



# The Global Financial Crisis: Preliminary Lessons

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# The first global crisis

## ■ Origin

- Originated in the U.S. housing market
- Subprime market sparked the crisis but global leverage was the real problem.

## ■ Nature

- A crisis of the linkages between the financial sector and the real economy.
- A global crisis.

**The Global Economy is Slowing  
Rapidly**

# Latest IMF growth forecasts

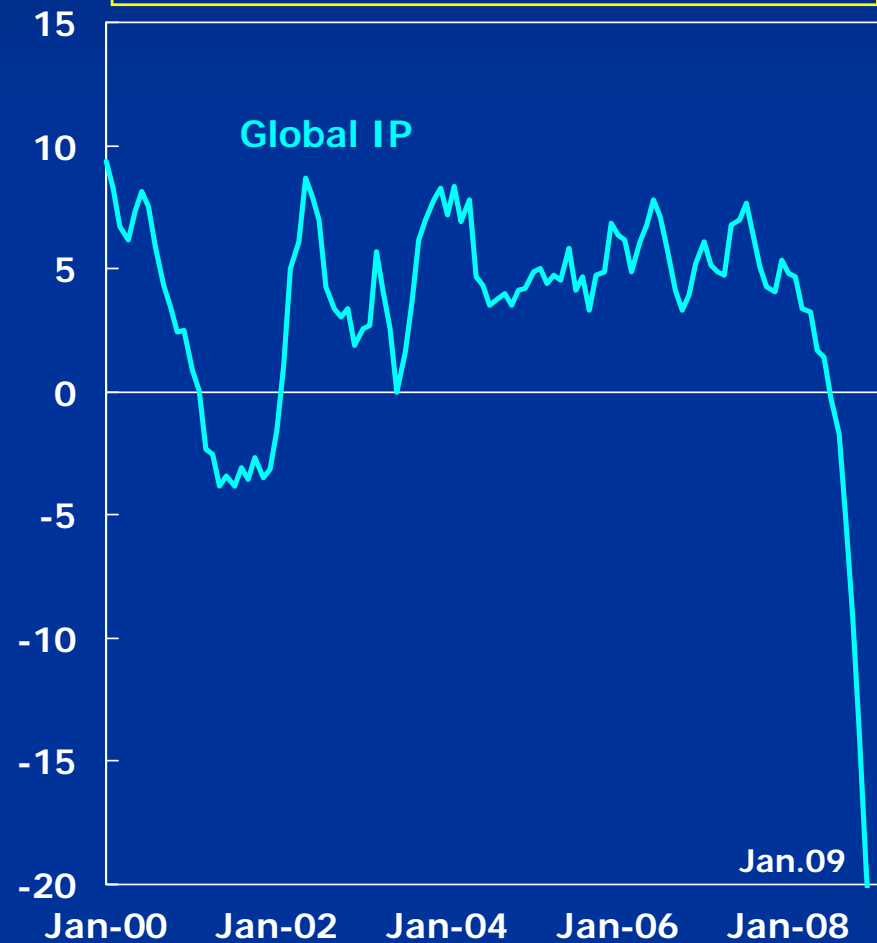
	2008	Projections	
		2009	2010
<b>World output</b>	<b>3.2</b>	<b>-1.0 to -0.5</b>	<b>1.5 to 2.5</b>
Advanced economies	0.8	-3.5 to -3.0	0.0 to 0.5
United States	1.1	-2.6	0.2
Euro area	0.9	-3.2	0.1
Japan	-0.7	-5.8	-0.2
Emerging and developing economies	6.1	<b>1.5 to 2.5</b>	<b>3.5 to 4.5</b>

Source: IMF Staff Note for G-20 Meeting of Ministers and Central Bank Governors, March 13-14, 2009

# Industrial activity and global trade have fallen dramatically

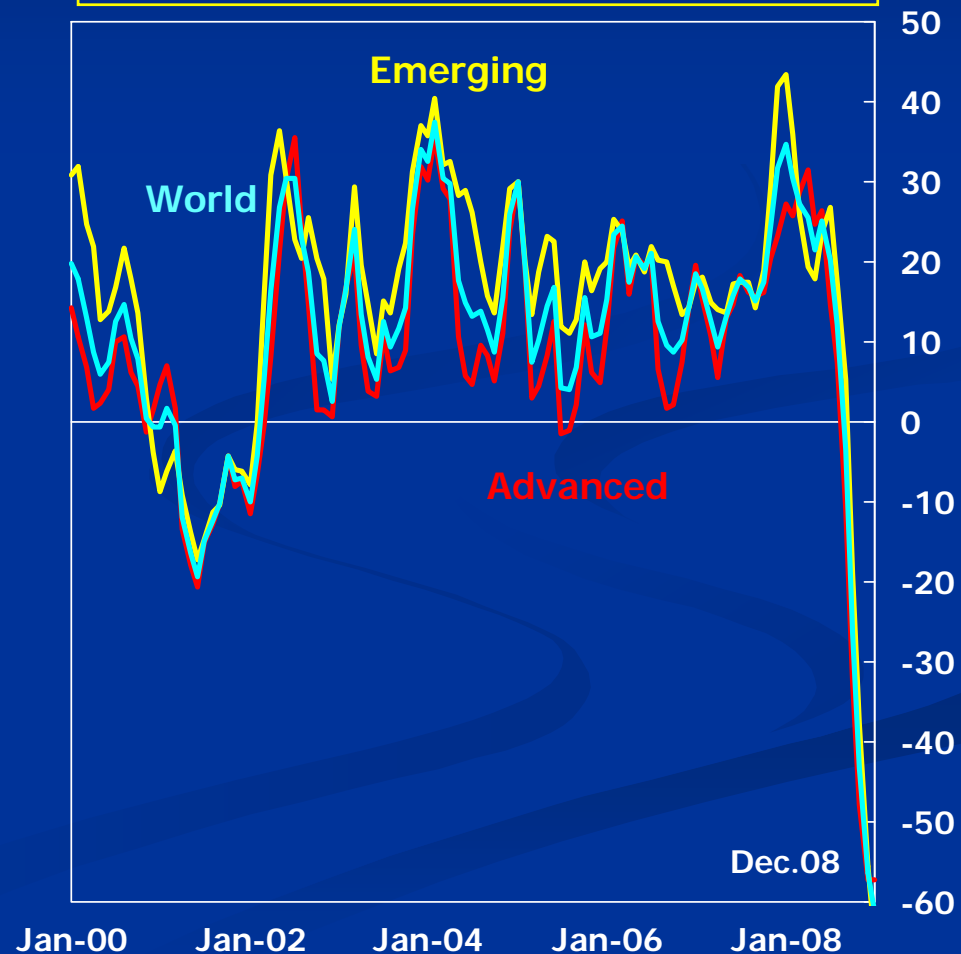
## Industrial Production

*(Annualized percent change of 3mma  
over previous 3mma)*



## Merchandise Exports

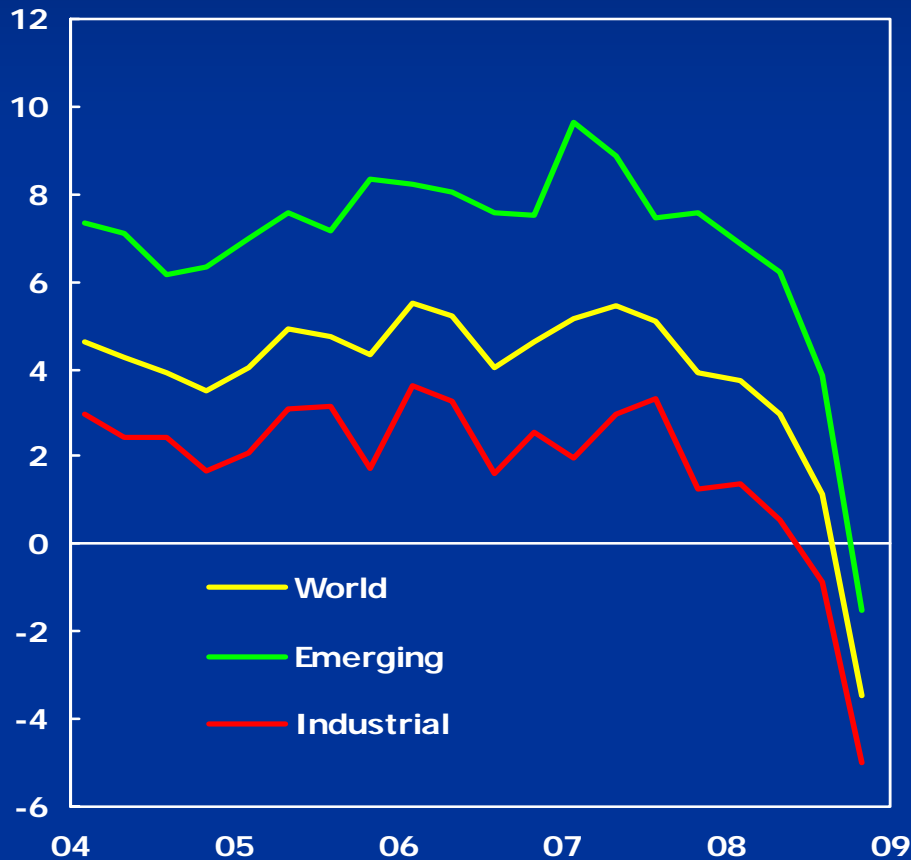
*(Annualized percent change of 3mma  
over previous 3mma)*



