



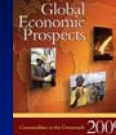
Seminar on

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

Global Economic Prospects 2009: The unfolding global financial crisis



IPS Seminar on
The Global Economic Crisis & Sri Lanka
Colombo, February 18, 2009



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Regional Economic Adviser, South Asia
The World Bank

Key questions

- What started the global financial crisis?
- How were emerging economies positioned to weather the storm?
- What was the impact on emerging economies and what are their prospects?
- What have been short & medium-term policy responses, what lessons being learned, and what risks remain?

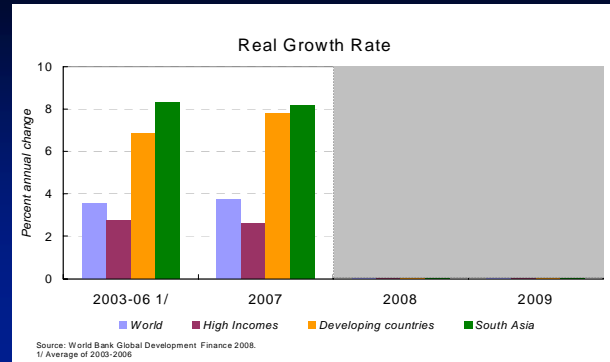
What started the crisis?

- Started in the U.S., still the epicenter of the crisis
- Three factors responsible—rapid growth in global liquidity, permissive US regulatory environment, global macro imbalances
- As credit crunch intensified, policy mistakes were made
 - Sept 15 Lehman collapse led to global collapse of trust
 - Initial bailout packages did not get ahead of markets
- Challenge quickly became how to prevent collapse of global financial system & avoid deep recession
- Speed at which the contagion has spread world-wide is staggering
- No country seems immune—decoupling a myth—though some are still in denial

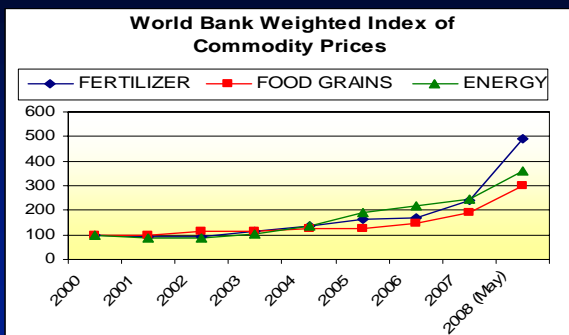
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Global economic growth before the crisis hit



Twin price shocks in food & fuel



Global impact of the twin shocks

Terms of Trade Impact
Jan 2003 to May 2008¹

	All commodities	Food	Energy
South Asia	-9.6	0.2	-9.1
East Asia and Pacific	-1.0	0.4	-0.4
Sub-Saharan Africa	25.5	-2.0	22.7
Latin America and Caribbean	10.1	0.9	5.1
Europe and Central Asia	12.8	-0.6	10.5
Middle East and North Africa	36.4	-2.7	44.9
EAP Oil Importers	-13.3	-1.4	-24.4
China	-3.9	-0.1	-1.8
SSA Oil Importers	2.5	-1.6	-4.6

Source: World Bank staff estimates.
Notes: 1. As a share of 2002 GDP.

South Asia: the food & fuel shocks

Terms of Trade Impact in South Asia Region Jan 2003 to May 2008¹

	All commodities	Food	Energy
Bangladesh	-7.7	-3.1	-2.6
India	-9.5	0.5	-9.5
Sri Lanka	-10.2	-2.4	-7.7
Maldives	-34.1	-3.9	-19.6
Nepal	-21.2	-3.4	-11.0
Pakistan	-11.3	1.6	-11.8

Source: World Bank staff estimates.

Notes: 1. As a share of 2002 GDP.

South Asia: worsening current accounts

% of GDP

	2003	2004	2005	2006	2007	2008
Bangladesh	0.3	-0.5	-0.3	2.0	1.2	0.8
India	1.5	0.1	-1.0	-1.0	-1.6	-3.8
Sri Lanka	-0.6	-3.4	-3.2	-5.3	-3.9	-7.8
Nepal	1.9	-0.6	0.0	-0.1	-1.2	1.2
Pakistan	4.3	-0.8	-3.3	-5.4	-5.8	-8.1
South Asia	1.6	-0.1	-1.2	-1.5	-1.9	-4.2

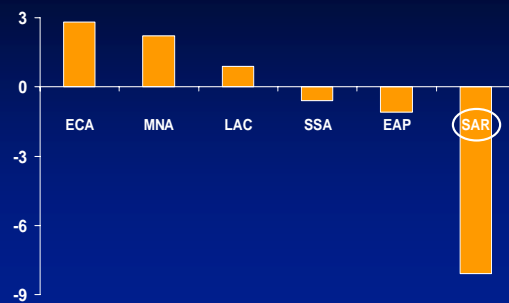
South Asia: high/rising fiscal deficits

% of GDP

	2003	2004	2005	2006	2007	2008
Bangladesh	-3.4	-2.9	-3.4	-3.3	-3.7	-4.7
India	-9.1	-7.2	-6.8	-6.5	-6.8	-8.5
Sri Lanka	-7.6	-7.7	-8.4	-8.1	-7.7	-7.5
Nepal	-1.8	-0.9	-0.8	-1.6	-1.4	-2.8
Pakistan	-1.0	-2.1	-0.4	-4.2	-4.2	-7.4
South Asia	-7.7	-6.3	-5.9	-6.1	-6.3	-8.1

