Global Korea 2009

# G20 and the Rearrangement of the International Financial Order

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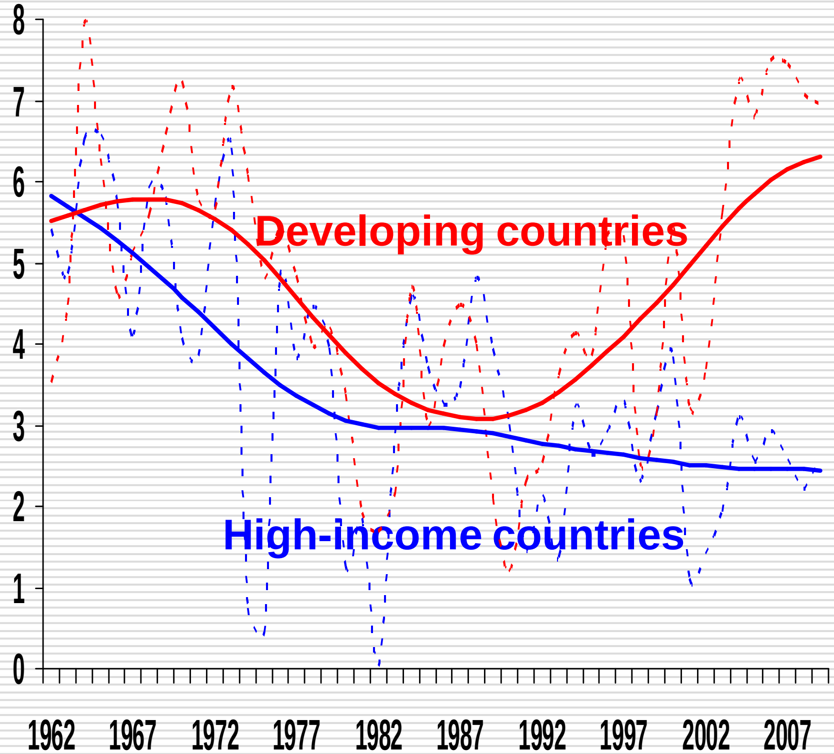
# The crisis will lead to a rebalancing of global influence towards emerging economies

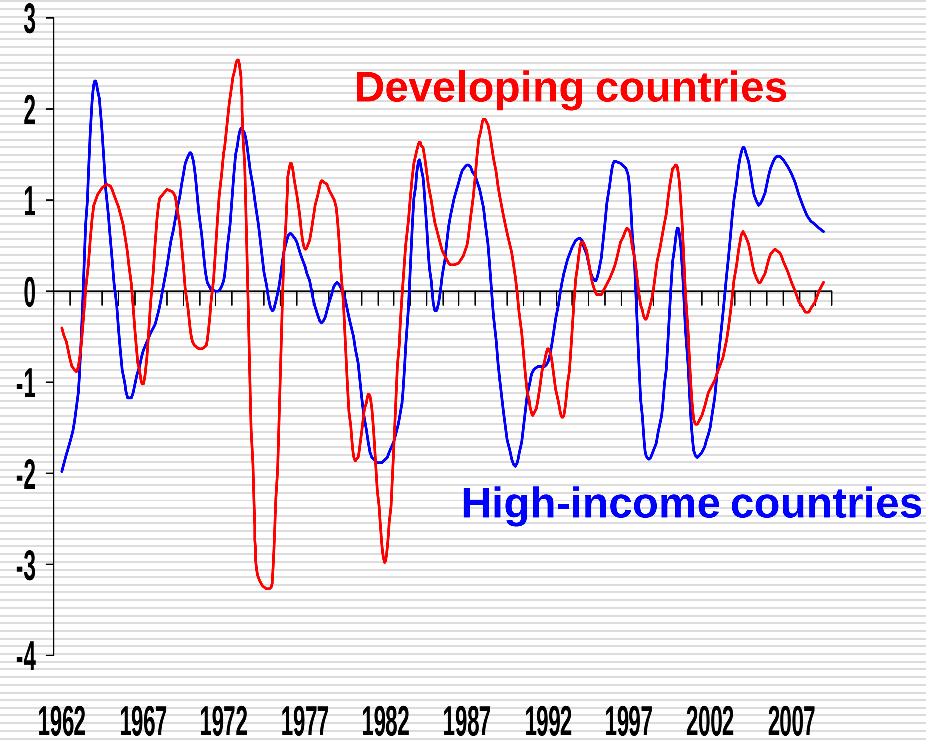
- Underlying fundamentals should support continued faster growth in emerging economies over the long term – if good policies are sustained
- At the level of *ideas*, the era of "top-down" one-way economic policy advice *from* advanced countries *to* developing countries is *over*.
- Now we are "all in it together".