# Unemployment is rising

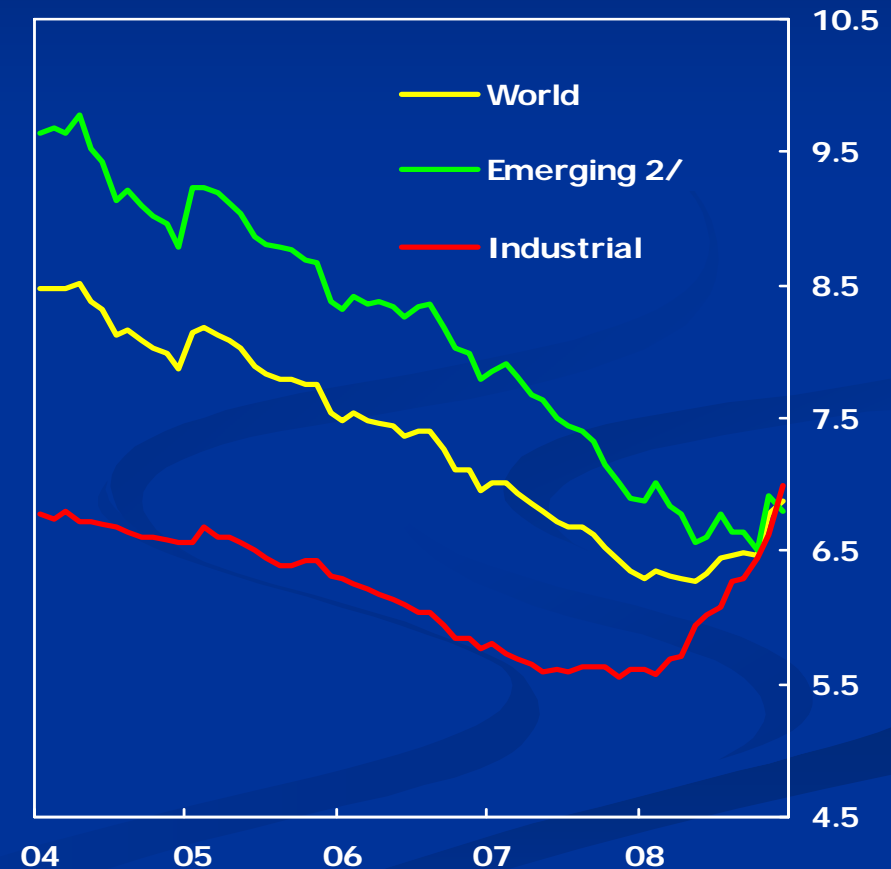
## Real GDP Growth

(Percent; quarter on quarter annualized)



## Unemployment Rate 1/

(Percent)



Source: IMF, Global Data Source and staff calculations.

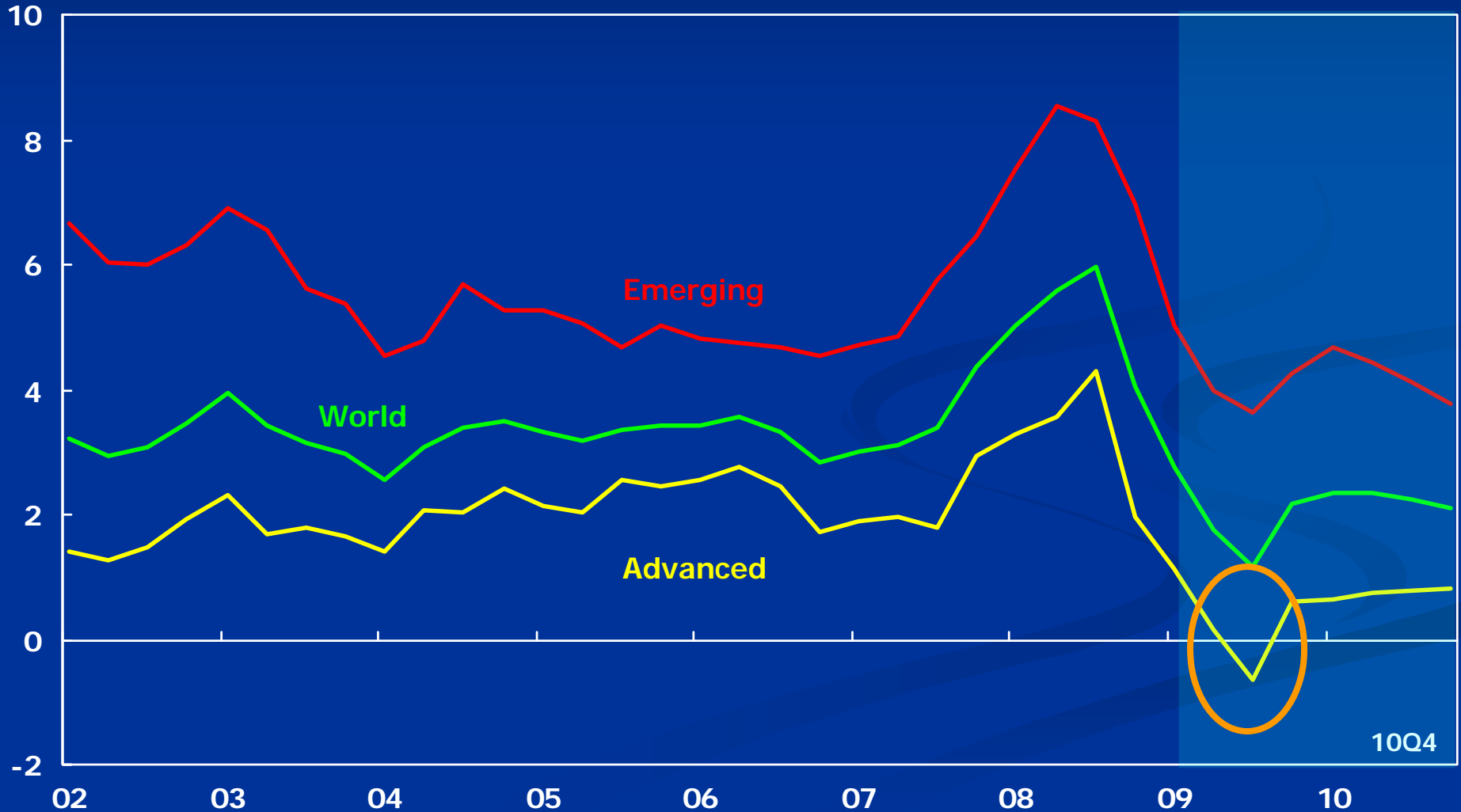
1/ Unemployment data series were aggregated using total labor force as weights.

2/ Excludes China and India.

# Inflation is falling

## Global Headline Inflation

*(Percent change from a year earlier)*



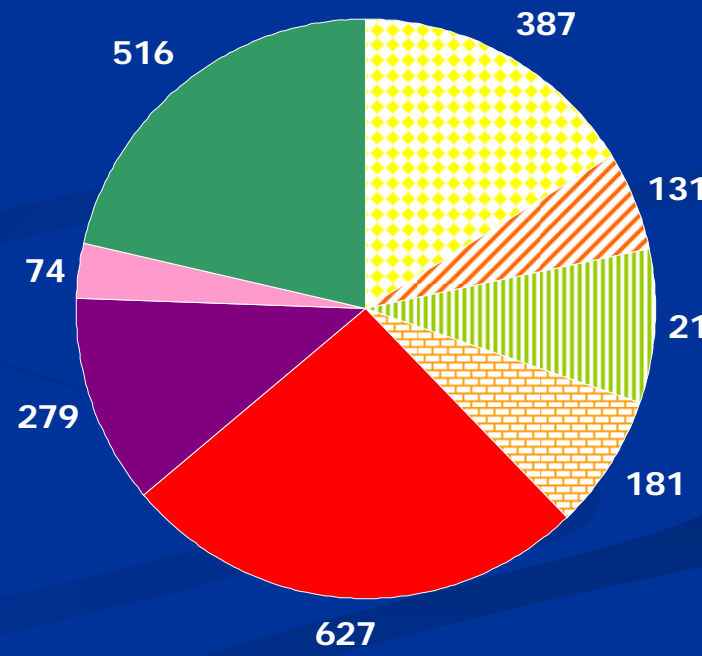
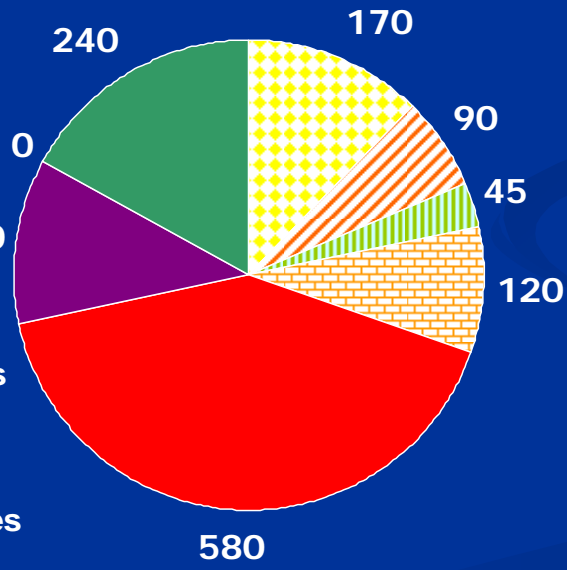
# Our estimate of financial sector losses is now over \$2 trillion

