



Seminar on  
**Global Economic Crisis & Sri Lanka**

Crystal Room - Lower, Taj Samudra Hotel, Colombo  
Wednesday 18 February, 2009

Organized by  
Institute of Policy Studies of Sri Lanka

Seminar by Institute for policy Studies

## The Global Economic Crisis

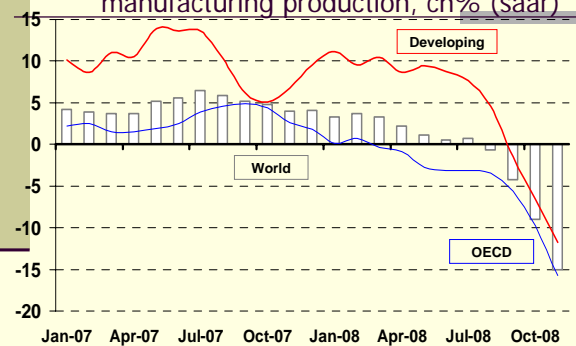
*The International Response*

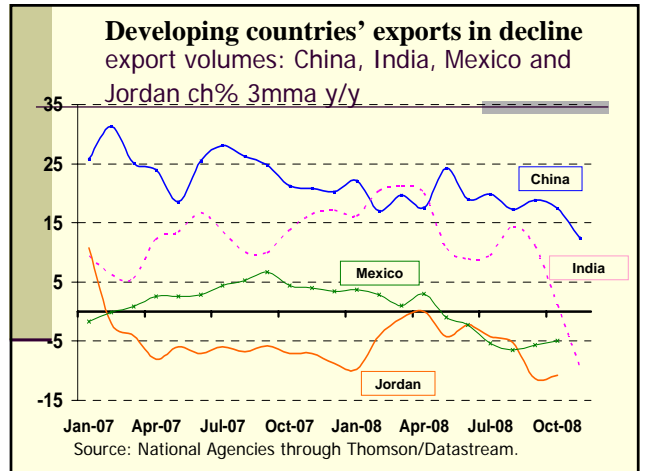
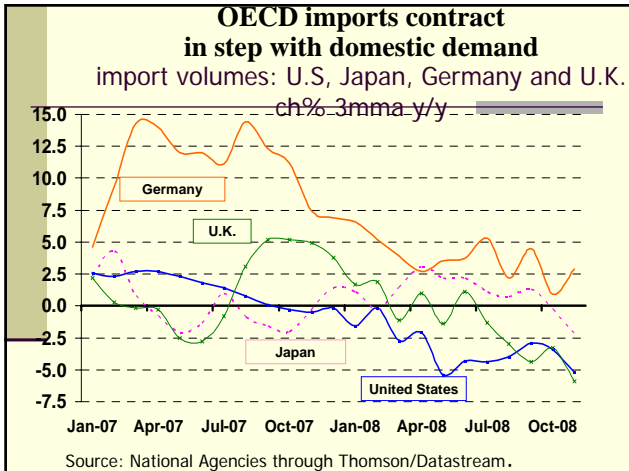
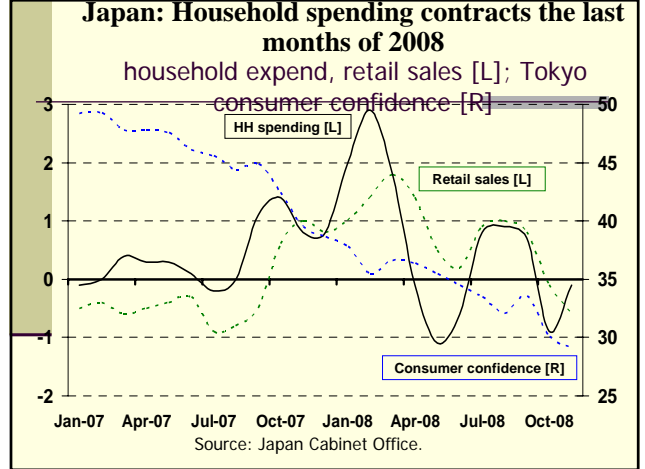
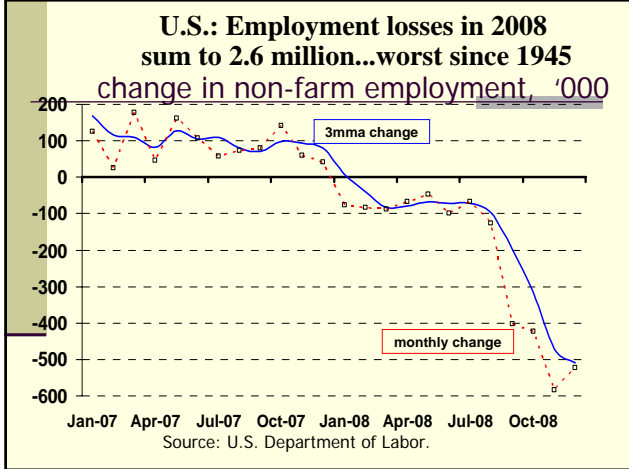
Claus Astrup  
World Bank  
Colombo, February 18, 2008

