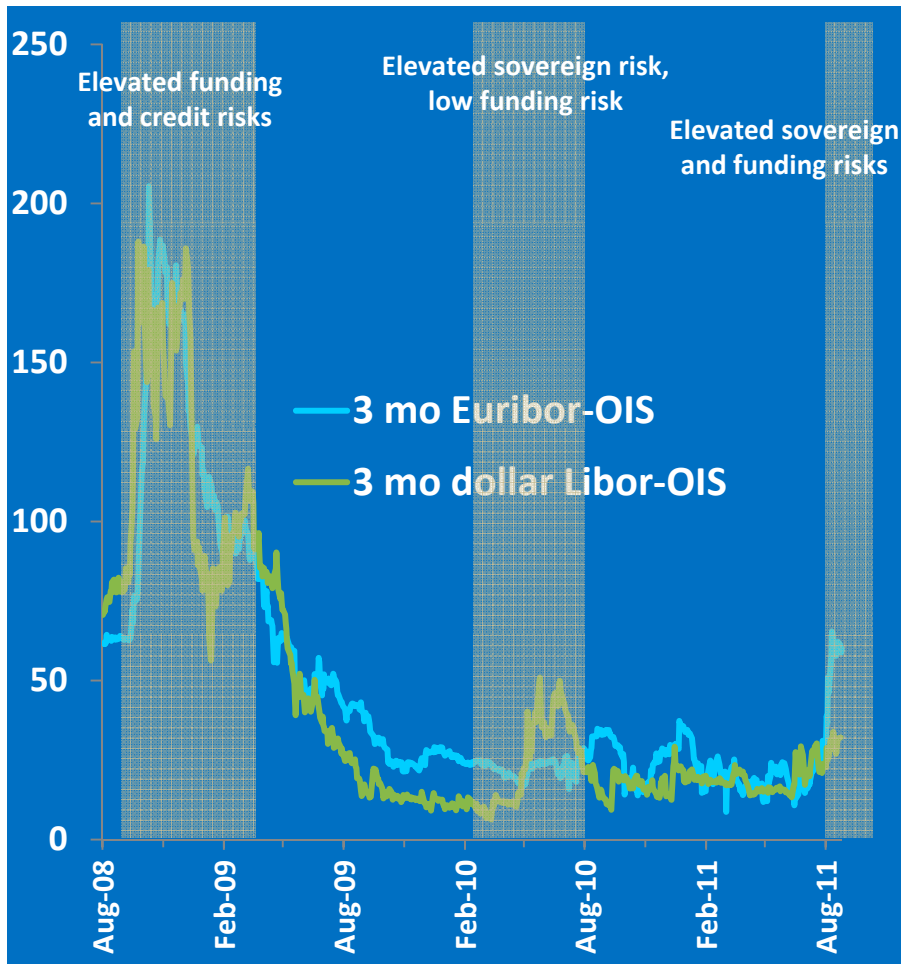
... exposing a particularly weak tail of banks

Distribution of Spillovers from High-Spread Euro Area Sovereigns to EU Banks

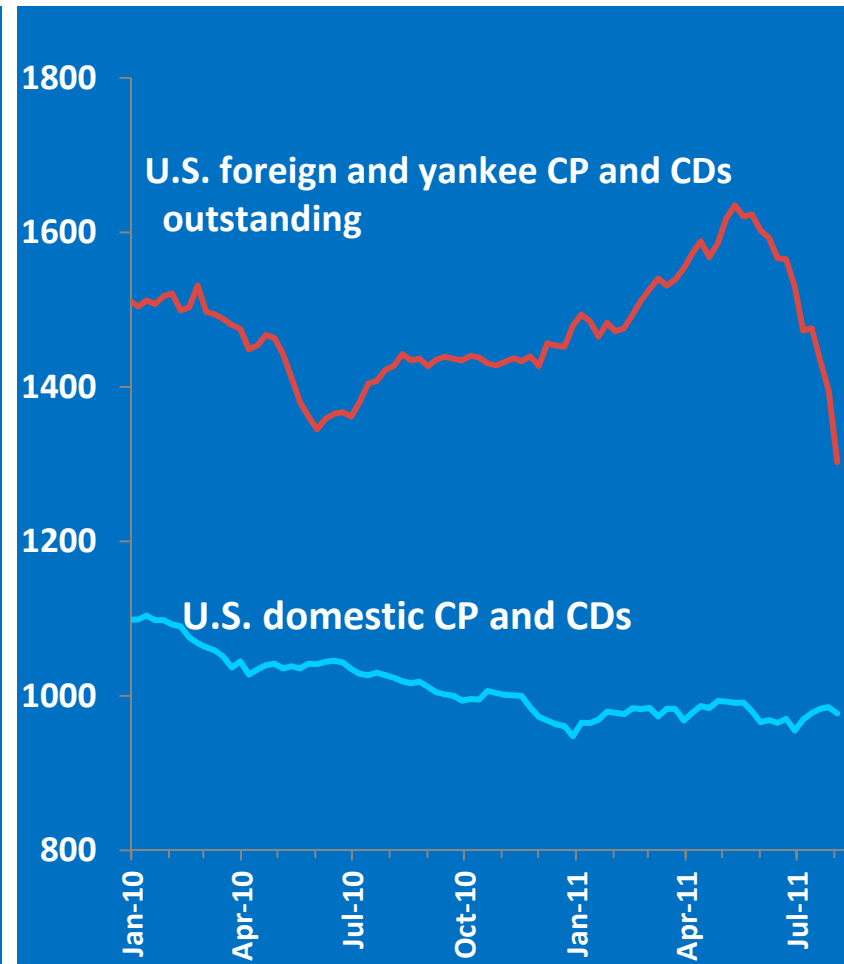


Banking system stress has adversely affected funding markets ...

Funding Spreads in Dollar and Euro Markets
(basis points)

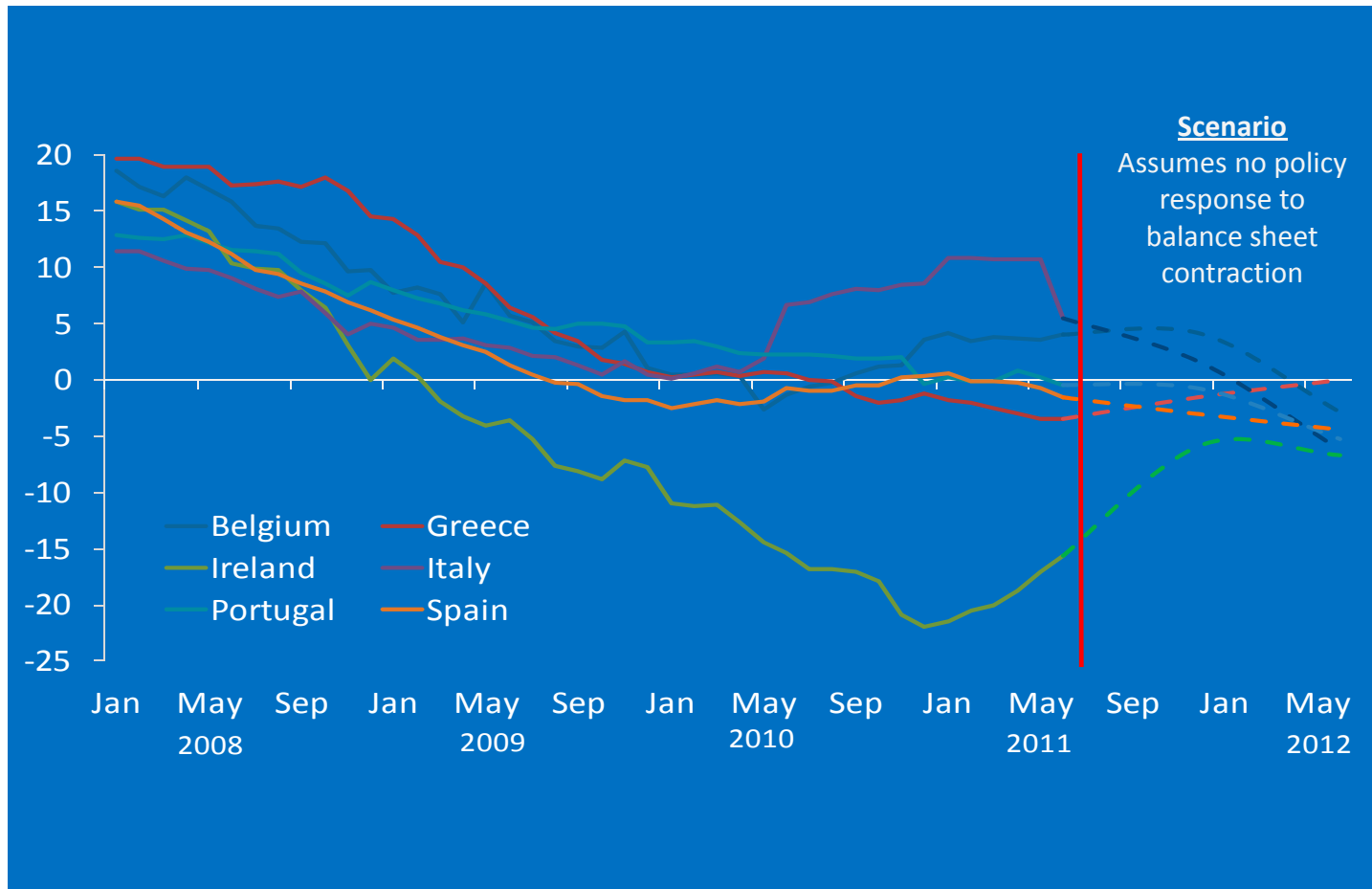


U.S. Money Markets
(\$ bn)