# Trend growth in developing countries accelerated in the 2000s

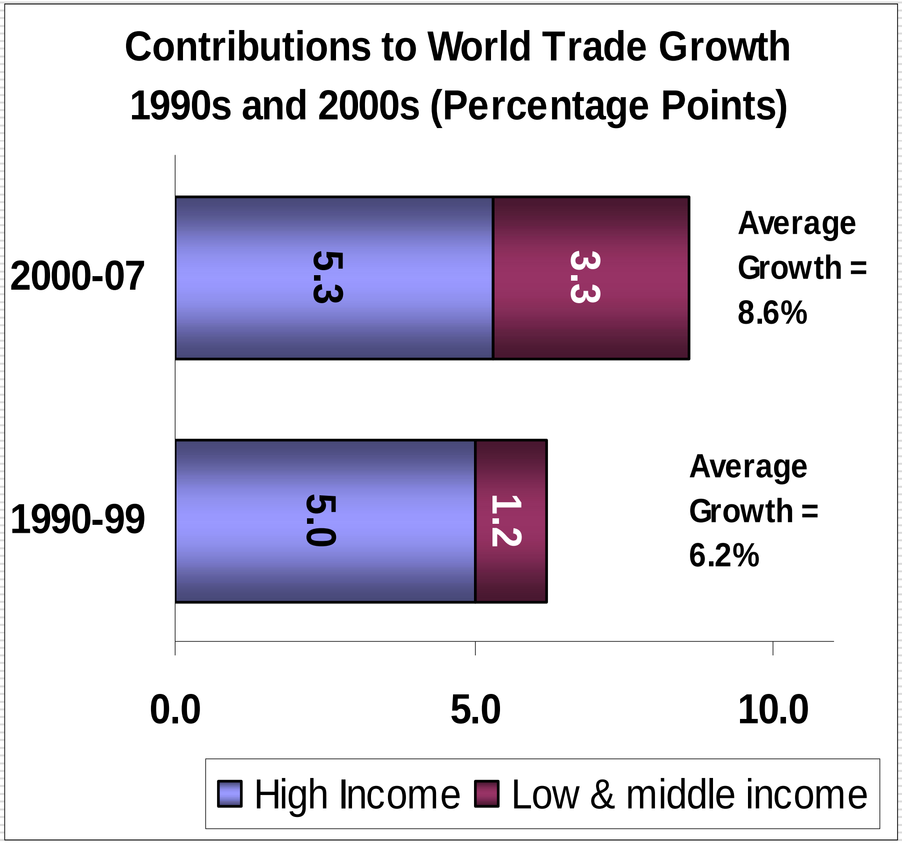
**Trend growth has diverged**

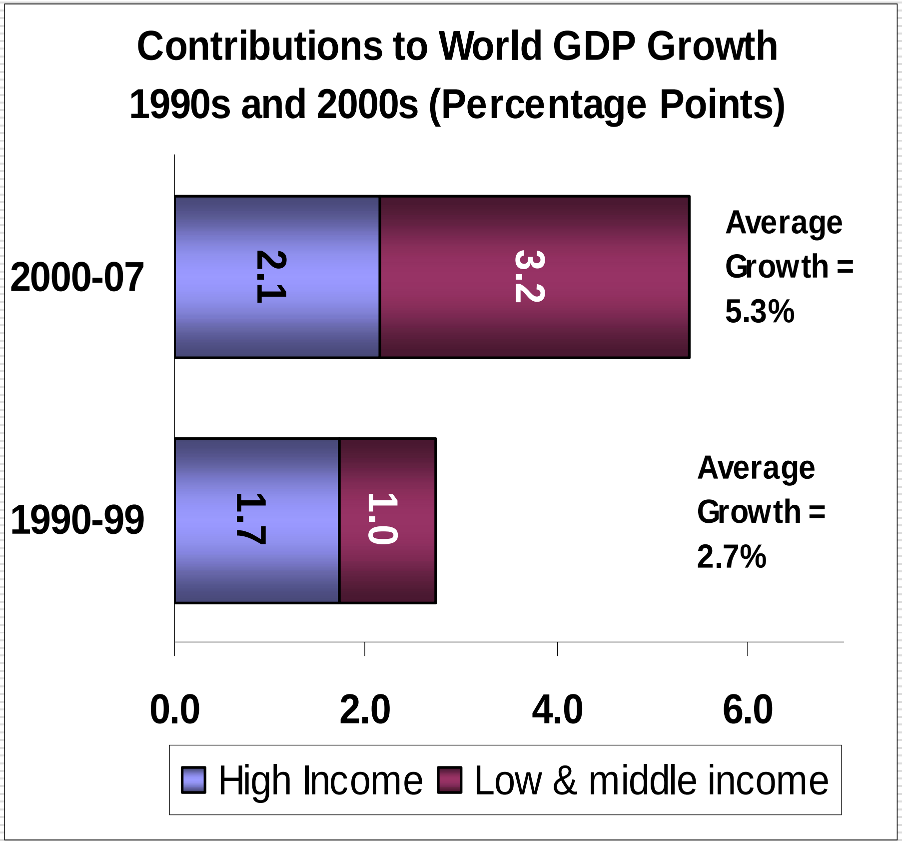



**Cyclical component of growth remains correlated**



# Emerging Economies' Contributed Virtually All of Faster World Growth in the 2000s.




Source: World Bank Development Indicators.

# *Everyone* makes mistakes ...

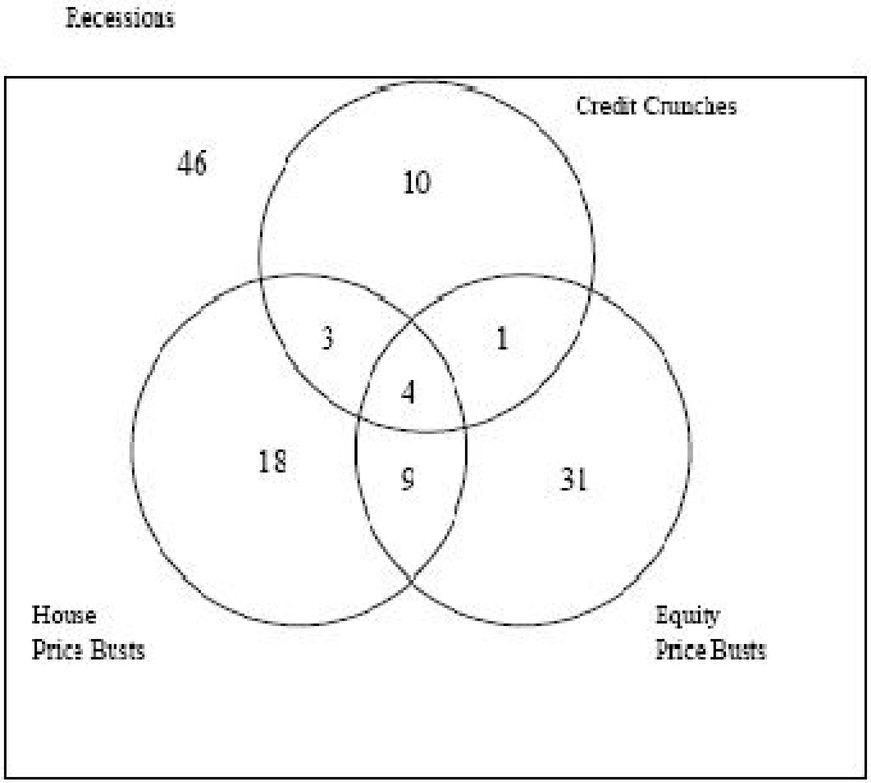
- The crisis originated in the *advanced* world.
- Advanced world policies that contributed to the causes of the crisis are still being sorted out, but candidates clearly include:
  - Failure of financial regulation over buildup of massive risks in the 'shadow banking system'.
  - Perverse incentives for excessive risk-taking and pro-cyclical financial expansion.
  - Monetary policy that took too little account of risks from rising asset prices, leverage and credit booms.
  - Fiscal policy was not a main contributor to the crisis, but lack of consolidation during the boom limits the fiscal space needed to fight the crisis.