## Outline and main points

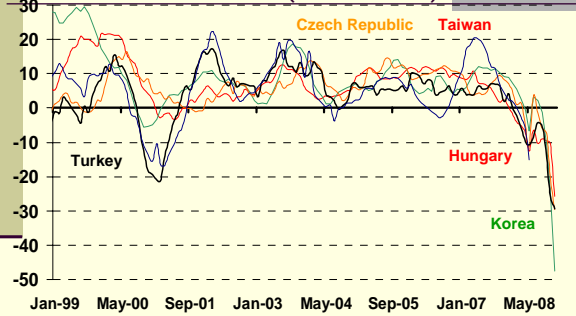
- The latest data leaves no doubt: the global economy is in crisis!
- What can (developing) countries do? Depend on initial situation, nature of vulnerability and implementation capacity.
- What have (developing) countries done? Many have eased monetary policy, let their exchange rate depreciate, and designed fiscal stimuli packages
- Will it work? Perhaps, but since crisis is global, developing countries cannot overcome it on their own. And don't forget the medium-term agenda.

## Global industrial production plummets into 4<sup>th</sup> quarter of 2008... manufacturing production, ch% (saar)





### Dramatic industrial production contraction in export intensive economies



Source: Thomson/Datastream, DECPG.

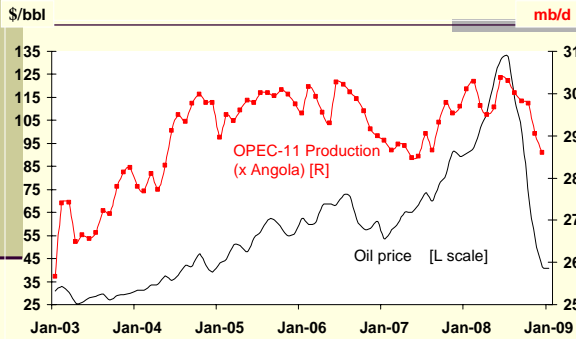
### A difficult year for emerging market capital flows

Gross capital flows to emerging markets

\$ billion	2007				2008				
	H1	Q3	Q4	Total	H1	Q3	Q4	Dec	Total
<b>Total</b>	349	163	139	652	253	73	44	16	371
Bonds	107	20	19	146	58	9	2	2	69
Banks	156	101	55	312	150	62	42	14	254
Equity	86	42	66	194	45	2	0	0	47
Lat. America	69	54	32	156	56	13	10	5	79
Bonds	31	6	8	45	17	1	2	2	20
E. Europe	156	45	46	247	101	35	21	4	158
Bonds	50	5	9	64	32	8	0.1	0.1	40
Asia	93	47	47	188	69	15	8	4	91
Bonds	18	5	1	23	7	0.4	0	0	7
Others	31	16	14	61	27	10	5	3	43

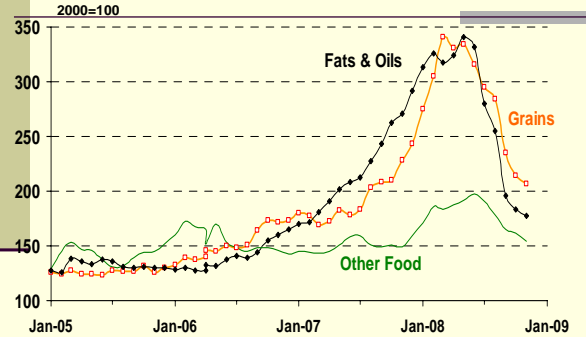
Source: DECPG Finance Team.

### The silver lining for many: Oil prices have declined dramatically



Source: IEA and DECPG Commodities Group.

### ...as have other commodity prices—but bottom appear to be approaching



Source: Datastream and DECPG Commodities Group.

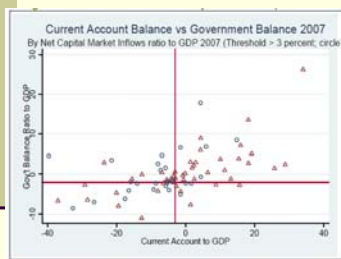
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## Not a single recipe; depends (among other things) on

1. Initial conditions => determine room for maneuver. (In particular fiscal and current account balances)
2. Nature of vulnerabilities => determine main transmission channels and policy objectives. (For example, large reliance on import of private foreign capital? High initial poverty? Large negative growth impact, e.g. from declining exports)
3. Institutional capacities => determine ability to respond. (Public expenditure management, and capacity to target the poor.)

