

THE GLOBAL FINANCIAL TURMOIL: Origins and Policy Response

Presentation by
Vivek Arora*

IMF Senior Resident Representative, Beijing
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* These are the opinions of the author alone and should not be taken to represent the views of the IMF, its executive board, or its management.

OVERVIEW

- **WORLD ECONOMIC OUTLOOK**
- **GLOBAL FINANCIAL TURMOIL**
 - Origins
 - Policy responses
 - Some basic principles of crisis resolution
 - Comparison with Asian crisis (1997-98)
 - Role of IMF.
- **CHINA'S ECONOMIC SITUATION:**
developments, outlook, risks.

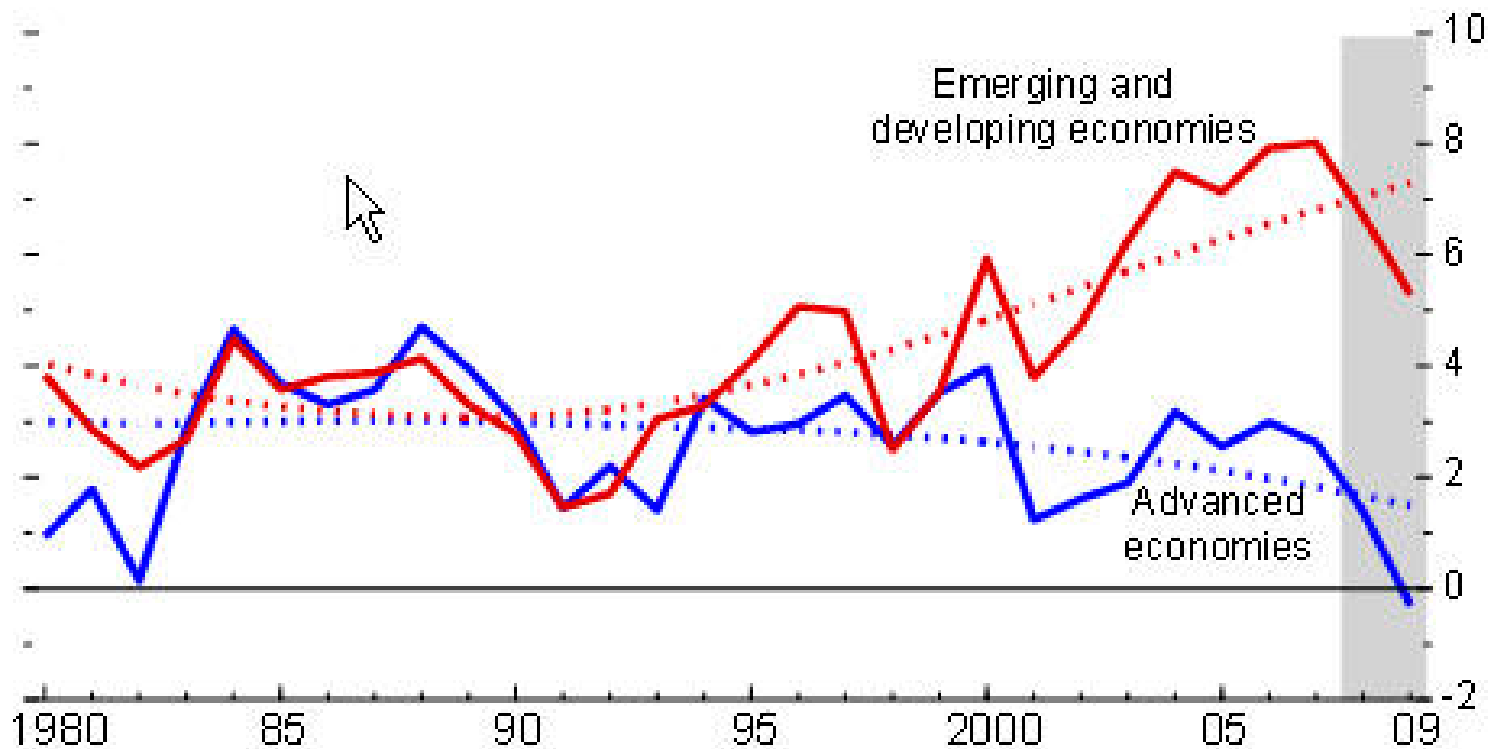
WORLD ECONOMIC OUTLOOK

- Picture worsened over past month.
- Major economies going into recession.
- Emerging economies also slowing.

World economy slowing sharply

Figure 1. Real GDP Growth and Trend

(Percent change)



Source: IMF staff estimates.

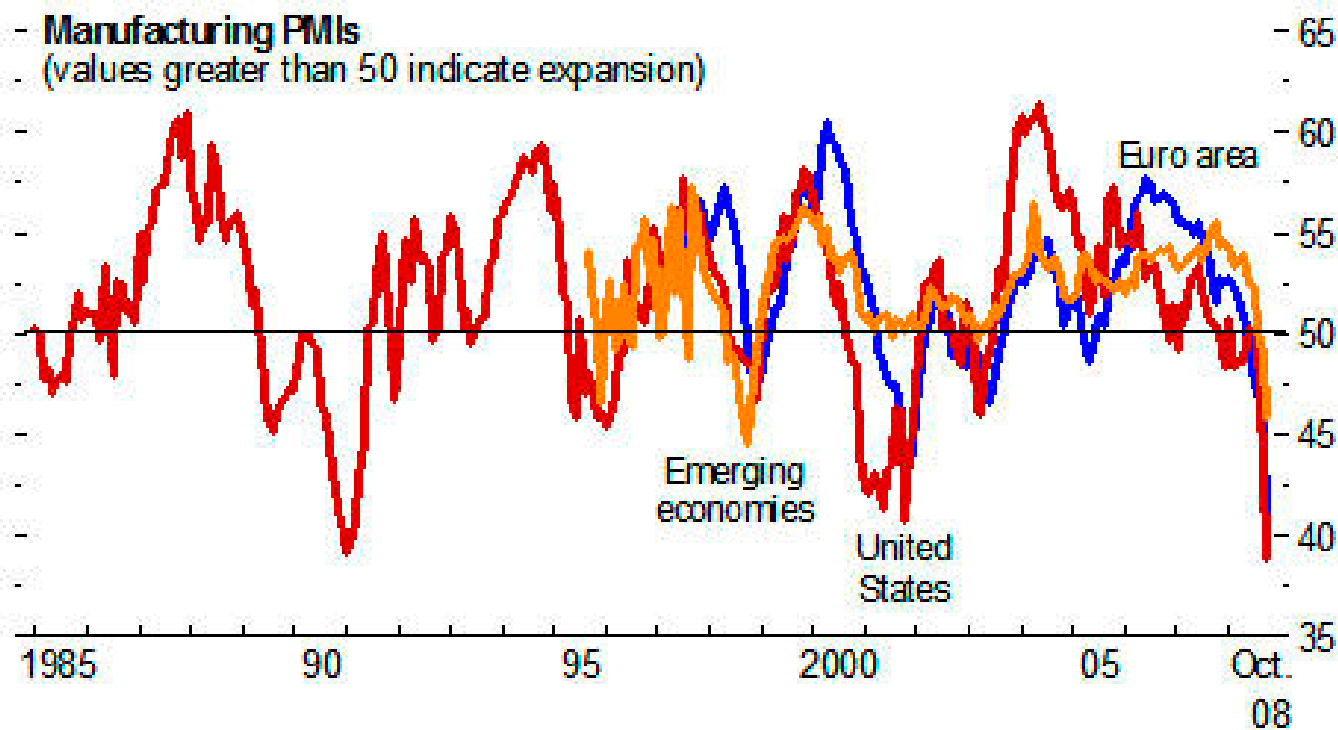
Particularly advanced countries

GDP growth (in percent) (WEO Update - November)

