The Global Financial Crisis: Preliminary Lessons

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French National Assembly
Committee on Foreign Affairs
March 25, 2009
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

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

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.
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)

Emerging

World

Advanced

10Q4
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

Source: Staff Estimates
This is reflected in markets and confidence.
Systemic risks remain elevated

CDS Spreads for High-Grade Financials (basis points)

- Bear Stearns collapse
- Lehman bankruptcy
- Banks begin issuing govt. guaranteed debt
- Bleak economic releases globally

Source: Bloomberg
Interbank liquidity remains impaired

Libor-Overnight Index Swap Spreads (basis points)

Spot and Forward Libor-OIS Spreads (basis points)

Source: Bloomberg
Bank lending standards have tightened

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

Source: Haver Analytics, Staff Estimates
Emerging markets face external financial pressures and lower commodity prices

**Emg. Sovereign CDS Spreads**

(index: 7/1/2007=100)

- Current account deficit larger than 5% of 2007 GDP
- Current account surplus or small deficit

**Commodity Price Indices**

(index: Jan. 2002=100)

- Metal Index
- Beverage Index
- Food Index
- Agricultural Raw Material
- Energy

**Metal Index**: \(0 \leq t \leq 3000\)

**Beverage Index**: \(300 \leq t \leq 700\)

**Food Index**: \(200 \leq t \leq 600\)

**Agricultural Raw Material**: \(100 \leq t \leq 400\)

**Energy**: \(100 \leq t \leq 700\)
Emerging market corporates face large rollover needs

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

Source: Dealogic, Bloomberg, Staff Estimates
At the same time, cross-border bank flows are dropping sharply

BIS Cross-Border Bank Liabilities
(Exch. Rate adjusted changes, in billions of U.S. dollars)

Source: BIS
Deterioration in emerging markets may be transmitted back to mature markets banks.

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

Source: BIS
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)

- United States
- United Kingdom
- Japan

**Selected Europe**
(5yr Sovereign CDS; in basis points)

- France
- Germany
- Italy
- Spain

Source: Bloomberg, L.P.
Fiscal packages are expected to boost economic activity.

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

Emerging and Developing economies

Advanced economies

World
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

<table>
<thead>
<tr>
<th>Program Access Levels</th>
<th>% of Quota</th>
<th>% of GDP</th>
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</thead>
<tbody>
<tr>
<td><strong>Average Current Crises</strong></td>
<td>941</td>
<td>8.7</td>
</tr>
<tr>
<td>Pakistan (2008)</td>
<td>500</td>
<td>4.7</td>
</tr>
<tr>
<td>Iceland (2008)</td>
<td>1,190</td>
<td>12.5</td>
</tr>
<tr>
<td>Ukraine (2008)</td>
<td>800</td>
<td>9.1</td>
</tr>
<tr>
<td>Hungary (2008)</td>
<td>1,015</td>
<td>9.7</td>
</tr>
<tr>
<td>Latvia (2008)</td>
<td>1,200</td>
<td>7.7</td>
</tr>
<tr>
<td><strong>Average of Past Crises</strong></td>
<td>1,140</td>
<td>6.3</td>
</tr>
</tbody>
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Memo: Precautionary arrangements

<table>
<thead>
<tr>
<th>Memo</th>
<th>% of Quota</th>
<th>% of GDP</th>
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<tbody>
<tr>
<td>El Salvador (precautionary, 2009)</td>
<td>300</td>
<td>2.2</td>
</tr>
<tr>
<td>Costa Rica (expected precautionary, 2009)</td>
<td>300</td>
<td>2.5</td>
</tr>
<tr>
<td>Serbia (precautionary, 2009)</td>
<td>75</td>
<td>1.4</td>
</tr>
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Focus and streamlining of conditionality has improved

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

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