
Emerging Markets in a Rapidly Deteriorating Global Environment

4th meeting of NIPFP DEA Program
March 24-25, 2009

**Chief Economist Office
Latin America and the Caribbean
Region
The World Bank**



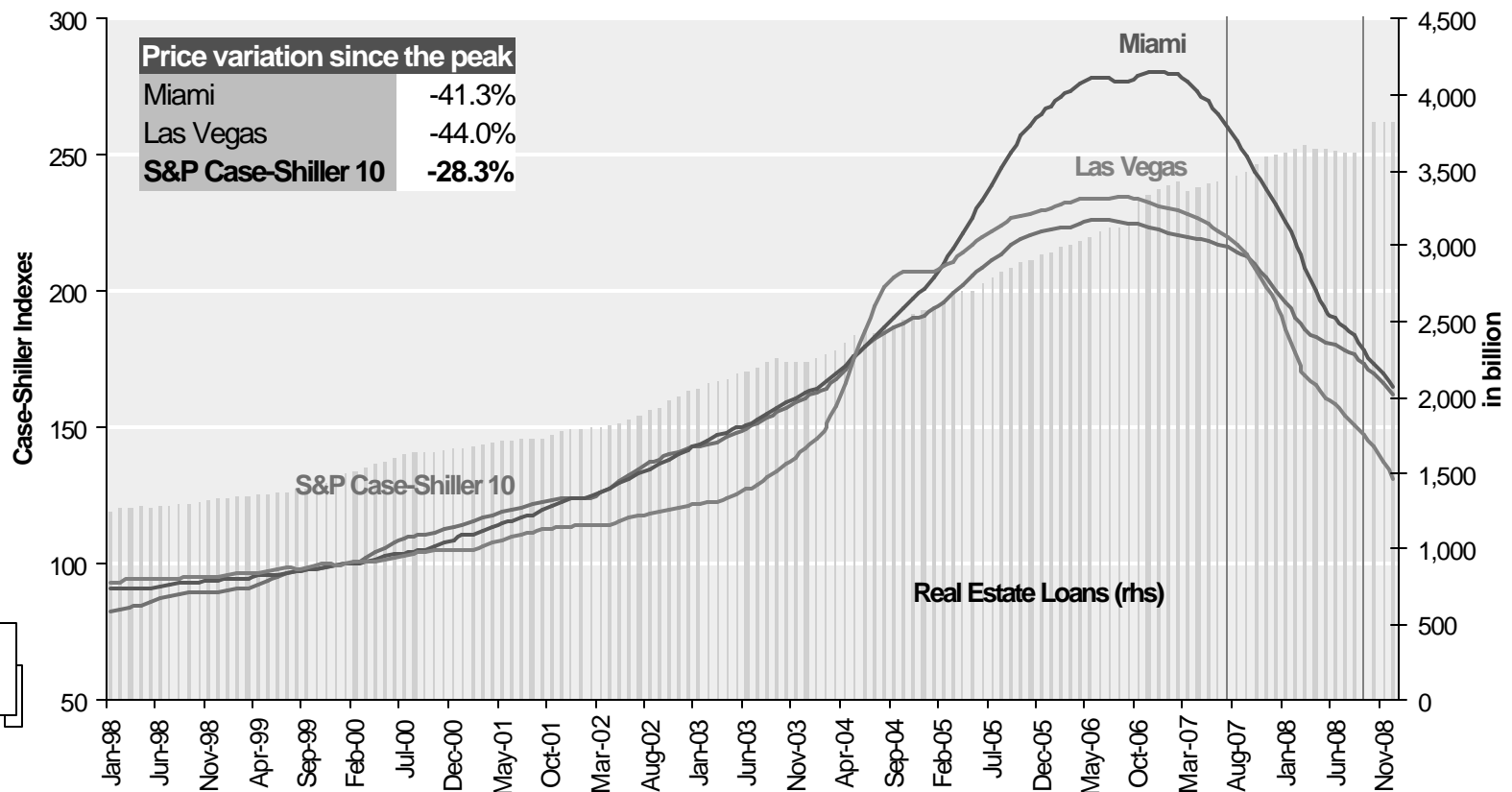
Outline

- External shocks – re-coupling with vengeance
 - Deepening financial crisis
 - Falling commodity prices
 - Sharp, world-wide economic slowdown
- Transmission channels to Emerging Markets
 - Financial contagion
 - Remittances
 - Commodity prices
 - External demand
- Final thoughts

} Interrelated

Falling housing prices and toxic subprime loans in the U.S. were the trigger of a global mess...

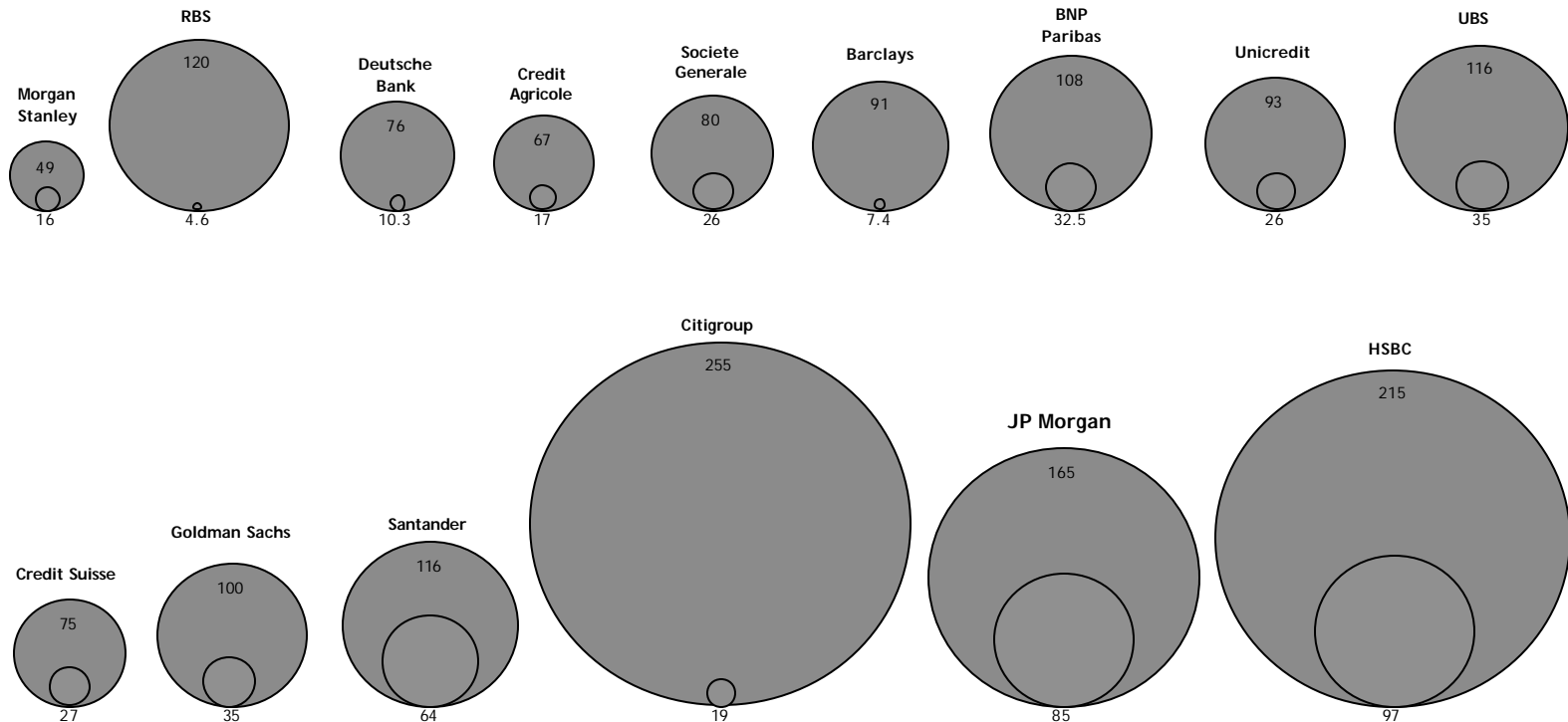
US House Prices and Real Estate Loans
S&P/ Case-Shiller Indices and Stock of Real Estate Loans



... that has resulted in unprecedented destruction of banks' net worth...

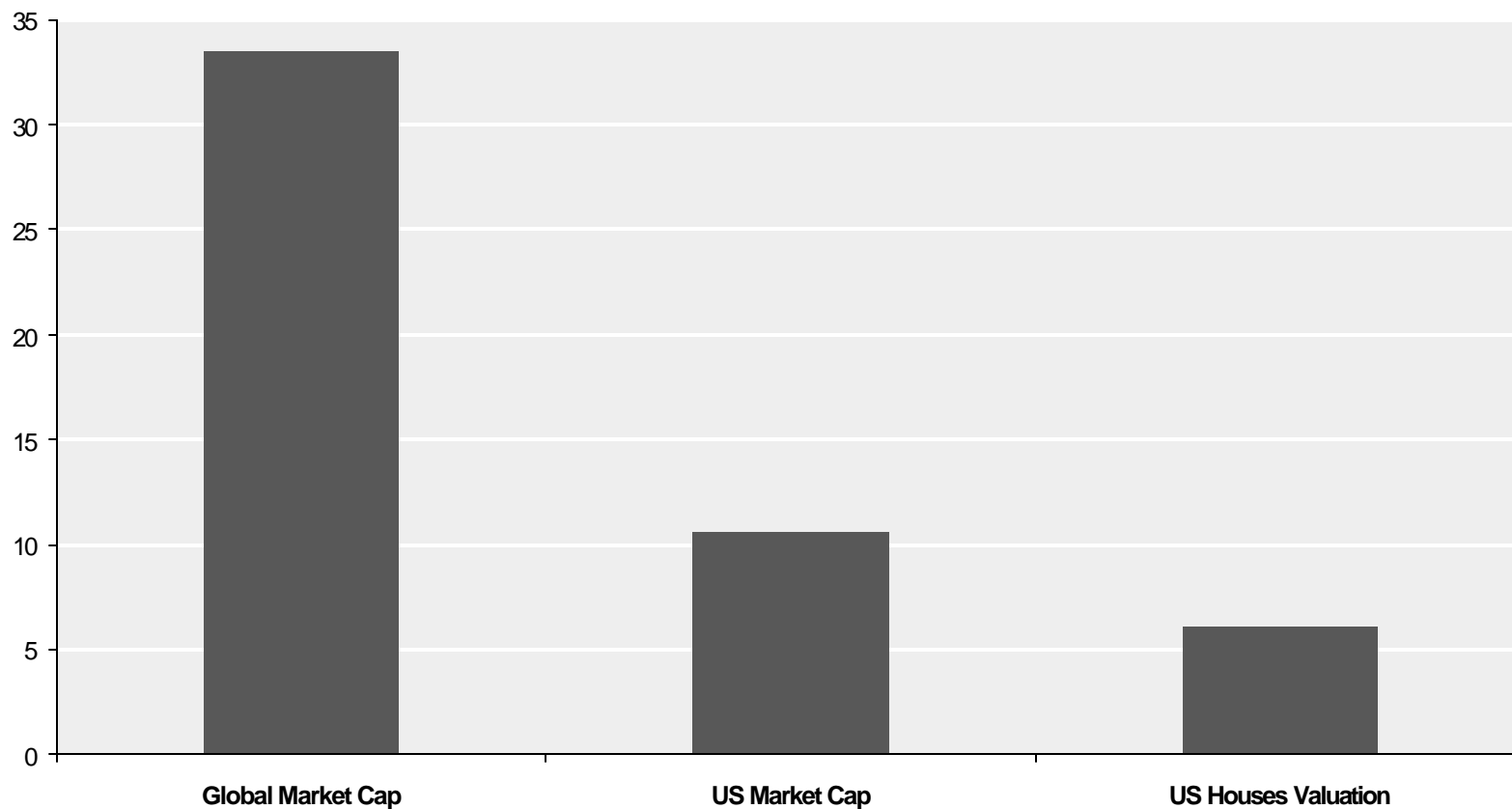
Banks: Market Cap

- Market Value as of January 20th 2009, \$Bn
- Market Value as of Q2 2007, \$Bn



... and of assets values more generally

Losses between July 07 and March 09
in trillion of US\$



Big question marks on the financial crisis

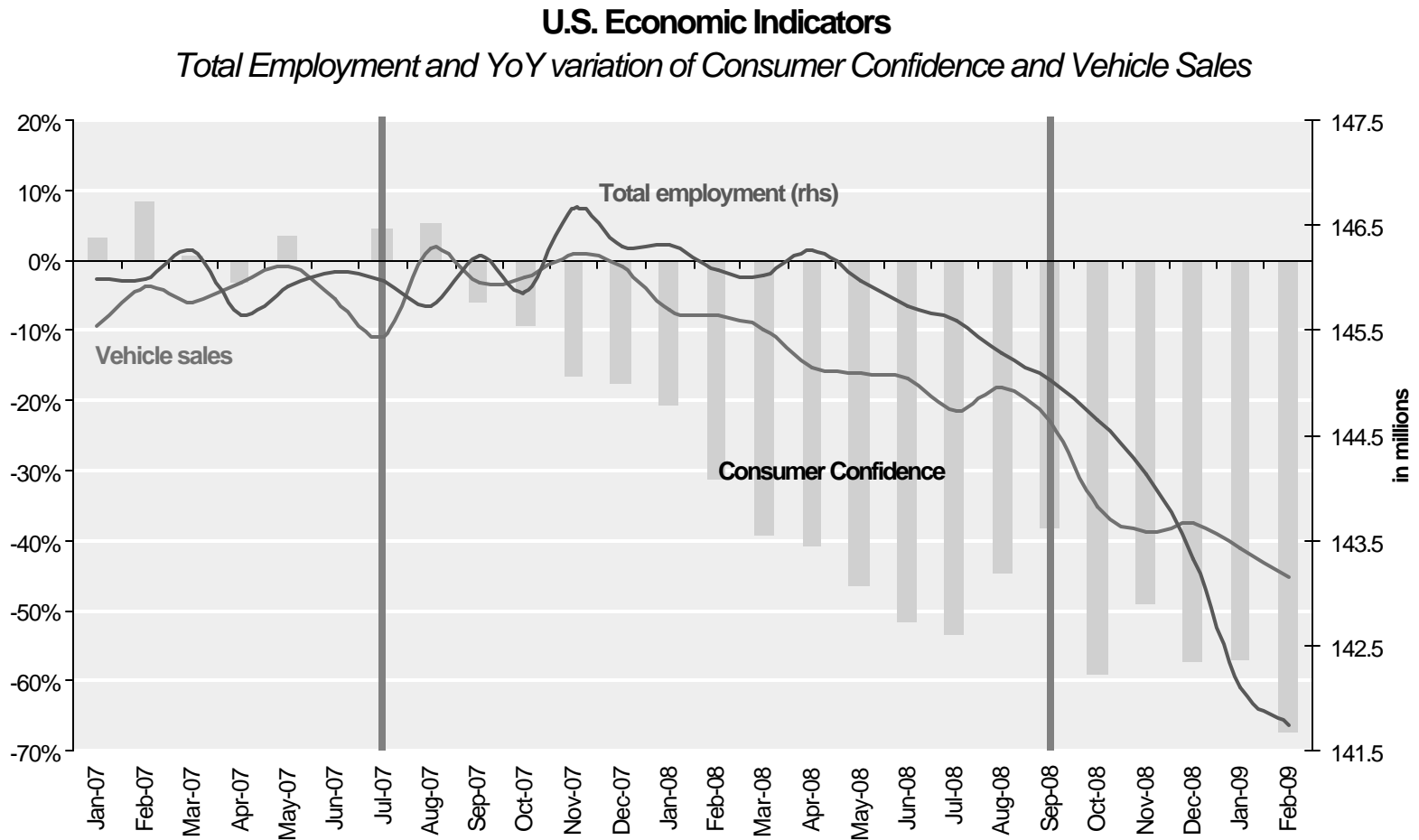
- What failed so badly (in markets and regulation) in the gestation and buildup to this crisis?
- Why did an apparently contained toxic problem with subprime mortgages become a generalized meltdown?
 - Only 17% of mortgages were subprime
 - Mortgages only around 20% of total bank credit
- Will fiscal stimulus and financial rescue packages stop downward spiral and stabilize markets?
- How to reform the future regulatory architecture?

Why did limited problem spread?

- Inevitable adjustment to credit and real estate bubble
- The Lehman effect – fueled sharp downward spiral
- Propagation of the shock – nasty feedback loops
 - Shock propagates inside the financial system
 - Opacity & uncertainty → runs → liquidations and deleveraging → connectedness → counterparty risk aversion → uncertainty → runs → ...
 - Shock hits real economy, exacerbating financial decay
 - ~~Shock propagates across countries~~

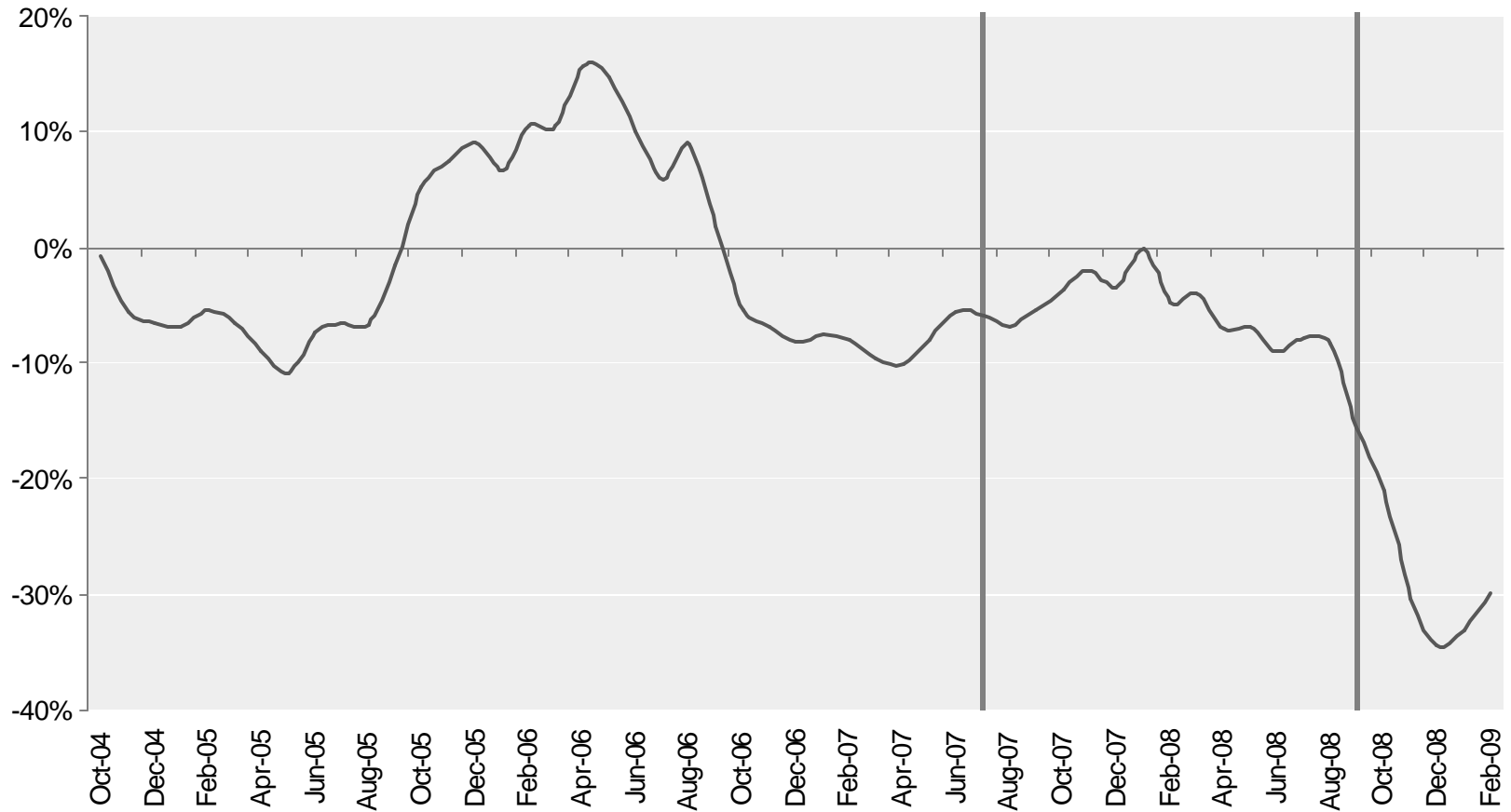
The crisis hits the world economy ...

The recession is in full swing in the U.S. ...