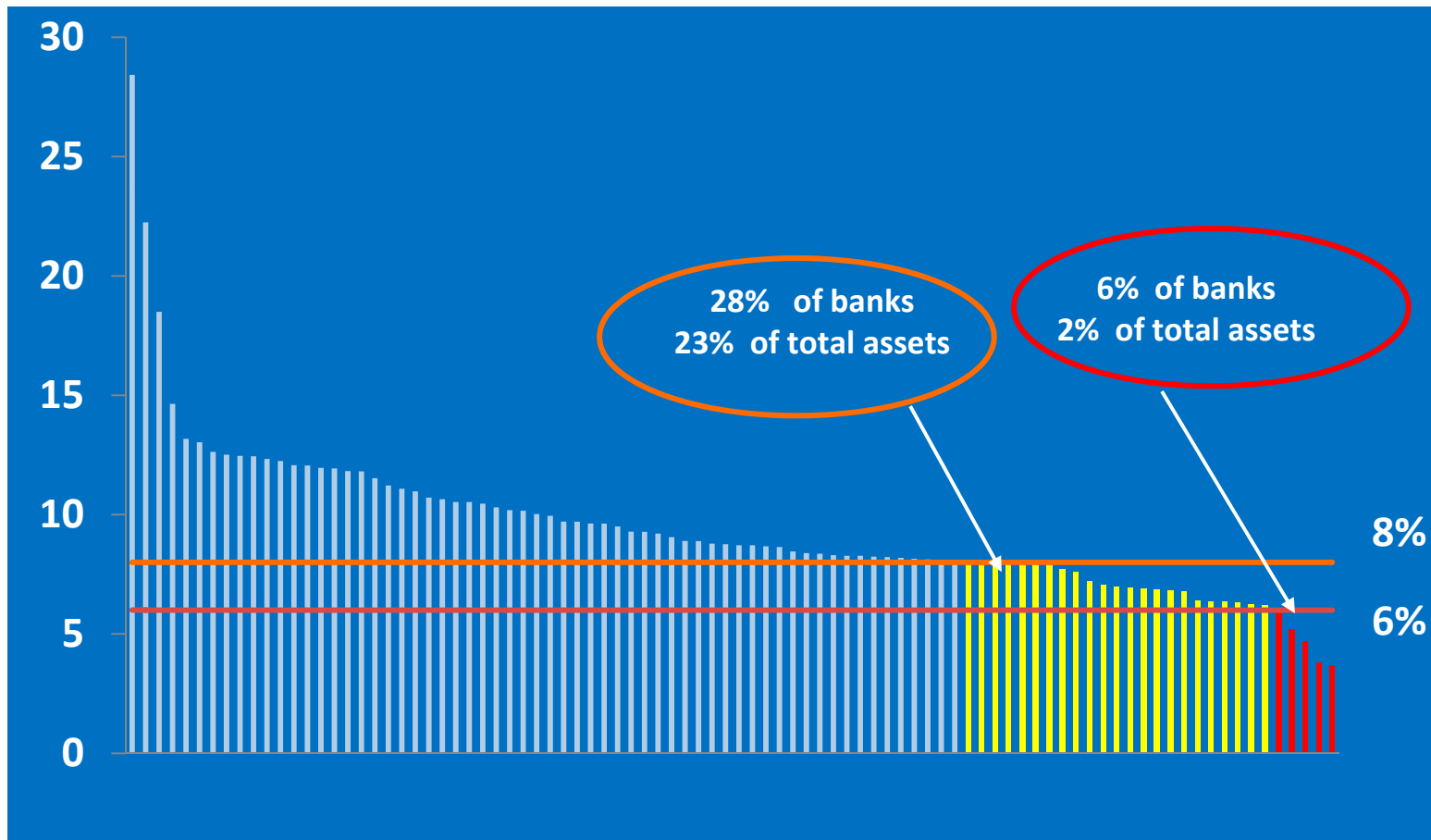
... and risks becoming a drag on the real economy ...

Bank Credit Growth
(percent year-on-year)



... as some banks continue to require stronger capital buffers

European Bank Core Tier 1 Ratios
(percent of risk-weighted assets)

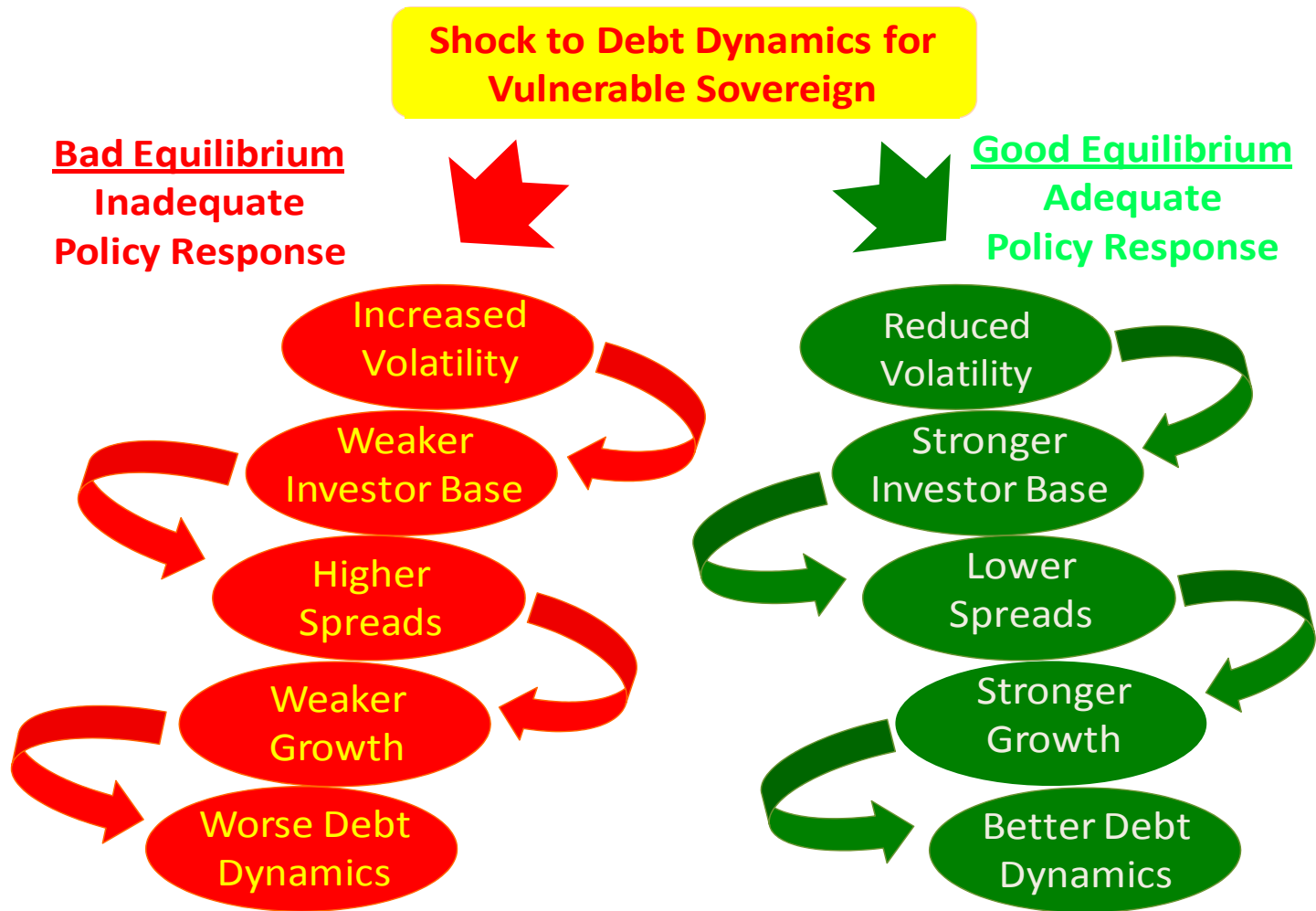


A Dangerous Spot to be In?

- Financial markets continue to question policymakers' ability to secure sufficient support for necessary policy actions
- High uncertainty in light of political disagreement on crucial questions in euro area and US
- Risk of an adverse feedback loop between sovereigns, banks, and real economy



Bad Equilibrium, Good Equilibrium



What needs to be done?