	2008	2009
World	3.7	2.2
Advanced economies	1.4	-0.3
United States	1.4	-0.7
Euro area	1.2	-0.5
Japan	0.5	-0.2
Emerging and developing economies	6.6	5.1
China	9.7	8.5

Confidence weak

Figure 4. Business Confidence Indicators



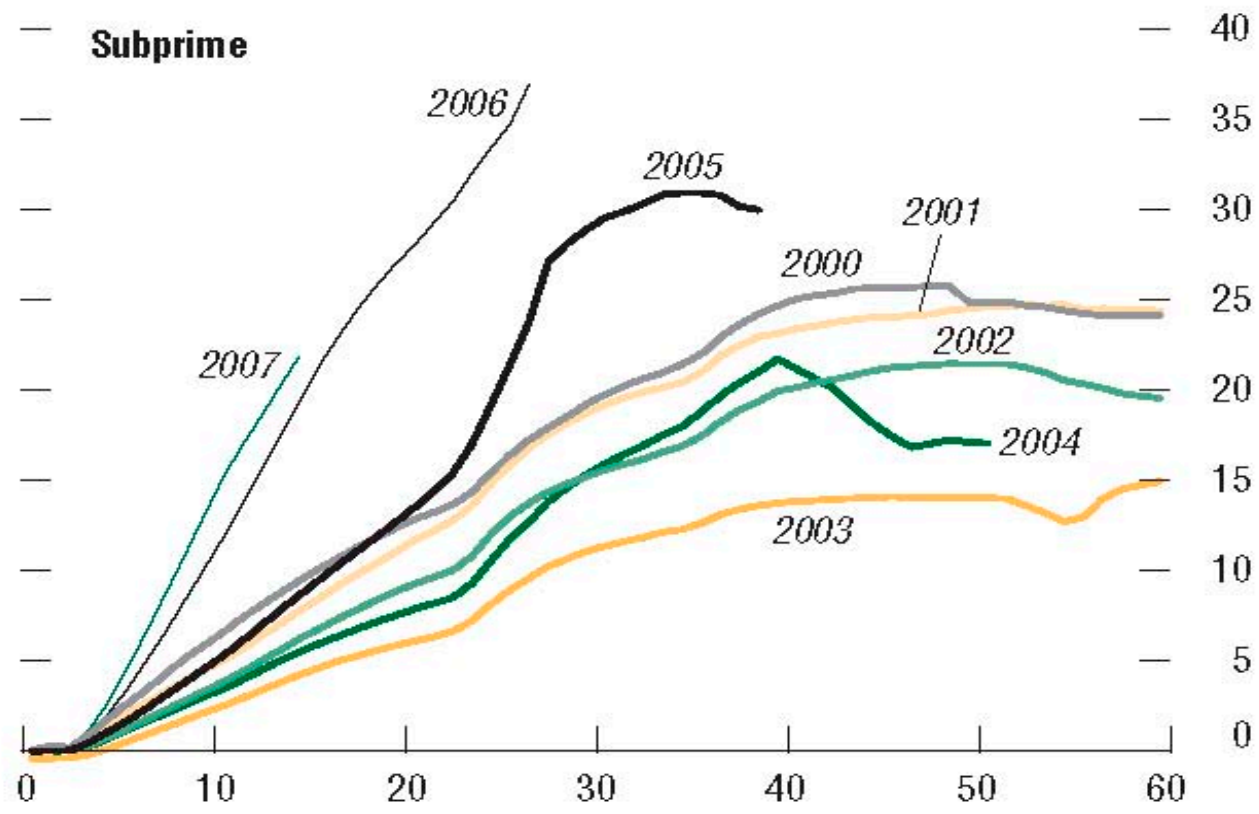
Sources: Haver Analytics; and IMF staff estimates.

GLOBAL FINANCIAL TURMOIL

- **Outline of crisis:**
 - monetary policy and easy regulation spurred risk taking and leverage,
 - supervision/regulation failed to keep pace with financial innovation.
- **Responses:** focus on *financial sector* (liquidity; recapitalization; distressed assets) and on *economic stimulus*.

Problems emerged first in sub-prime mortgages...

(60+ day delinquencies, in percent of original balance)



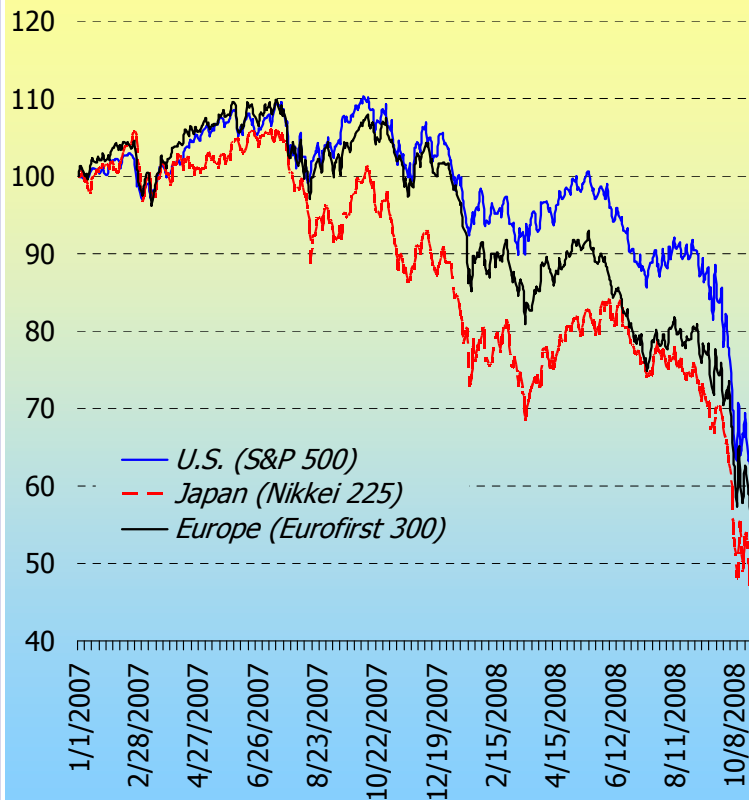
...but soon in many other markets,
including during 2007-2008:

- Derivatives (CDS, CDO, etc.)
- Corporate finance
- Monolines (bond insurers)
- Auction rate securities
- Even the interbank money market.

Market panic, leading to sharp price declines, risk aversion, volatility....