... and in the world

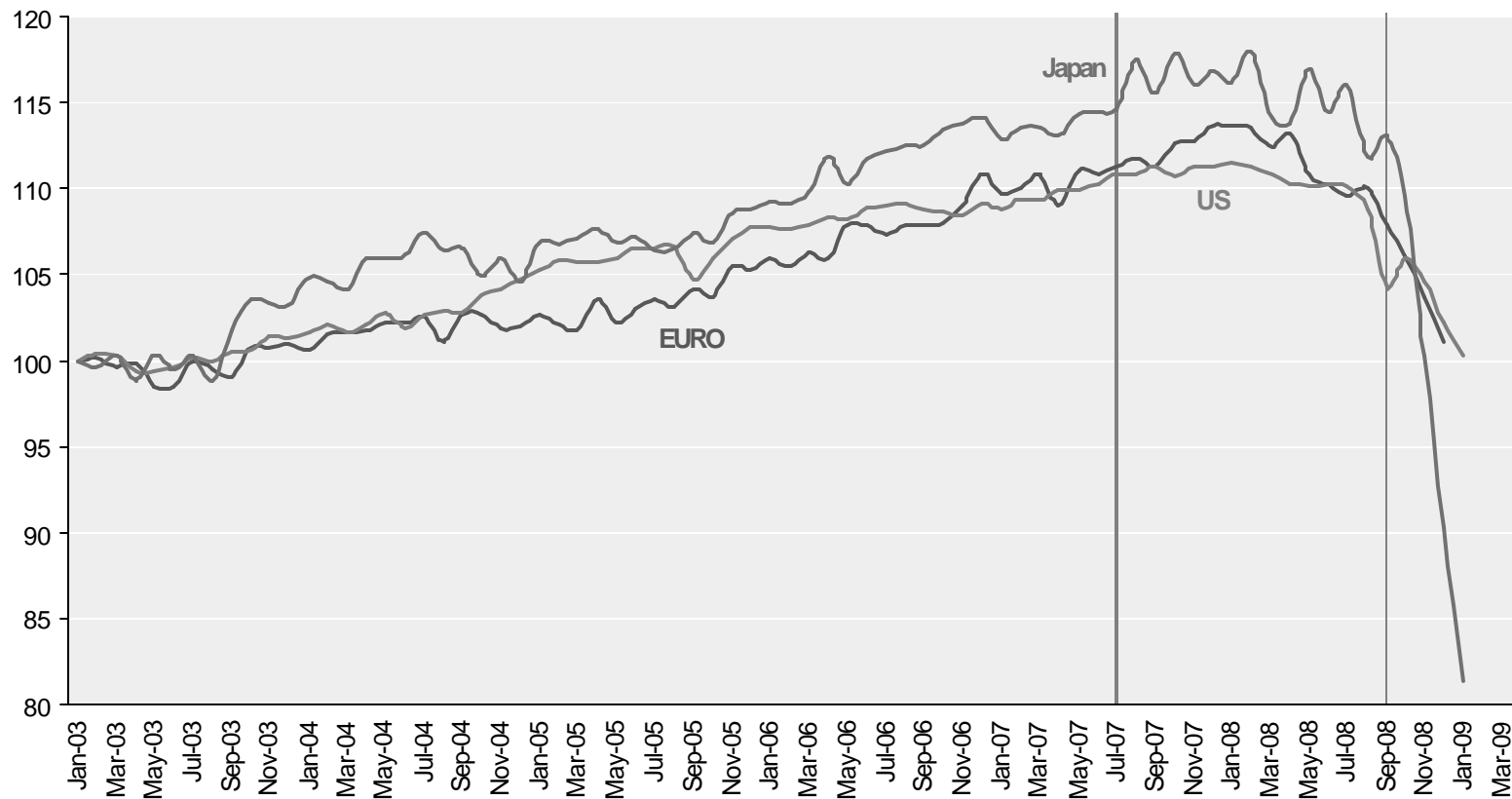
JPMorgan Global Manufacturing PMI
YoY variation - Seasonally adjusted



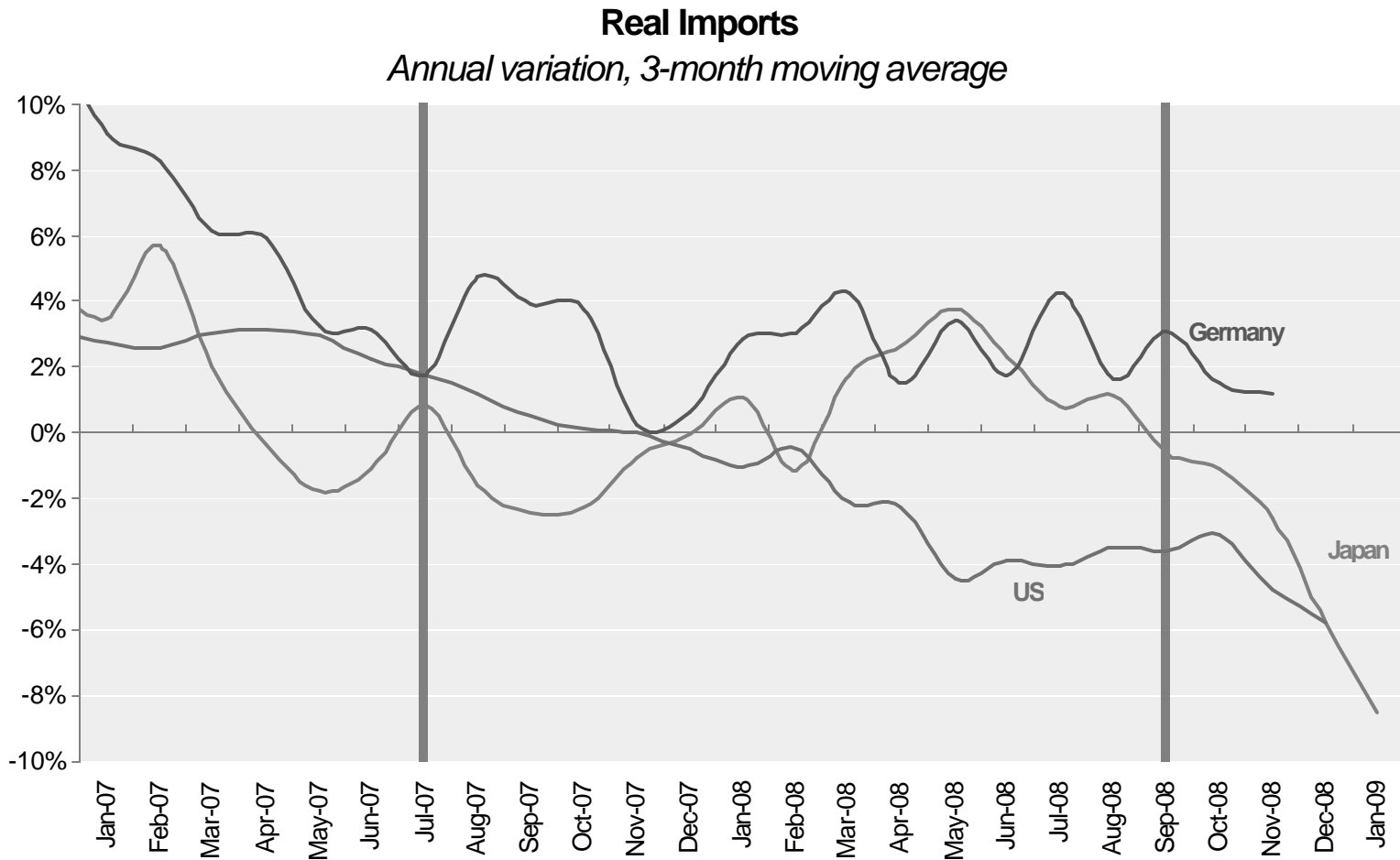
Strong contraction of industrial production...

Industrial Production Indexes

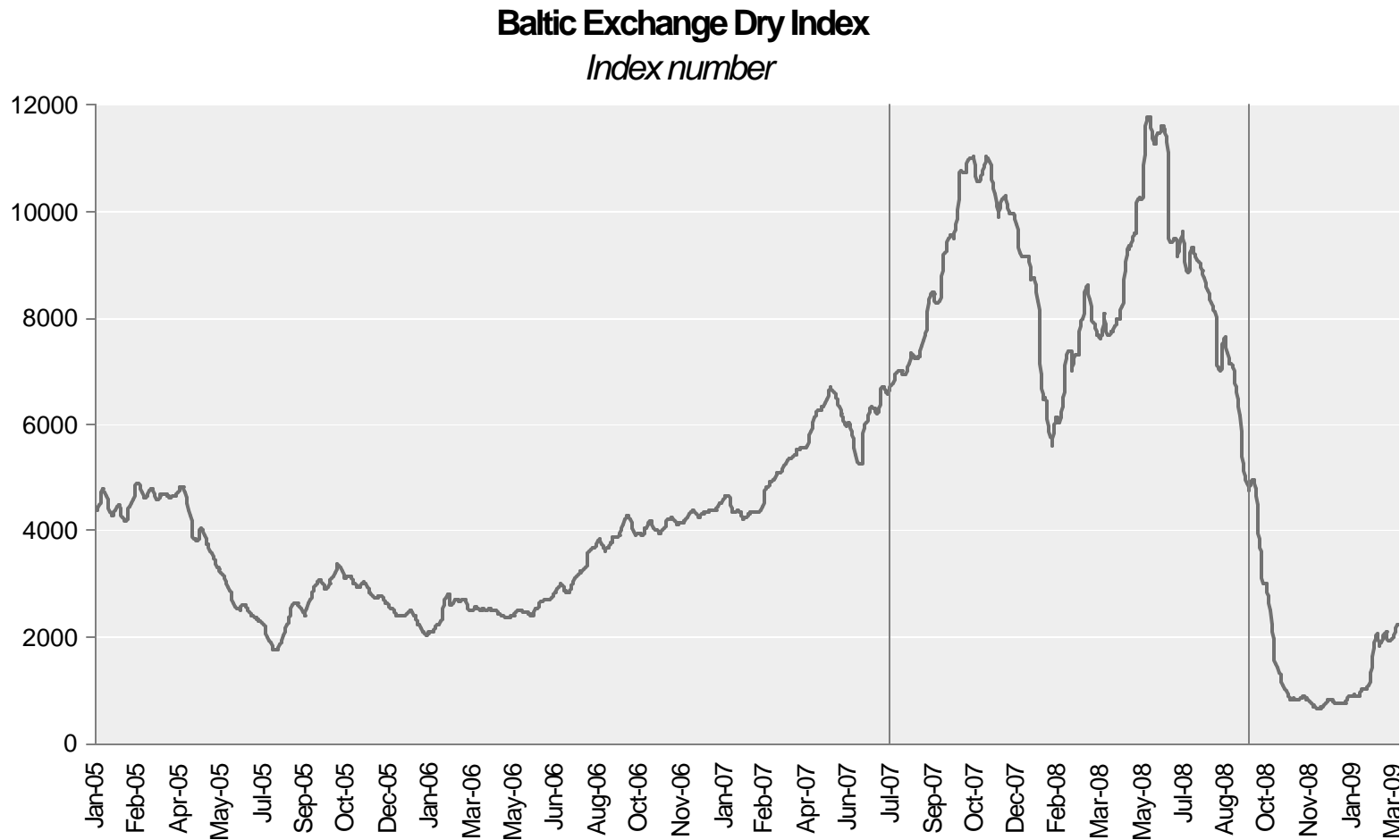
Index number - Jan-03=100



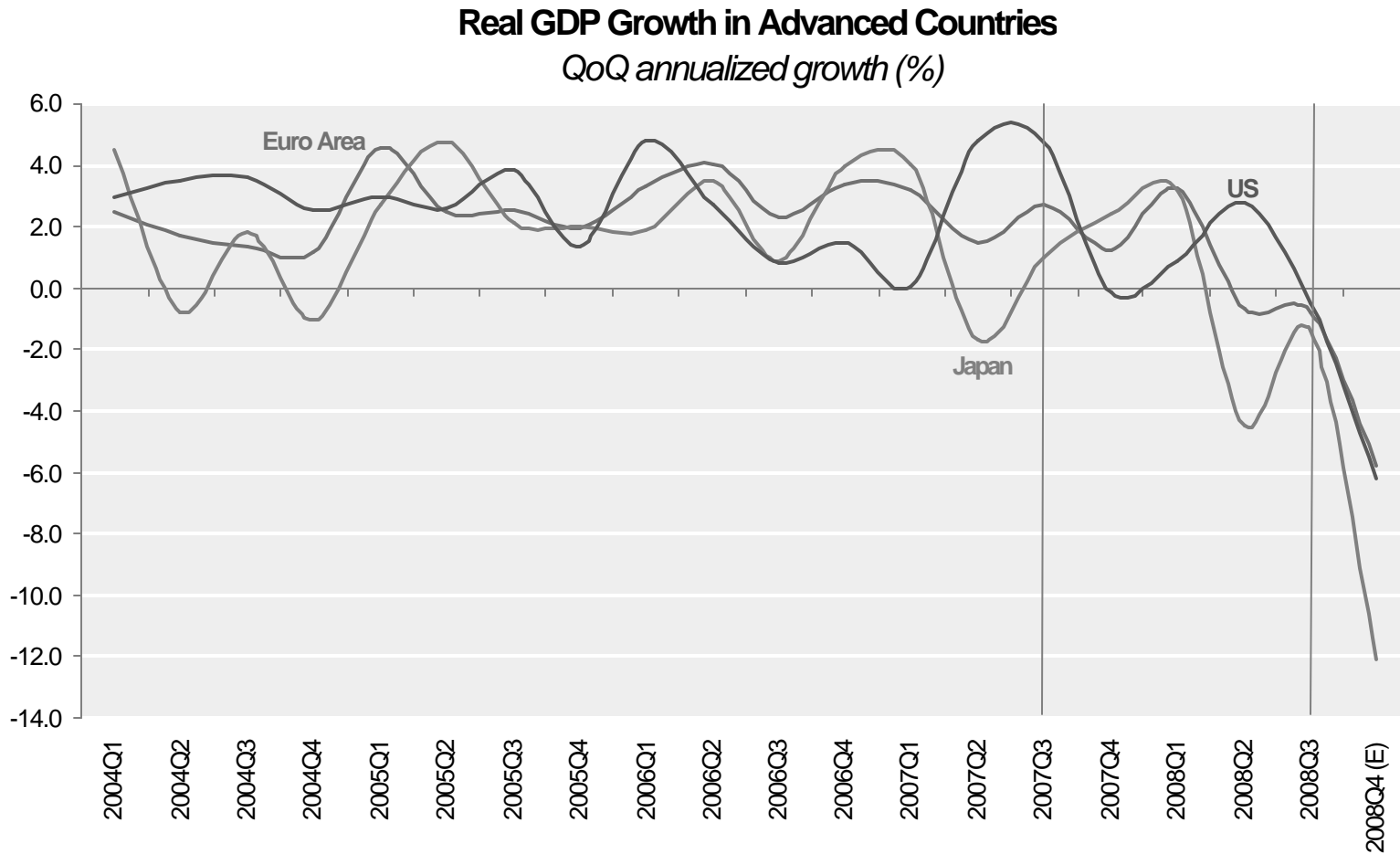
Imports by rich countries are dropping fast



International maritime commerce has been tanking since mid-2008

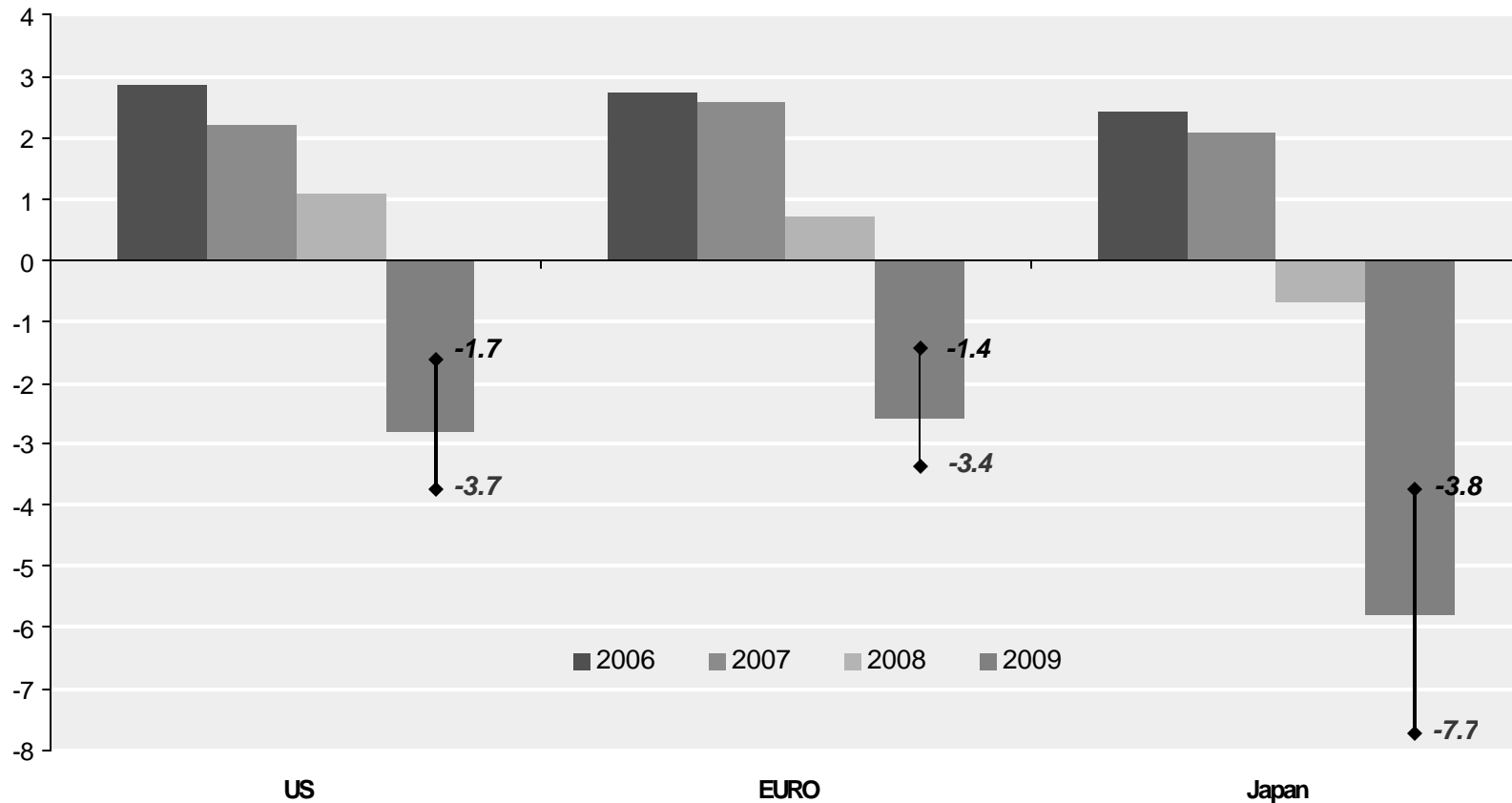


An awful 4th quarter of 2008 for economic activity in rich countries ...