Reduce sovereign risk and prevent contagion:

- Credible plans for medium-term deficit reduction
- Pro-growth structural reforms
- Swift implementation of EFSF reform in euro area
- Enhance euro area crisis management framework further

Strengthen the resilience of the EU financial system:

- Stronger capital buffers to help break the link between sovereign risk and banking sector health

Global Regulatory Reform

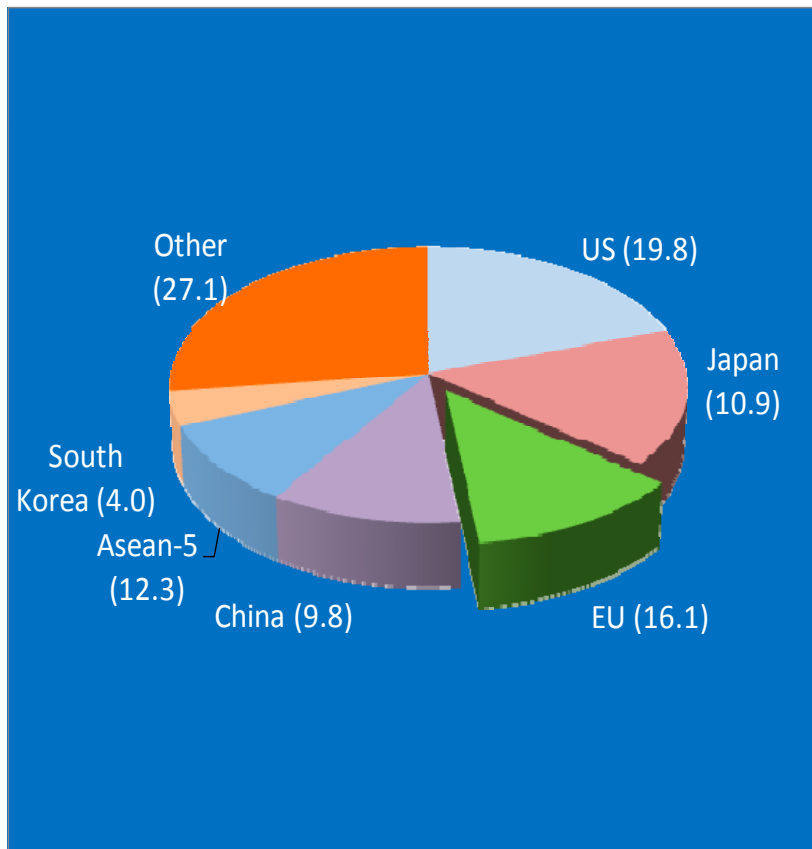
Complete	Basel III SIFIs Shadow Banking Macro-prudential
Implement	Nationally and Internationally

Trade, Investment and Financing

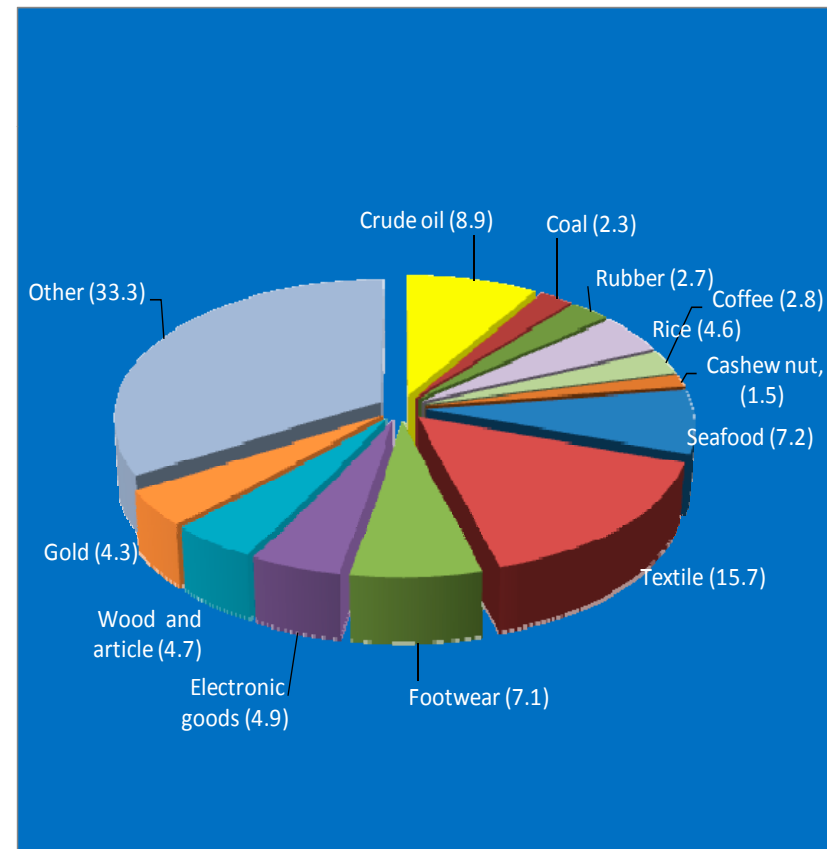
Trade—Direction of Trade and Commodity Composition

Vietnam's Exports and the EU

Vietnam: Exports by destination
(In percent)



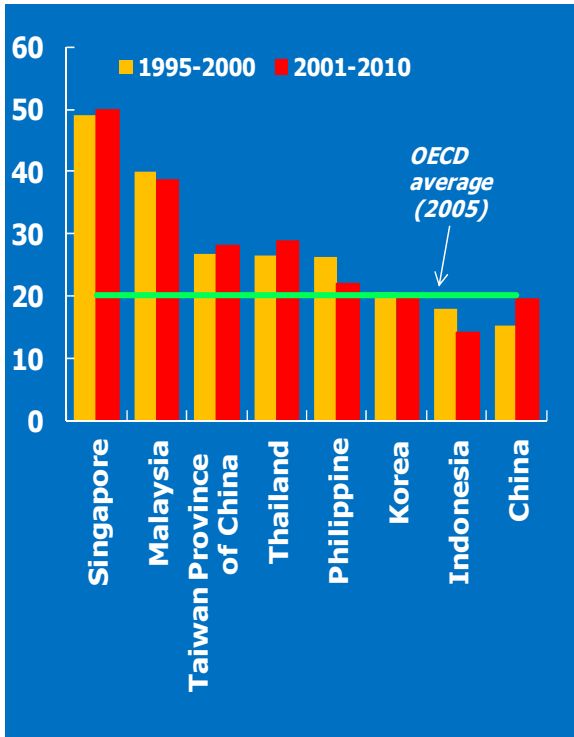
Vietnam: Exports by commodities
(In percent)



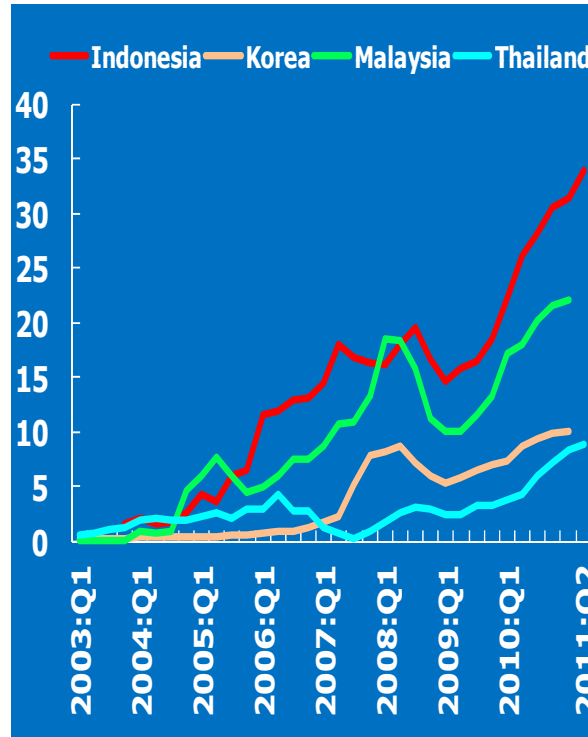
Asia and a Global Recession

Trade and Financial Sector Channels

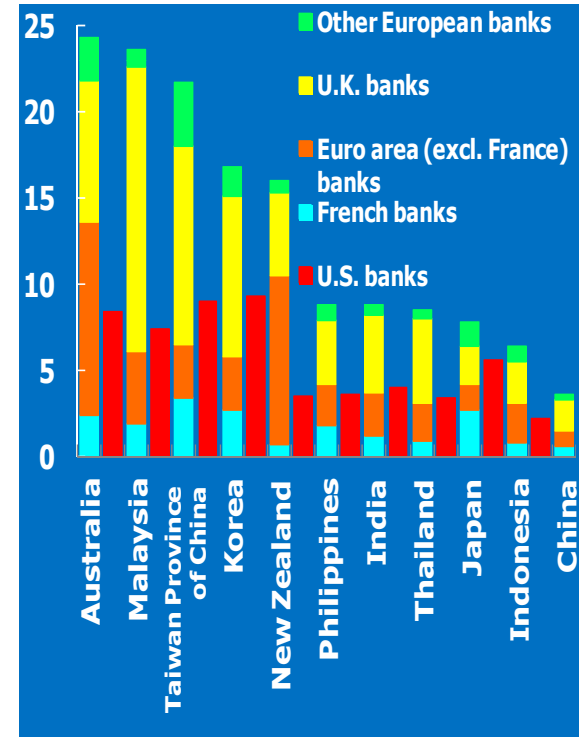
Selected Asia: Contribution of Non-Asian Final Demand to Value Added
(In percent of GDP)



Selected Asia: Foreign Holdings in Local Currency Government Bonds
(In percent of total outstanding local currency government bond)