# *Everyone* makes mistakes ...

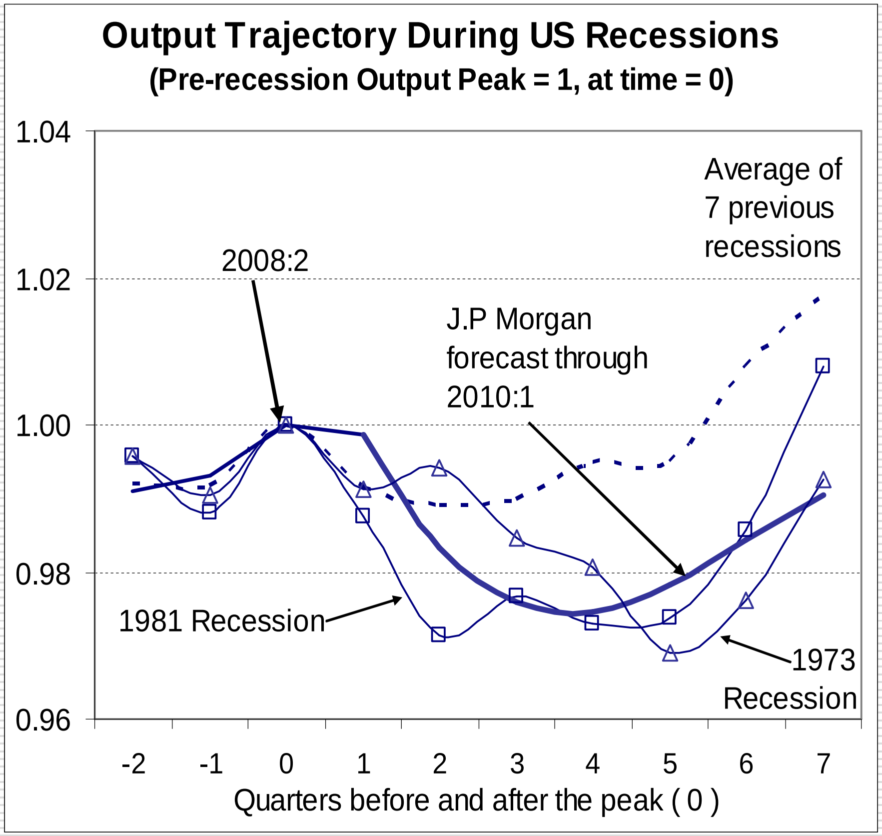
- There have also been tough tradeoffs in recent crisis management policies:
  - widespread use of blanket guarantees for bank depositors and creditors
  - extensive liquidity support
  - despite evidence such policies foster moral hazard, increase the ultimate fiscal cost and prolong duration of the crisis.
  - Large government stakes in banks
- Conclusion: simply because advanced countries follow a policy does not automatically count in its favor. This was never true. Now it is obvious.
- All policies require the same, unbiased scrutiny.