## Estimates of Potential Financial Sector Writedowns on US Assets (as of January 2009)

2008 GFSR Loss Estimate  
(\$ 1.40 tn)

WEMD Jan 2009 Loss Estimate  
(\$ 2.20 tn)

- Mortgages(Prime+Subprime)
- ▨ Commercial Real Estate
- ▨ Consumer
- ▨ North American Corporates
- US Residential Mortgage Securities
- US Commercial Mortgage Securities
- US Consumer Securities
- North American Corp Debt Securities



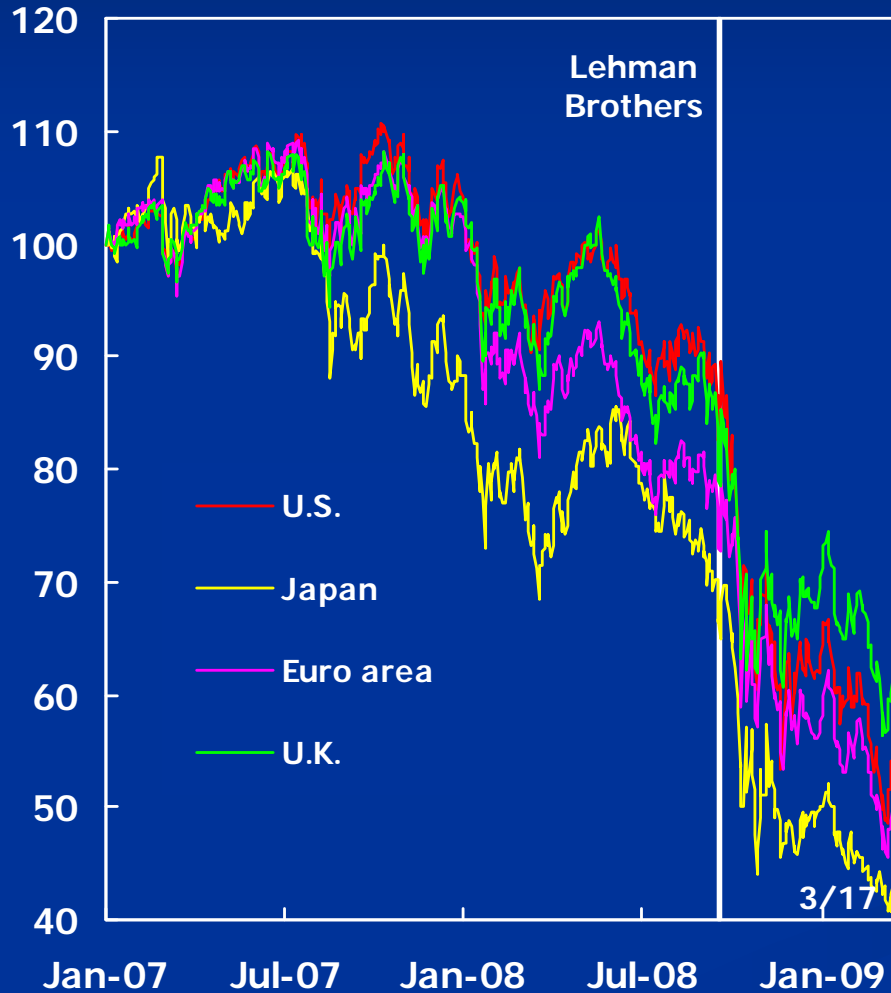
Numbers are in \$ Billions



# This is reflected in markets and confidence

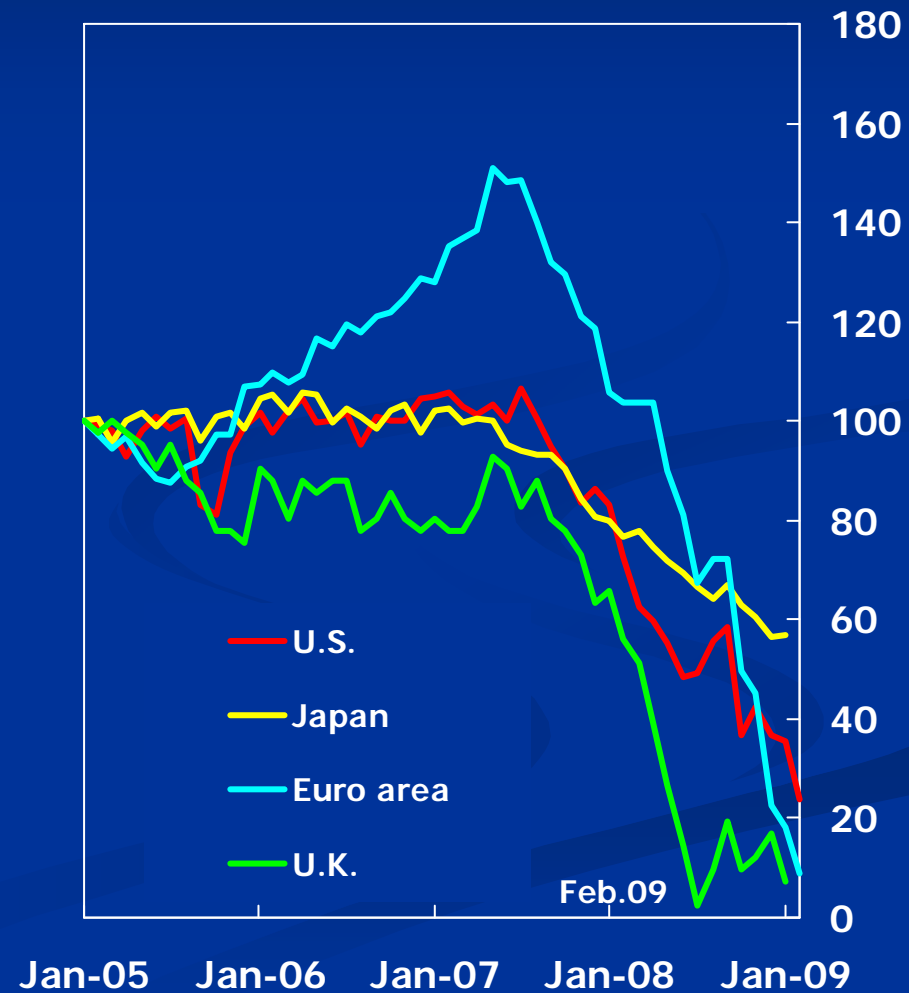
## Equities

(1/1/2007=100; FTSE)



## Consumer Confidence

(Jan. 2005=100)