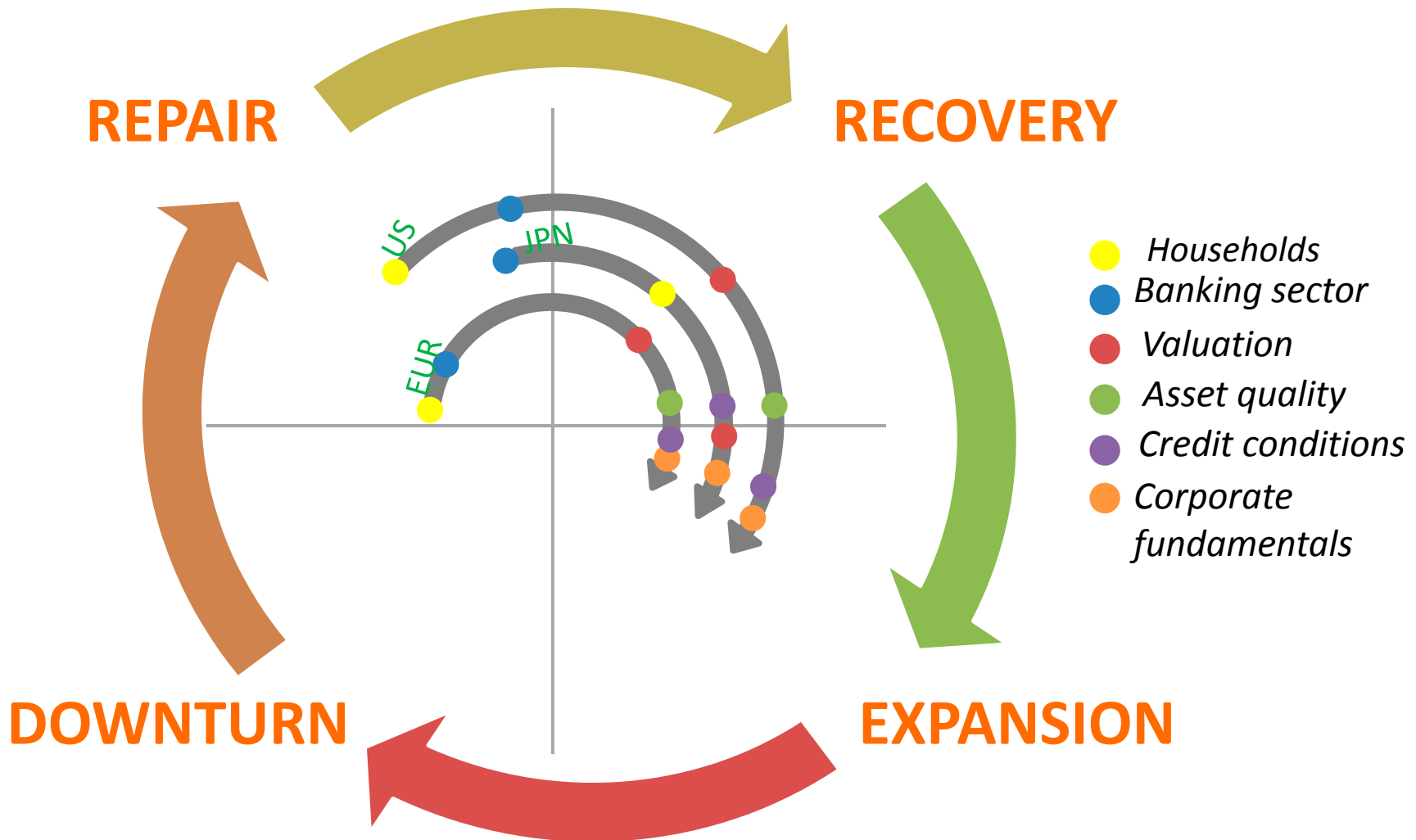
Consolidated Claims of European and U.S. Banks on Selected Asia
(In percent of GDP)



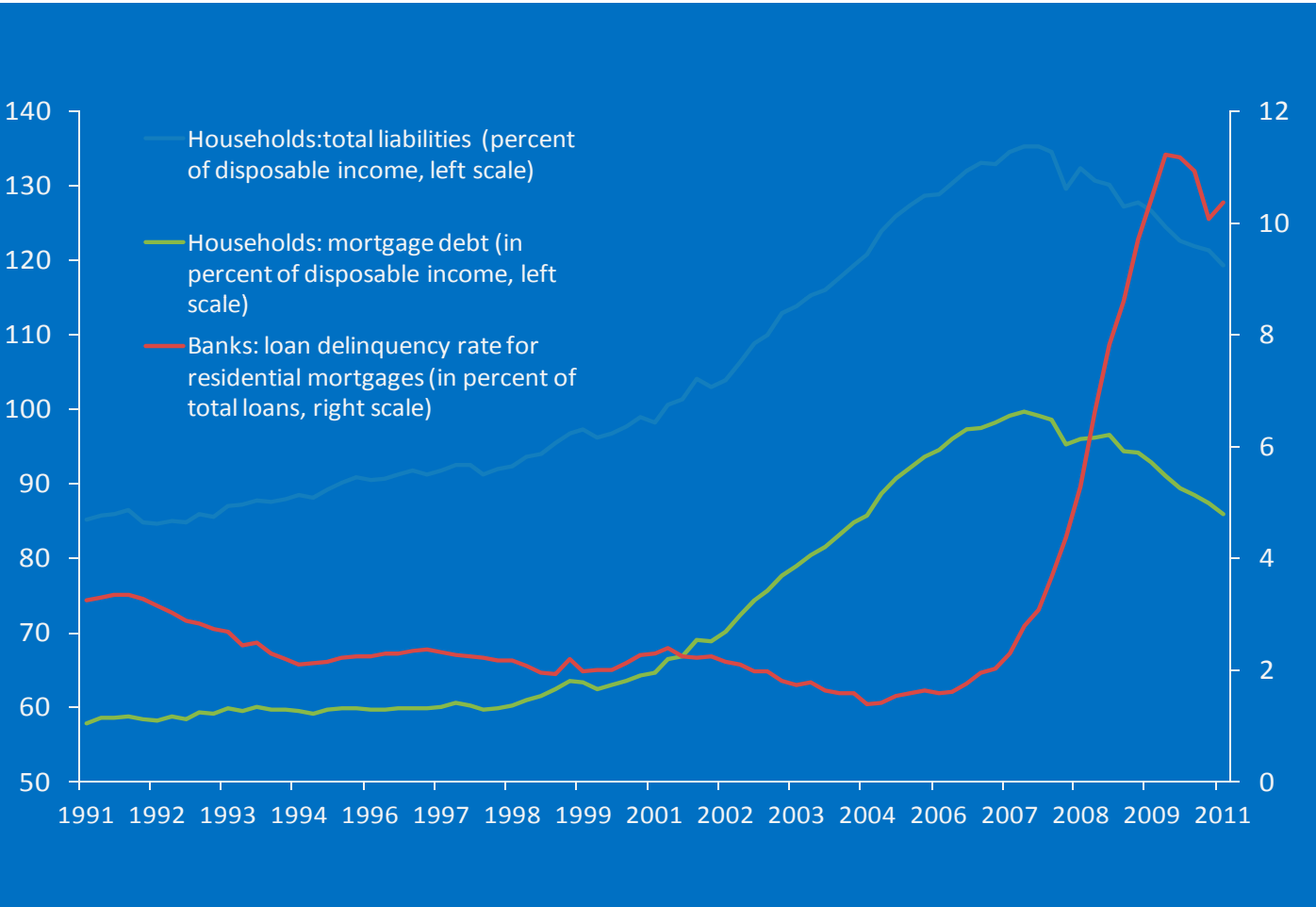
The Credit Cycle and the “Search for Yield”

Advanced economies are stuck between repair and expansion phase of the credit cycle

