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
  \[\text{Interrelated}\]
- Transmission channels to Emerging Markets
  - Financial contagion
  - Remittances
  - Commodity prices
  - External demand
- Final thoughts
Falling housing prices and toxic subprime loans in the U.S. were the trigger of a global mess...

The S&P/Case-Shiller 10 index is a composite index of housing prices in 10 U.S. metropolitan areas. Source: Bloomberg.
… 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

Source: Bloomberg, Jan 20th 2009
... and of assets values more generally

Source: Bloomberg
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 became 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 $\rightarrow$ runs $\rightarrow$ liquidations and deleveraging $\rightarrow$ connectedness $\rightarrow$ counterparty risk aversion $\rightarrow$ uncertainty $\rightarrow$ runs $\rightarrow$ ...
  - 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

Source: Bloomberg
Strong contraction of industrial production…
Imports by rich countries are dropping fast

Source: DECPG World Bank
International maritime commerce has been tanking since mid-2008

Source: World Bank and Bloomberg
An awful 4th quarter of 2008 for economic activity in rich countries …

Source: Barclays Capital
... points to a bad recession in 2009

Recent Growth and Forecasts for 2009

annual GDP real growth rate, in%

Source: Consensus Forecasts (March-09)
What a difference a quarter can make!

Growth Forecasts for 2009

annual GDP real growth rate, in %

As of August 08
As of March 09

Source: Consensus Forecasts
… and the emerging economies …
A marked slowdown in industrial production across emerging markets in 2008-Q4 ...

Regional aggregates are calculated as weighted averages. Source: World Bank DECPG
The slowdown in selected countries…

**Industrial Production in selected countries**

*Annual variation*

- Mexico: 5%
- Brazil: -10%
- China: 15%
- Korea: -25%
- India: 0%
- Pakistan: -5%

*Source: Haver Analytics*
... augurs badly for growth in 2009 for Latin America

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

Sources: Consensus Forecasts (as of March 09), ECLAC and World Bank. LAC growth range is based on LCRCE Estimations
Recent Growth and Forecasts for 2009
annual GDP real growth rate, in %

Sources: Consensus Forecasts as of February 09
... and Asia

Recent Growth and Forecasts for 2009

annual GDP real growth rate, in %

Sources: Consensus Forecasts as of March 2009
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...

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 sovereign spreads more than doubled...
EM firms facing a steep rise in FX borrowing costs, with Eastern Europe as an outlier
Portfolio flows to EMs declining fast

NON-FDI Gross capital flows to emerging markets

In US$ billions

Source: World Bank
Portfolio flows to EMs declining fast

Source: IIF

Net private financial flows to emerging market economies by region

In US$ billions

<table>
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<tr>
<th>Region</th>
<th>2006</th>
<th>2007</th>
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Source: IIF
Will FDI remain resilient in this crisis, given the decline in M&A?

Source: SDC M&A database
Will FDI remain resilient in this crisis, given the decline in M&A?

Source: SDC M&A database
Corporate issues virtually stopped, in local & foreign mkts

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

New issues of debt and equity securities in international markets. Source: STC Thomson
Corporate issues virtually stopped, in local & foreign mkts

New issues of debt and equity securities in international markets. Source: STC Thomson
Corporate issues virtually stopped, in local & foreign mkts

**Capital Raising Activity in South-East Asia**

*Corporate issues, in US$ millions*

New issues of debt and equity securities in international markets. Source: STC Thomson
Bank credit in BRCM countries…

Real Credit Growth in BRCM countries
Annual variation

Source: National Authorities, Bloomberg and Haver Analytics
Eastern Europe is most vulnerable to a bank crisis

Loan to Deposit Ratio

in %

Loans to the private sector. Source: Fitch Ratings
Remittances
Remittances are contracting all around the world

Source: Migration and Remittances. Factbook 2008 – World Bank
The origin of remittances is much more diversified for Eastern Europe and Asia than for Latin America.

Source: Migration and Remittances. Factbook 2008 – World Bank
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*

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

Regional aggregates are calculated as simple averages. Source: LCRCE Office calculations based on Haver Analytics
External demand effects
Different vulnerabilities

Structure of GDP
as % of GDP

Regional aggregates are calculated as simple averages. Source: LCRCE Office calculations based on EIU
Exports collapsed in all the regions…

Source: World Bank DECPG
Exports and imports collapsed in the 4\textsuperscript{th} quarter of 2008 in Latin America, with trade balances disappearing …

Imports and Exports in selected LAC countries

\textit{In billions of US$}

\textbf{LAC:} Argentina, Brazil, Chile, Mexico and Peru. Source: Bloomberg
... similarly in Eastern Europe ...
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$

South Asia countries: India and Pakistan. Source: Haver analytics
And with trade surpluses rising in East Asia...

*East Asia countries: China, Hong Kong, Indonesia, Korea, Singapore, Taiwan, Thailand. Source: Haver analytics*
Fiscal and financial policies
Governments are designing fiscal stimulus packages

Announced fiscal stimulus packages

as % of GDP

Source: IILS
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…

Source: St. Louis FED
Partly because they are not able to securitized them...

United States Asset Backed Securities Issuance

in billion of US$ - 3-month moving average

Source: Asset-Backed Alert
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