# A slow, hard recovery

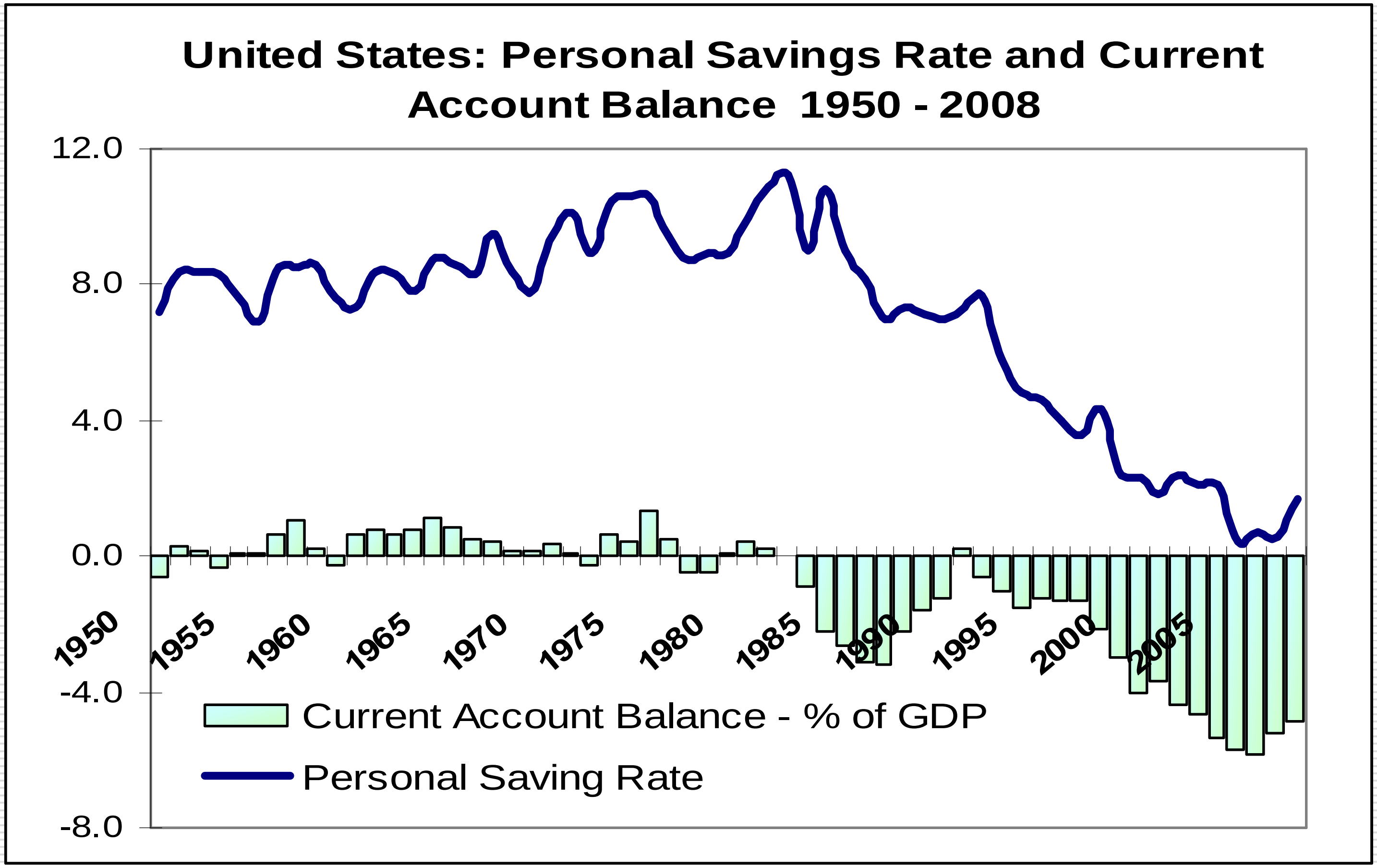
**Figure 1. Associations between Recessions, Crunches and Busts**
*(number of events in each event category)*