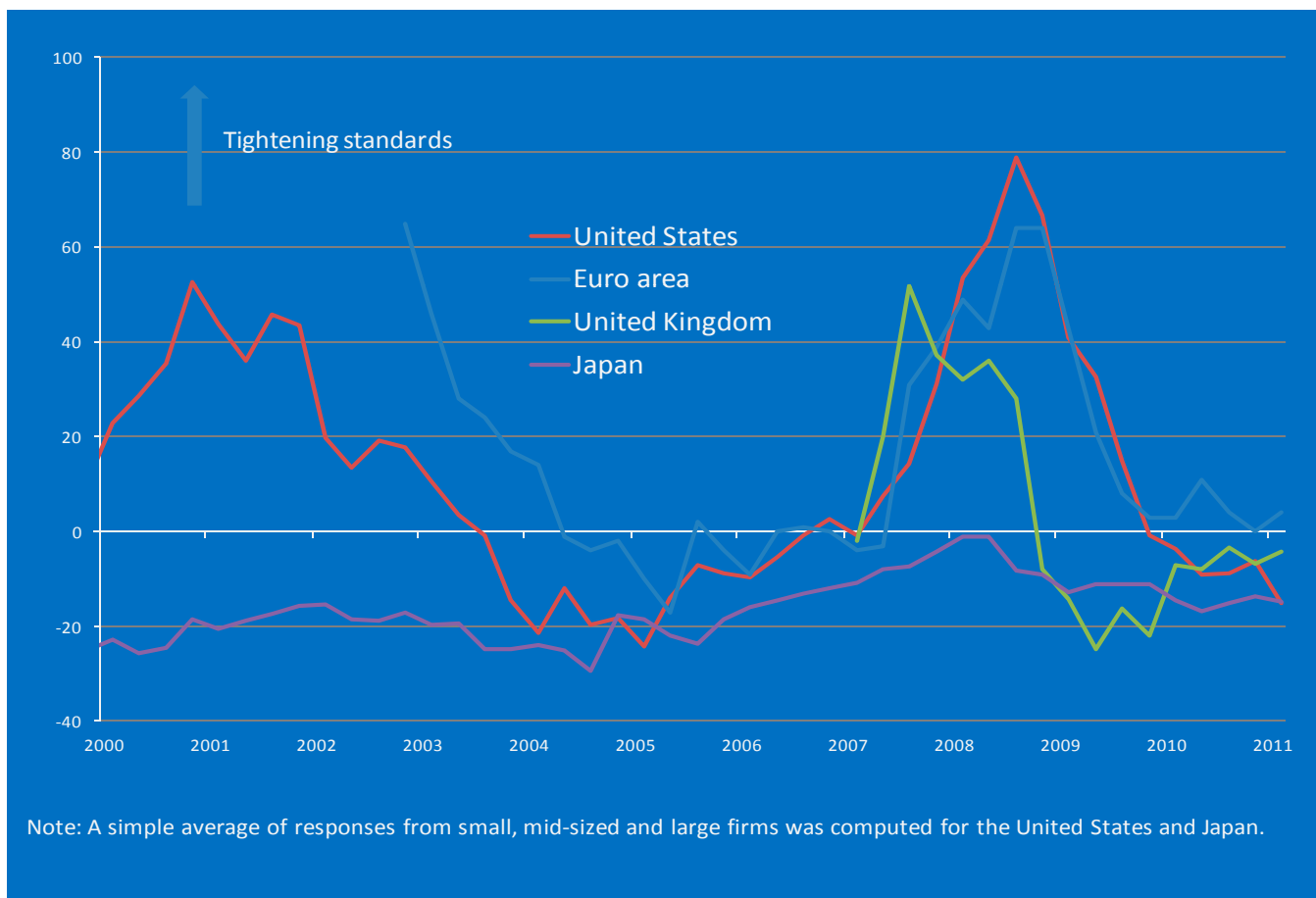
Phases of the Credit Cycle



US Household Sector Financial Conditions



Bank Lending Conditions for Non-financial Corporates



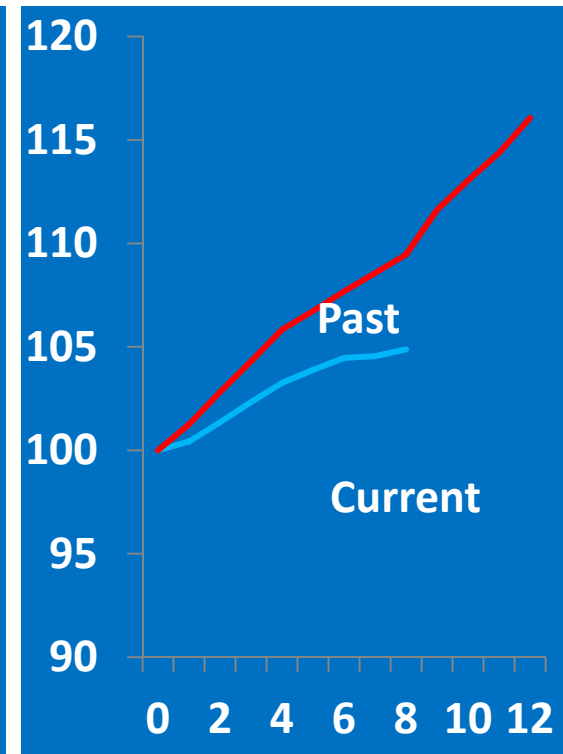
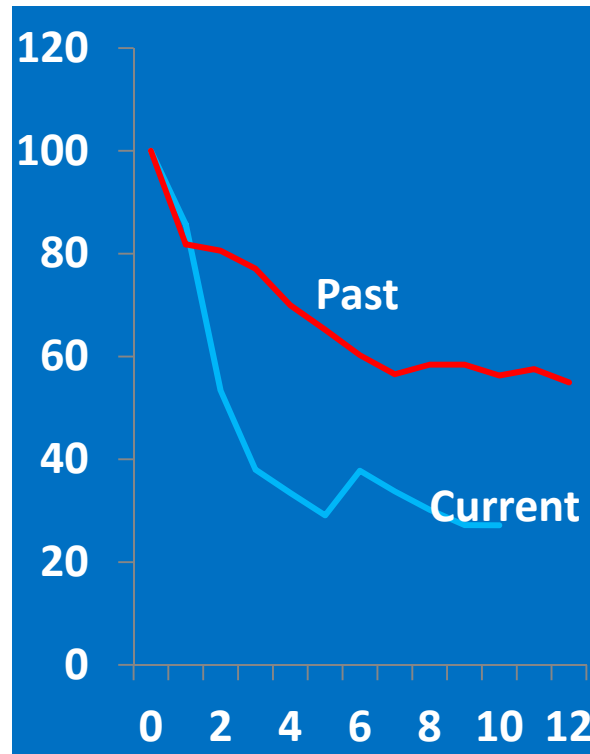
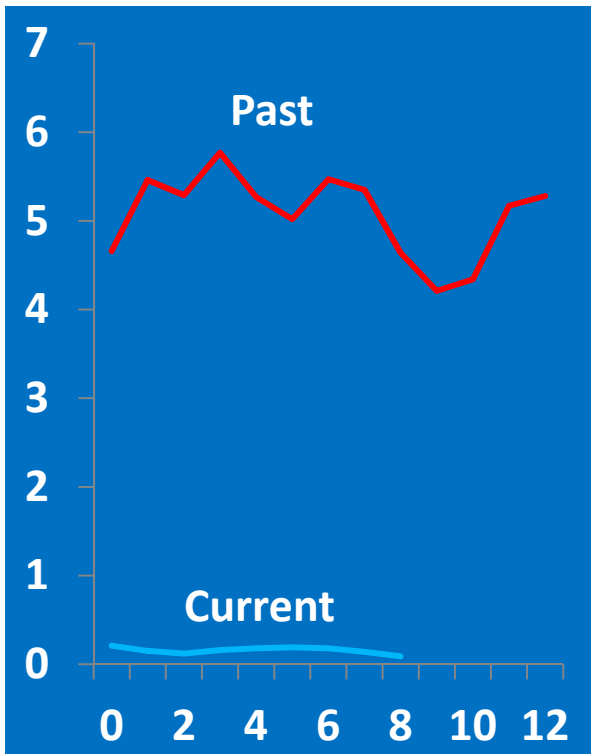
Low policy rates encourage a “search for yield” ...

Fed Funds Rates, BBB-rated Corporate Credit Spreads, and U.S. Real GDP Cumulative Growth

U.S. Fed Funds Rate
(percent)

U.S. BBB-rated Corporate Spreads
(100 = beginning of each cycle)

U.S. Real GDP Cumulative Growth
(100 = beginning of each cycle)

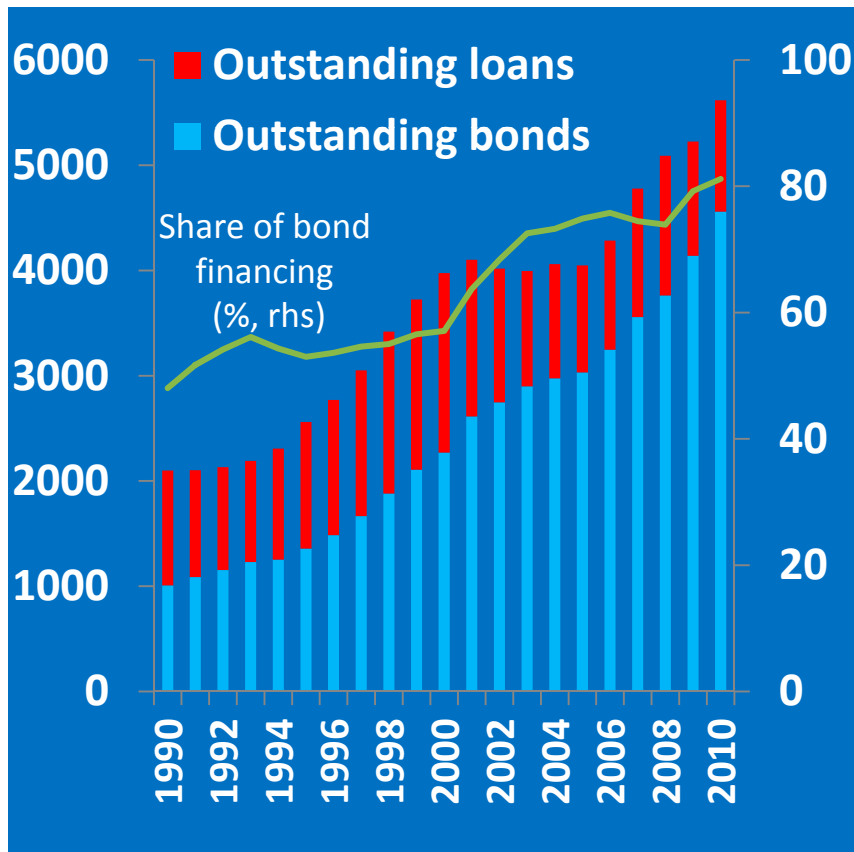


— Past cycles

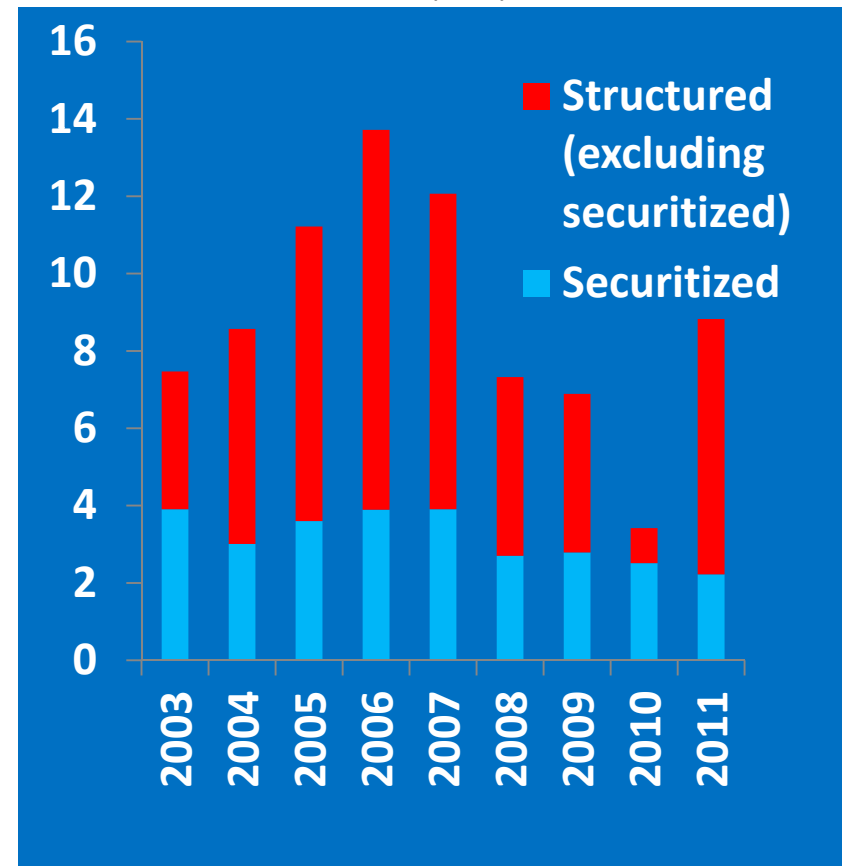
— Current cycles

... accompanied by a shift to capital-markets-based financing and expansion of the shadow banking system