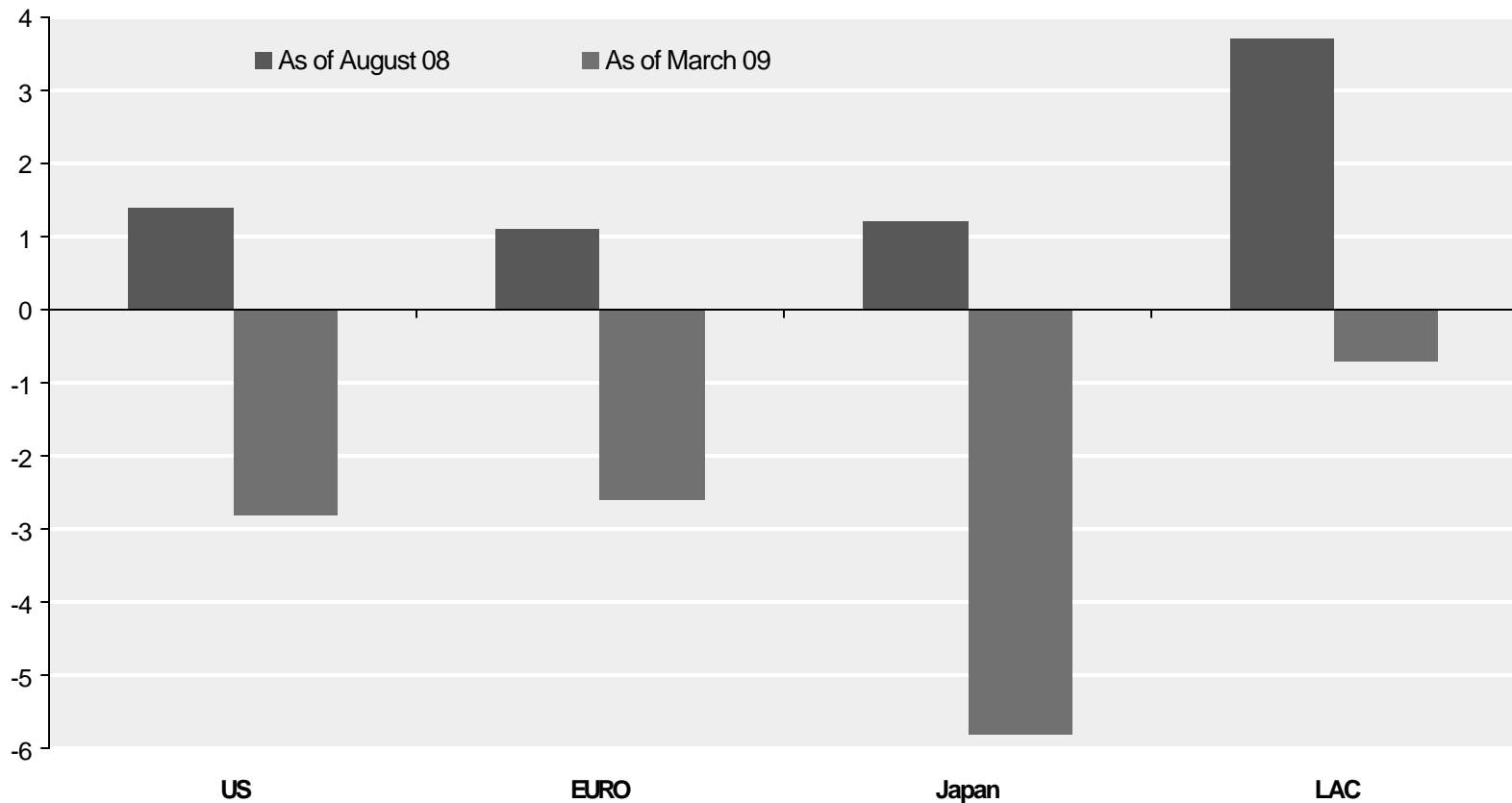
... points to a bad recession in 2009

Recent Growth and Forecasts for 2009
annual GDP real growth rate, in %



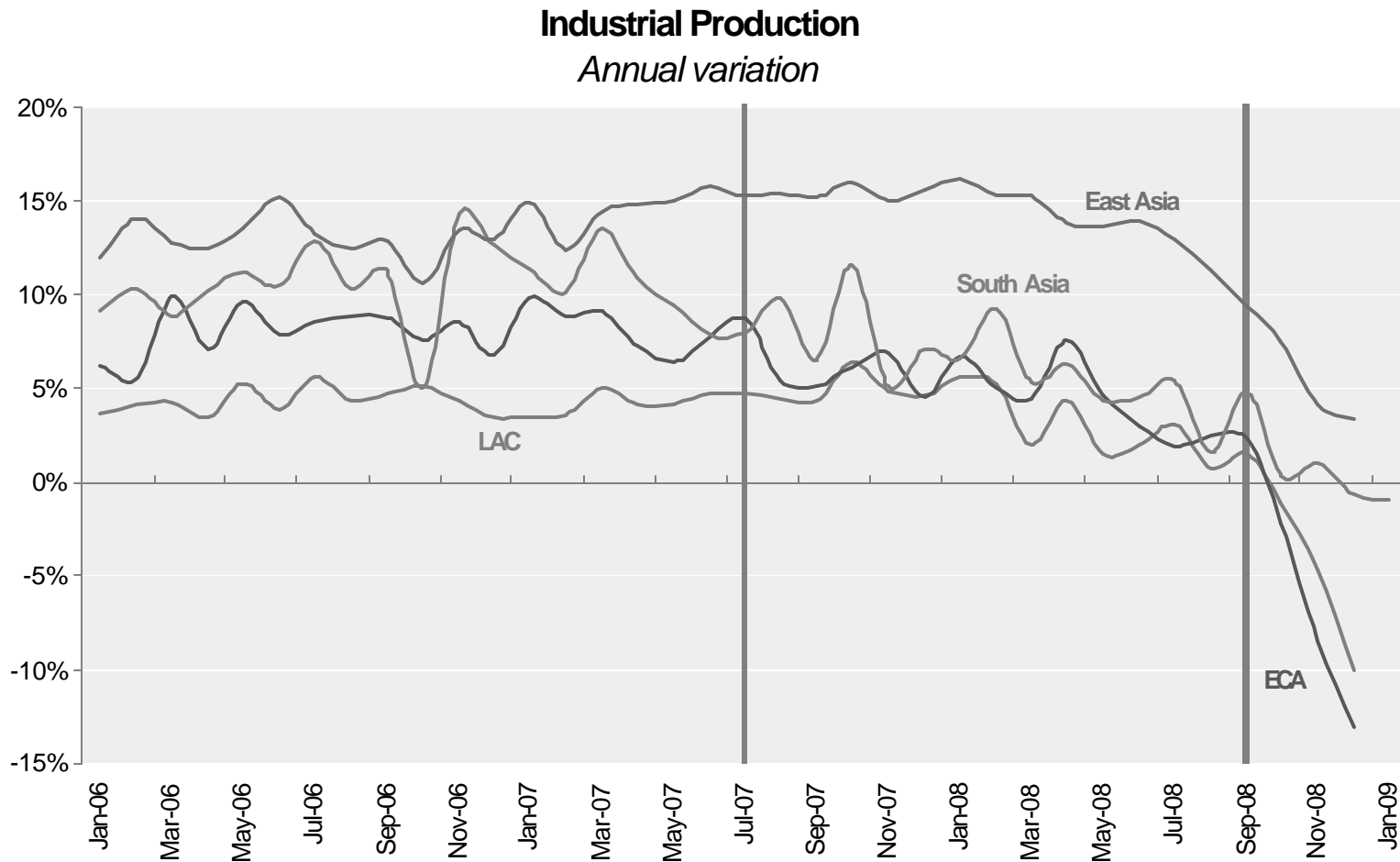
What a difference a quarter can make!

Growth Forecasts for 2009
annual GDP real growth rate, in %



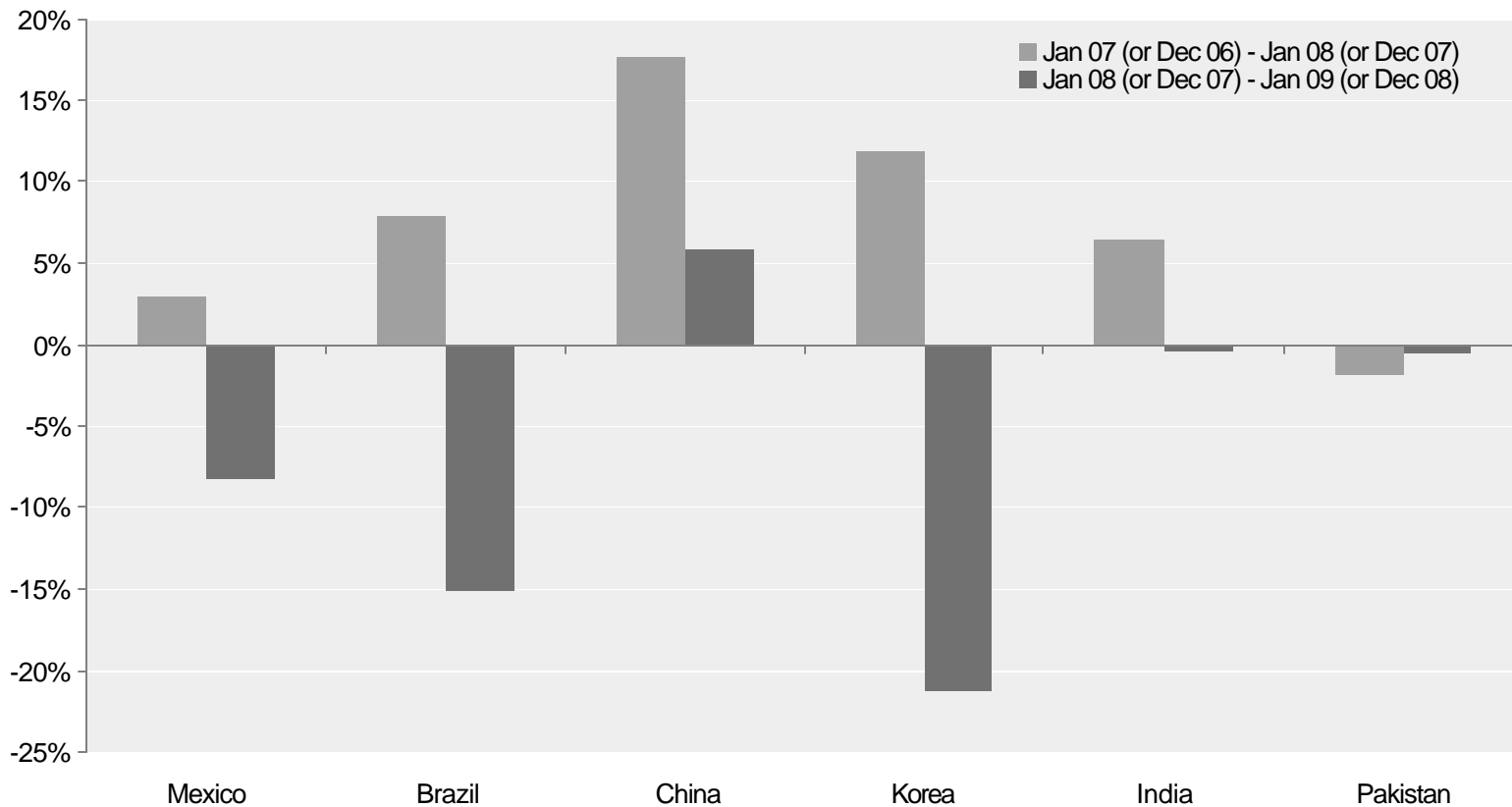
... and the emerging economies ...

A marked slowdown in industrial production across emerging markets in 2008-Q4 ...



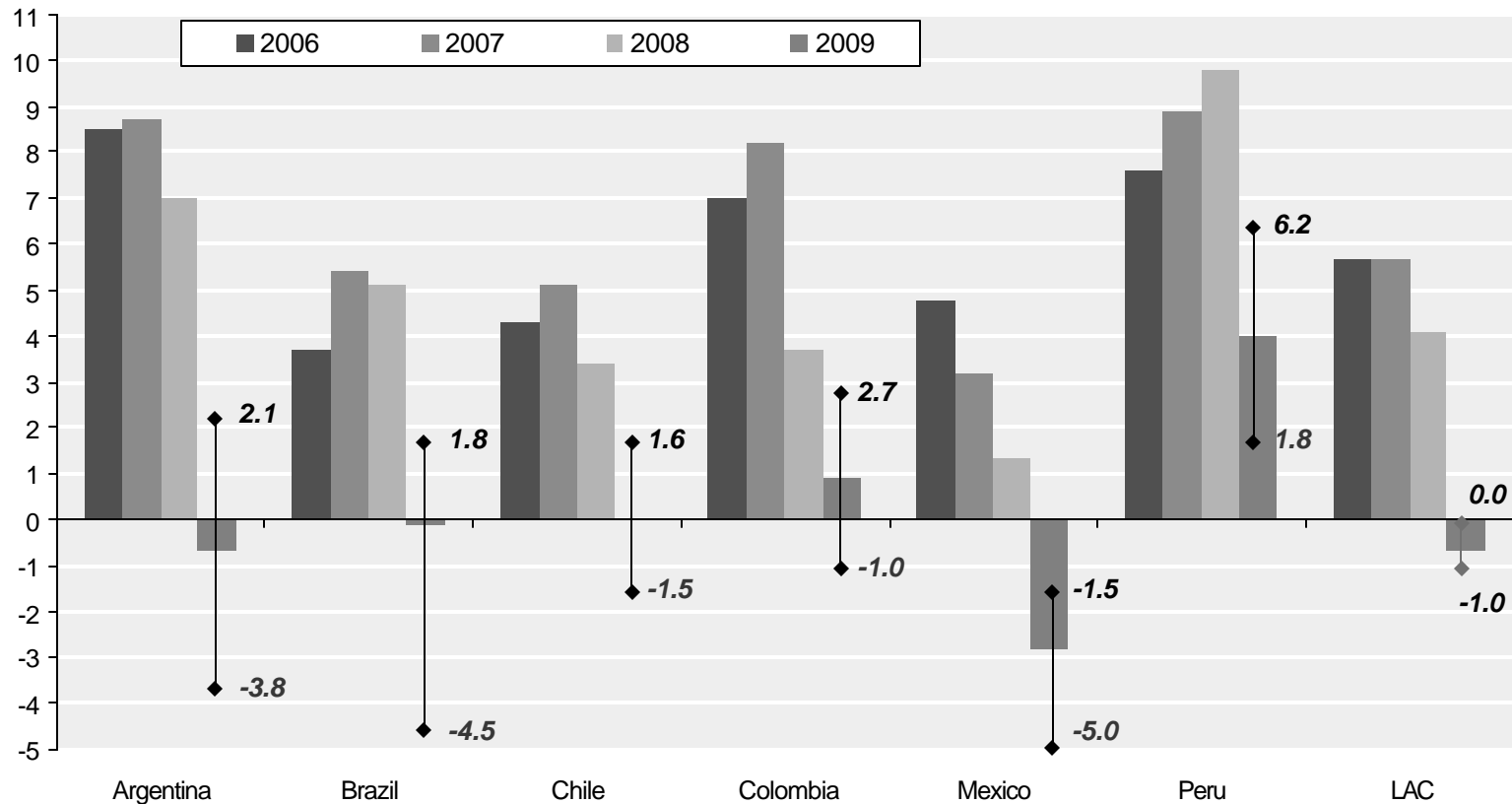
The slowdown in selected countries...

Industrial Production in selected countries
Annual variation



... augurs badly for growth in 2009 for Latin America

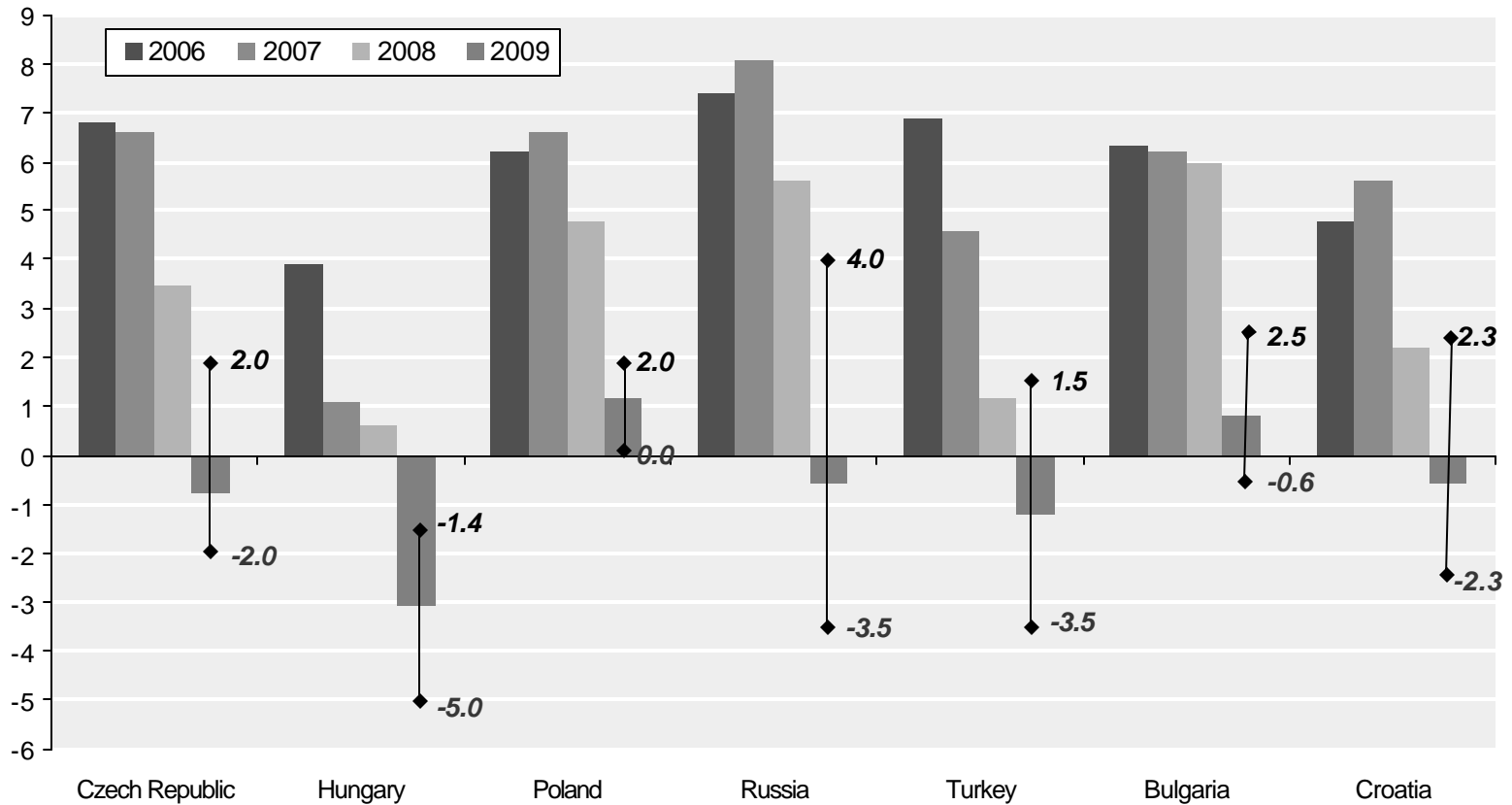
Recent Growth and Forecasts for 2009
annual GDP real growth rate, in %



... Eastern Europe ...

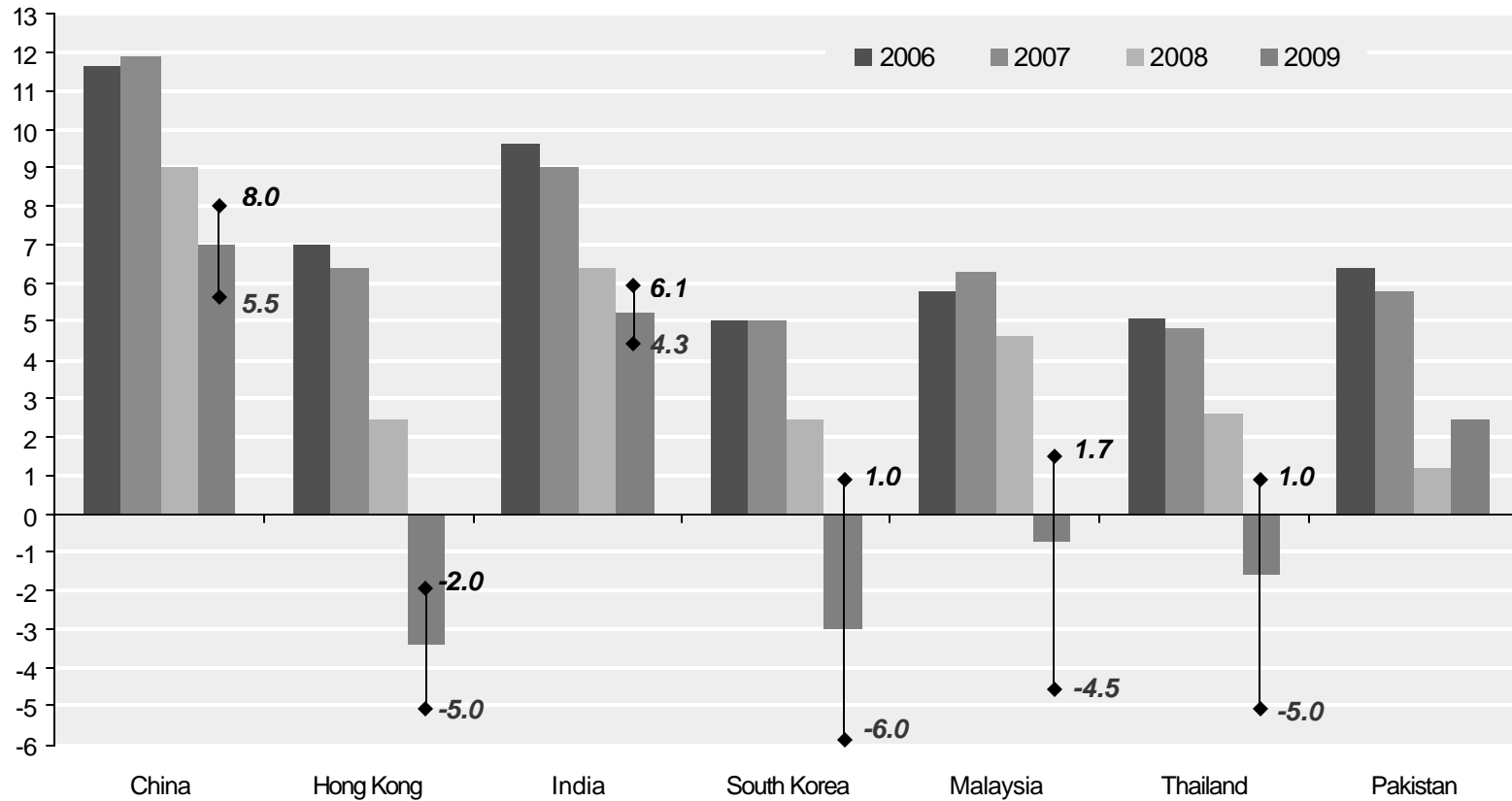
Recent Growth and Forecasts for 2009

annual GDP real growth rate, in %



... and Asia

Recent Growth and Forecasts for 2009
annual GDP real growth rate, in %



Transmission of shocks to Emerging Markets

- Stages of the transmission
 - Decoupling stage (Aug 07 – May 08)
 - Rise in commodities decoupled from financial crisis
 - Re-coupling stages (begins May 08, accelerates Oct 08)
 - Commodity collapse, Lehman effect, and real side downturn