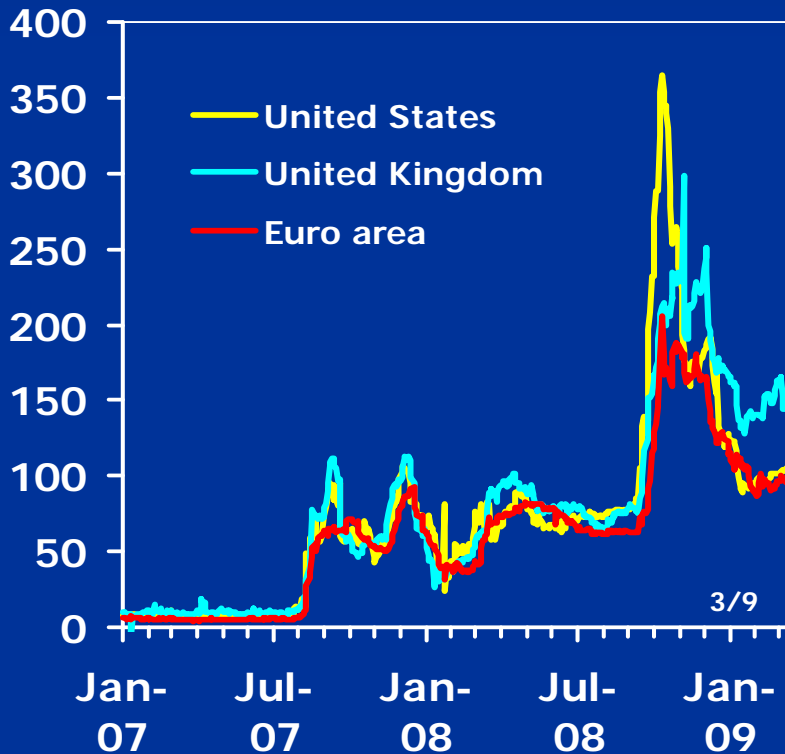
# Systemic risks remain elevated

## CDS Spreads for High-Grade Financials (basis points)

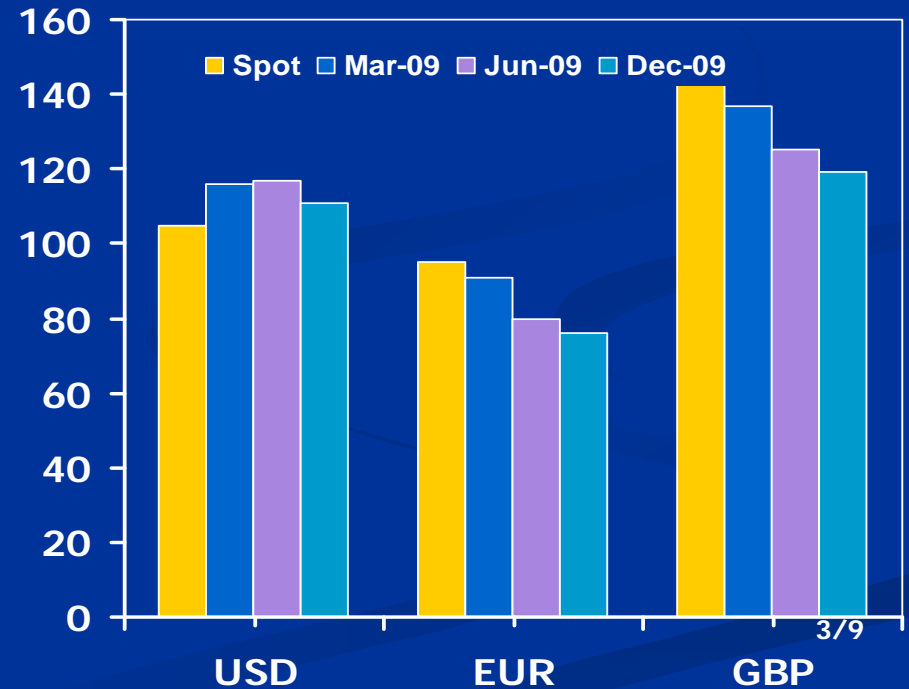


# Interbank liquidity remains impaired

## Libor-Overnight Index Swap Spreads (basis points)

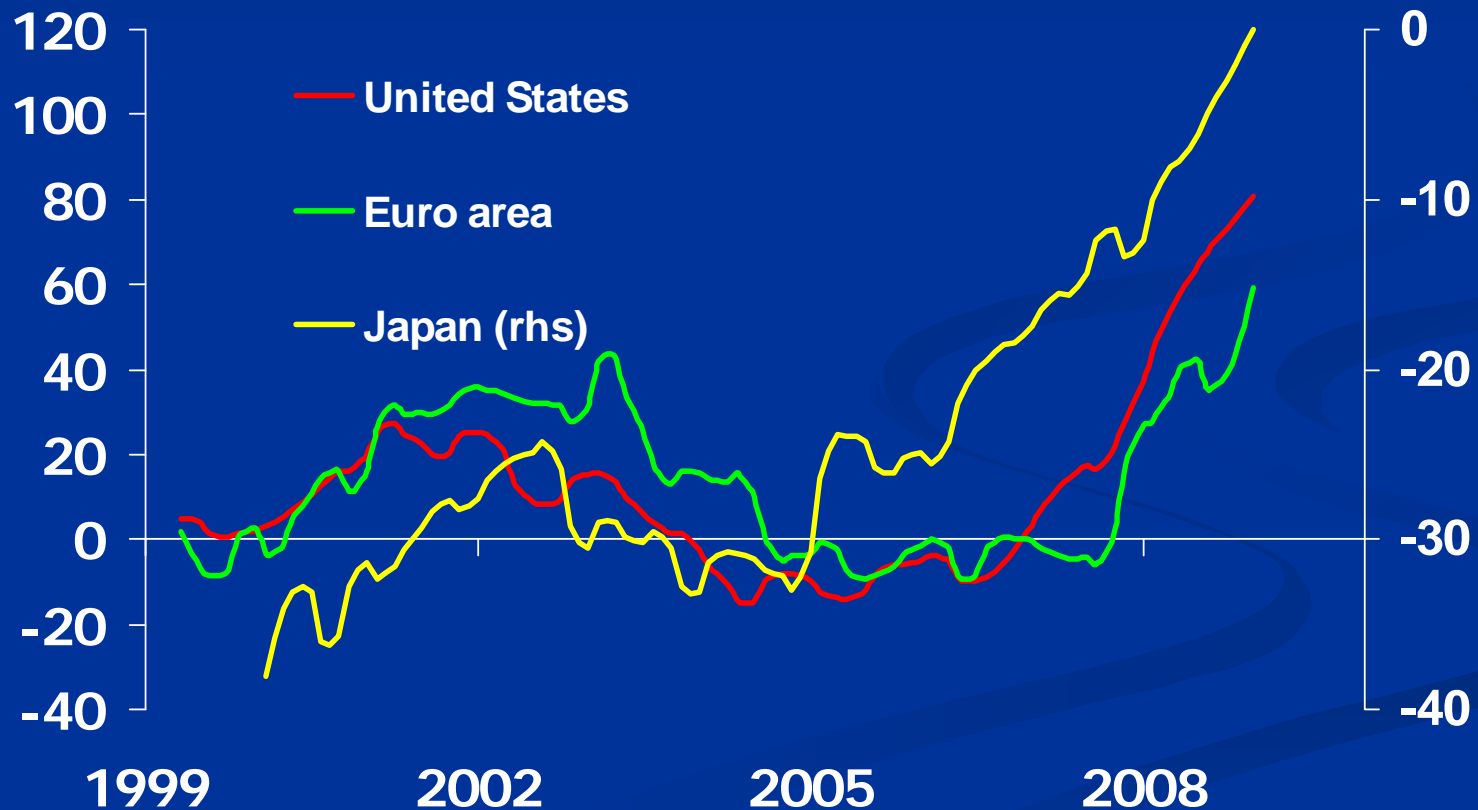


## Spot and Forward LIBOR-OIS Spreads (basis points)



# Bank lending standards have tightened

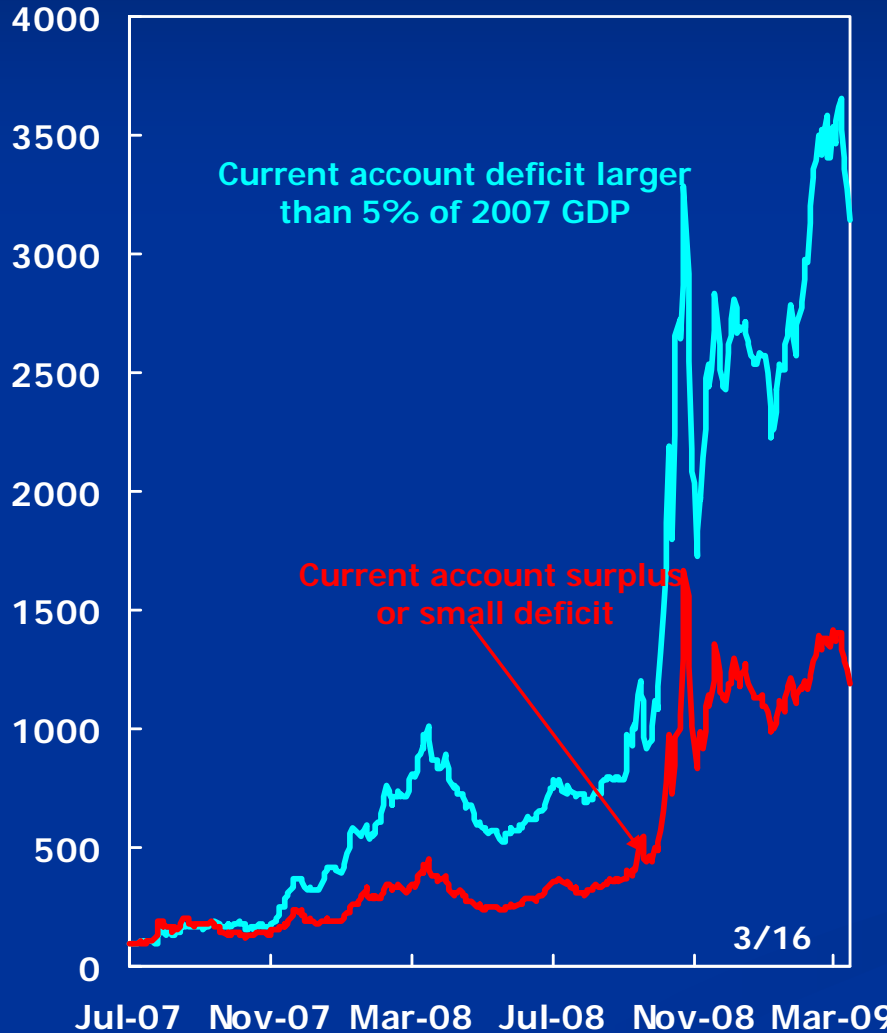
## G-3 Bank Lending Conditions (net percentage of respondents tightening loan standards)