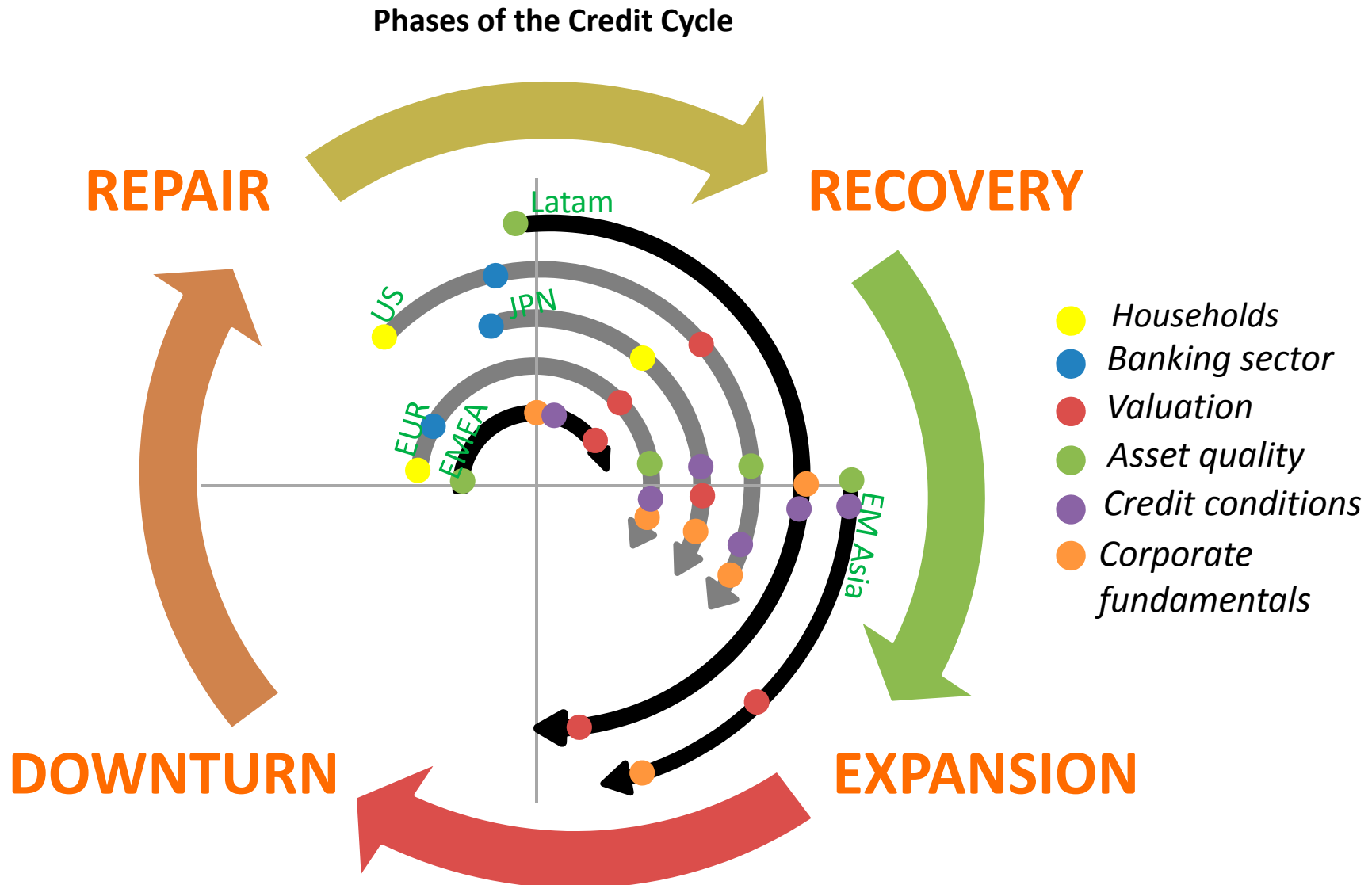
U.S. Corporate Financing
(\$ bn)



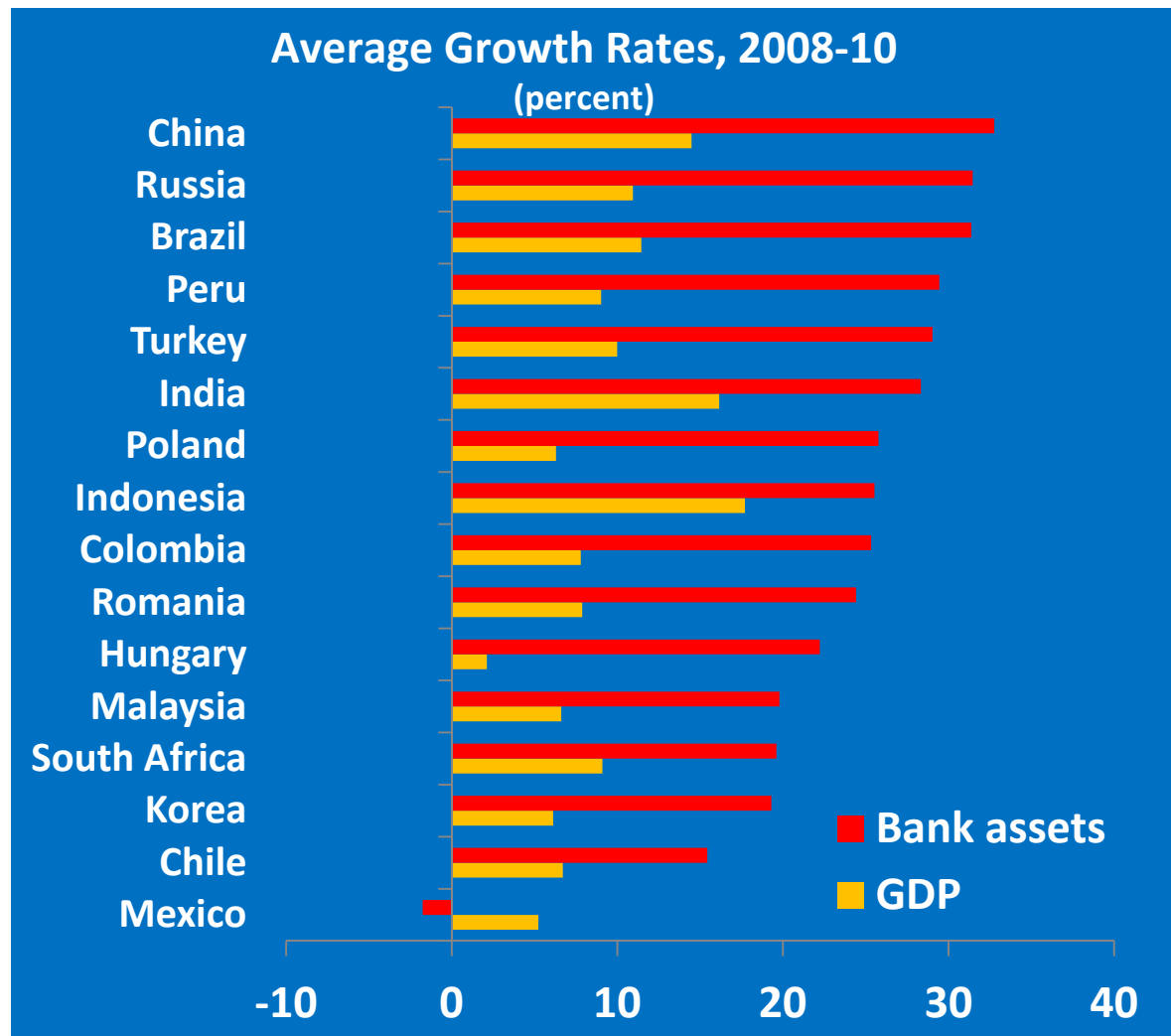
Global Securitization and Structured Products Issuance
(\$ tn)