Stock Market Indices

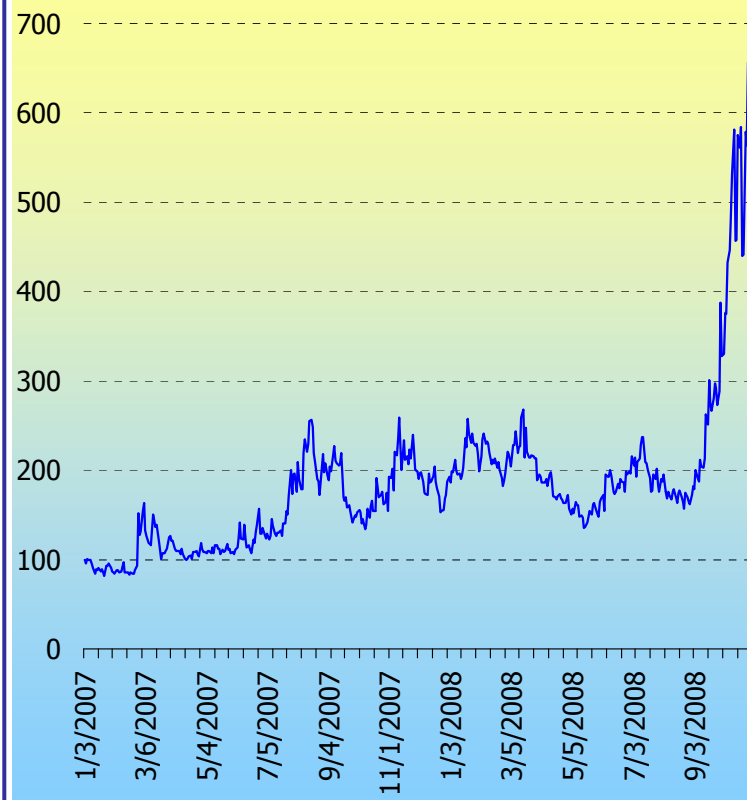
(January 1, 2007=100)



Source: Bloomberg LP.

VIX Index

(Index, January 1, 2007=100)

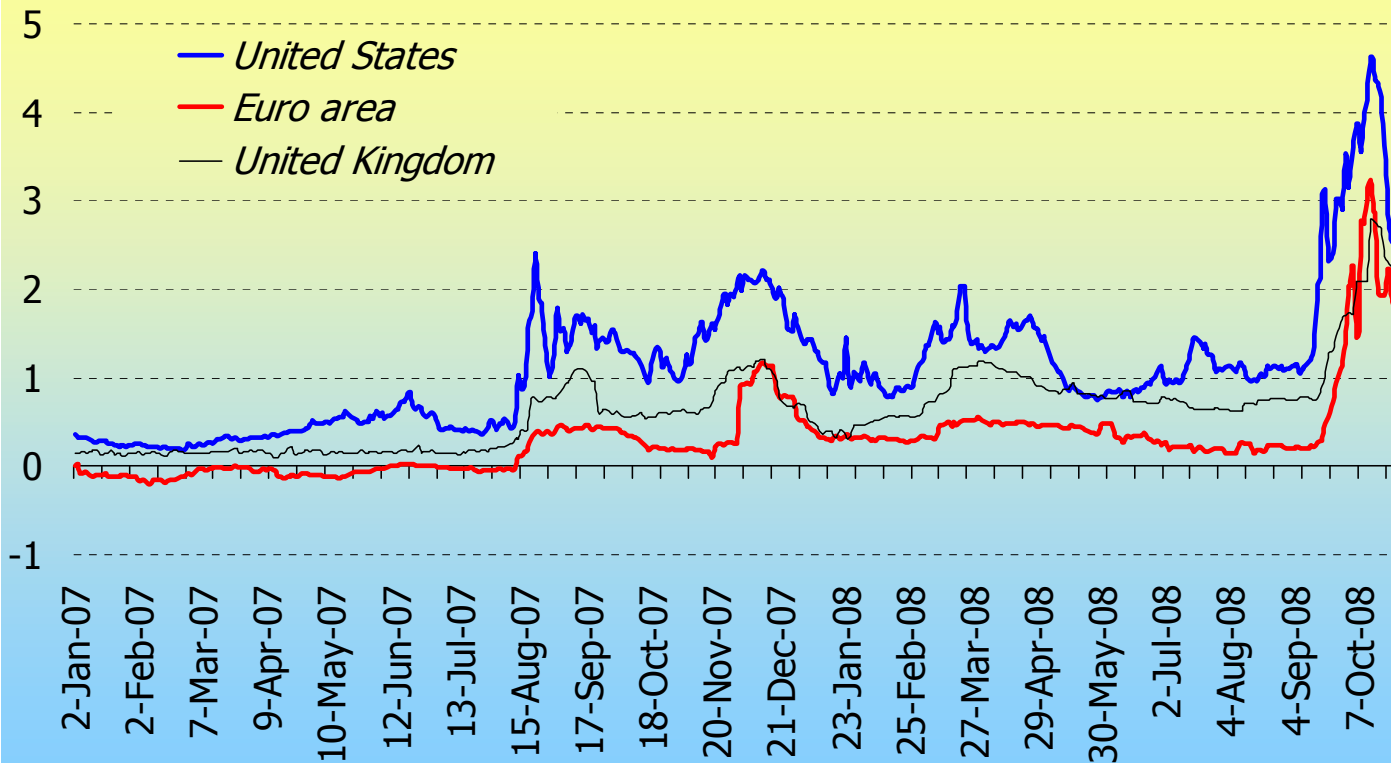


Source: Bloomberg LP.

...and shortage of liquidity.

Money Market Spreads

(3-month LIBOR minus government bond yields, in percent)



Sources: Bloomberg LP; and Datastream.

U.S. financial sector potential writedowns (Oct 2008; U.S. \$ bns.); GFSR Oct 2008

	Outstanding	Estimated losses
Total loans	12,370	425
Of which, subprime	300	50
Total securities	10,840	980
Total	23,210	1,405

U.S. update: policy response

- Problems: drying up of liquidity, eroded capital base, bad assets.
- **Bailout**: was necessary.
 - Alternatives (ad hoc, case by case) were not working; is a **systemic** response.
 - Initially focused on **distressed assets**. But now appropriately has turned to **solvency concerns (recapitalization)**.
- **Stimulus**: measures.
- **Risks**: regional banks, real-financial feedback loops, size of solvency problems.

Europe update

- Initially different approaches: Ireland, Germany, UK on deposit guarantees
- Needed **systemic**, pro-active approach
- UK showed the way
- Joint commitments for: timely recapitalization, cross-border institutions/regulations, etc.
- Stimulus

Asia: many countries taking measures to maintain confidence in banking system...

- **Liquidity injections:** new facilities; expanding range of collateral and access to central bank discount windows.
- **Extended guarantees** to bank deposits (Hong Kong SAR, Malaysia, Singapore, Australia) and bank debt (Australia, Korea).
- Plans for **bank recapitalization contingency funds** (Japan, India, Hong Kong SAR).

...and macroeconomic responses

- With inflation easing, **cuts in policy rates** (e.g., Australia, China, India, Korea, New Zealand, Vietnam).
- **Fiscal stimulus** measures (e.g., Australia, China, Japan, Korea, and New Zealand).

Some principles of crisis resolution

- Restoring confidence 1st priority
- Requires comprehensive plan (not piecemeal/ad-hoc)
- Liquidity problems often turn out to be solvency problems
- Re-capitalization is key
- Use of public money has to come with safeguards for taxpayers

How is current crisis similar/different from the Asian crisis (1997-1998)?

- Financial crisis (U.S.) versus financial-plus-f.x. crisis (Asia): different implications for **monetary policy**
- **Fiscal policy** easing: similar response
- **Financial sector**: similar responses: early loss recognition; liquidity support; support depositors; close non-viable institutions; AMCs; bank supervision
- **Trade/capital** liberalization: situations different; also, advice more focused.