# Emerging markets face external financial pressures and lower commodity prices

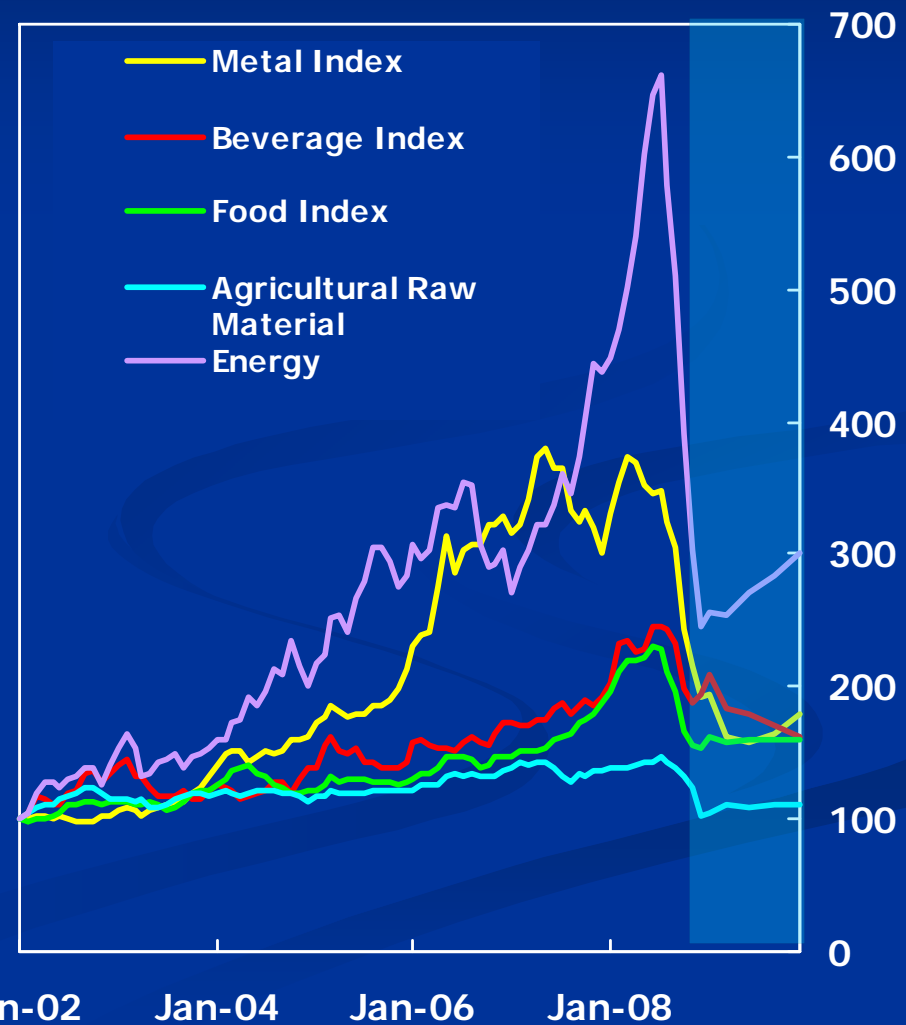
## Emg. Sovereign CDS Spreads

(index: 7/1/2007=100)



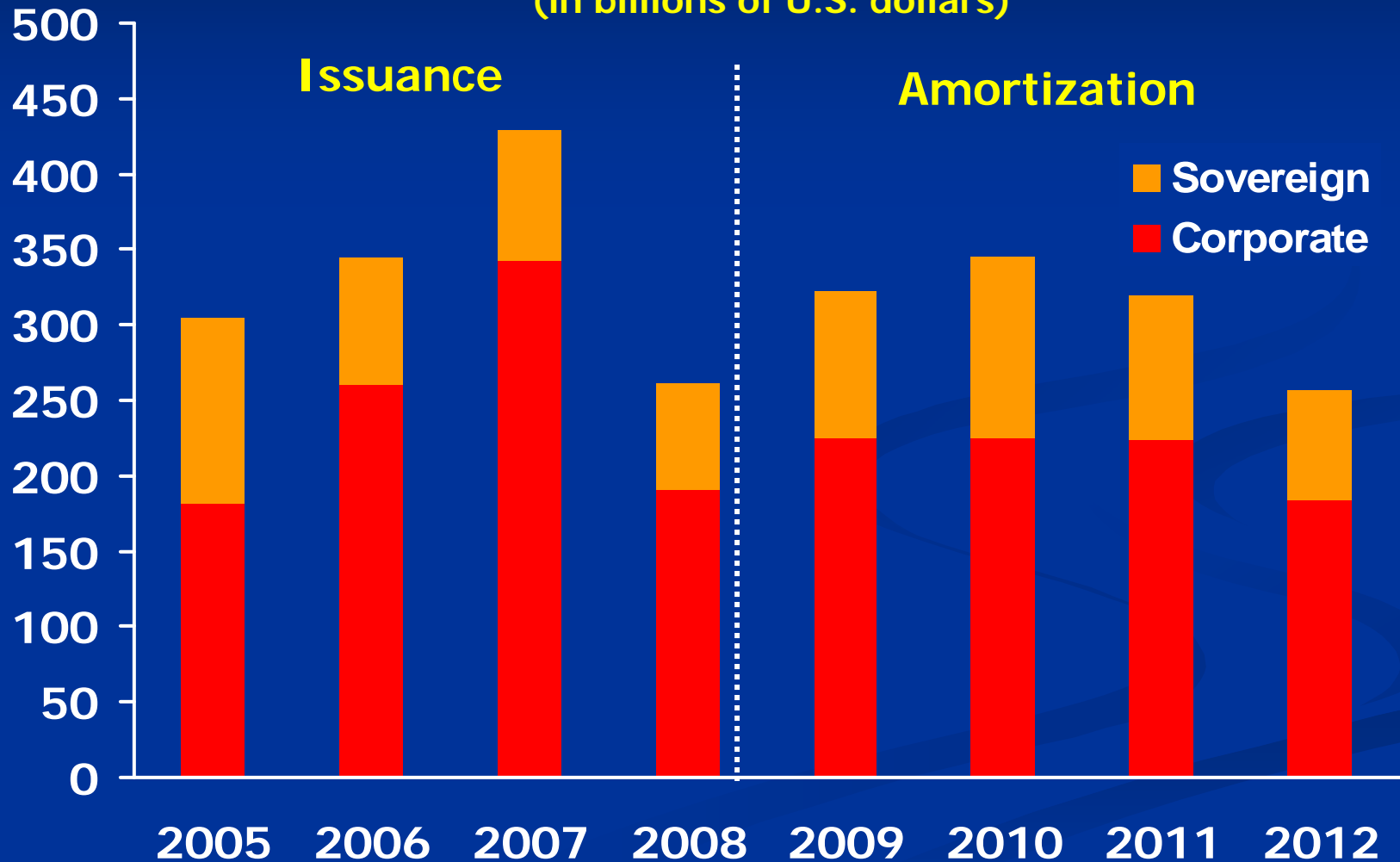
## Commodity Price Indices

(index: Jan. 2002=100)