Emerging economies are further along in the credit cycle

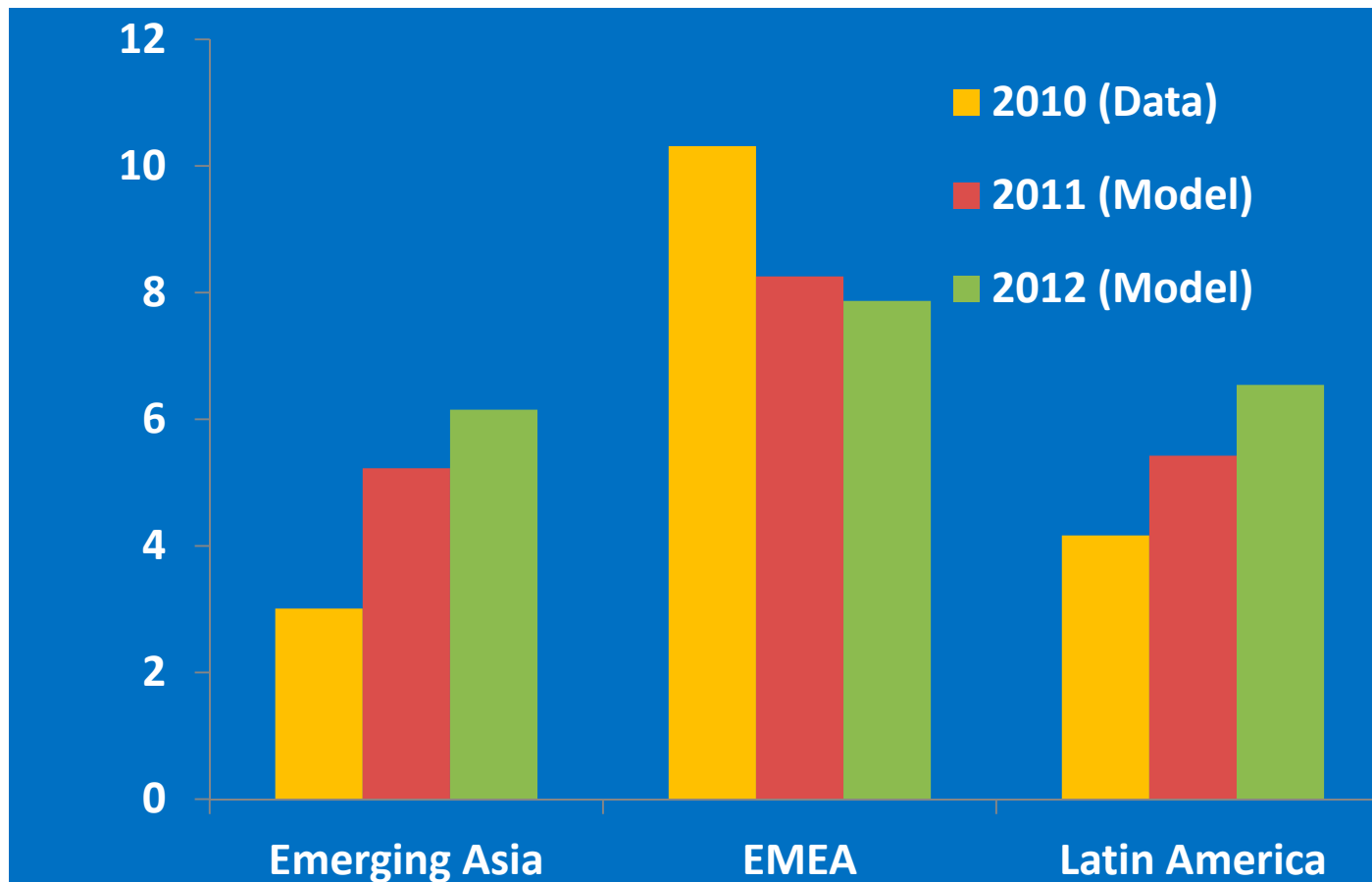


In many economies credit is running well ahead of GDP



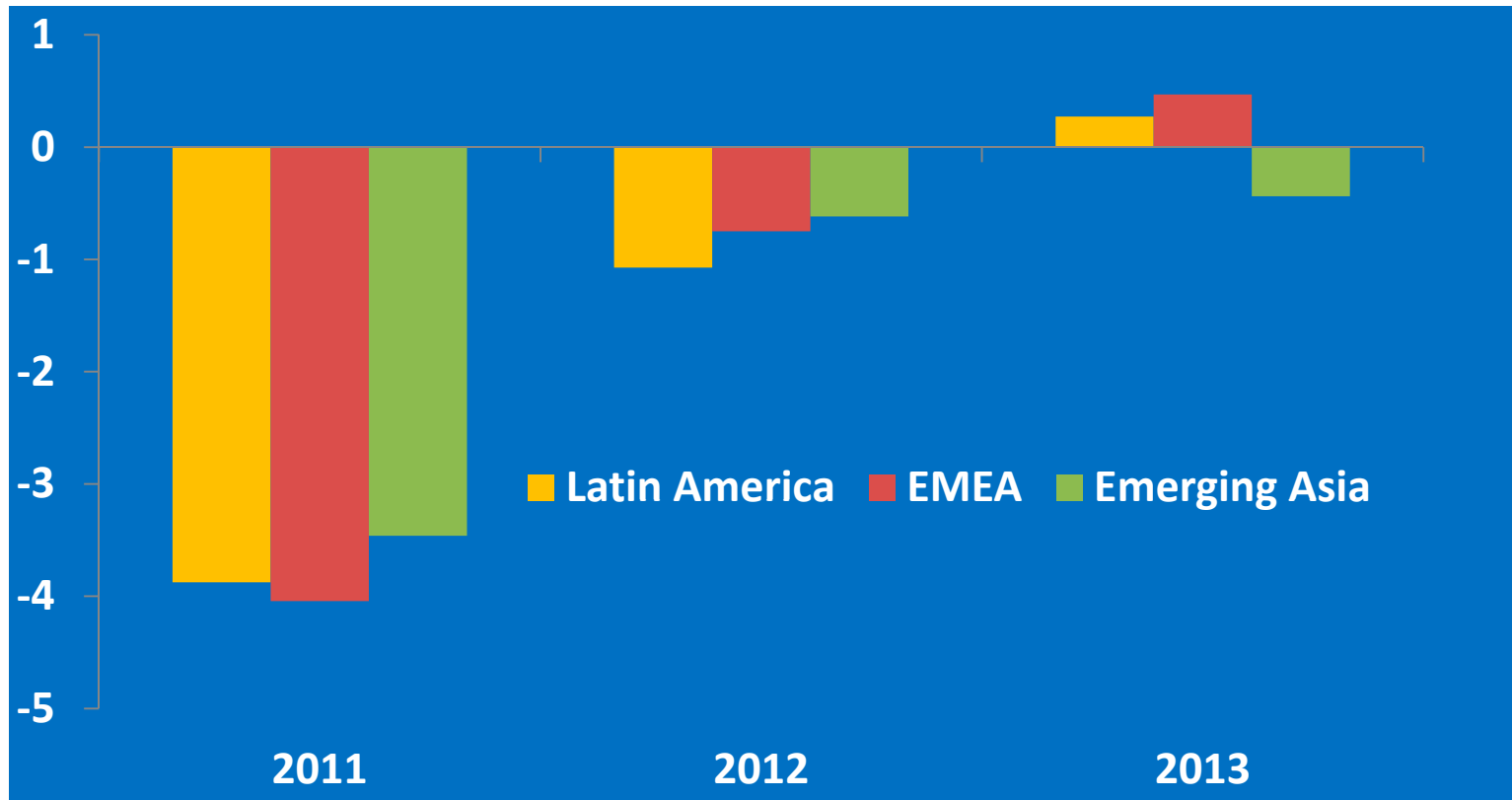
Rapid credit growth *now* can lead to rising nonperforming loans *later*

Model Prediction for NPL Ratios in 2011 and 2012
Based on 2010 Values
(percent, no shock)



An external shock would test the resilience of emerging market banks

**Absolute Change in Capital Adequacy Ratios
Under Combined Macro Shocks**
(percentage points)



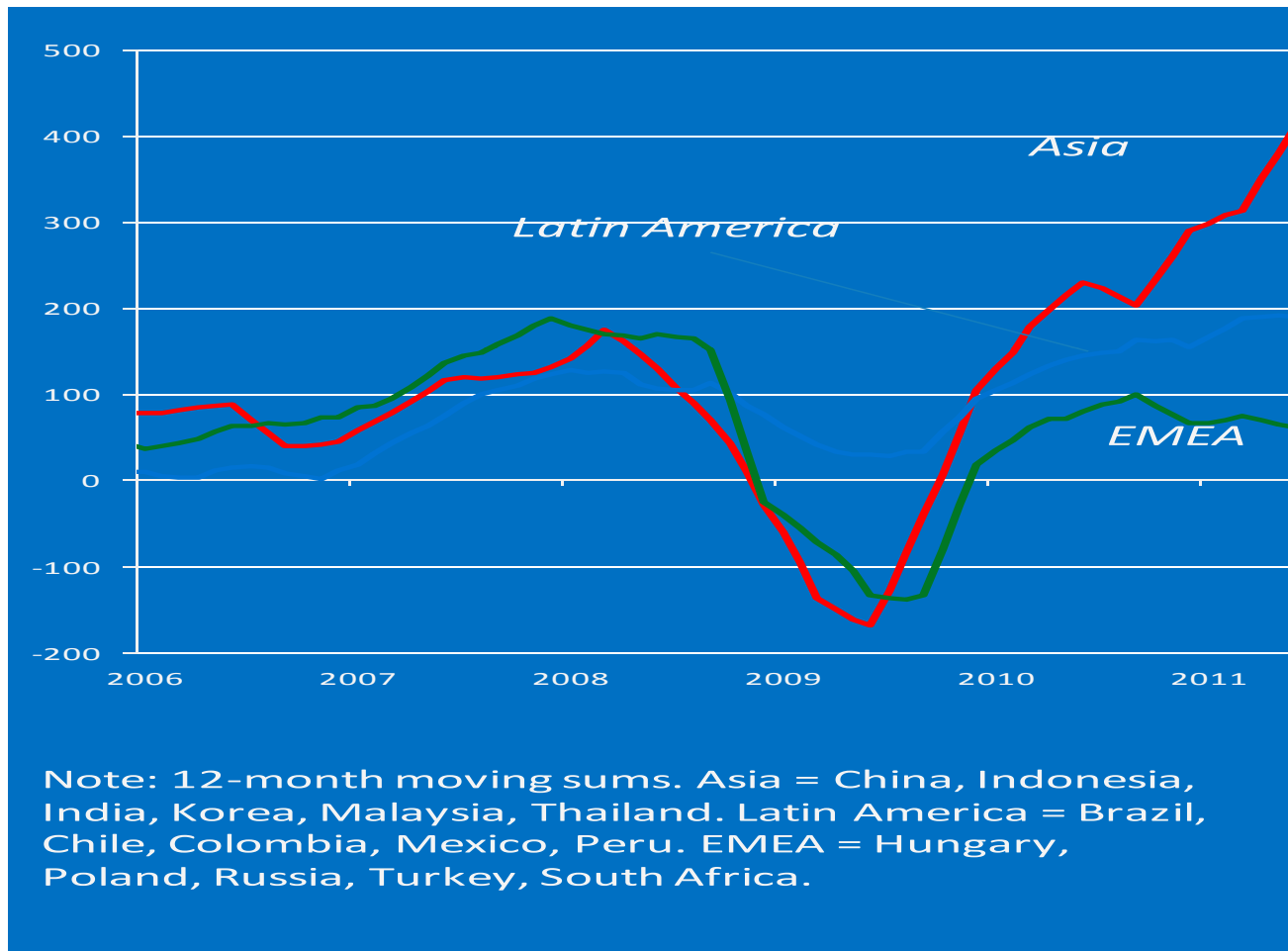
Emerging Market Banks: Sensitivity to Macro and Funding Shocks

