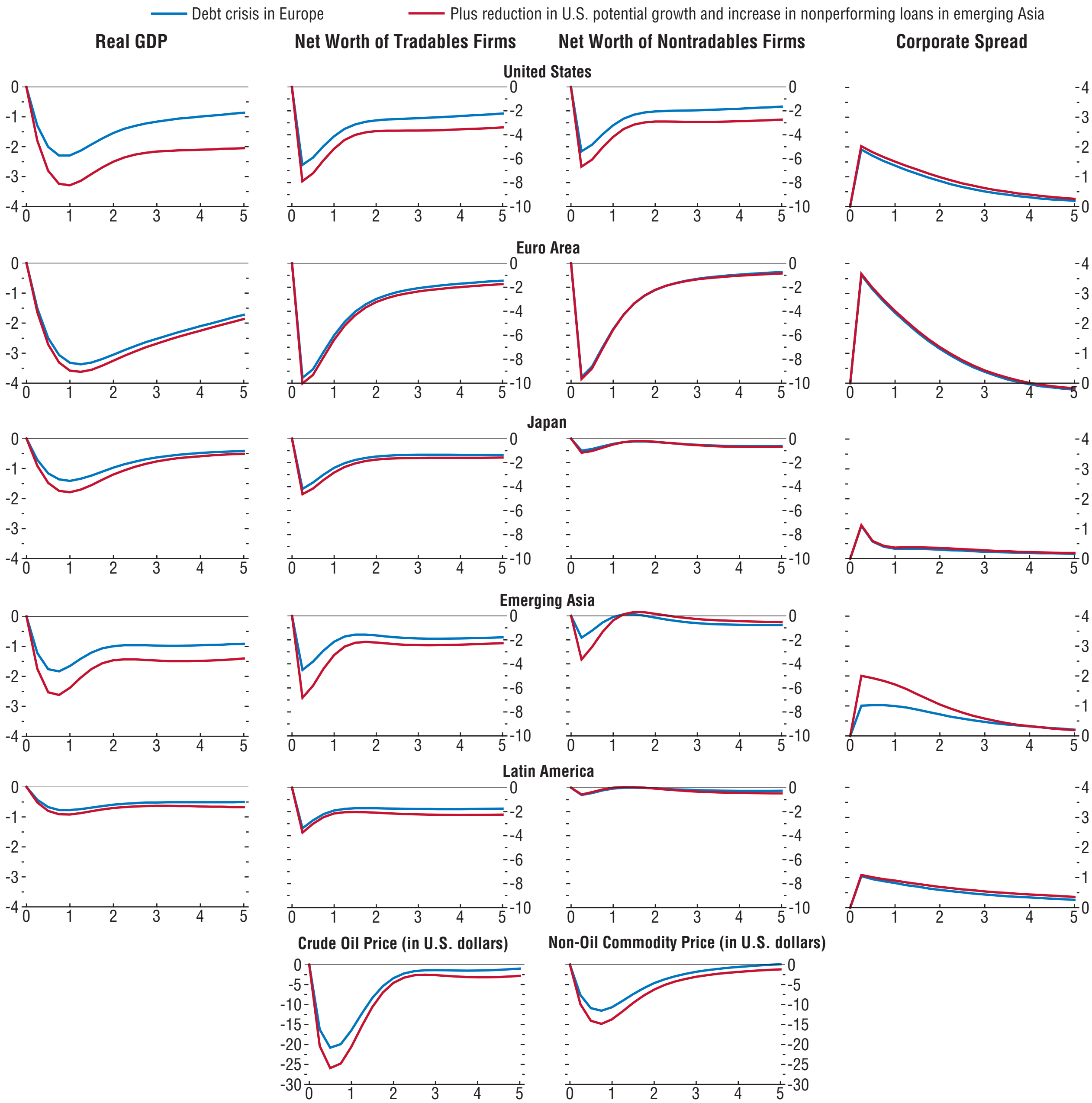
Figure 1.16. WEO Downside Scenario

(Deviation from control; years on x-axis)

This downside scenario uses a six-region version of the Global Economy Model (GEM) calibrated to represent the United States, Japan, the euro area, emerging Asia, Latin America, and the rest of the world. The scenario features shocks arising in three regions: the euro area, the United States, and emerging Asia. In the euro area, the shock is to bank capital, reflecting primarily recognition of losses on holdings of public debt but also of other losses on loans arising from the macroeconomic fallout. In the United States, the shock has two components. The first is slower potential output growth and the second is the resulting increase in loan losses (e.g., on the mortgage portfolio). The shock in emerging Asia is loan losses, reflecting poor lending decisions in the past. Furthermore, corporate risk premiums in emerging Asia, Japan, and Latin America are assumed to be correlated with the rise in risk premiums in the euro area and the United States, in a manner broadly consistent with what was observed during the collapse of Lehman Brothers. As a result of the large shock to global output, especially in the euro area and the United States, commodity prices plummet, dragging down activity in commodity exporters. The accompanying charts trace out the implications for GDP, firm net worth (in both the tradables and nontradables sectors), the effective interest rate faced by firms in the various regions, and commodity prices.



Source: GEM simulations.