Notes: The rectangle shows the distribution of 122 recession episodes in the sample into those associated with crunches and busts (76) and those associated with none (46). Out of 122 recessions, 18 are associated with credit crunches, 34 are with house price busts, and 45 are with equity price busts. 46 recessions are not associated with either a crunch or bust episode



# What will provide the next locomotive for global growth?



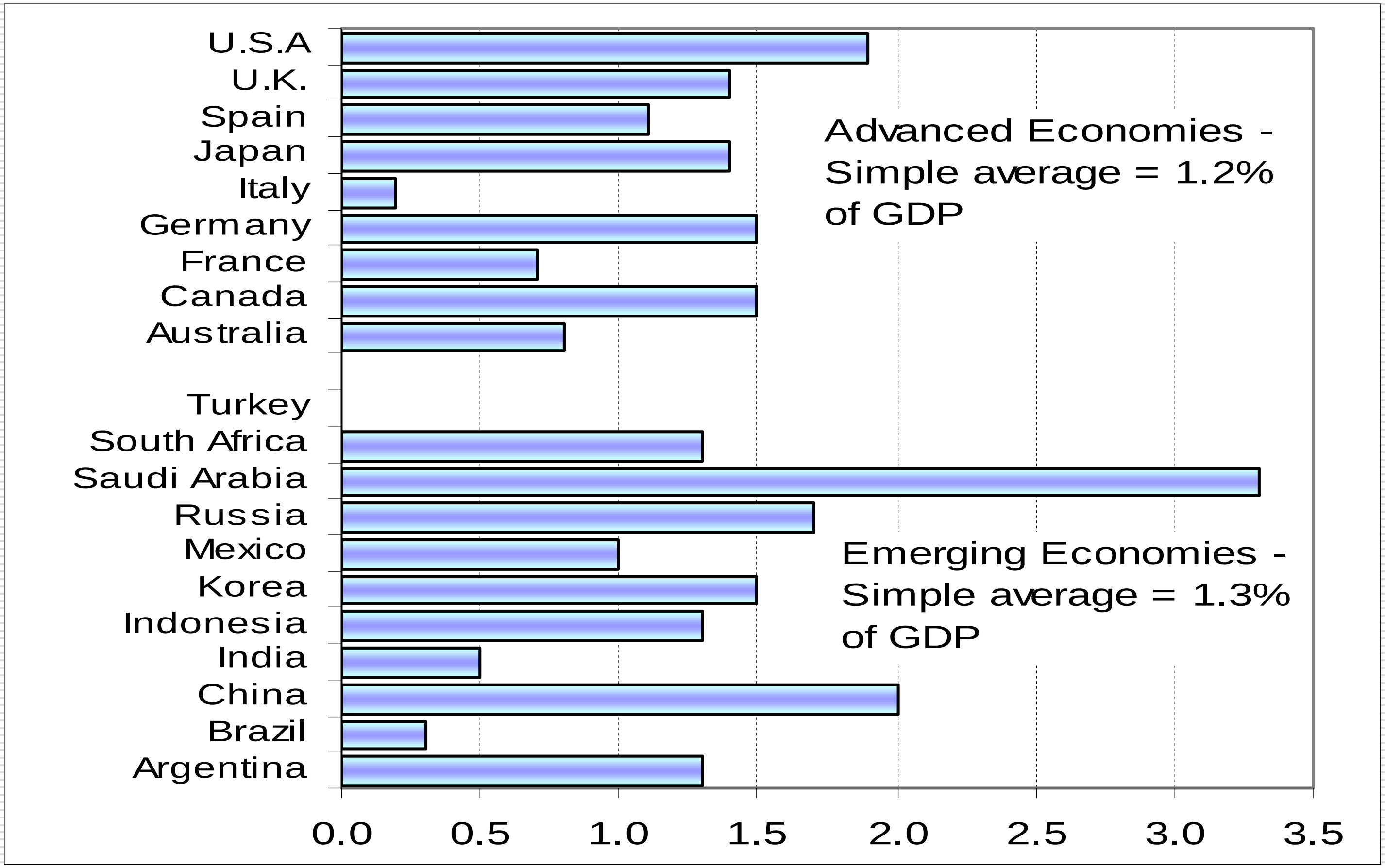
# A plunge in all types of private capital flows to emerging economies