## Initial position differed significantly among emerging market economies..



40% with **low** CA and fiscal deficits (prudent past)

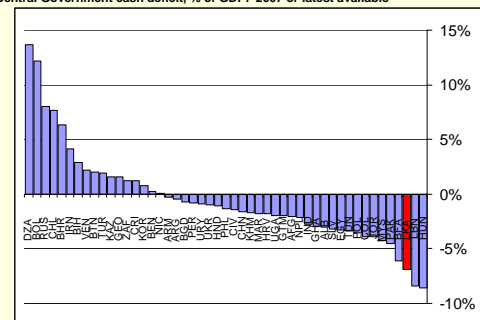
25% with **high** CA and fiscal deficits

.. many countries with high CA deficit depend heavily on private capital inflows, which exacerbate need for external adjustment (blue bullets)

Source: IMF World Economic Outlook 2008 and World Bank data and staff calculations  
Capital market inflows comprise portfolio equity and other (mostly portfolio and bank) debt flows.

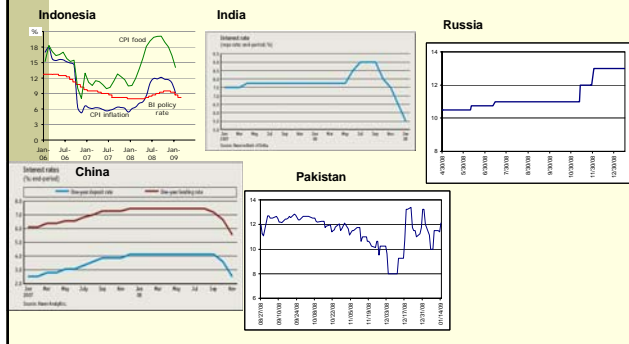
## Sri Lanka has comparatively high fiscal deficit...

Central Government cash deficit, % of GDP. 2007 or latest available



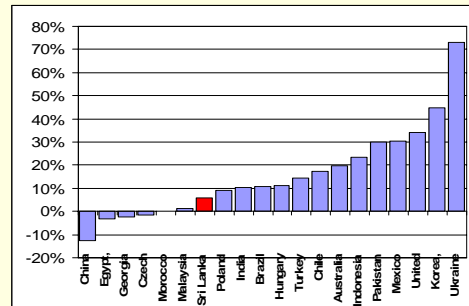


## Many (but not all) countries have eased monetary policy



## Many countries have seen their exchange rate depreciate, as foreign currency fled

% change in Selected emerging market exchange rates vis-à-vis US\$ between January 1, 2007 and January 14, 2009



## Many countries have announced fiscal stimulus packages..

	Date of announcement	Amount (billion US\$)	Share of 2008 GDP (%)
China	November 2008	586	6.9
Malaysia	November 2008 (stimulus package) January 2009 (economic restructuring)	2.0	1.0
India	December 2008 (1 <sup>st</sup> stimulus package) January 2009 (2 <sup>nd</sup> stimulus package)	16	1.4
Korea, Rep. of	December 2008	24.4	3.5
Philippines	December 2008	6.3	4.0
Indonesia	January 2009	6.3	1.4
Singapore	January 2009	13.7	7.8
Thailand	January 2009	3.4	1.0
Viet Nam	January 2009	1.0	1.1
Sri Lanka	December 2009	0.14	-0.3

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## Monetary policy may be less effective at the present moment...

...because

- the financial nature of the crisis weakens the traditional monetary transmission mechanism;
- in many countries, monetary policy was already quite loose, so room for lower policy rates may be small;
- in open capital account countries, lower interest rates may further spur capital outflows.

## Exchange rate depreciation can help spur export-led recovery and protect reserves,

but..

- puts upward pressure on domestic prices;
- can create expectations about future depreciations;
- is clearly not an option open to the world as a whole;

## Fiscal stimuli packages need to be carefully designed and executed..

..in particular..

- it is critical to maintain medium-term fiscal sustainability; otherwise stimuli can back-fire;
- it should be based on measures that are reversible and have credible sunset clauses, including expanding scope of automatic stabilizers, which by definition are countercyclical;
- related, watch for risk of capture by vested interest and perceptions of creating an uneven playing field.

## No strong empirical evidence that one stimuli has large multiplier effect...

...and situation is one of extraordinary uncertainty. Therefore perhaps not surprising that emphasis of stimuli packages vary considerably among countries...

- China and Malaysia: mainly increased government spending on infrastructure (..but high import content?).
- India (and Sri Lanka): greater emphasis on supporting particular industries, including labour-intensive and export-oriented businesses (..but risk of arbitrariness in distribution of support?).
- Thailand: aimed at poor households, supporting living standards and household spending (...but negative impact on incentives?).

## In closing...

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...also important to keep eyes on the medium term;

- Financial sector regulation?
- Efficiency of tax system?
- Strengthening business environment?
- Rationalize public spending?
- Improve public enterprises?

**Thank you!**