Role of IMF in current situation

- **Moving quickly to help affected emerging countries.** Stands ready to lend over \$200 billion. Offering policy advice.
- **New short-term lending facility:** help countries with sound fundamentals who face acute liquidity pressures.
- **Questions of resources and new roles** in global financial architecture. (November 15 summit.)

CHINA

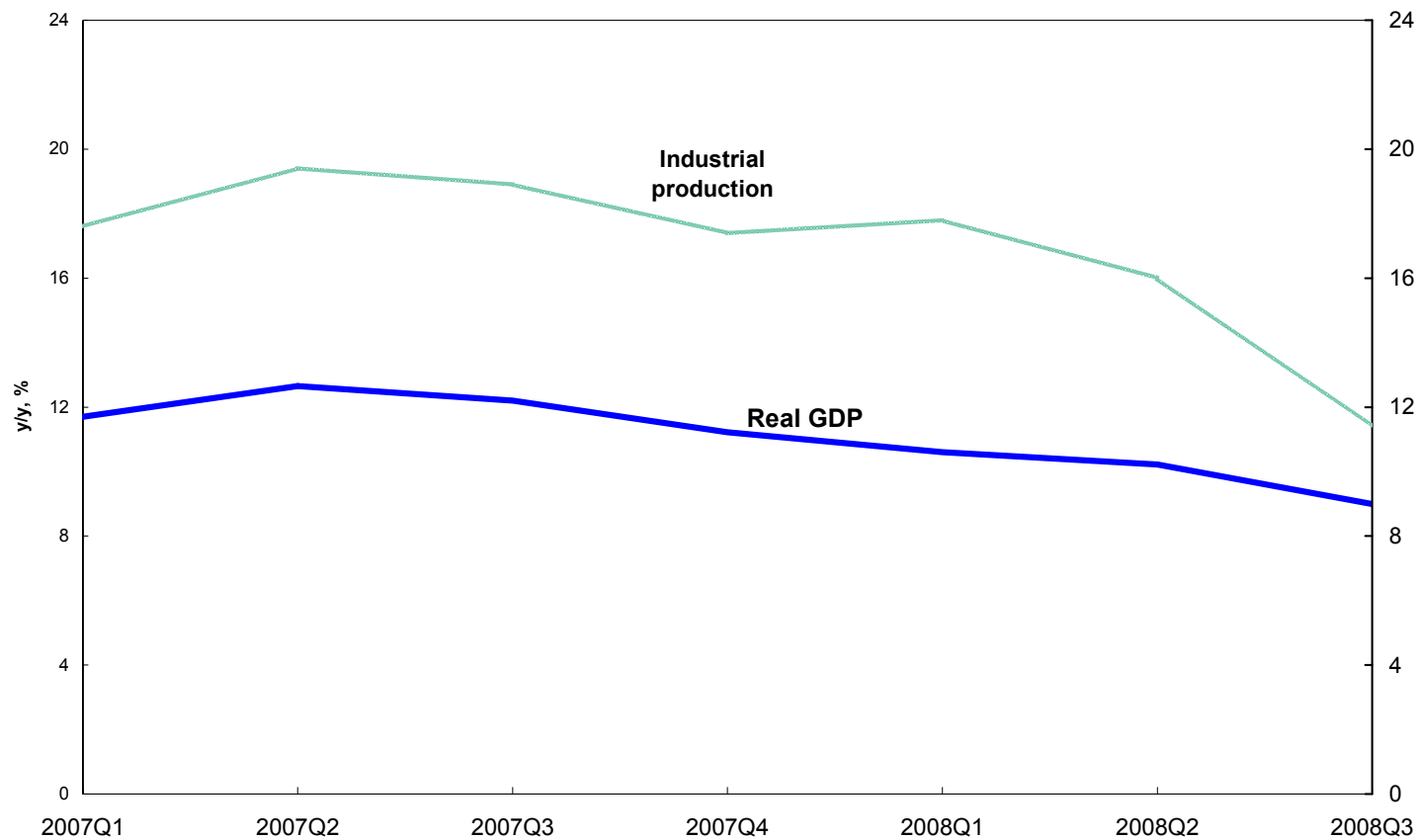
- China's economic conditions and outlook

CHINA: Outlook

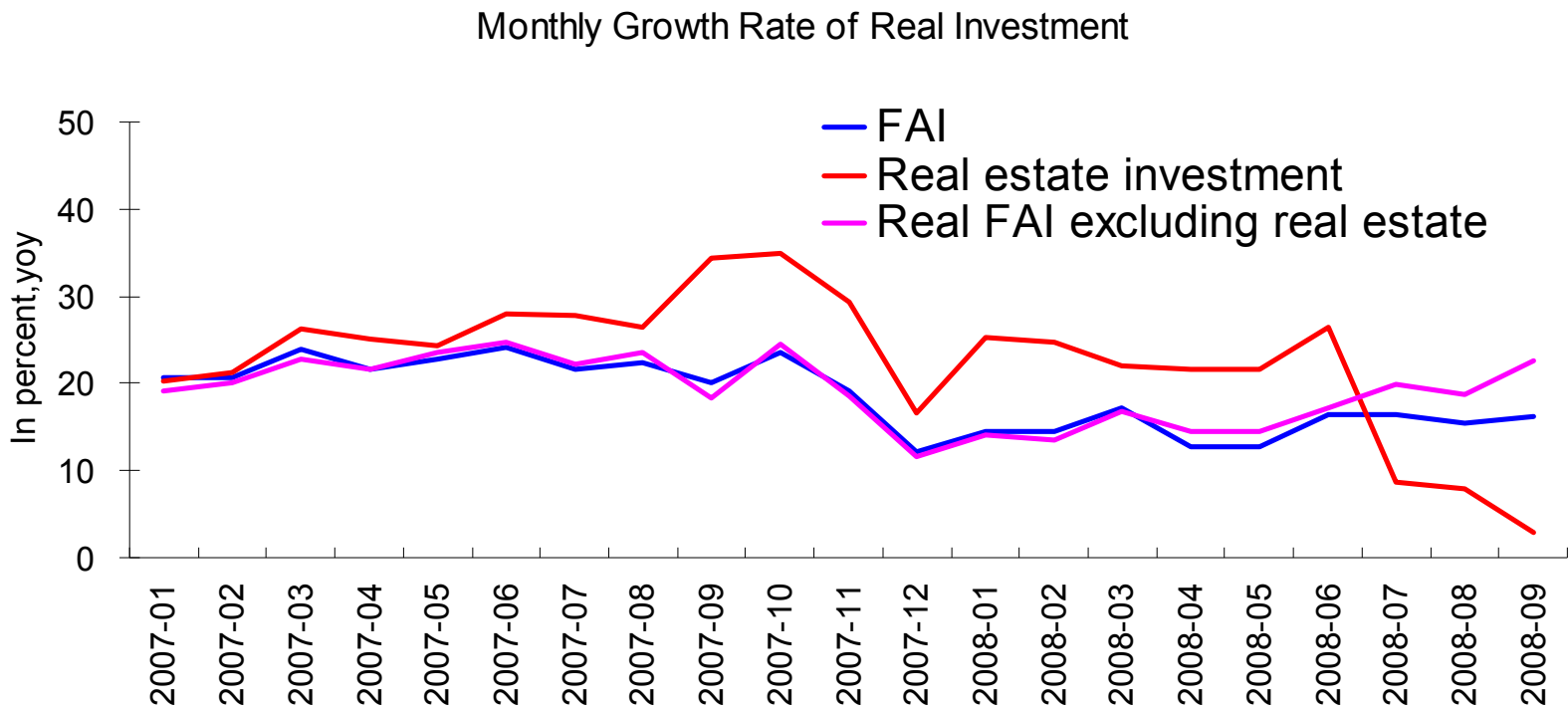
- Growth slowing but still 8-9% (2009). China's growth helpful for world economy.
- Direct exposure to troubled foreign institutions limited.
- Low inflation provides scope for policy easing if needed (Nov. 9 stimulus).
- Risks: overcapacity from high investment (NPLs); fall in foreign demand (e.g., ↓ in global conditions/↑ in protectionism).