**Capital flows to emerging economies**

| (US dollars, billions, net) | **2006** | **2007** | **2008** | **2009** |
|---|---|---|---|---|
| **Private flows** | 565 | 929 | 466 | 165 |
| Equity investment | 222 | 296 | 174 | 195 |
| Direct | 171 | 304 | 263 | 198 |
| Portfolio | 52 | -8 | -89 | -3 |
| Private Creditors | 343 | 632 | 292 | -30 |
| Commercial banks | 212 | 410 | 167 | -61 |
| Nonbanks | 131 | 222 | 125 | 31 |
| **Official flows, net** | -58 | 11 | 41 | 29 |
| IFIs | -30 | 3 | 17 | 31 |
| Bilateral | -27 | 9 | 24 | -2 |

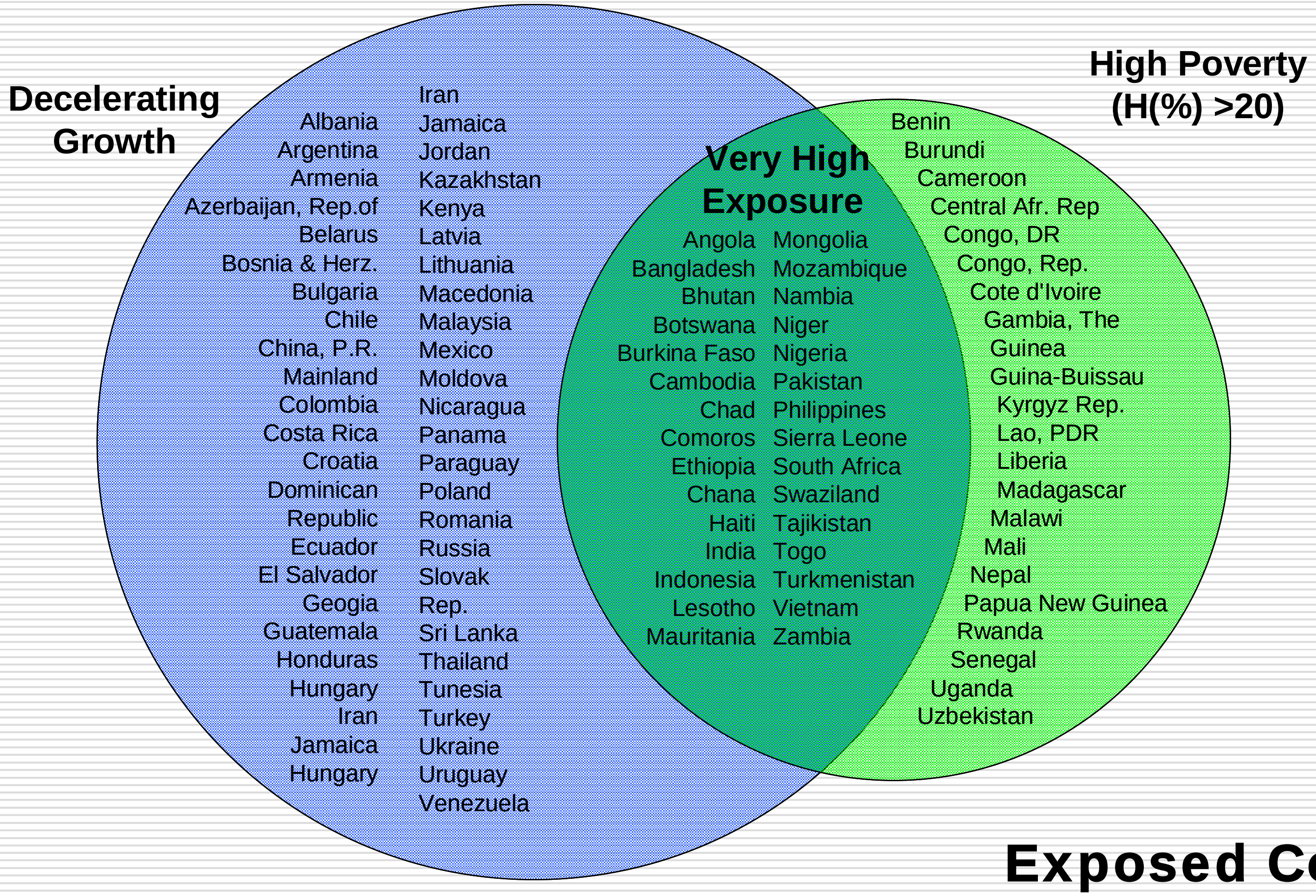
Source: Institute for International Finance: "Capital Flows to Emerging Market Economies." 01/27/09.