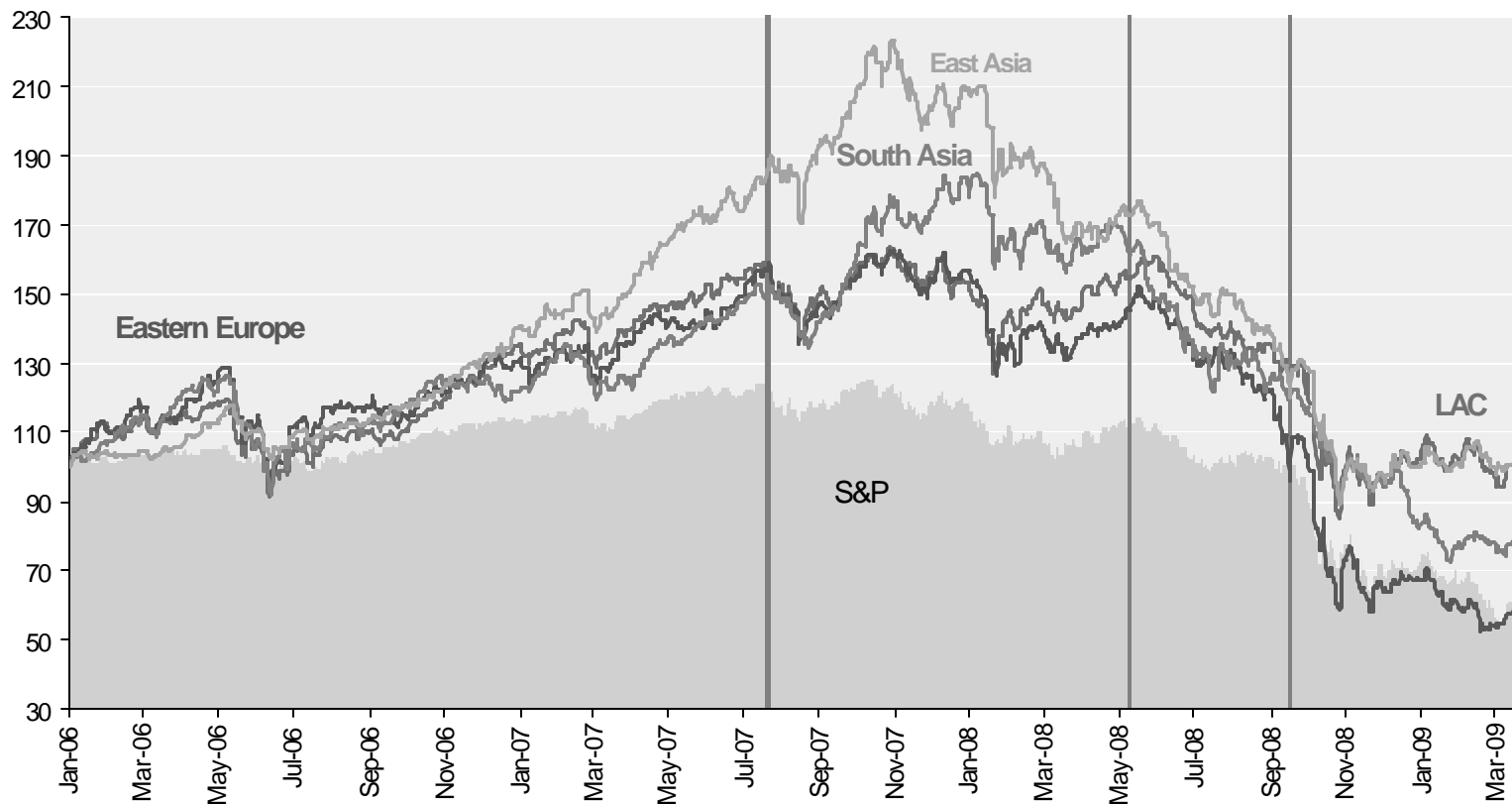
- Transmission channels
 - Financial contagion
 - Remittances
 - Commodity prices
 - External demand

Financial contagion effects

In the re-coupling stages: EMs join the massive global selloff of stocks...

Stock Prices in Emerging Markets and the U.S.

Index number - Jan 06=100

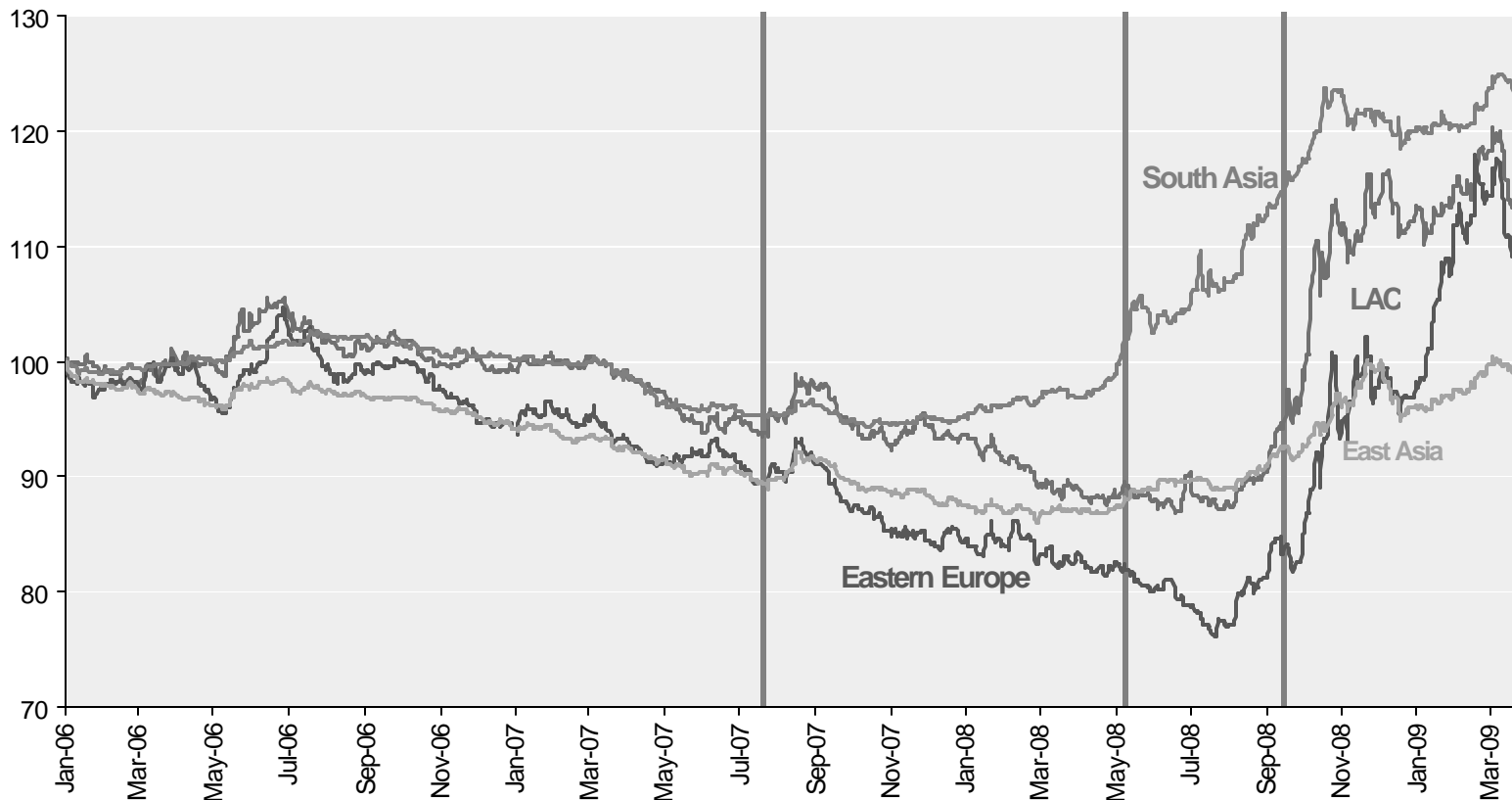


Regional aggregates are simple averages. LAC: Argentina, Brazil, Colombia, Chile, Mexico. Eastern Europe: Czech Republic, Hungary, Poland, Turkey and Russia. South Asia: India and Pakistan. East Asia: China, Hong Kong, Indonesia, Malaysia, Philippines, South Korea and Thailand. Source: Bloomberg

... EM currencies hit hard, especially in Eastern Europe, but stabilizing now...

Currencies in Emerging Markets (*vis-à-vis* US dollar)

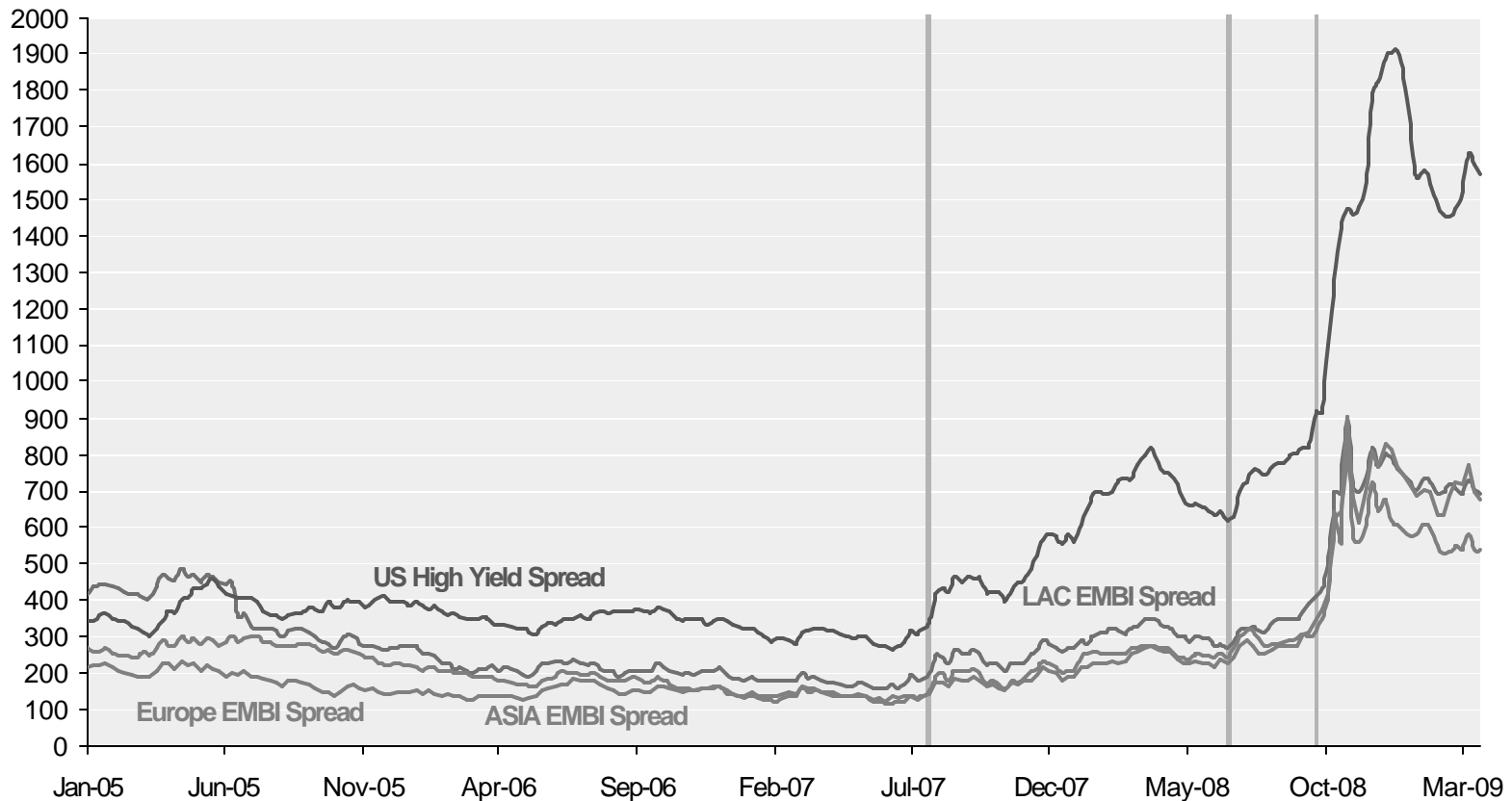
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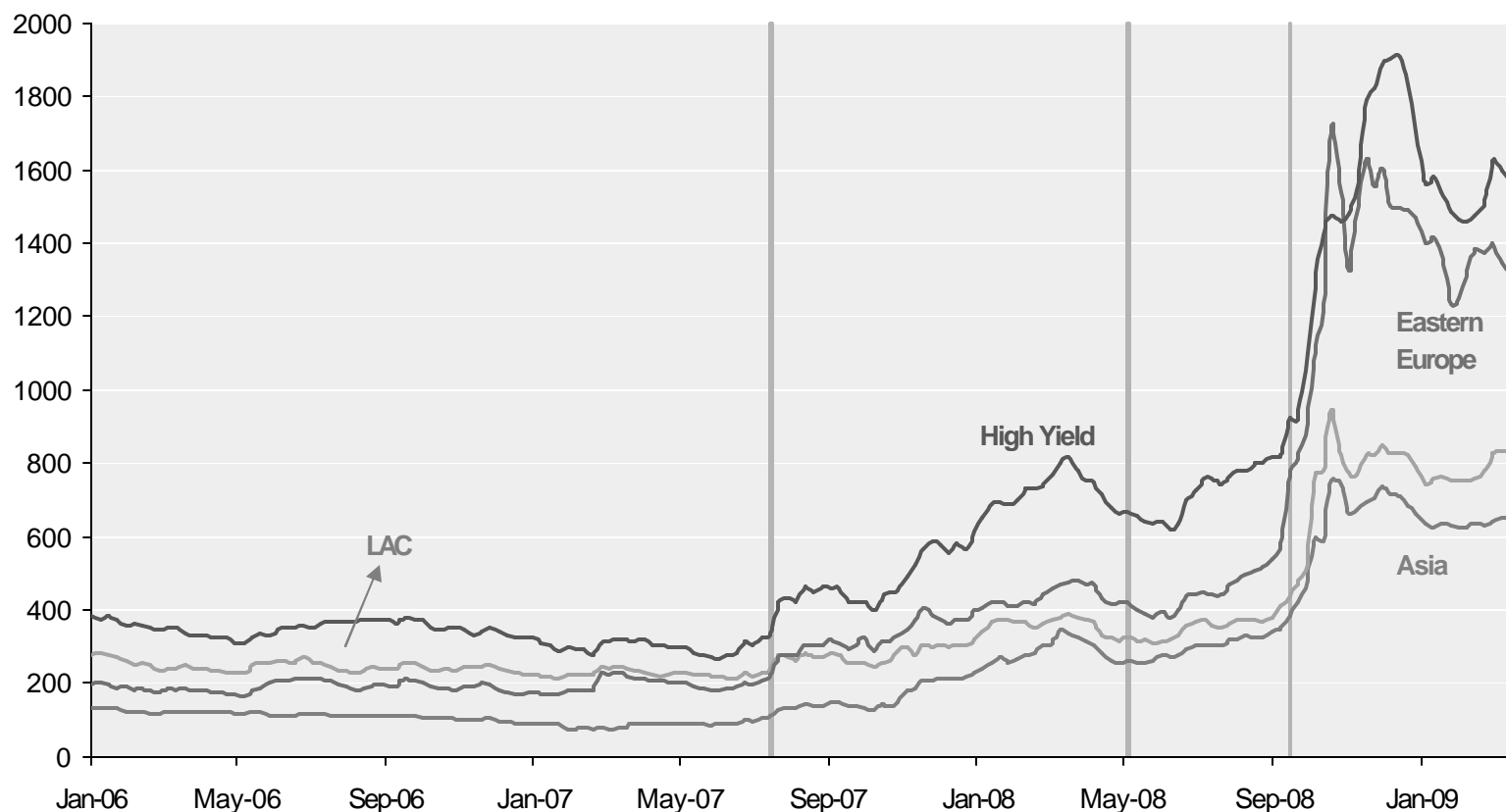
... EM sovereign spreads more than doubled...

Latin America EMBI & U.S. High Yield Spreads
in basis points



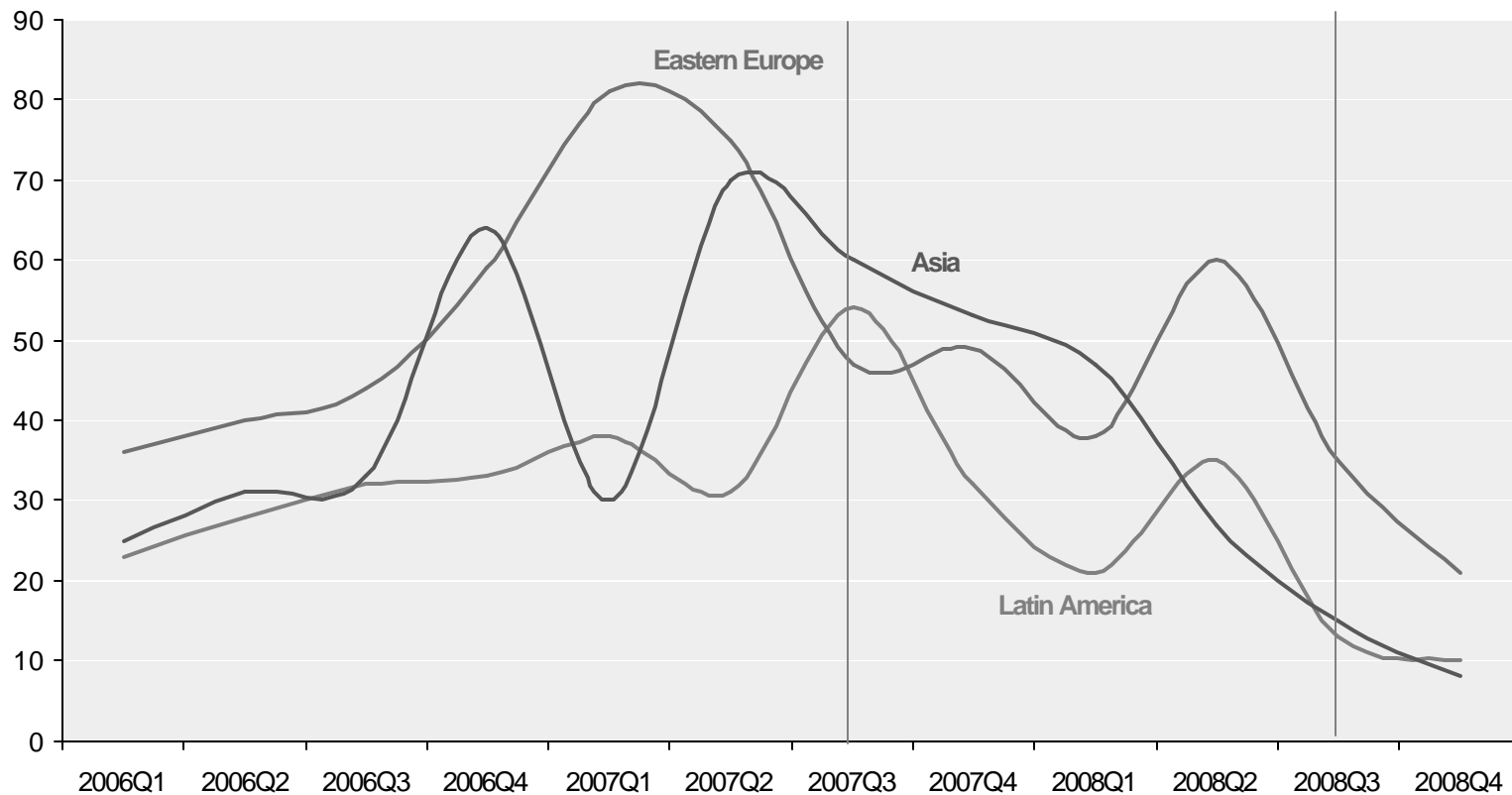
EM firms facing a steep rise in FX borrowing costs, with Eastern Europe as an outlier