Regulatory capital/RWA using economic (IRB/Basel II) risk weights
(Percentage point deviations from baseline CARs in 2013)

	GDP growth shock (5 percentage points lower than WEO)	Terms of trade shock (2 standard deviations)	Funding shock (300 basis points)	Combined shock
Europe, Middle East, and Africa	-3.4	-1.1	-1.2	-5.1
Latin America	-4.5	-1.5	-0.8	-5.7
Asia	-1.3	-0.7	-1.3	-2.5

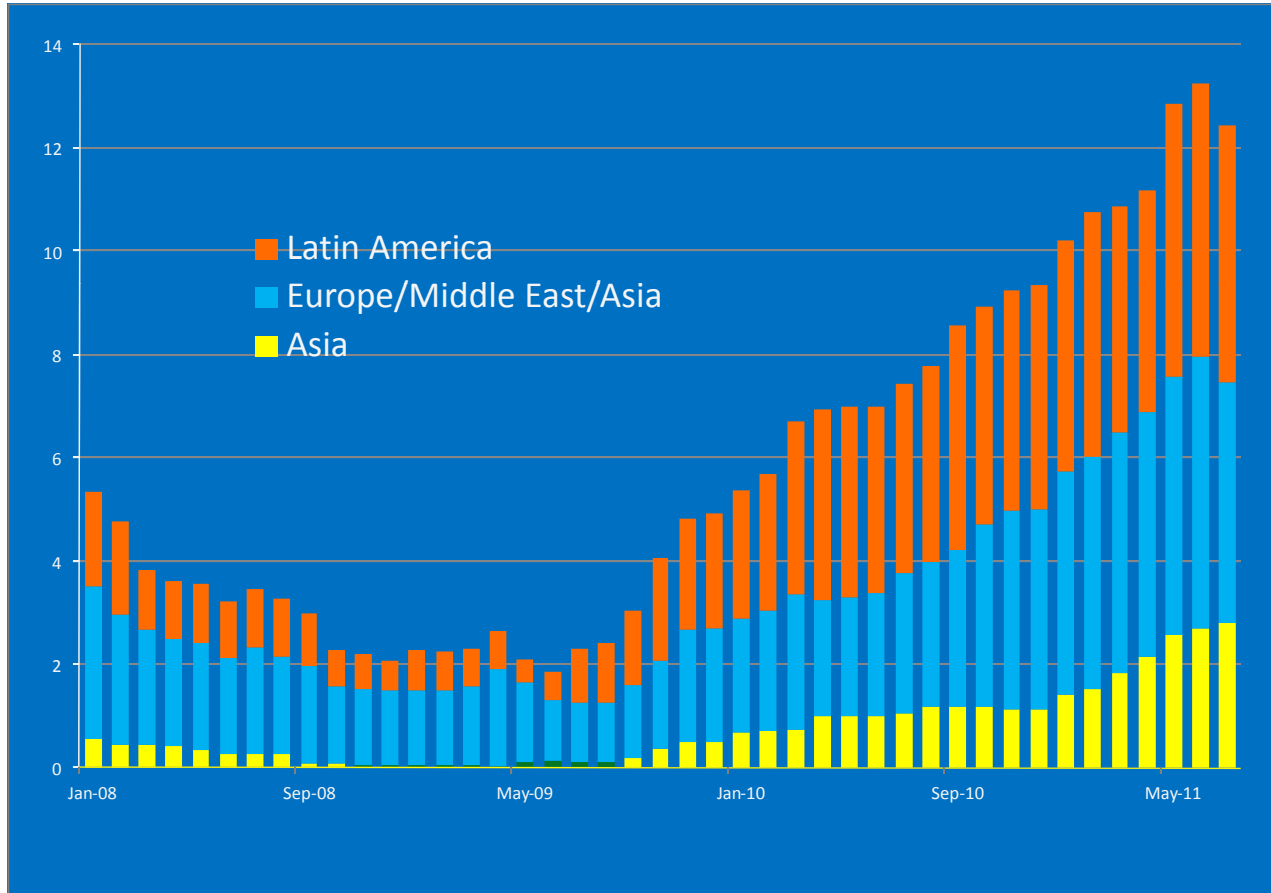
Capital Flows to Emerging Markets

Emerging markets: capital flows

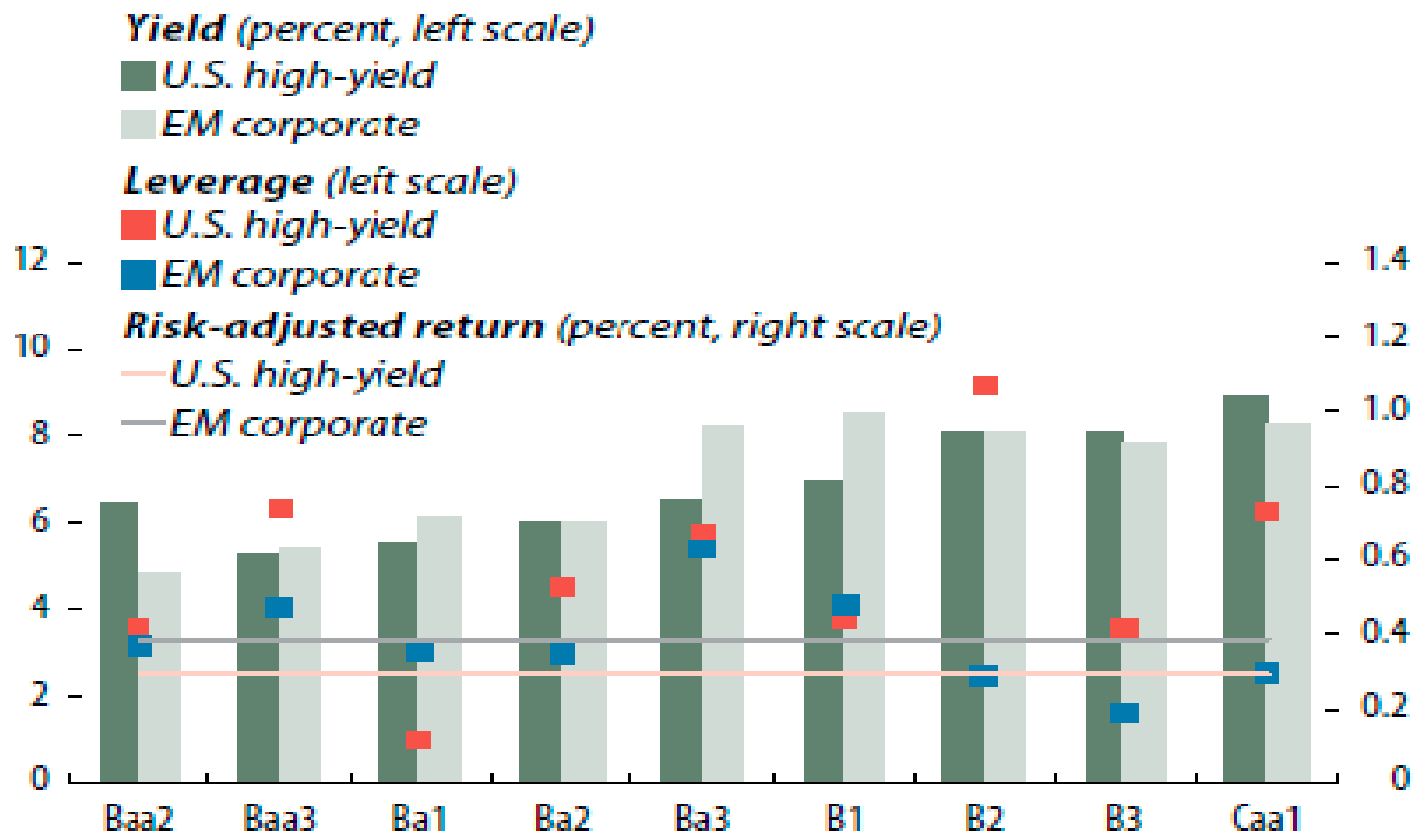


Emerging Market External Corporate Issuance

(in billions of US dollars, 12-month moving average)



Emerging Market Corporate vs. US High-yield Debt



Leverage is total debt/EBITIDA, returns estimated for the 6-months through June 2011

At the Crossroads in Emerging Markets

- Uneven normalization of finance in advance economies may be set back by market turbulence
- Search for yield and capital flows driving rebound in emerging markets faces early challenge
- Emerging market policy makers need to manage financial volatility stemming from strong global linkages while building resilient financial systems



Emerging Economies → avoid *future* crisis



Thank you