# G20 Countries – Discretionary Fiscal Stimulus in 2009 (% of GDP)




Source: IMF Staff Note to G20 Deputies Jan. 31, 2009

# The crisis is exposing households in most developing countries to increased risk of poverty




**Exposed Countries**

## Two thirds of exposed countries have little fiscal space – but many have administrative capacity to benefit from increased external assistance

**Fiscal and Institutional Capacity**

| Institutional Capacity | Fiscal Capacity: Low | Fiscal Capacity: High or Moderate |
|---|---|---|
| Low | 16% of exposed countries. Vulnerability Fund for selected support (e.g. ongoing projects, maintenance). | 12% of exposed countries. Technical assistance and targeted financial support (30% of these are aid dependent). |
| High or Moderate | 59% of exposed countries. High priority for Vulnerability Fund. Reasonable absorptive capacity for Budget support | 14 % of exposed countries. Room to increase spending. (30% of these are aid dependent |

# Use of IMF Resources

In 2008 and 2009 (to date); Millions of SDRs

| Facility | Member | | Amount Agreed | Undrawn Balance | Credit Outstanding |
|---|---|---|---|---|---|
| **Standby Arrangements** | Total (11 countries) | | 32646 | 21580 | 11117 |
| | Of which | - Ukraine | 11000 | 8000 | 3050 |
| | | Hungary | 10538 | 6323 | 4215 |
| | | Pakistan | 5169 | 3101 | 2071 |
| | | Belarus | 1618 | 1100 | 518 |
| **Extended Arrangements** | | | .. | .. | .. |
| **PRGF** | Total (9 countries) | | 499 | 210 | 289 |
| **Exogenous Shocks Facility** | Total (3 countries) | | 167 | 92 | 227 |
| **Short Term Liquidity Facility** | | | .. | .. | .. |
| **Total** | | | 33312 | 21882 | 11633 |

Short Term Liquidity Facility:
- Introduced October 2008 for market access countries but not yet used.
- Upto 500% of quota with 3 month maturity. Policies assessed "very positively" in latest Article 4.
- Criticisms voiced: access limits too low, maturity too short, not available on precautionary basis.

# World Bank Response

- *IBRD lending* – could triple to $35 bn this year and total $100 bn over 3 years.
- *IDA* – record 15th replenishment - $42 bn over 3 years - $20 bn can be delivered in FY09, including via new *IDA Financial Crisis Fast Track Facility.*
- *Food crisis response*: new $1.2 bn food facility
- New *Infrastructure Recovery Initiative*
- World Bank call for a *Vulnerability Fund* – 0.7 percent of developed country stimulus packages for developing country safety nets, infrastructure and SME finance.
- *New IFC facilities* - upto $30bn over 3 years:
  - Ensure trade flows–new Global Trade Finance Program - $3bn
  - Bolster distressed banking systems - $3 bn equity fund
  - New $500mn Microfinance Enhancement Facility
  - Refocus advisory services to help companies weather the crisis