Corporate EMBI & U.S. High Yield Bond Spread
in basis points



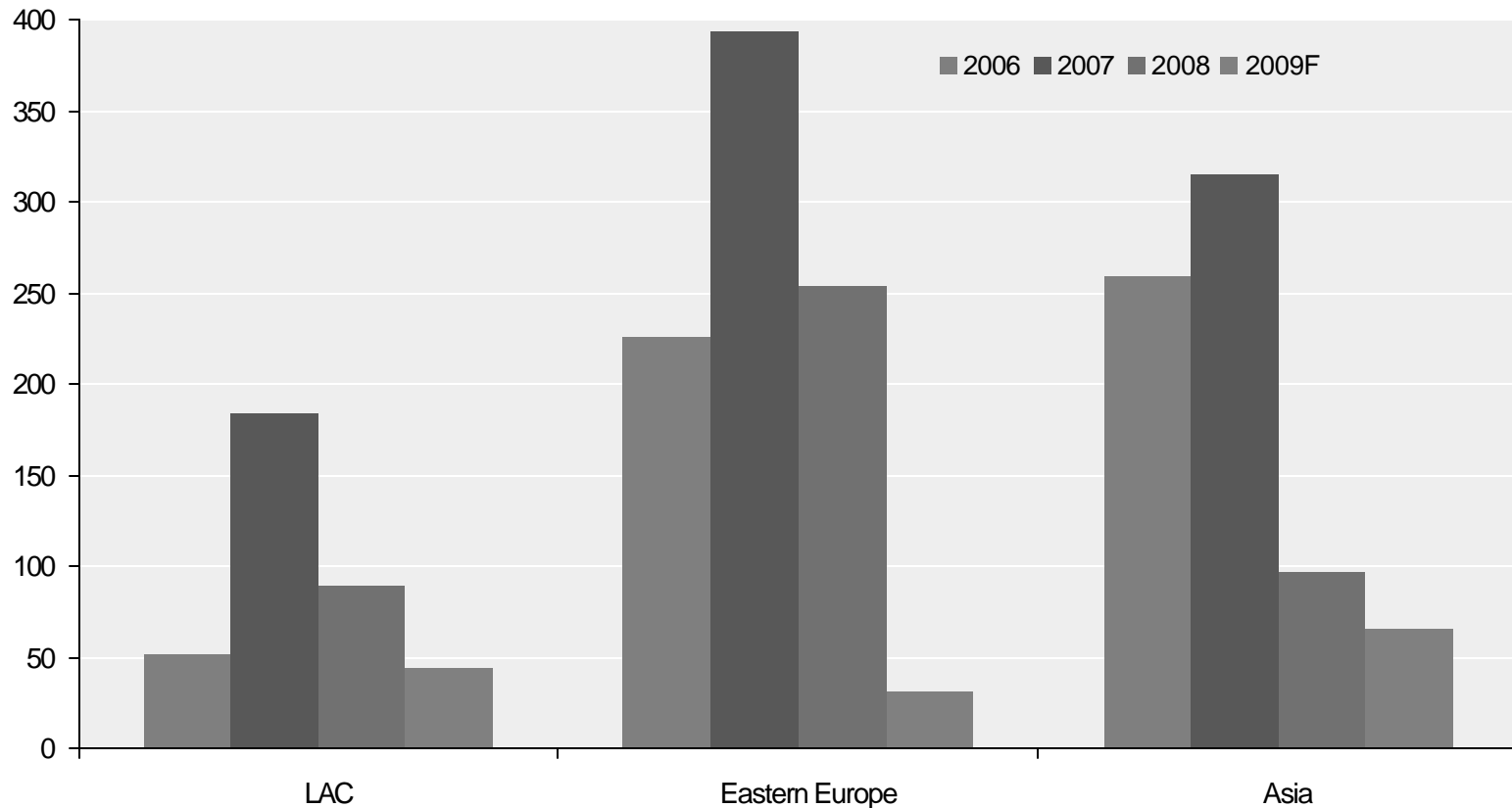
Portfolio flows to EMs declining fast

NON-FDI Gross capital flows to emerging markets
In US\$ billions

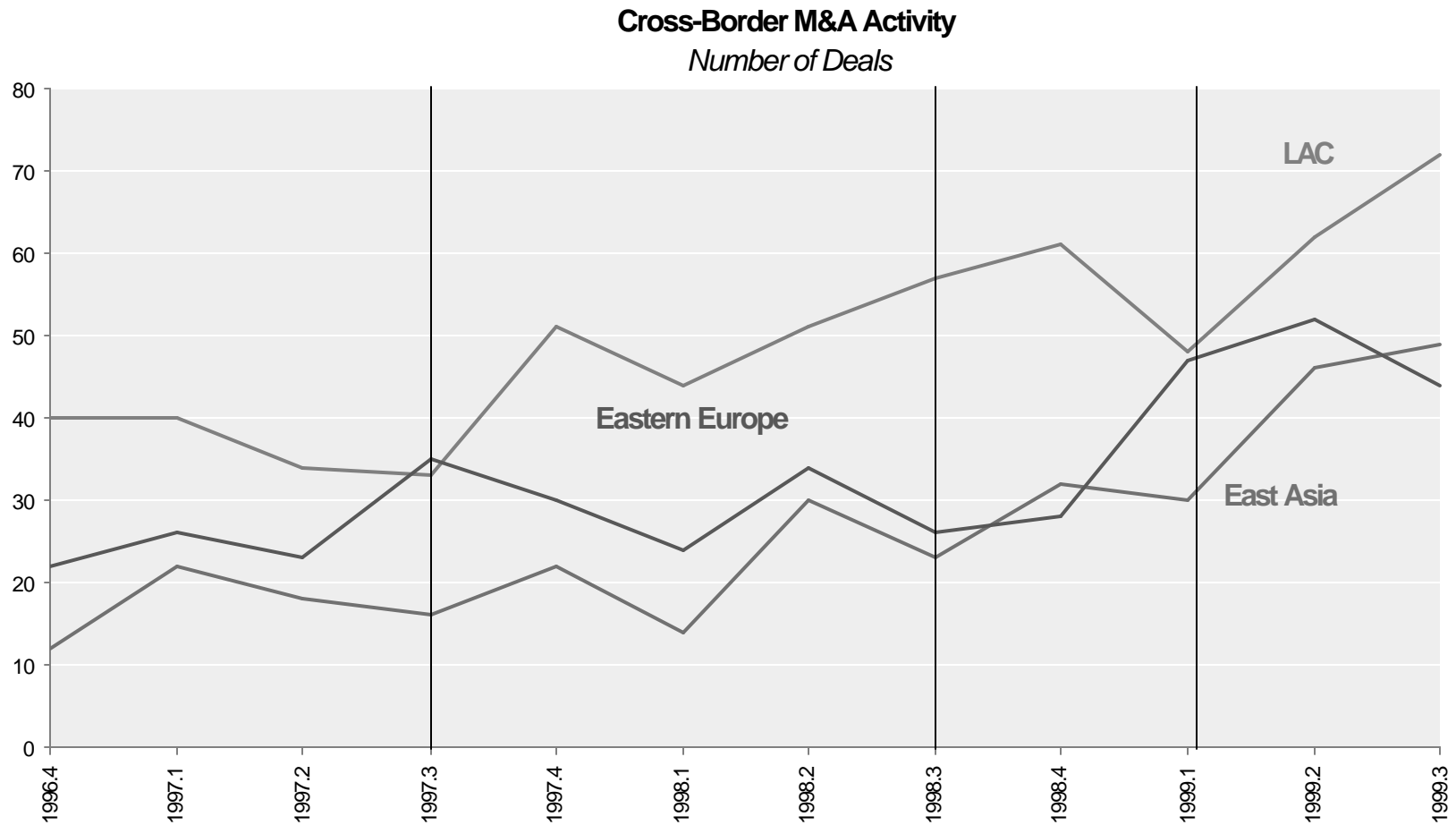


Portfolio flows to EMs declining fast

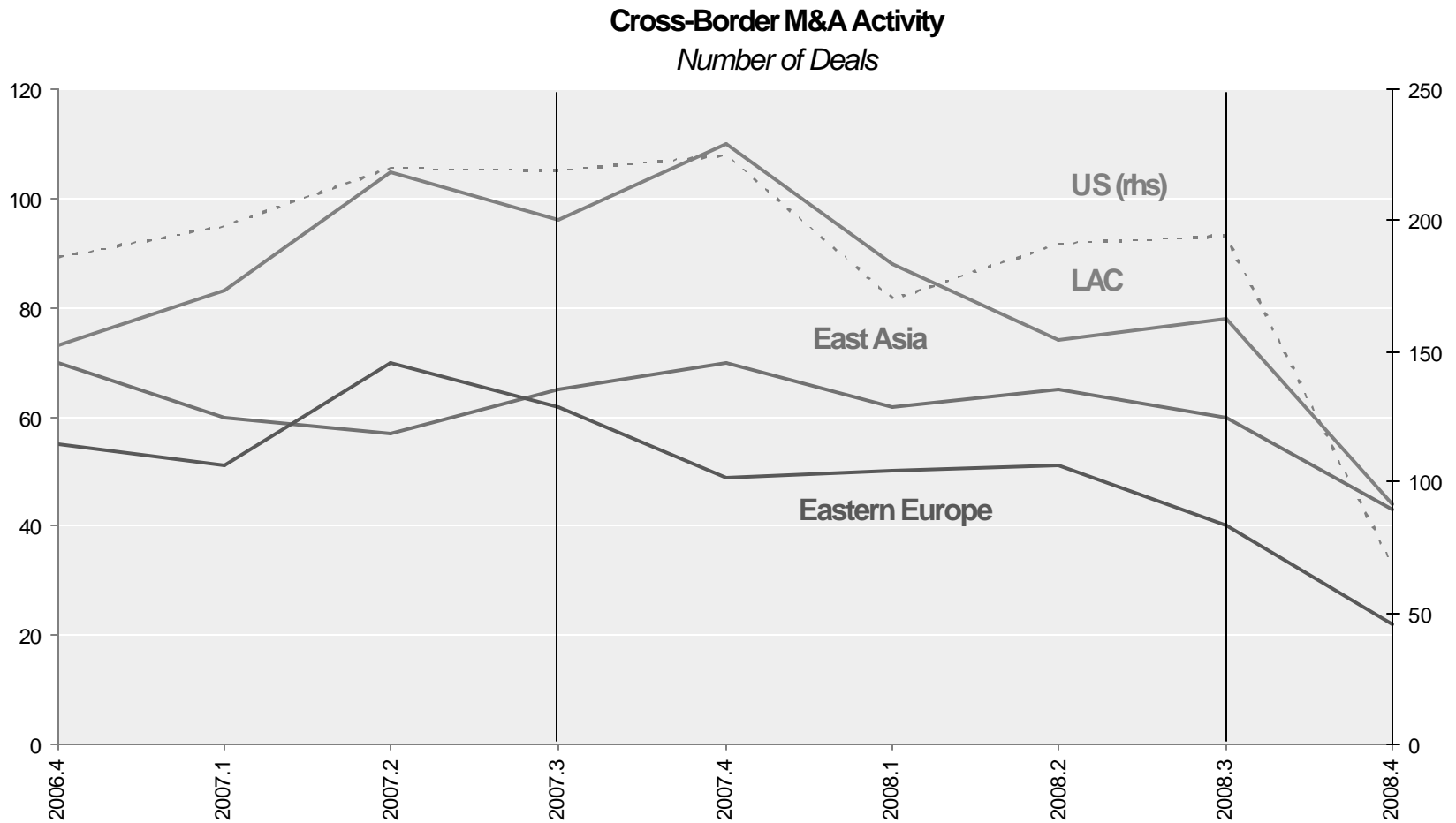
Net private financial flows to emerging market economies by region
In US\$ billions



Will FDI remain resilient in this crisis, given the decline in M&A?

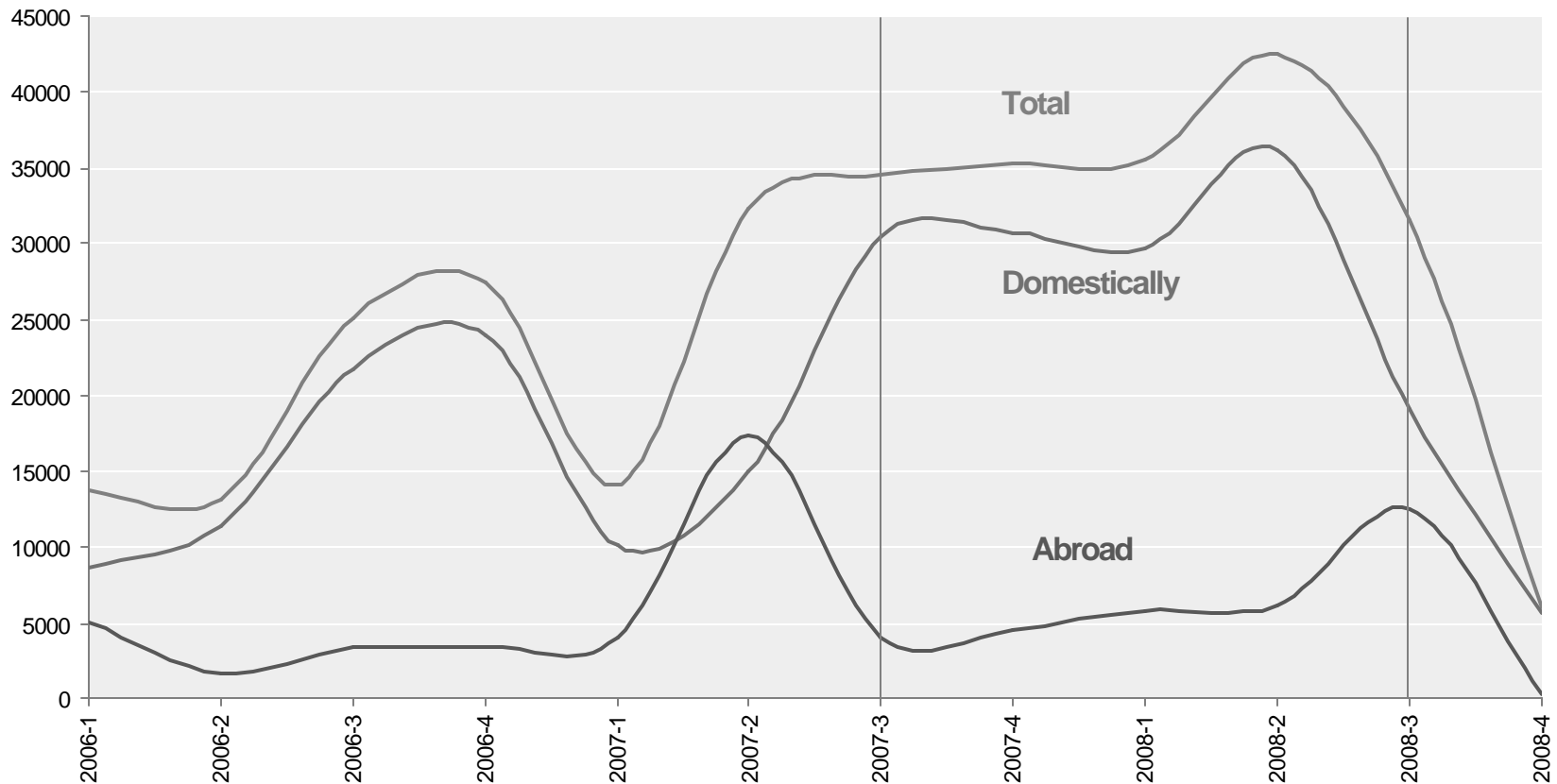


Will FDI remain resilient in this crisis, given the decline in M&A?



Corporate issues virtually stopped, in local & foreign mkts

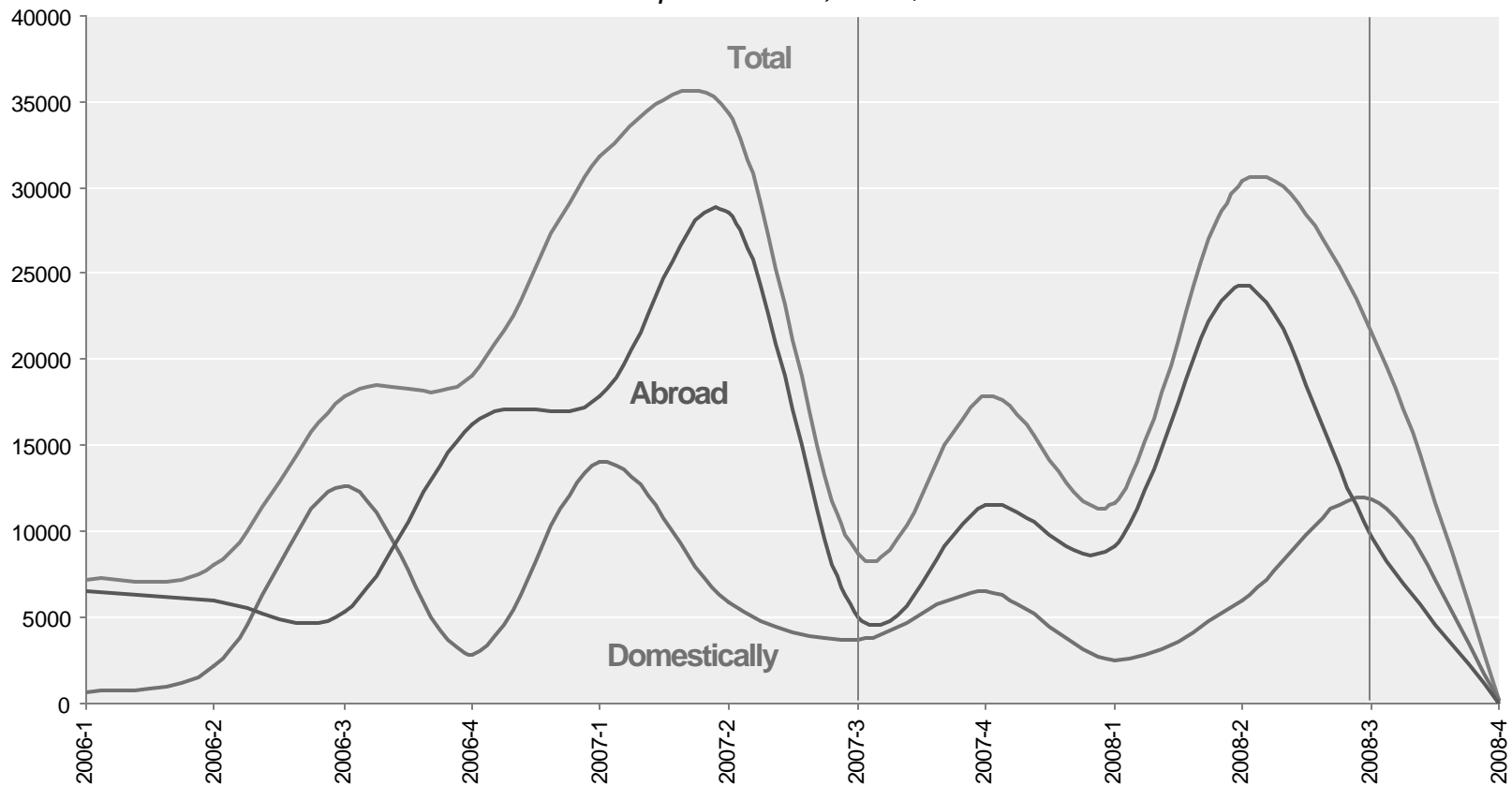
Capital Raising Activity in LAC
Corporate issues, in US\$ millions