GDP slowing

China: GDP growth



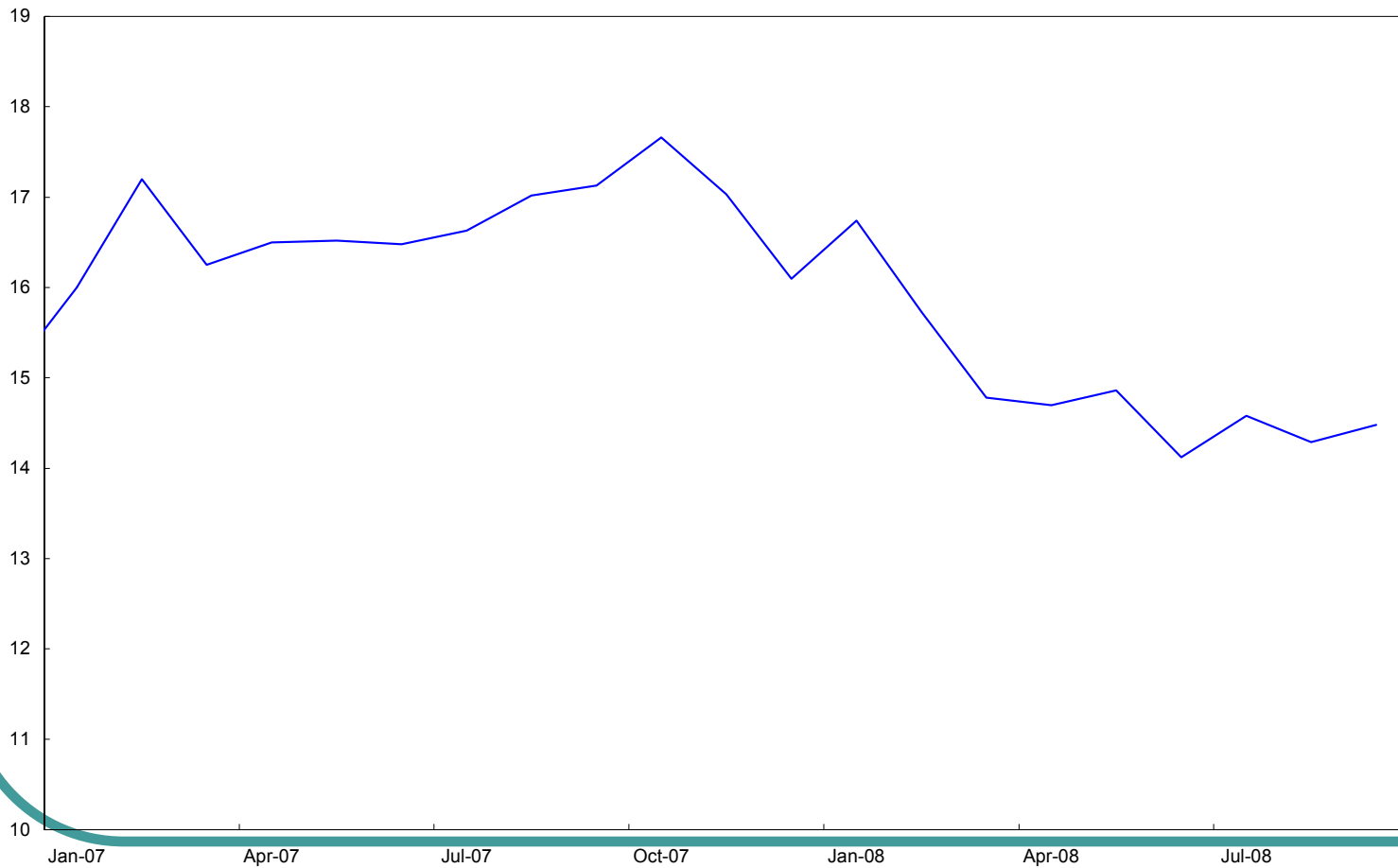
FAI growth driven down by weakening real estate sector



Source:CEIC, IMF Staff Calculation

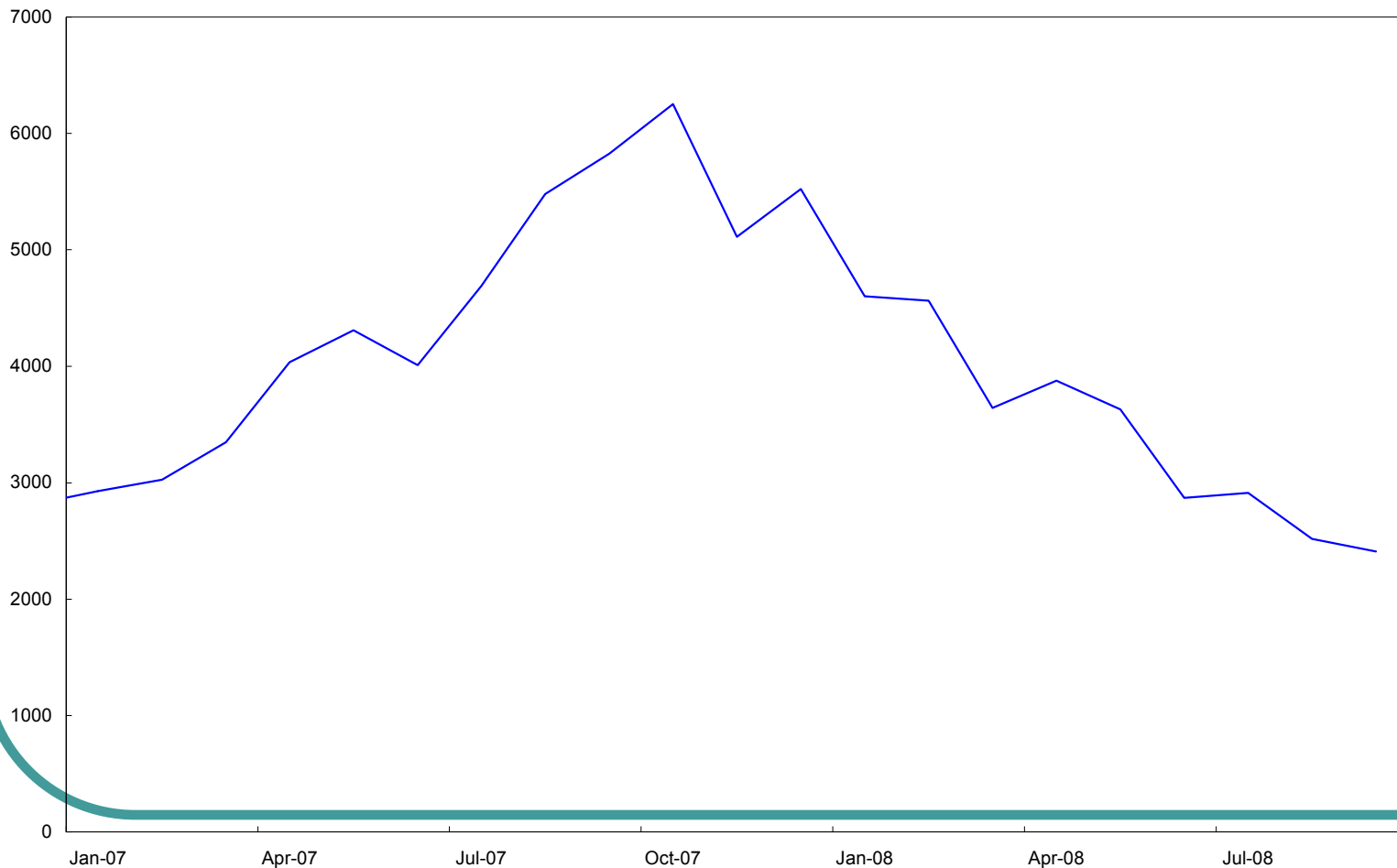
Slower loan growth (credit constraints)...

