Financial Crisis and Global Recession: At a Turning Point?

Richard Newfarmer
Special Representative to UN and WTO
World Bank

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Main messages

- Recession in the US now appears to be bottoming out, but speed and strength of recovery is uncertain.

- Even though recession will eventually end, several daunting challenges remain, particularly for the poorest countries and vulnerable social groups.

- Domestic policy is critical, but generating a sustained recovery requires new forms of multilateral collaboration.
Crash of Lehman in September...precipitated financial panic that swept through global markets

MSCI equity price indexes, January 2005=100

So...
- 30% of household wealth wiped out
- $4 trillion of equity worldwide
- Pension funds obliterated
- Unprecedented contraction in consumption

Contracting consumption in rich countries transmits recession to poor countries – as world trade collapses

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**Percentage change**

**Annual growth of global trade volumes**

-10 -8 -6 -4 -2 0 2 4 6 8 10 12 14 16


...and diminished **capital flows** have deepened recession in the developing world

Net private capital flows / GDP in developing countries

So now the world economy is contracting.... for the first time in the last half-century.

Crisis affects regions differently in 2009

GDP growth, percent

- **East Asia**: 5.0%
- **South Asia**: 4.6%
- **Middle East & North Africa**: 3.1%
- **Sub-Saharan Africa**: 1.0%
- **Latin America**: -2.3%
- **Europe and Central Asia**: -4.7%

Trade in capital- and durable goods hit hard as global investment collapses

Growth in nominal exports of developing countries, year-over-year

Production declines concentrated among countries specialized in investment goods

Industrial production; %change, January 2009 versus July 2008


Countries specialized in investment goods
Countries with strong pre-existing imbalances

Green shoots? Incipient signs of recovery....?

Credit markets have stabilized...secondary markets beginning to reappear

Spread between 3 month $ LIBOR and $ OIS

Green shoots? Incipient signs of recovery….

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Green shoots? Incipient signs of recovery….

- Credit markets have stabilized…secondary markets beginning to reappear
- Equity markets appear to have established a floor
- Personal income in US rose 0.4% in April…household savings hit 5.7% of disposable income (highest since 1995)
- Some life in the real sectors…

Green shoots? Incipient signs of recovery....

...and China’s fiscal stimulus is beginning to take hold

Outlook? Recovery will probably begin later this year or early next year … but strength is uncertain

U.S., China and other developing countries lead upturn contributions to global growth (percentage points)

<table>
<thead>
<tr>
<th>Year</th>
<th>USA</th>
<th>Japan</th>
<th>Europe</th>
<th>China</th>
<th>Other DEV</th>
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<tr>
<td>2009</td>
<td>0.0</td>
<td>1.0</td>
<td>-2.0</td>
<td>2.0</td>
<td>-4.0</td>
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<tr>
<td>2010</td>
<td>-2.9</td>
<td>2.0</td>
<td>3.2</td>
<td>2.0</td>
<td>-3.0</td>
</tr>
<tr>
<td>2011</td>
<td>-2.9</td>
<td>2.0</td>
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</tbody>
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Shape of the coming recession depends on responding to several daunting challenges...
Daunting challenges: At-risk countries...

Those are at risk:

- export only a few commodities
- have large % in poverty
- have weak fiscal positions
- have low reserves/ high debt

Implications of slowdown...

- Crises in Mexico, Argentina, and East Asia increased poverty dramatically
- 200 million likely to be trapped in poverty
- Infant mortality and child mortality rises – 200,000- 400,000 infants annually
- Cutbacks in health services
Daunting challenges: Providing support to workers and the poor

Widening fiscal deficits will put pressures on social safety nets

Fiscal deficits will widen sharply in 2009

Daunting challenges: Providing support to workers and the poor

- Widening fiscal deficits will put pressures on **social safety nets**
- Poor households suffer declines in **remittances**
- ...and continued **higher food and fuel prices**
- Firms will face **tighter credit** conditions and weaker demand, so they will be slow to create new jobs... and **unemployment will rise**

![Unemployment rate graph](Source: JP Morgan, World Financial Markets, June 2009)
Multilateral collaboration is crucial... and the G20 leaders have begun the process...

Agreed:
- Accelerated restructuring of banks and increased regulation
- Pledge to avoid protection
- Fiscal stimulus and expansive monetary policy
- Mobilization of more capital for developing countries
  - IMF – $700- b. New arrangement to borrow (NAB)
  - World Bank   MDBs – Capital increase for ADB
- Reform of the IMF and World Bank – Increased capital , new voting, merit selection of leaders
but improving the multilateral response requires...

- Fulfilling pledges for development assistance
- Keeping global markets open and resisting pressures for trade protection – and renewing a commitment to the Doha Development agenda
- Improving regulation of financial markets will require careful balancing of national regulatory authorities with international cooperation
- Developing multilateral governance mechanisms to be more inclusive
Recovery is near, but its strength is in doubt and it will take many quarters to have full effect on incomes.

Meantime, assertive policy interventions are needed to protect core social spending and support households – and invest in reforms that will revive growth.

The G20 process has helped but much remains to be done – in keeping markets open, financial regulation, and providing adequate development assistance.
Acknowledgements and Selected References

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