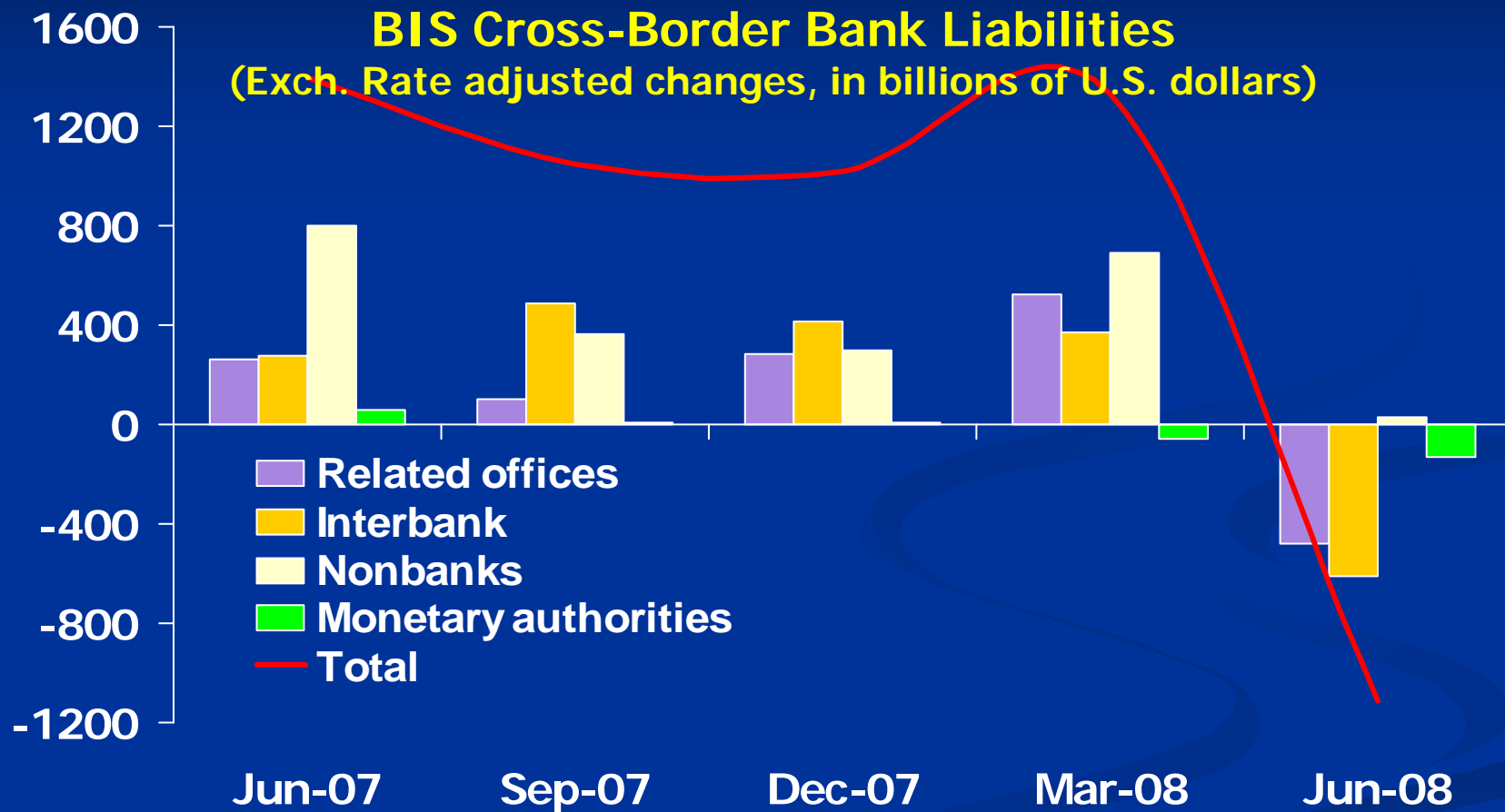


# Emerging market corporates face large rollover needs

**Historical Issuance and Upcoming FX-Denominated Debt**  
(in billions of U.S. dollars)

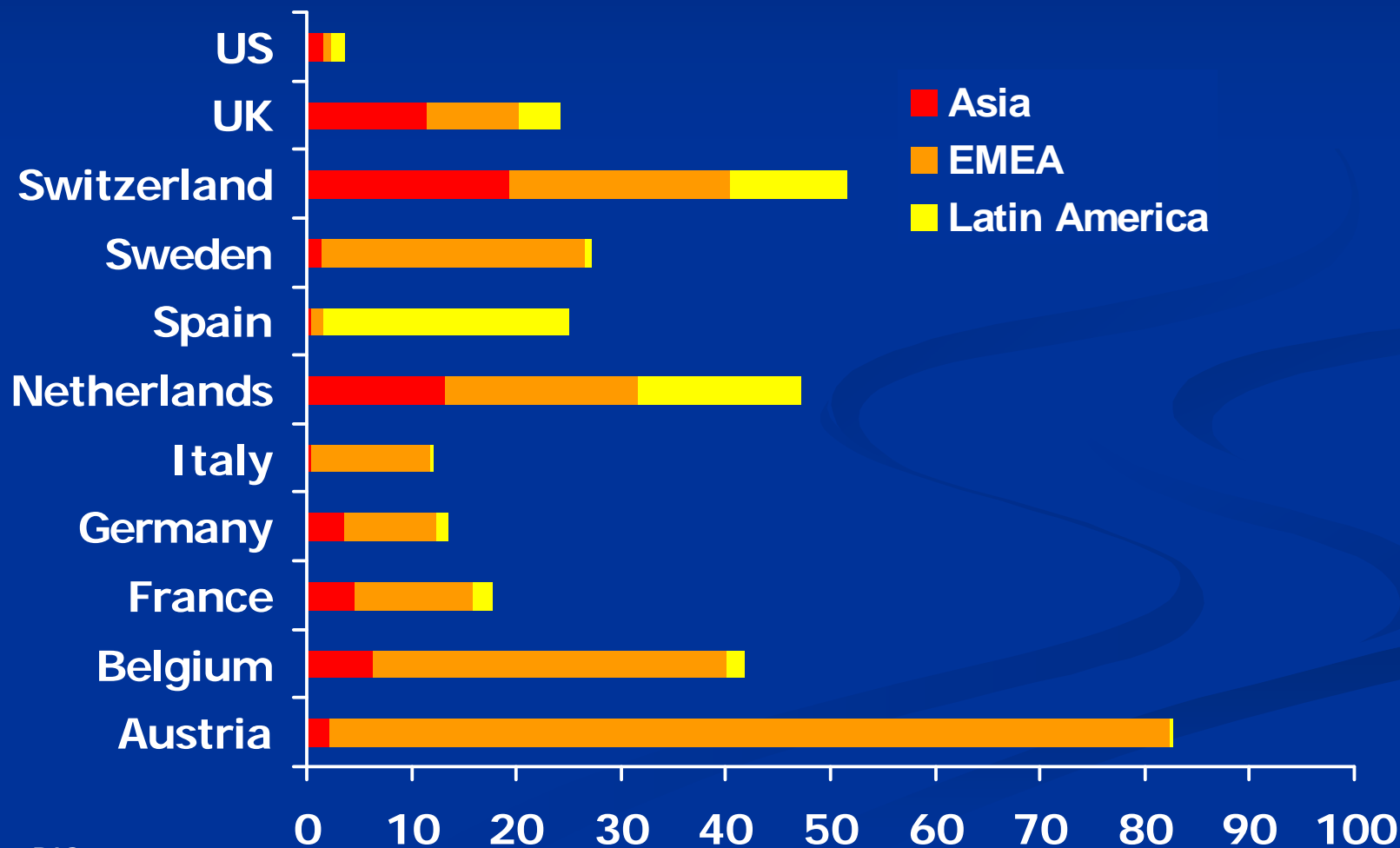


# At the same time, cross-border bank flows are dropping sharply



# Deterioration in emerging markets may be transmitted back to mature markets banks

## Banking System Exposures to Emerging Markets ( as % of Mature Market's GDP )





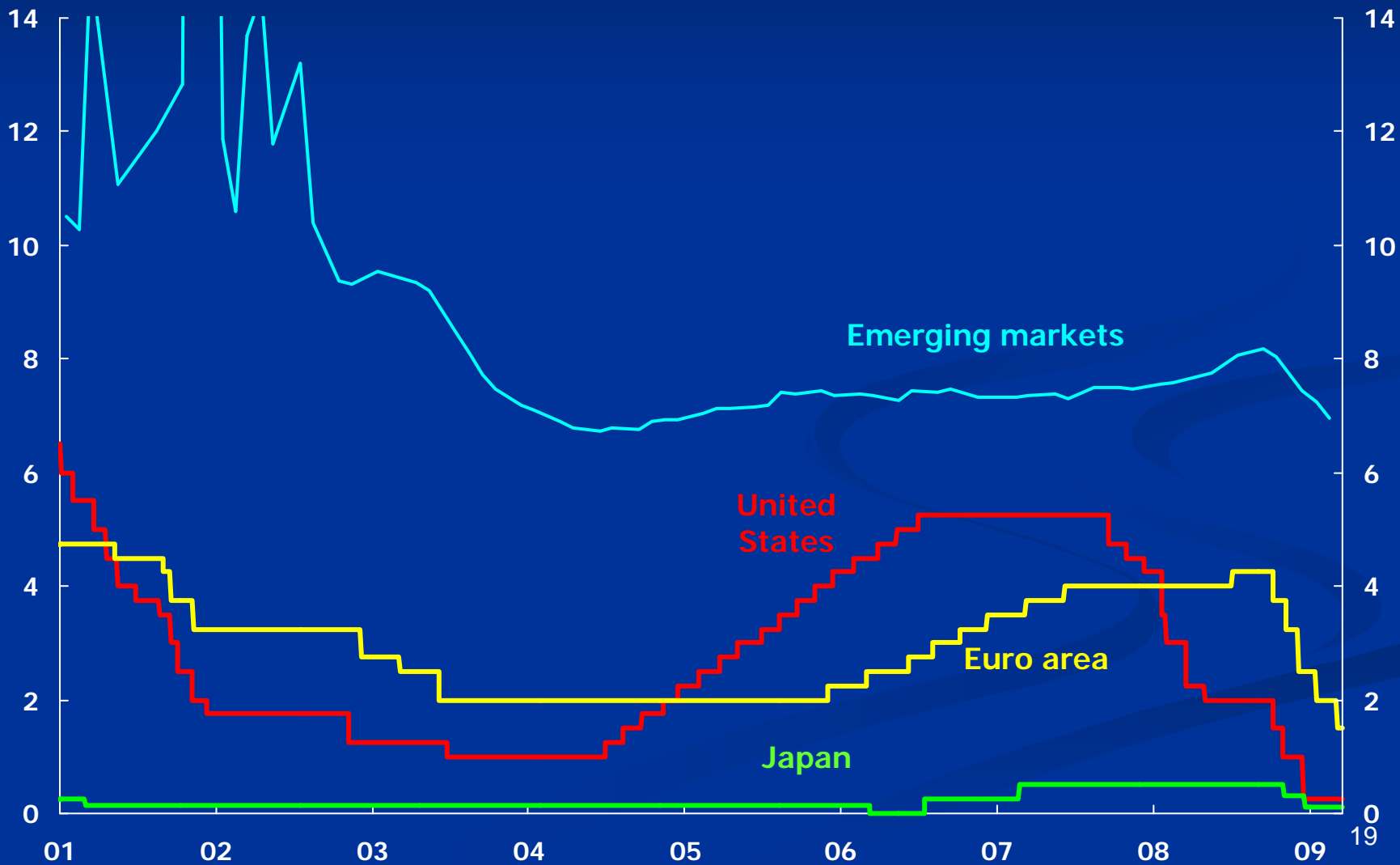
# Policy Response

# The first line of defense: monetary policy

- Inflation concerns are receding rapidly.