Corporate issues virtually stopped, in local & foreign mkts

Capital Raising Activity in Emerging Europe

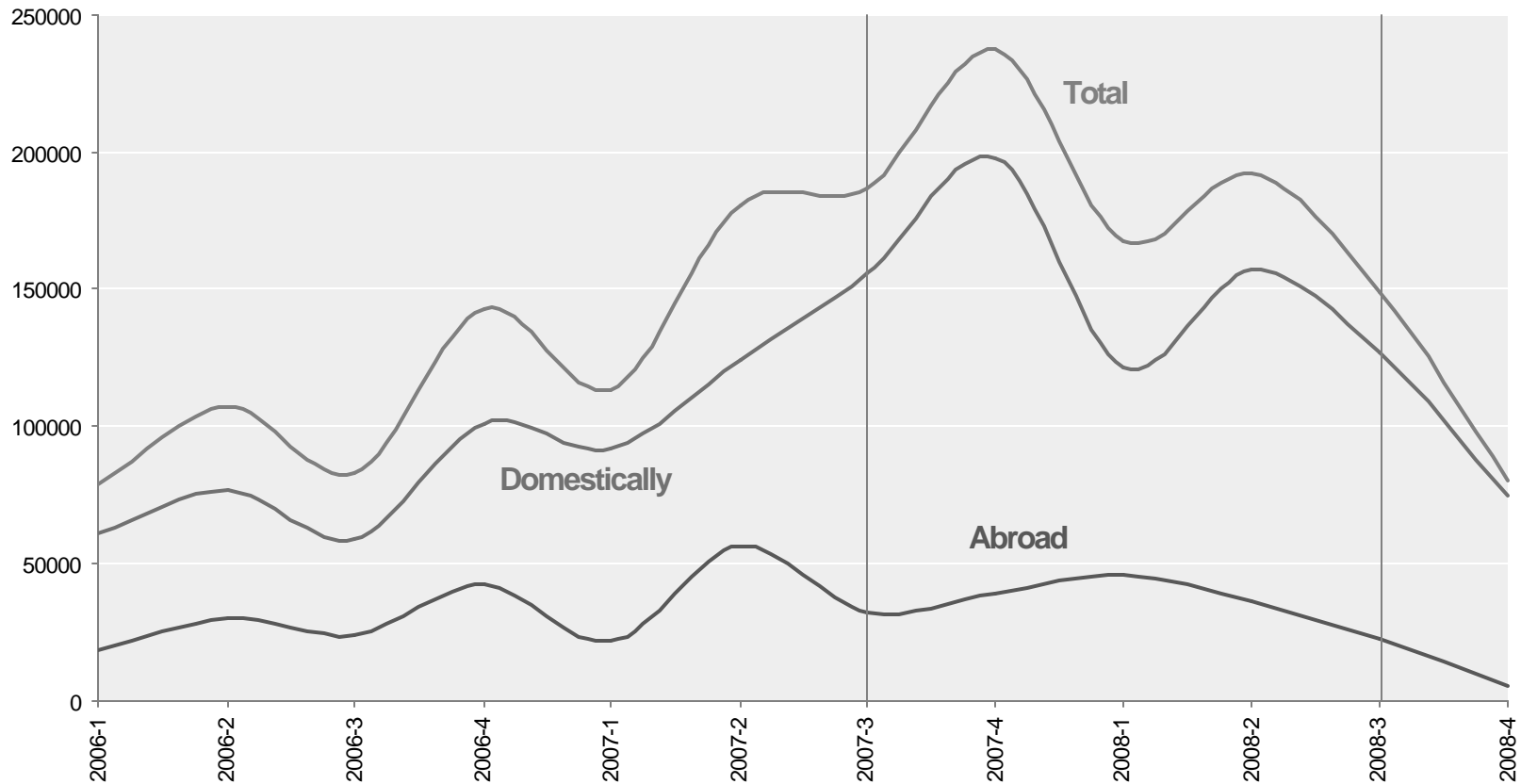
Corporate issues, in US\$ millions



Corporate issues virtually stopped, in local & foreign mkts

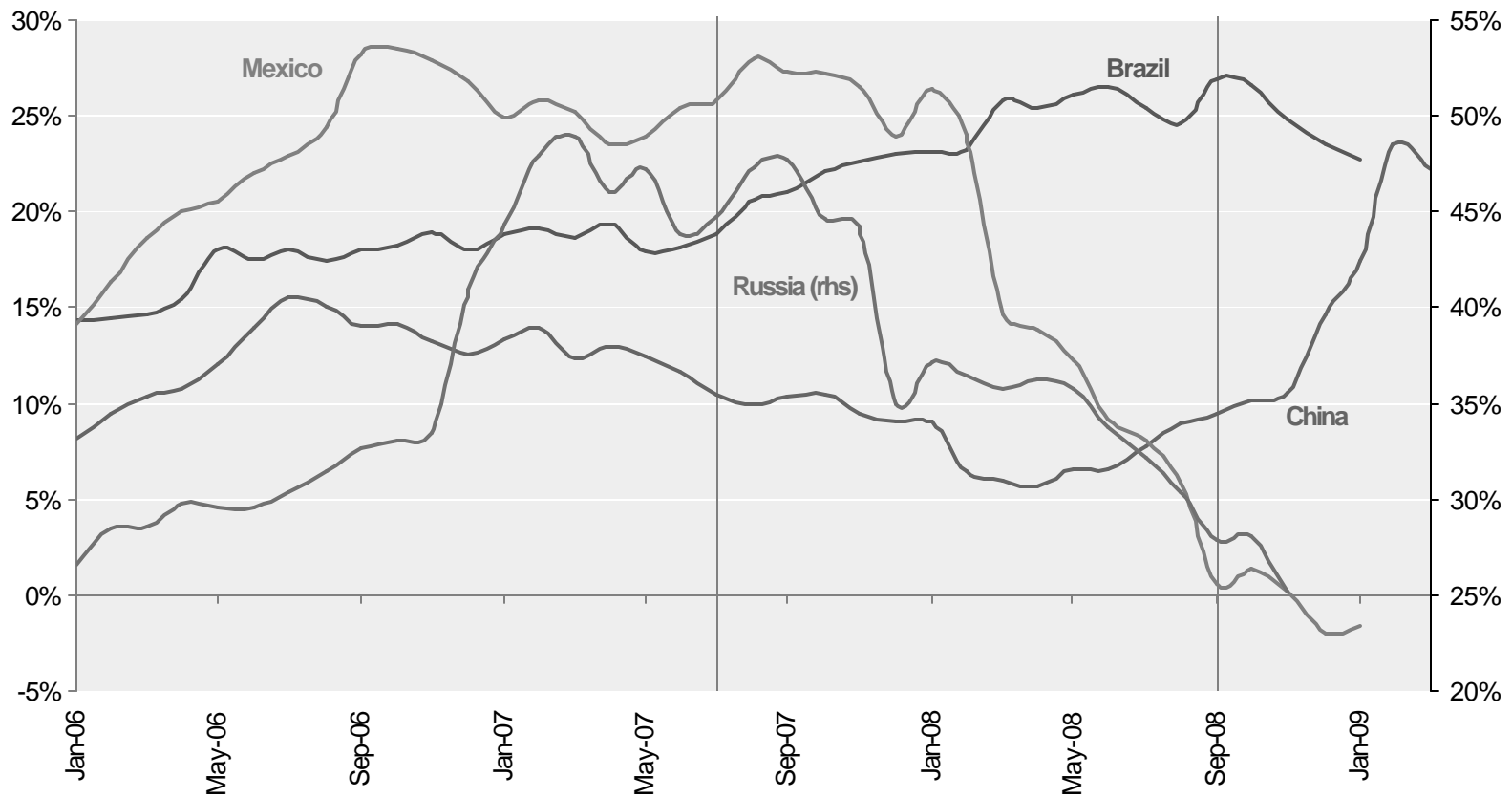
Capital Raising Activity in South-East Asia

Corporate issues, in US\$ millions

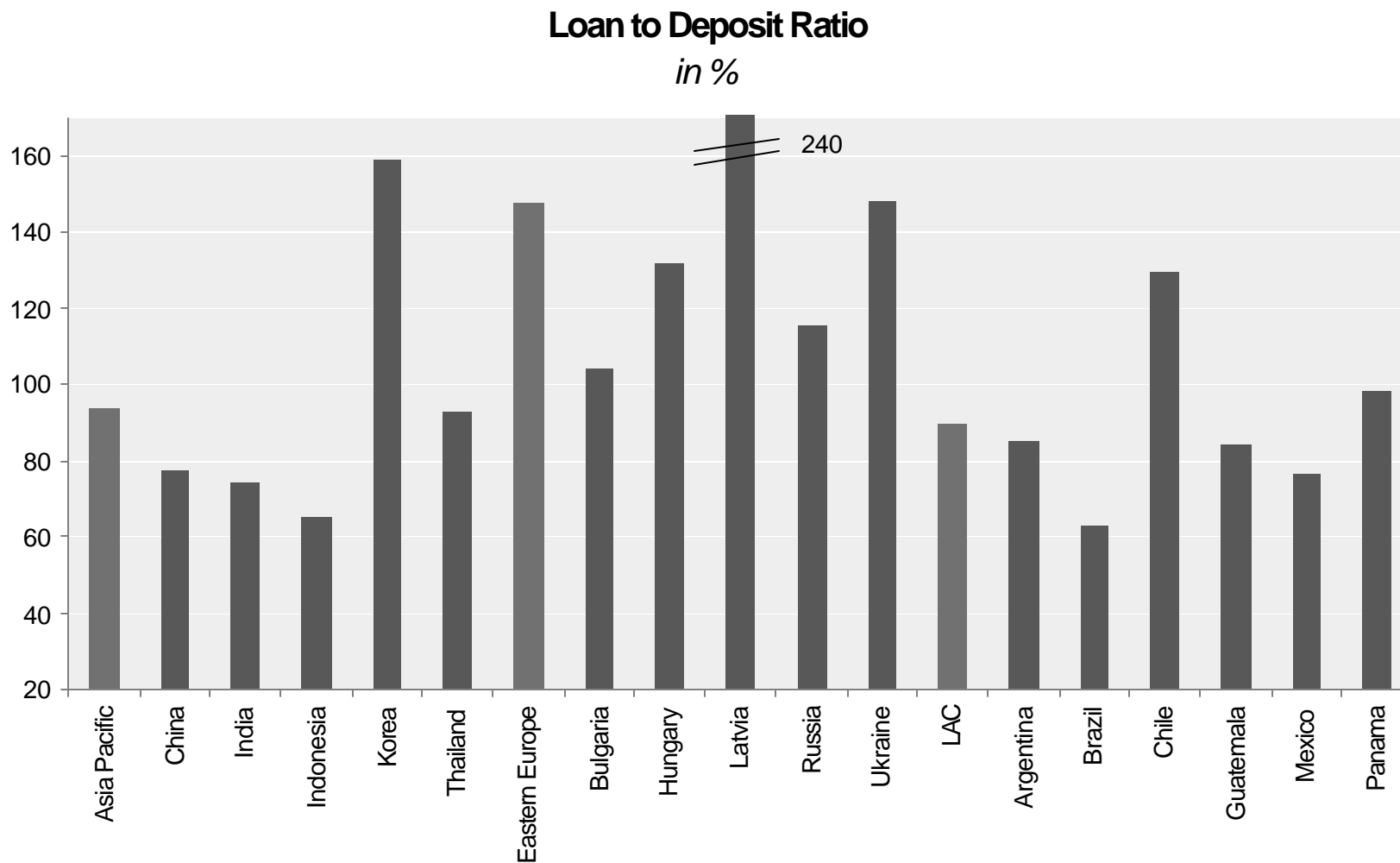


Bank credit in BRCM countries...

Real Credit Growth in BRCM countries
Annual variation



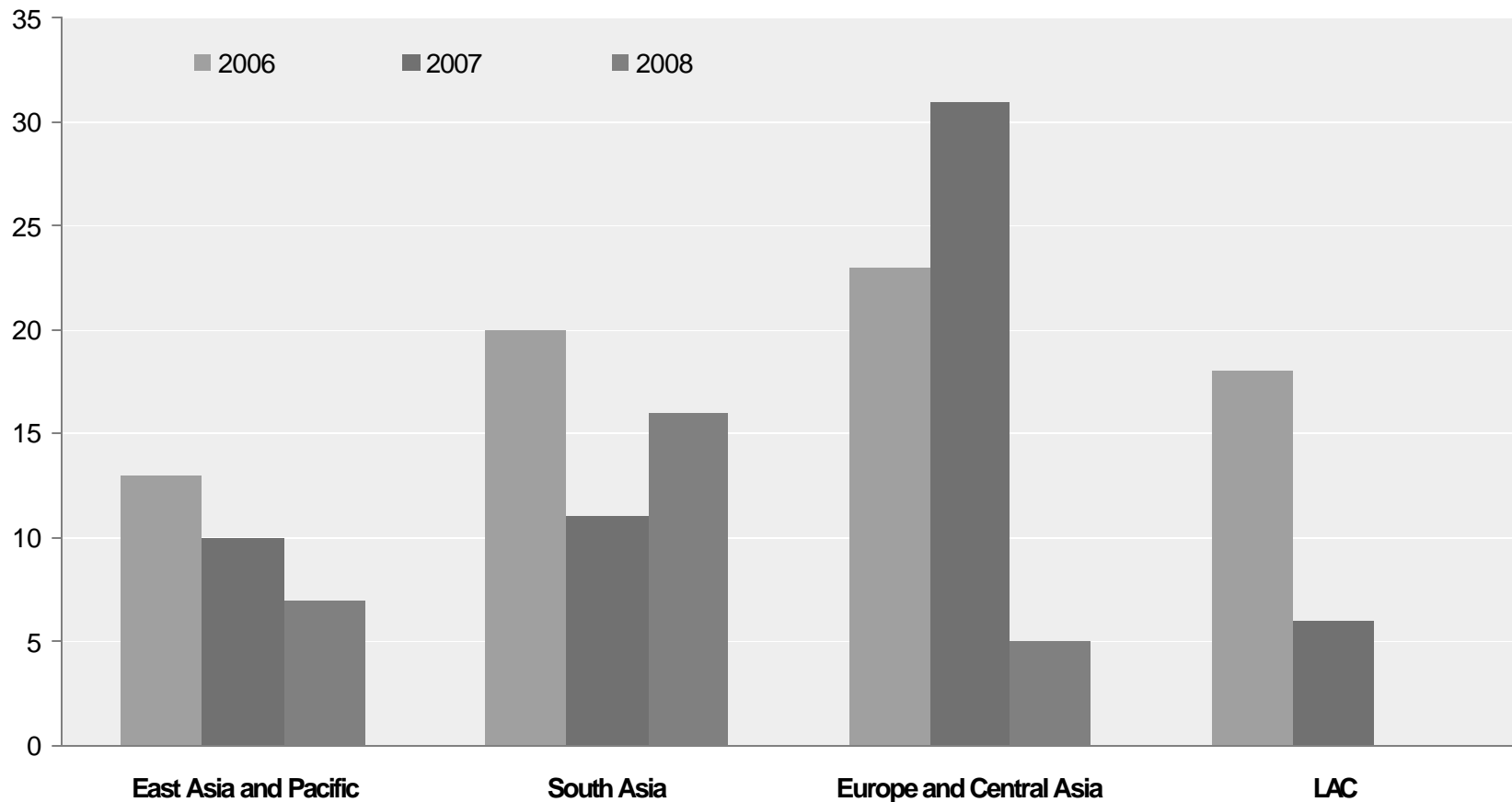
Eastern Europe is most vulnerable to a bank crisis



Remittances

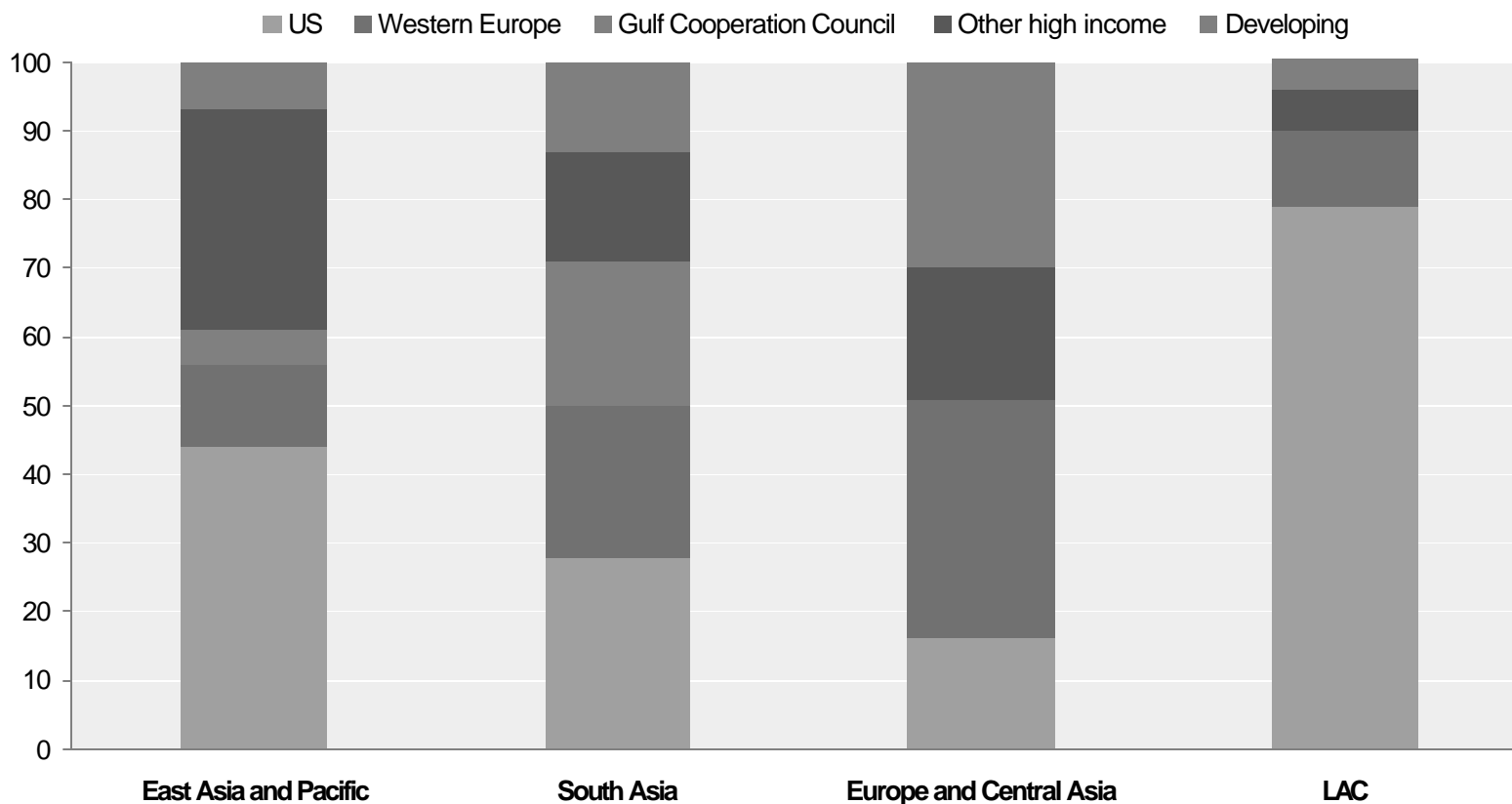
Remittances are contracting all around the world

Remittance flow to developing countries
Annual variation (in %)



The origin of remittances is much more diversified for Eastern Europe and Asia than for Latin America

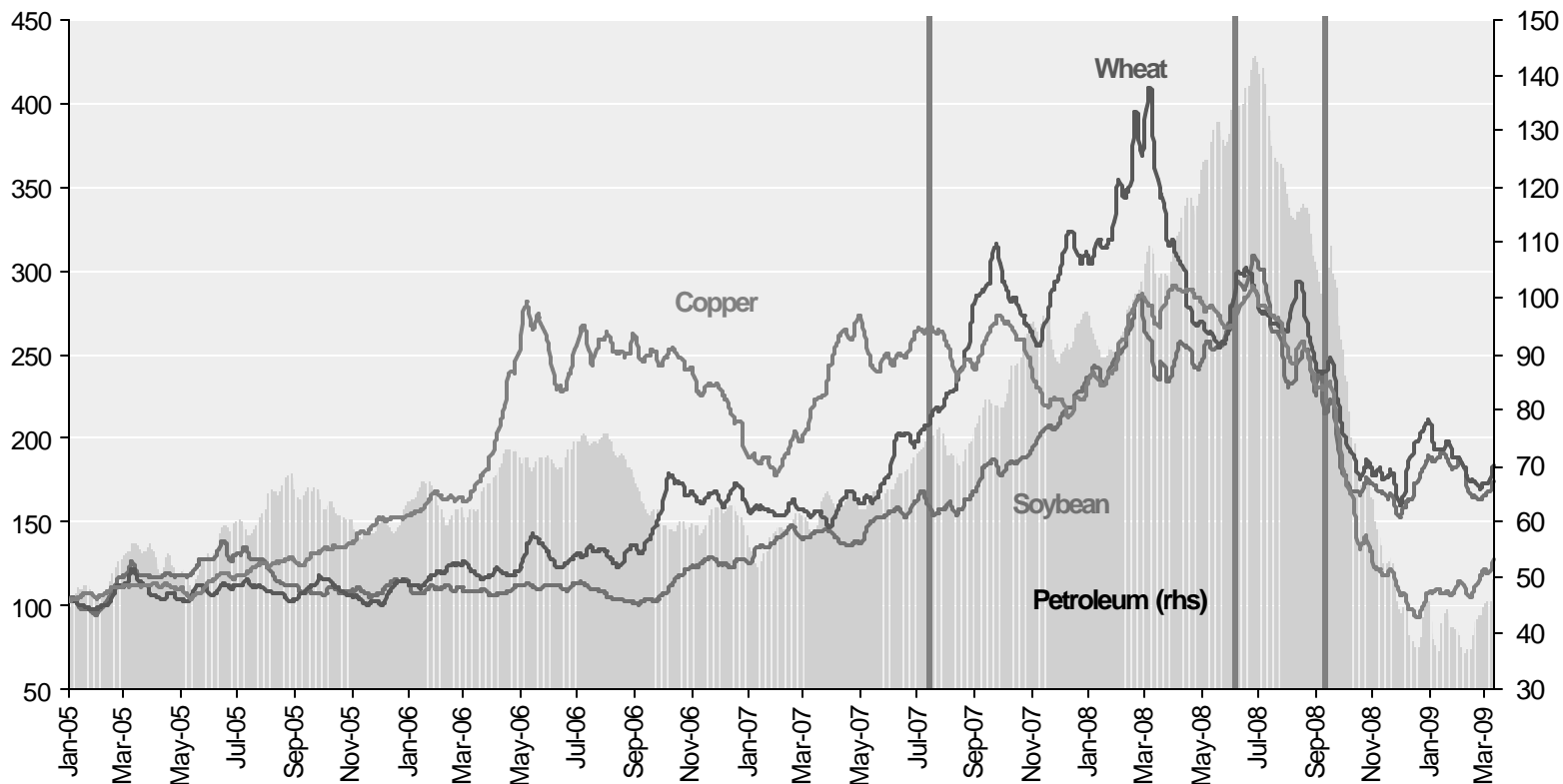
Sources of remittances by recipient regions
in 2008



Commodity prices

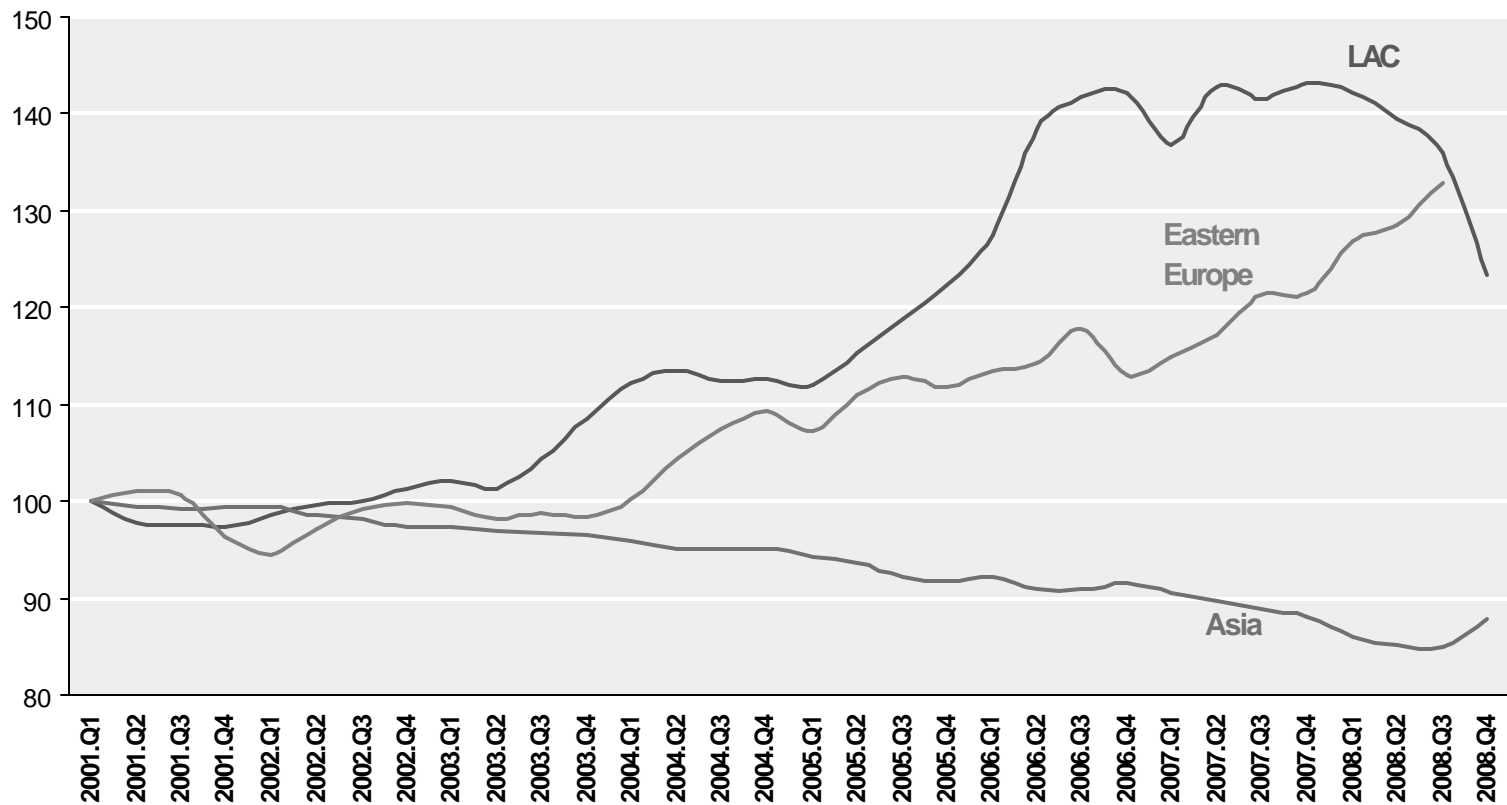
Commodity prices collapsing since mid-2008

Commodity Prices (5-day Moving Average)
*Oil WTI in current US\$, Wheat,
Copper and Soybean are Index numbers: 1/01/05=100*



Terms of trade gains in LAC and Eastern Europe in the last years...