China: Loan growth
(y/y, %-change)



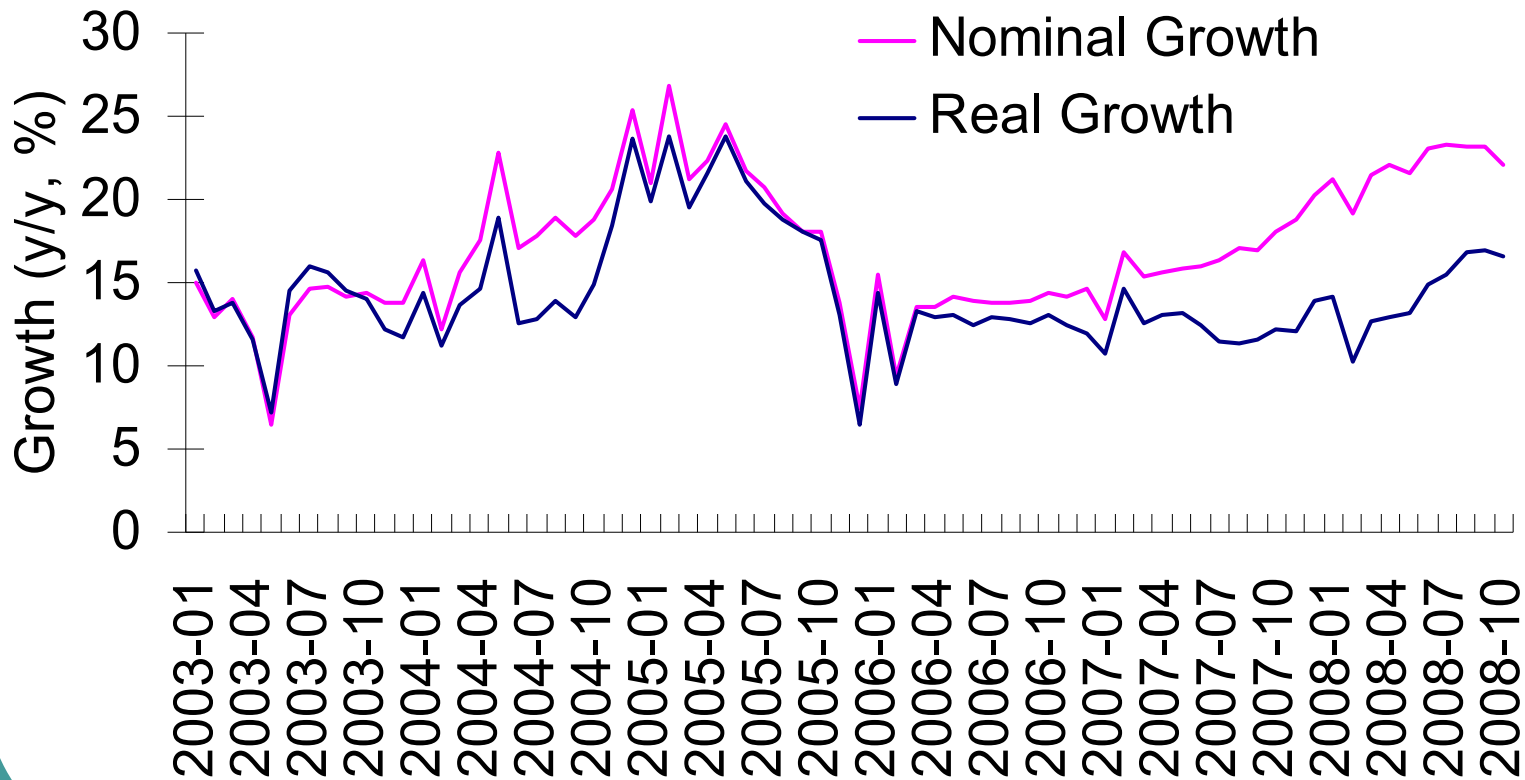
...and decline in stock market since Oct. 2007

China: Stock Market (Shanghai A)