- Some countries still have scope to cut policy rates.

# Monetary policy is supportive

*(Policy rates; percent)*



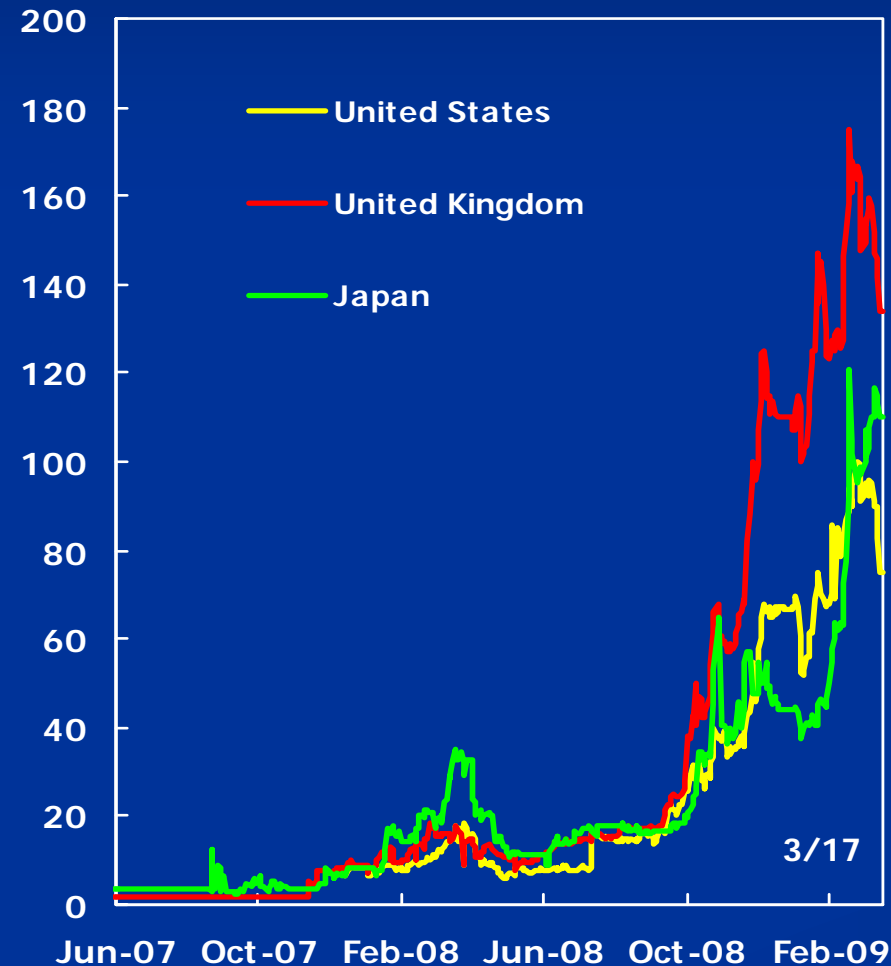
# The second line of defense: fiscal stimulus

- The IMF has asked for 2 percent of GDP as an average.
- While some countries have room to raise deficits, others do not.
- Fiscal packages will boost growth but need an exit strategy.
- Eventually, coordination was not that bad.

# While some countries have room to raise deficits, others do not

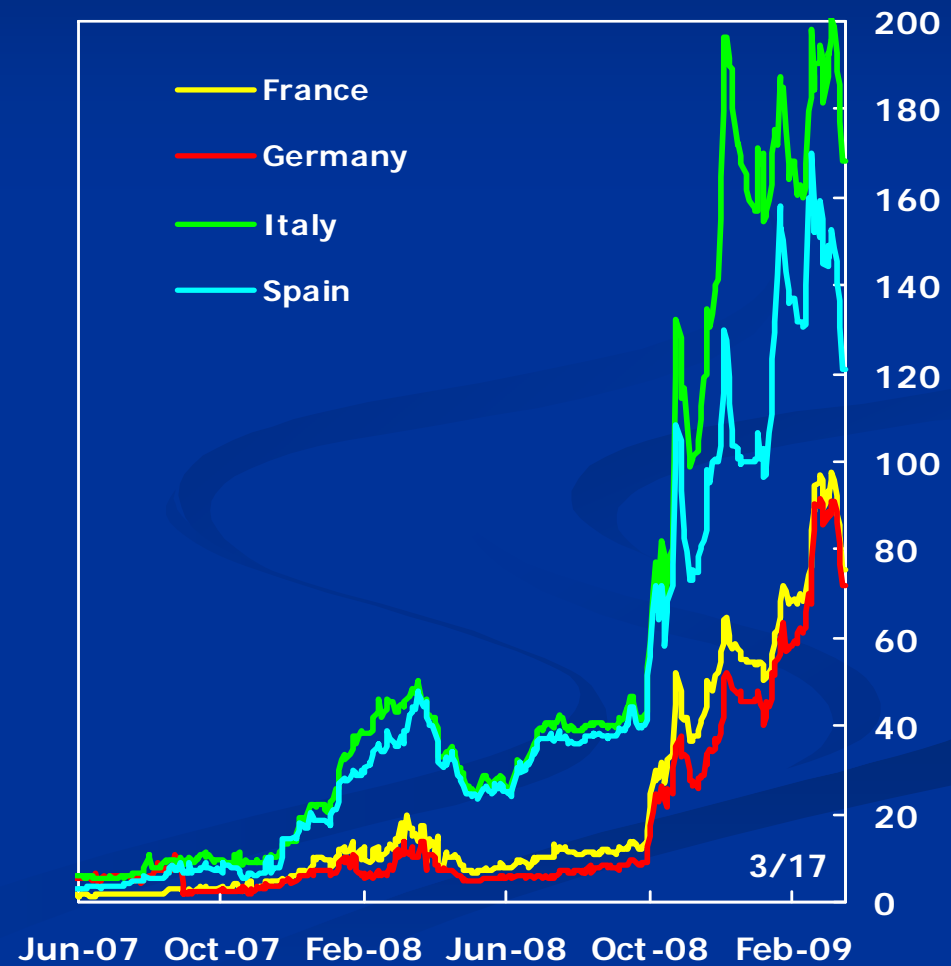
## Industrial Economies

(5yr Sovereign CDS; in basis points)