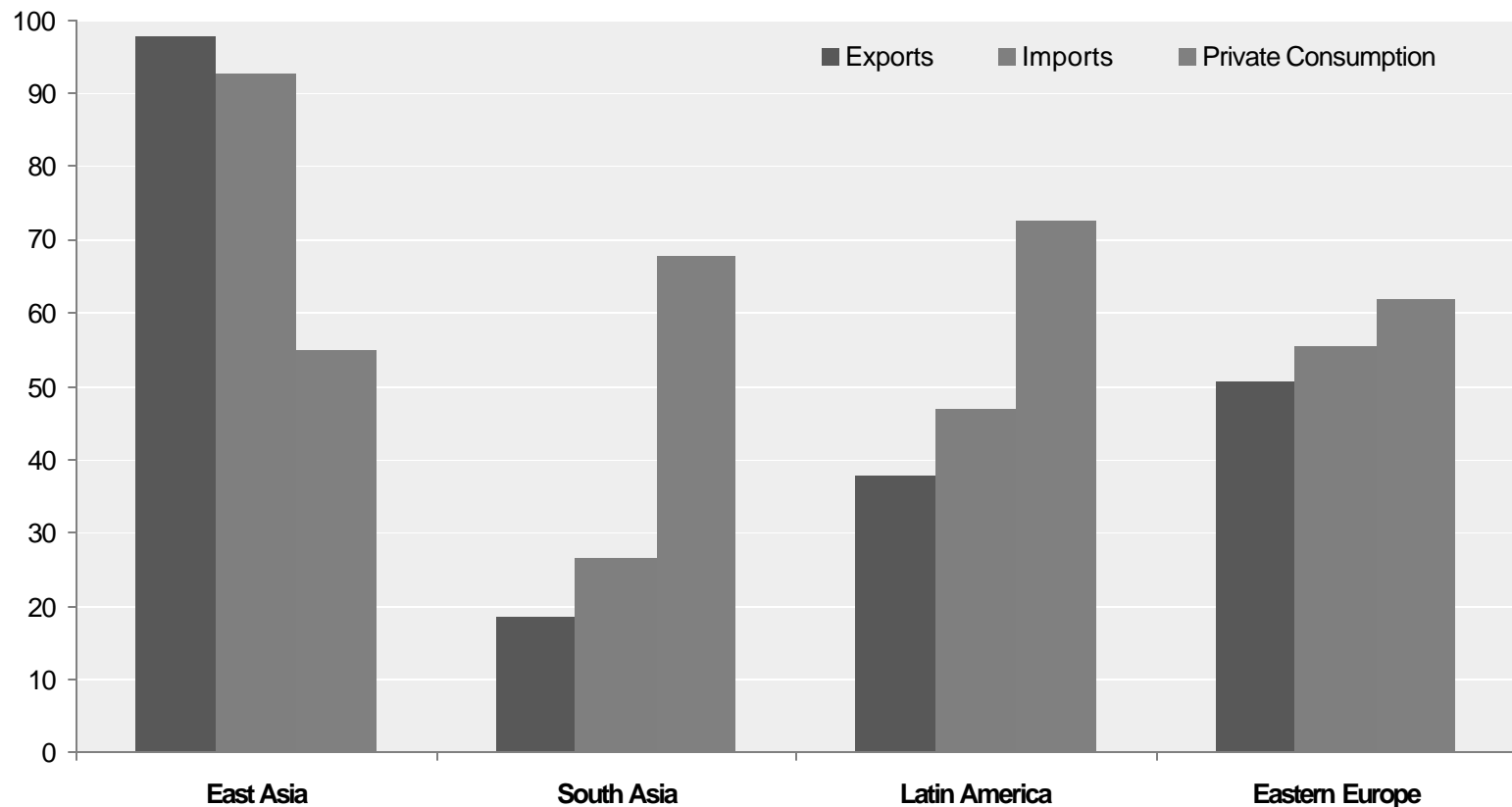
Terms of Trade
2001.Q1=100



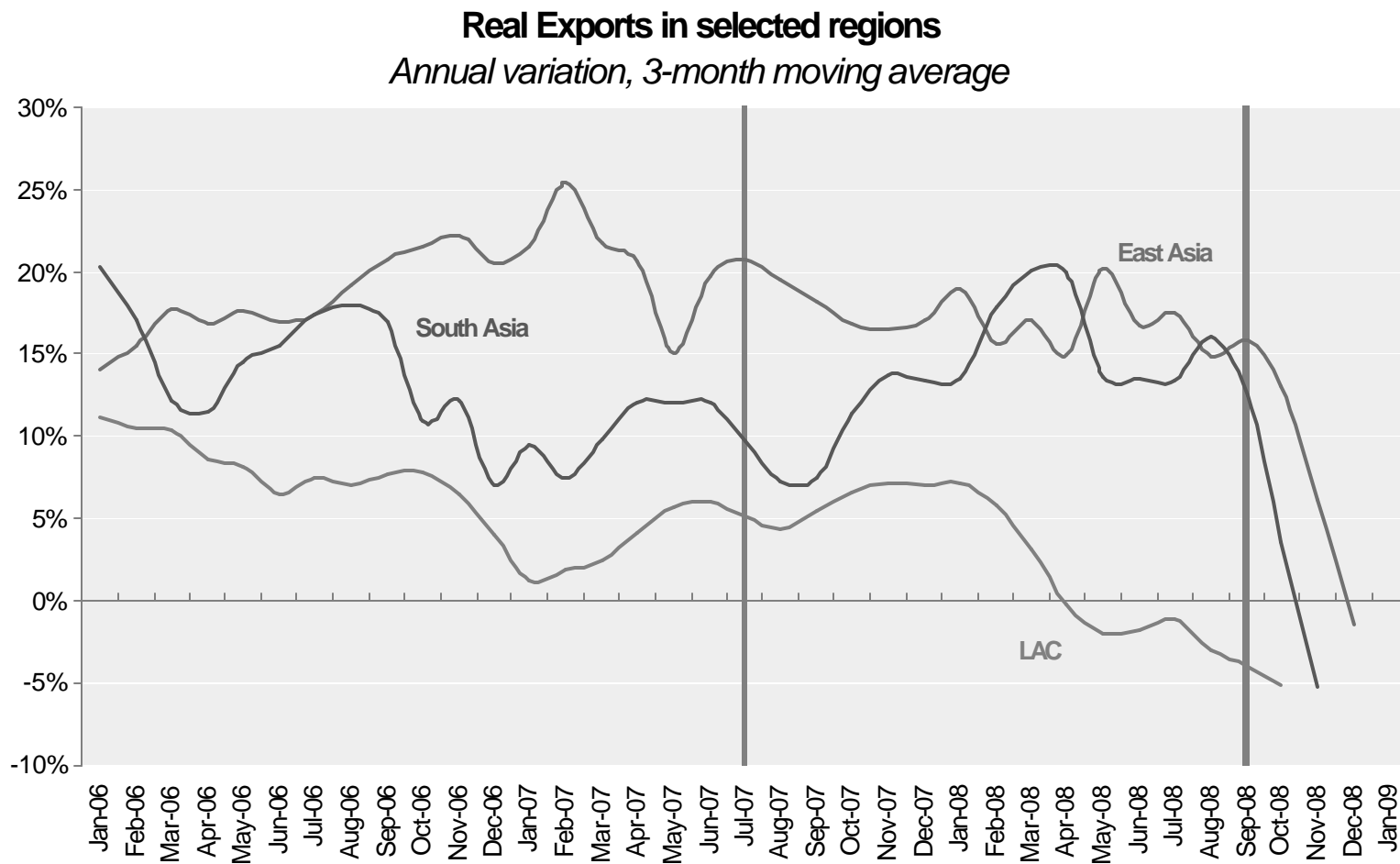
External demand effects

Different vulnerabilities

Structure of GDP
as % of GDP

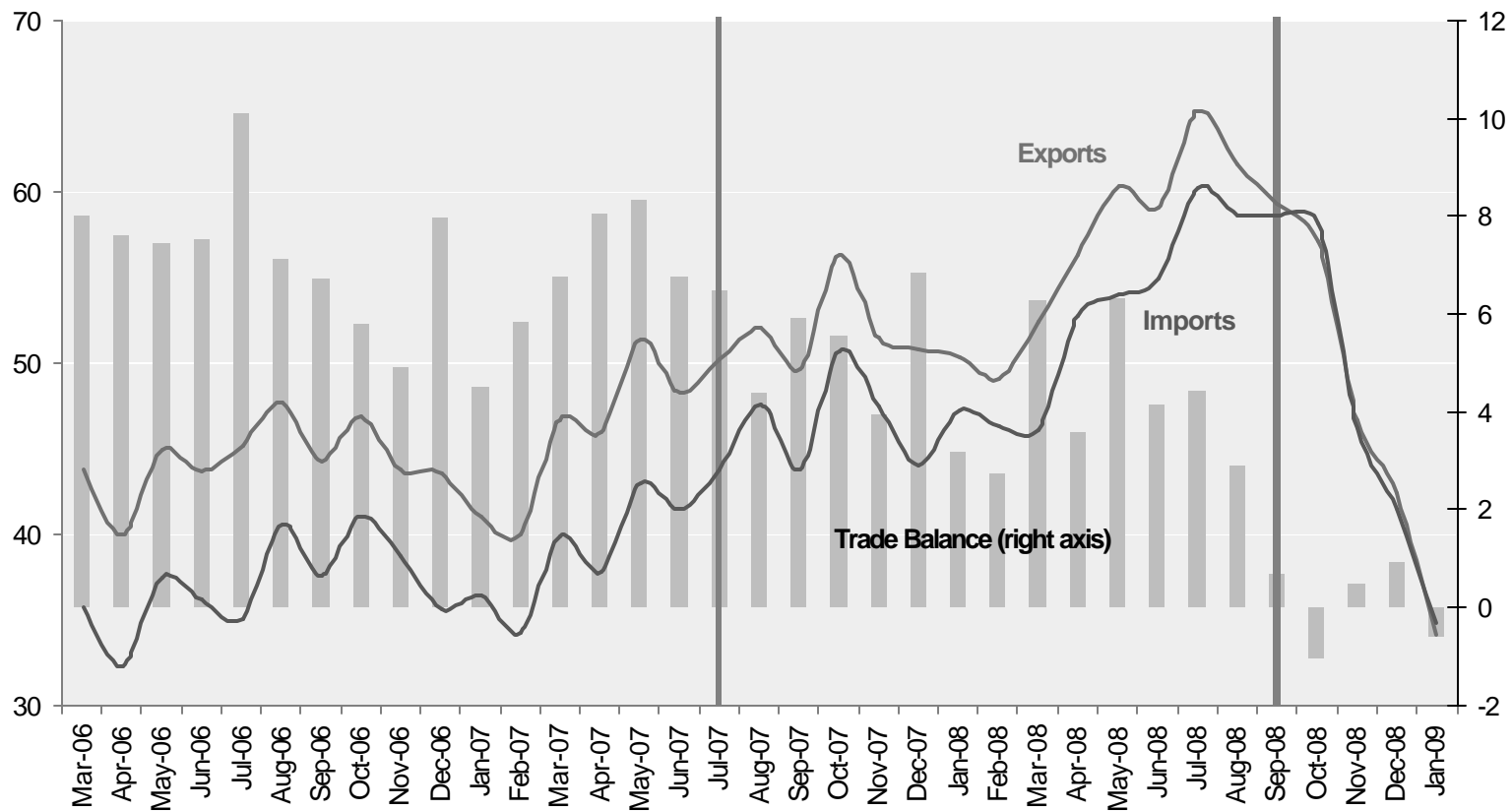


Exports collapsed in all the regions...



Exports *and* imports collapsed in the 4th quarter of 2008 in Latin America, with trade balances disappearing ...

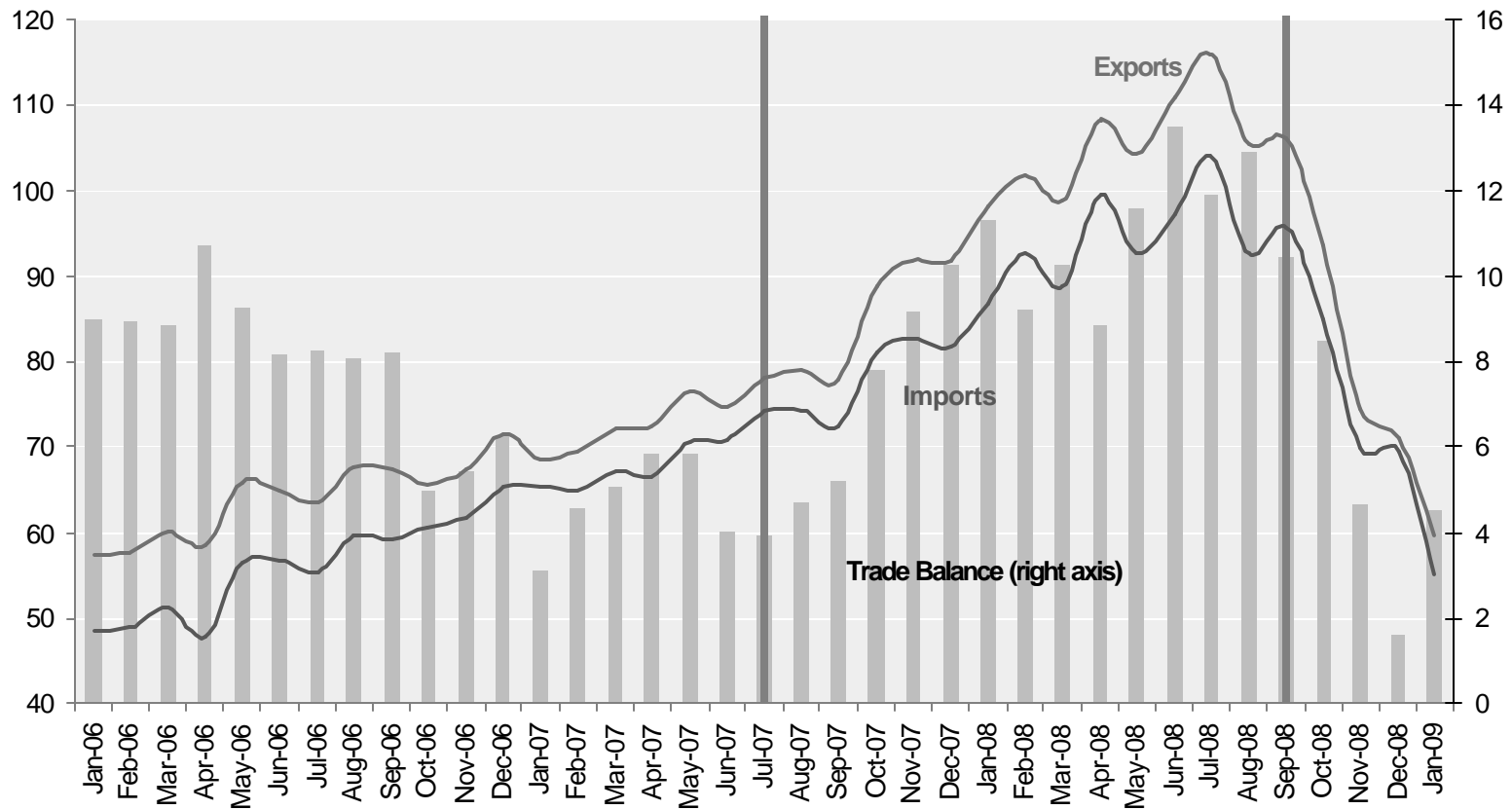
Imports and Exports in selected LAC countries
In billions of US\$



... similarly in Eastern Europe ...

Imports and Exports in selected Eastern Europe and Western Asia countries

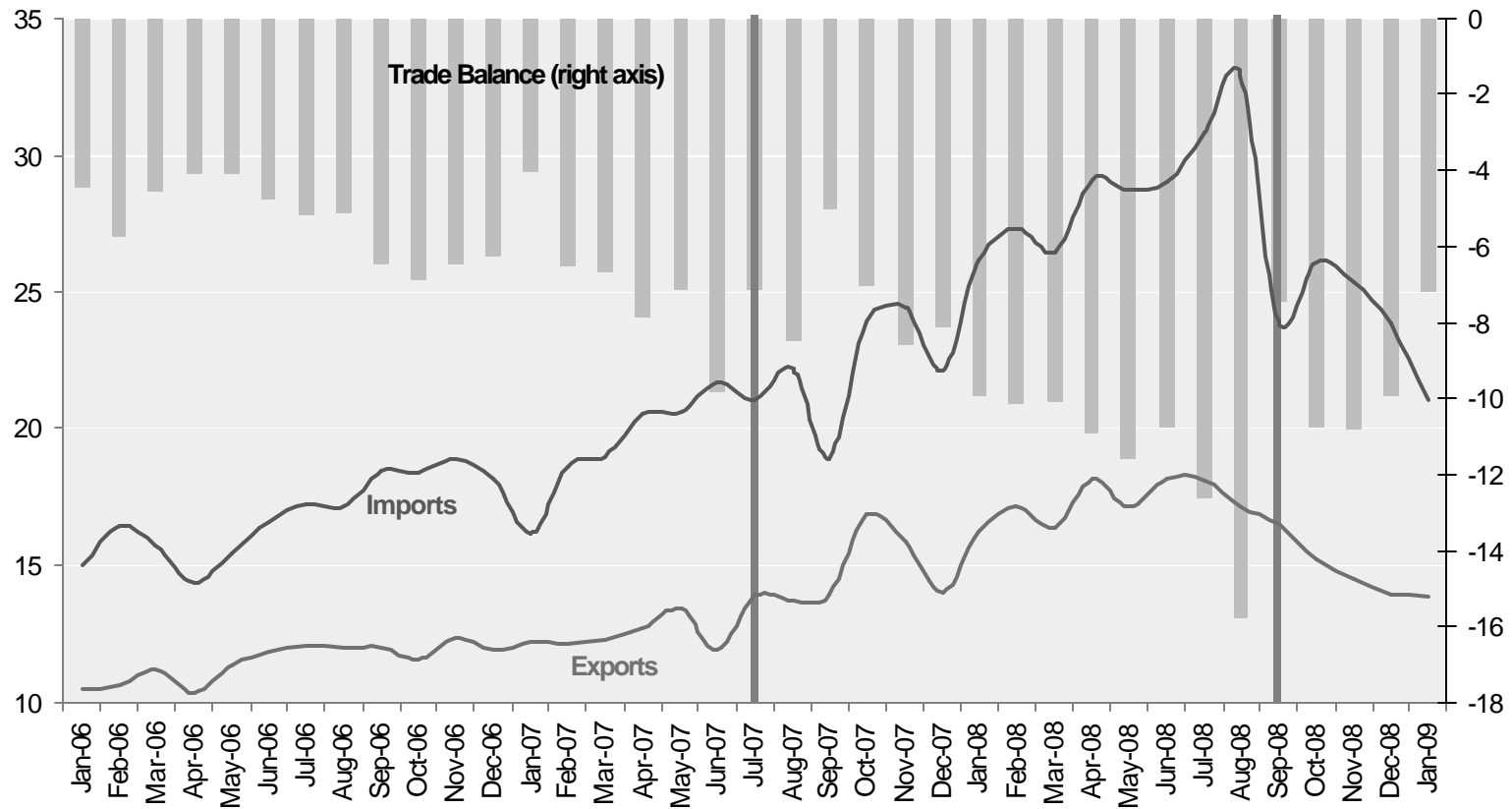
In billions of US\$



In Asia the pattern is different, with trade deficits decreasing in South Asia...