But retail sales robust

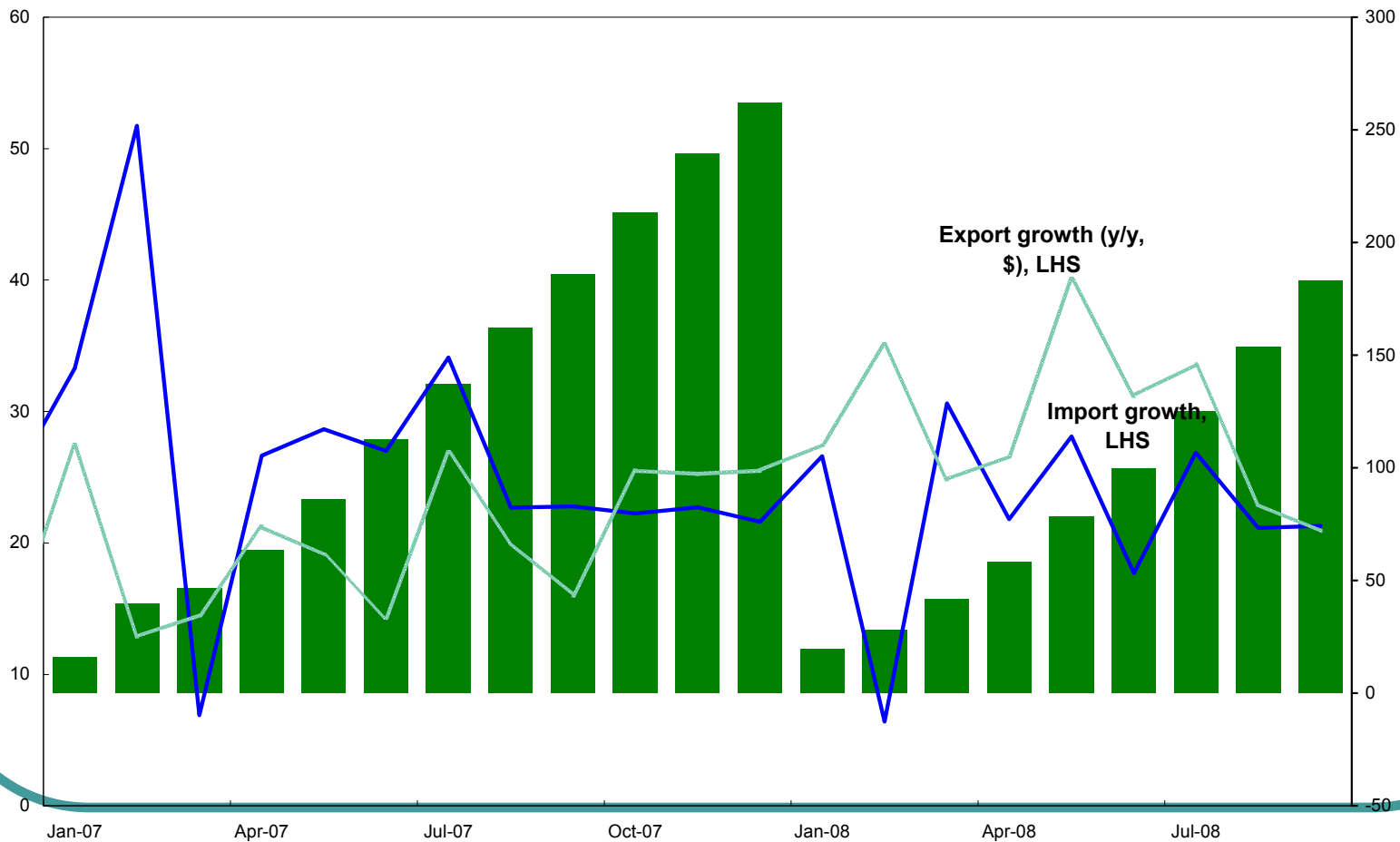
Retail sales growth rate



Source: CEIC, IMF staff

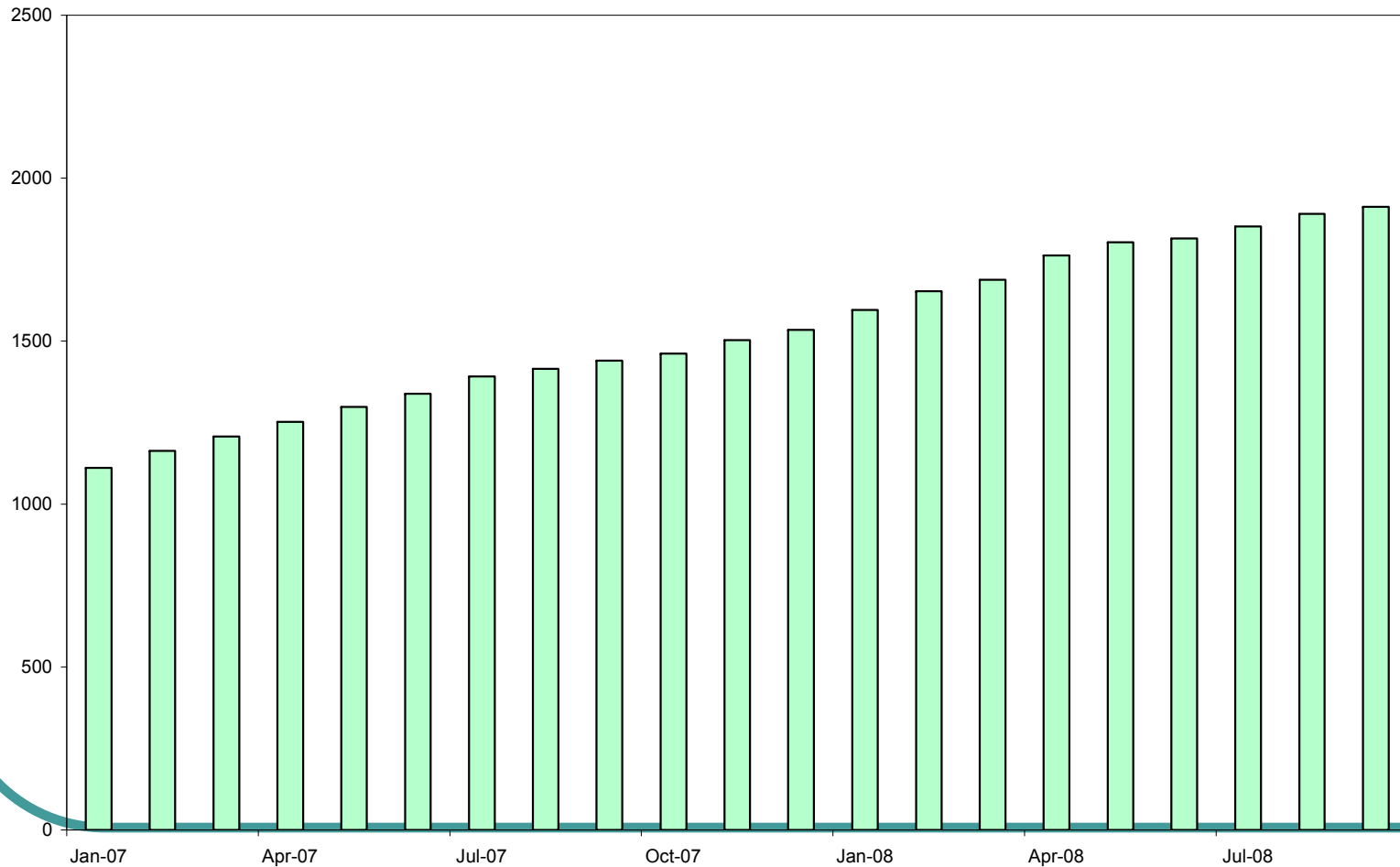
And trade balance still large.

China: Trade Balance
(cumulative, \$ bns.)