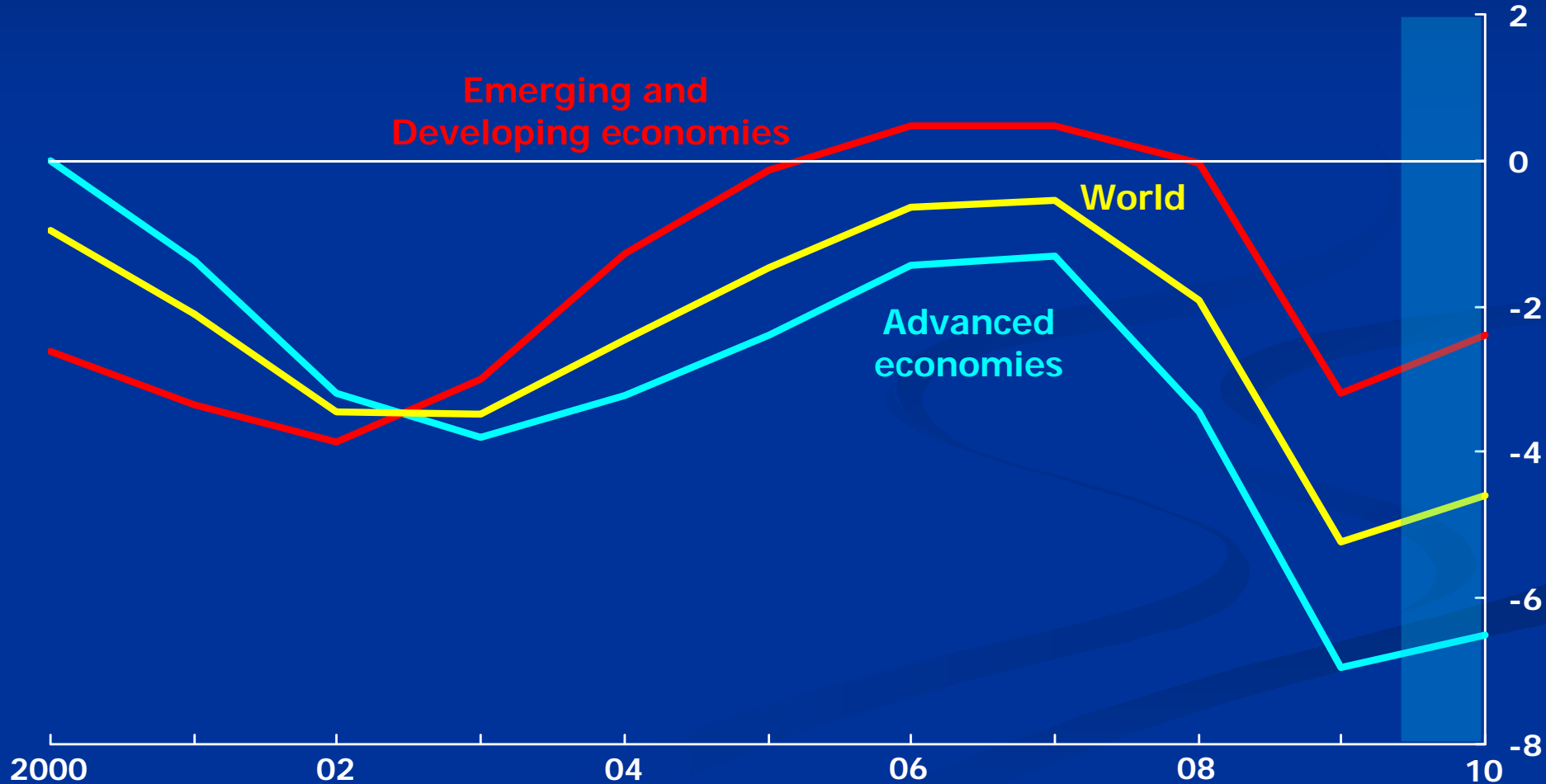
## Selected Europe

(5yr Sovereign CDS; in basis points)



# Fiscal packages are expected to boost economic activity

**General Government Fiscal Balances**  
*(Percent of GDP)*



# The third line of defense: cleansing of banks' balance sheets

- Despite efforts so far, no decisive breakthrough.
- Three pronged approach.
  - Deal aggressively with distressed assets.
  - Recapitalize banks.
  - Continue to provide broad-based liquidity support.
- Contingency plans needed in countries where the situation could quickly turn for the worse.

# The fourth line of defense: the IMF

- IMF lending has been large.
- Focus and streamlining of IMF conditionality has improved.
- Need to double resources, including for concessional lending.
- Increase flexibility of IMF lending arrangements.



# IMF lending has been large

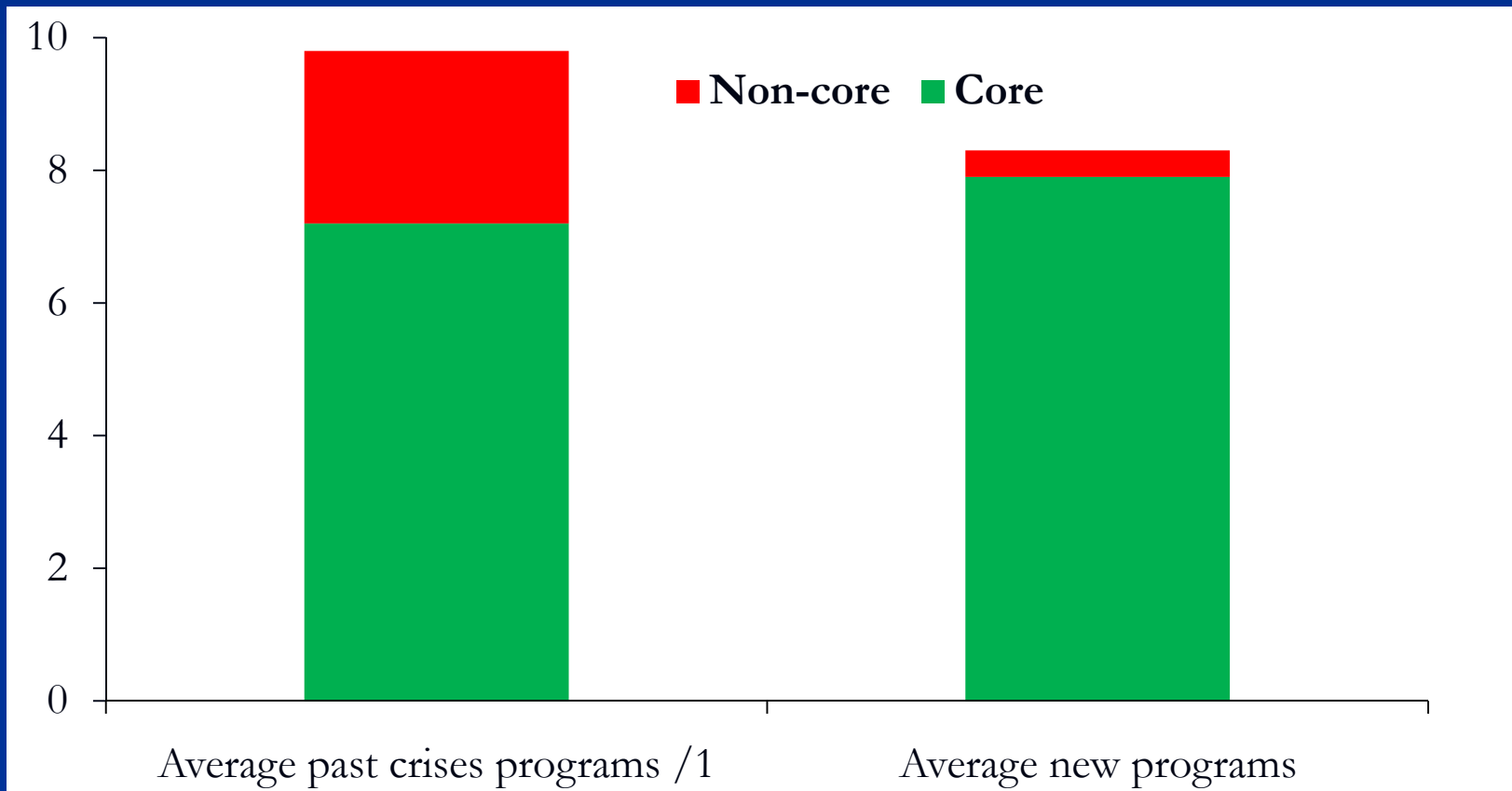
## Program Access Levels

	% of Quota	% of GDP
<b>Average Current Crises</b>	<b>941</b>	<b>8.7</b>
Pakistan (2008)	500	4.7
Iceland (2008)	1,190	12.5
Ukraine (2008)	800	9.1
Hungary (2008)	1,015	9.7
Latvia (2008)	1,200	7.7
<b>Average of Past Crises <sup>1</sup></b>	<b>1,140</b>	<b>6.3</b>
Memo: Precautionary arrangements		
El Salvador (precautionary, 2009)	300	2.2
Costa Rica (expected precautionary, 2009)	300	2.5
Serbia (precautionary, 2009)	75	1.4

<sup>1</sup> Thailand(1997), Indonesia(1997), Korea(1997), Turkey(2002)

# Focus and streamlining of conditionality has improved

Number of Structural Conditions in Initial Programs  
Core measures: financial/monetary, exchange rate and fiscal policy



/1 Thailand(1997), Indonesia(1997), Korea(1997), Turkey(2002)

# Despite all this, risks are to the downside

- Overarching Risk: further delays in implementing policies to stabilize financial conditions – this would intensify feedback loops
- Deflation: could reinforce a deeper and longer downturn
- Rollover of external financing for emerging economies
- Protectionism: trade; but also “backdoor” financial
- Sovereign fiscal sustainability concerns