Imports and Exports in selected South Asia countries

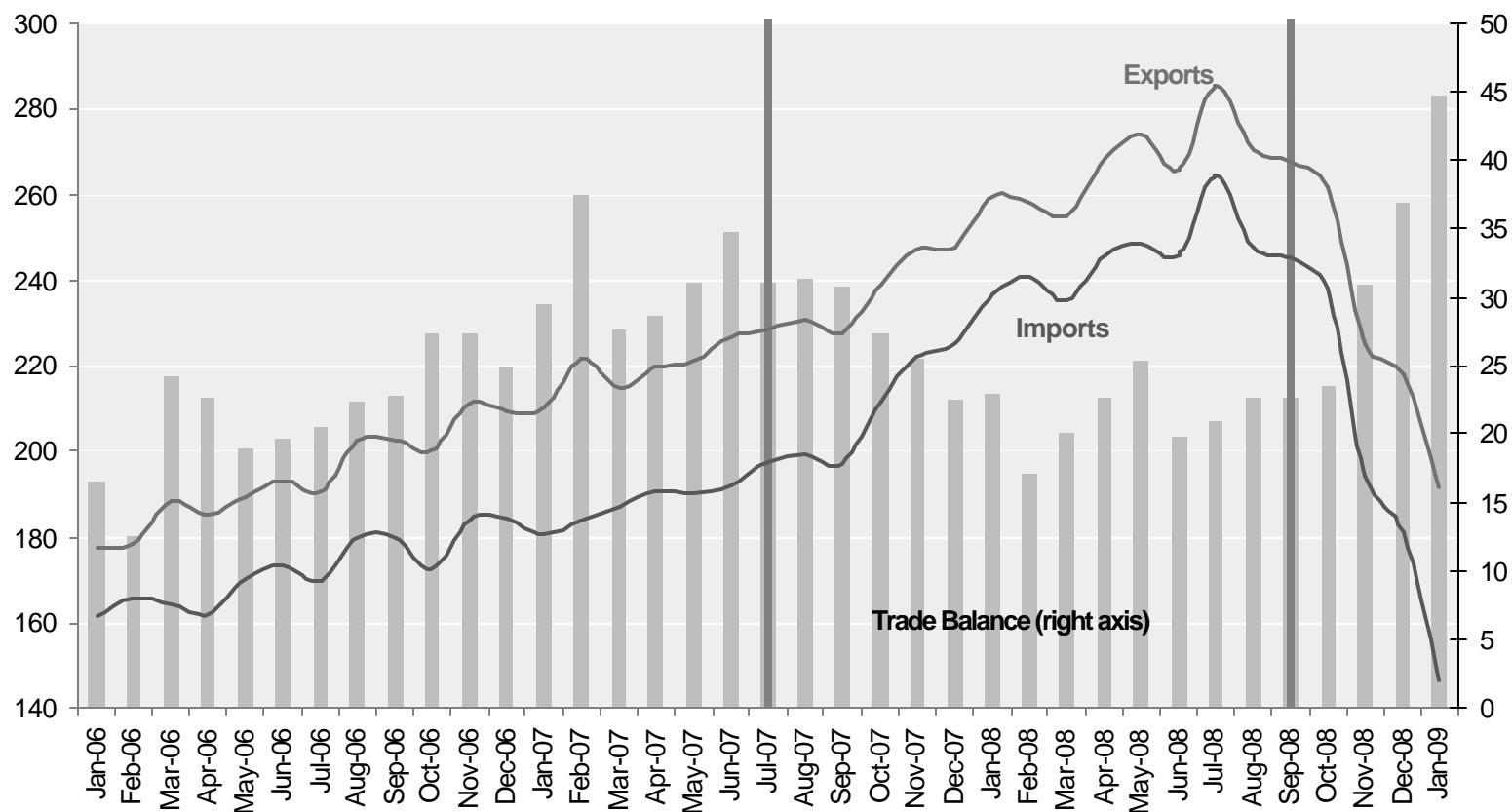
In billions of US\$



And with trade surpluses rising in East Asia...

Imports and Exports in selected East Asia countries

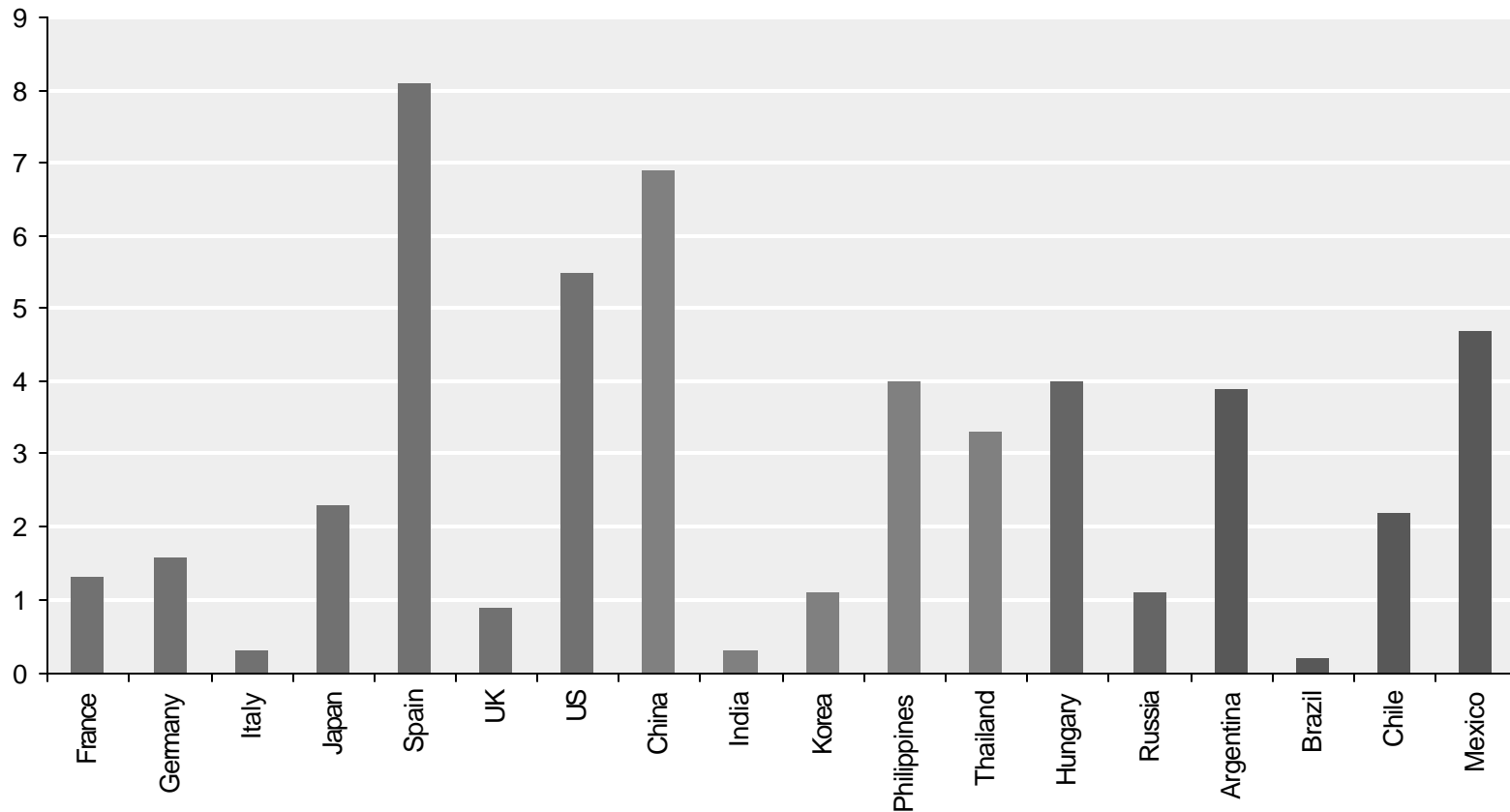
In billions of US\$



Fiscal and financial policies

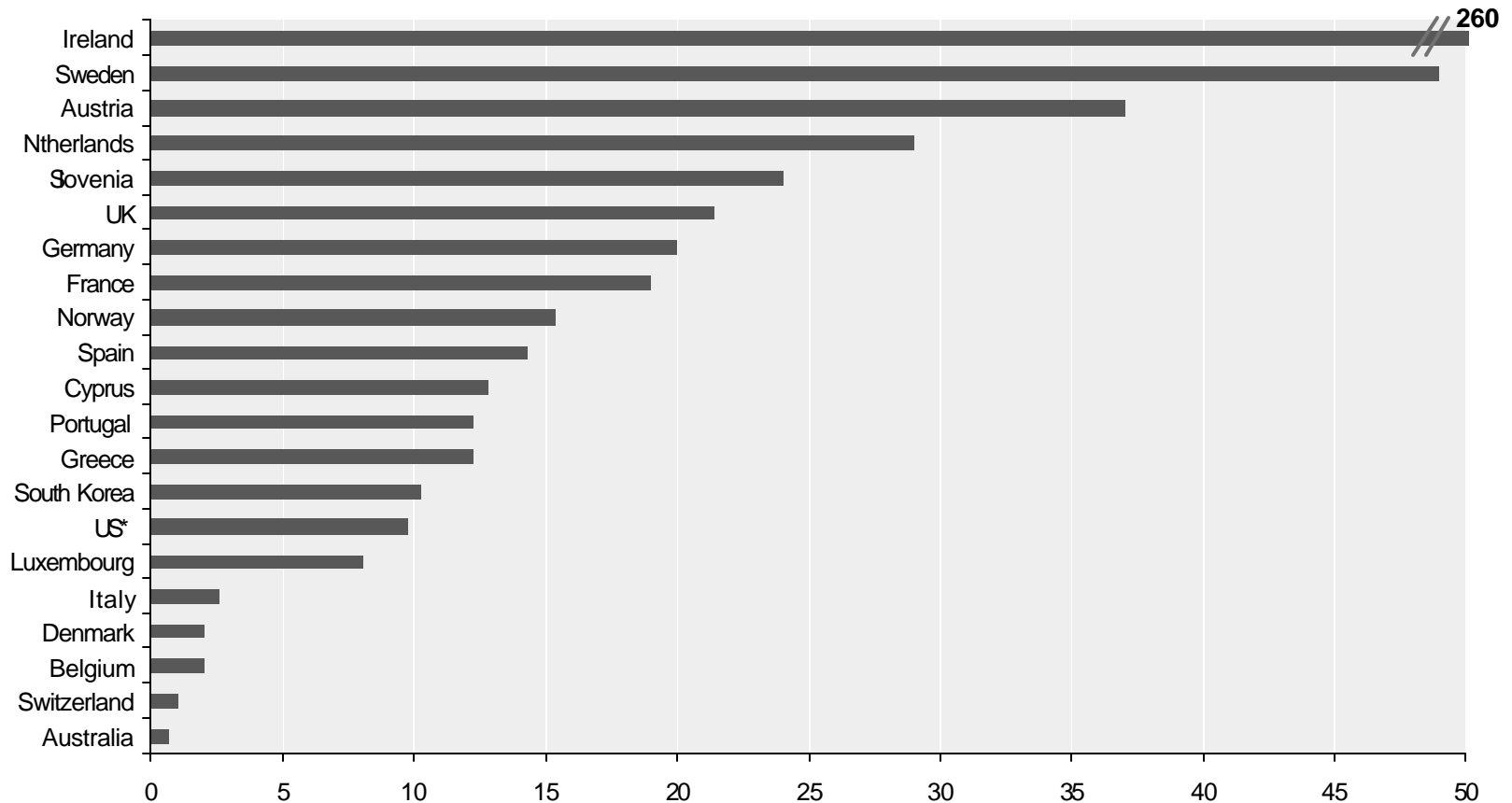
Governments are designing fiscal stimulus packages

Announced fiscal stimulus packages
as % of GDP



And extraordinary state interventions

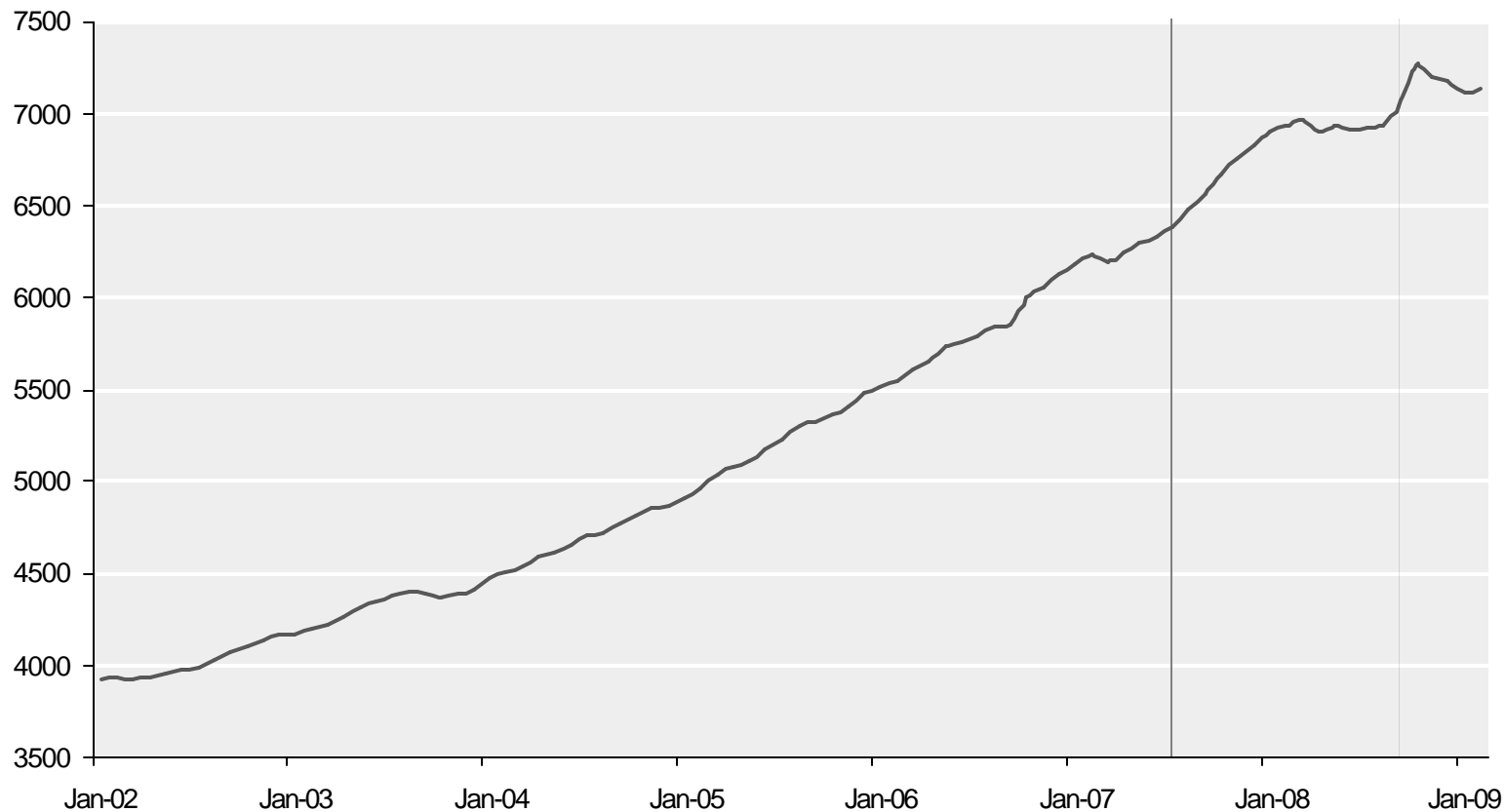
Size of Bailout Packages
as % of GDP



*Own estimations. Bailout packages mostly involve either capital injections, guarantees on newly issued debt, or deposit guarantees. Source: BNP Paribas

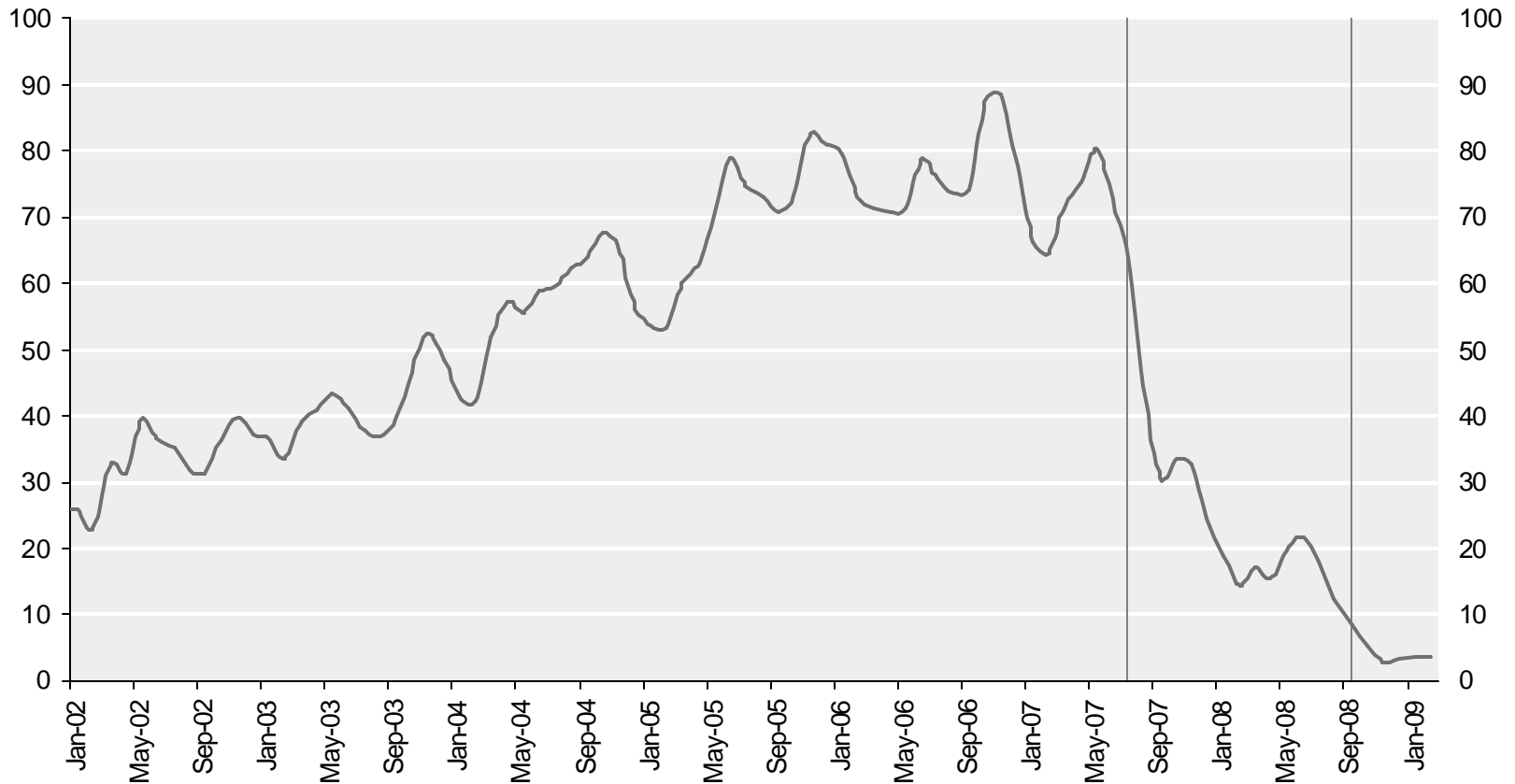
Loans have not decreased in US banks' balance sheets...

US Banking Loans - All Commercial Banks
Stock in billion of US\$ - seasonally adjusted



Partly because they are not able to securitized them...

United States Asset Backed Securities Issuance
in billion of US\$ - 3-month moving average



Final thoughts

- The world is gripped by the broadest, deepest, and most complex crisis since the Great Depression
- Economic prospects depend on the success of fiscal stimulus and financial packages in the US and other rich countries
 - The jury is still out regarding the packages' effectiveness
 - Even if effective, they may have adverse short-term consequences
 - Crowding out
 - Risk of protectionism
- Heterogeneity across EM regions is significant
 - Degree of openness and integration to the global production chain
 - Assymetries in commodity dependence
 - Differences in macro-financial options and vulnerability

Thank you