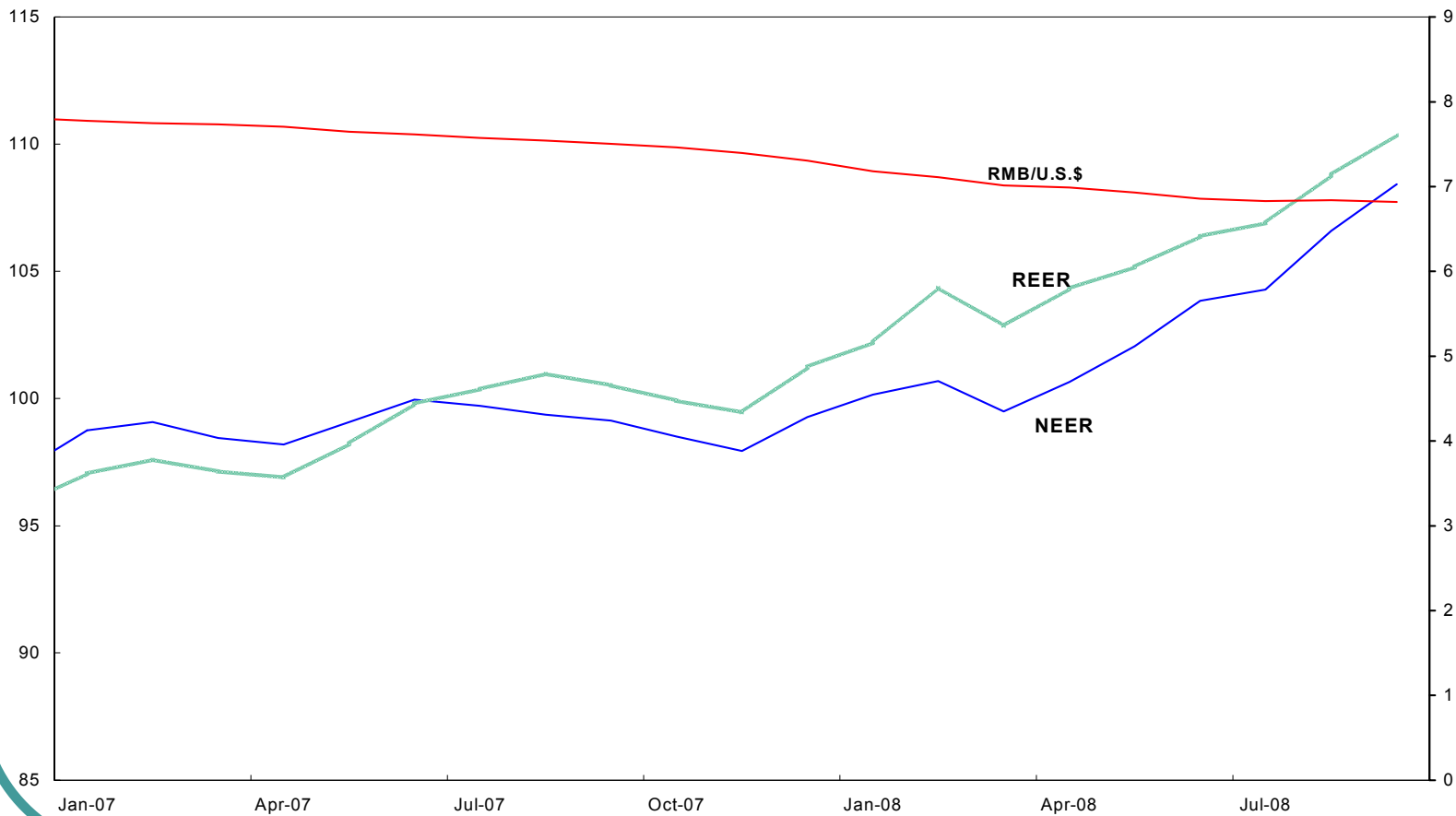
Reserves continue to rise

China: International Reserves (\$ bns.)



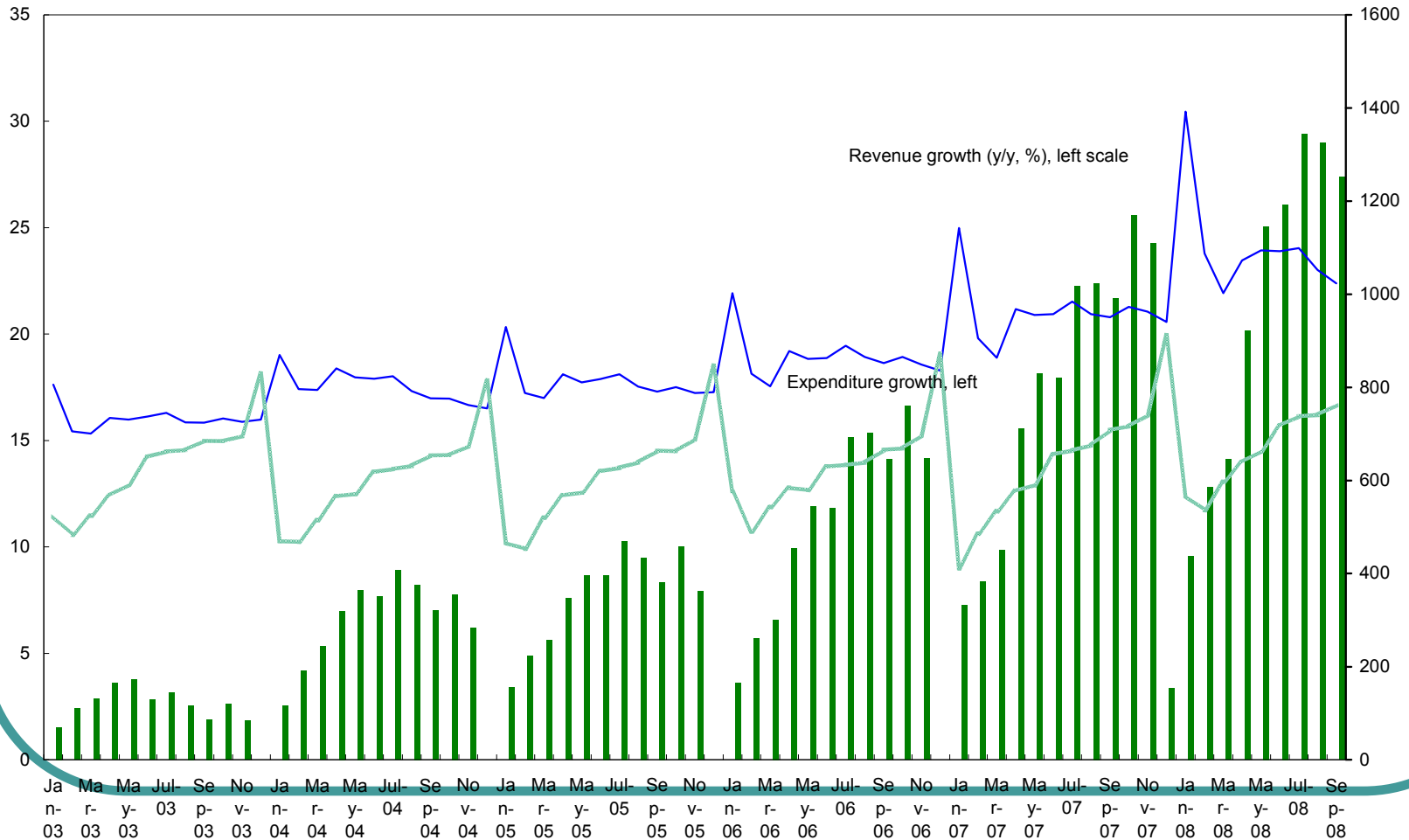
Exchange rate strengthening

China: Exchange Rate



Fiscal situation healthy

**China: Fiscal balance
(RMB bns., cumulative)**



Measures to support growth

- **Nov. 9 stimulus package** (headline figure RMB 4 trillion, 14% of 2008 GDP).
- **Monetary policy loosening**: interest rates, reserve requirements, lifting of credit quotas
- **Tax rebates.**
- Support to the **property market.**
- **Ongoing reforms** in social services, rural areas, infrastructure.

China outlook

	2007	2008	2009
Growth rates			
Real GDP (production based)	11.9	9.7	8.5
Consumption	11	11-	11+
Gross investment	14	11	10
Net exports (contribution)	3.6	1.2	0.0
Export growth	19	11	8
Import growth	13	11	11
CPI inflation (average)	4.8	6.2	3.4
Percent of GDP			
Current account balance	11.3	9.4	9.6
Trade balance (g/s)/GDP	9.6	7.9	8.2

WEO staff projections

Risks

- Domestic: Overcapacity → activity↓, NPLs ↑. (Years of high investment; non-real-estate investment still robust.)
- External: protectionism; sharper/longer than expected global slowdown

Summary

- World economic outlook in near-term is weak. Strong growth in China is helpful.
- Countries moving to repair financial sectors and provide stimulus. IMF helping with financial and policy support.
- China little affected by financial damage, but will experience some slowdown. Recent measures are helpful, but there are also risks.