South Asia: least fiscal space among low/middle income regions

% share of GDP, projected 2008

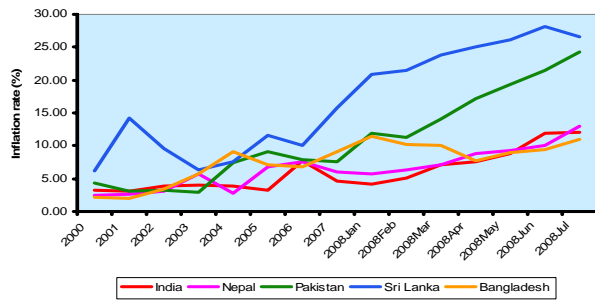


Source: World Bank

South Asia: rising inflationary pressures

Annual % rates

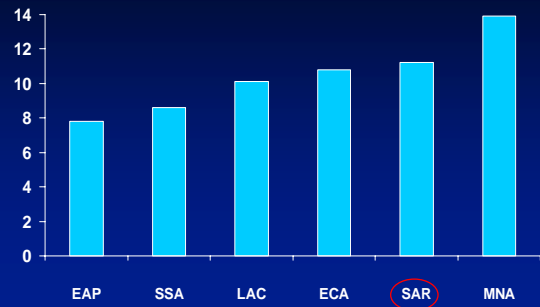
Figure 5: Trend in Inflation in South Asia



Source: Data from country authorities

South Asia: second-highest inflation among low/middle income regions

Median GDP deflator (LCU)



Source: World Bank

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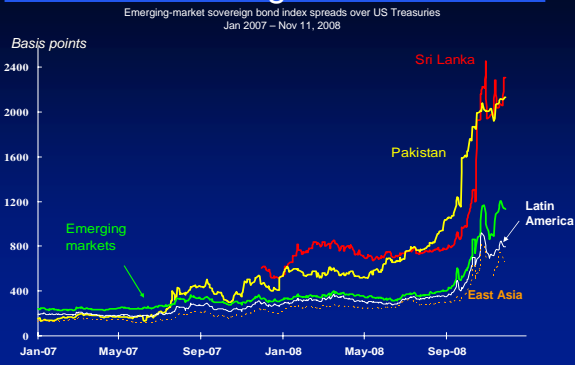
Emerging-market bond spreads surged, sharply tightening credit

Emerging-market sovereign bond spreads

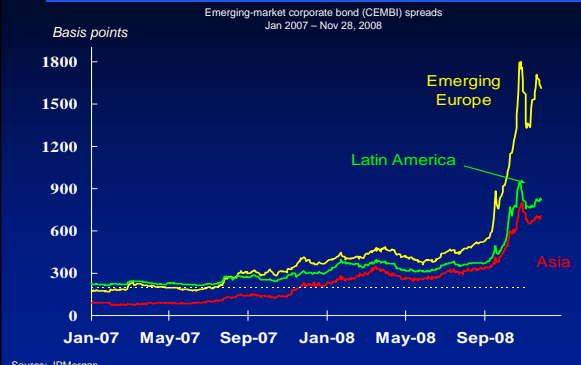


Source: JPMorgan-Chase

...Emerging-market bond spreads surged



As did corporate bond spreads...



Massive liquidity infusion has lowered interbank rates, but spreads remain high

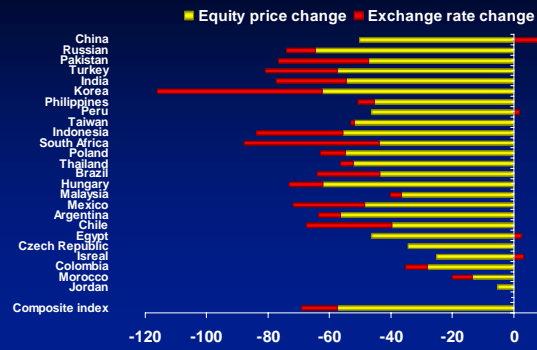


Emerging-market equities hit hard



... Emerging-market equities hit hard

Percent change in equity prices in \$US since Nov 1, 2007



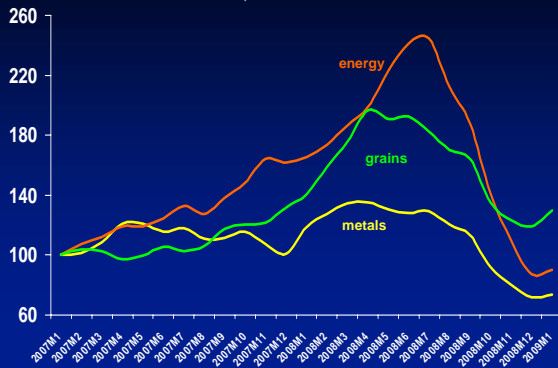
And capital flows have dried up

Gross capital flows to emerging markets

\$ billion	2007				2008				
	H1	Q3	Q4	Total	H1	Q3	Q4	Dec	Total
Total	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

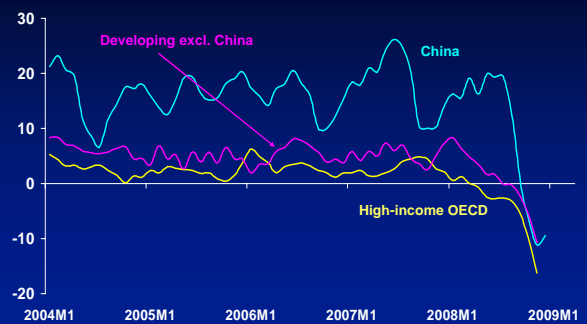
Commodity prices have plunged

index; 2007M1 = 100

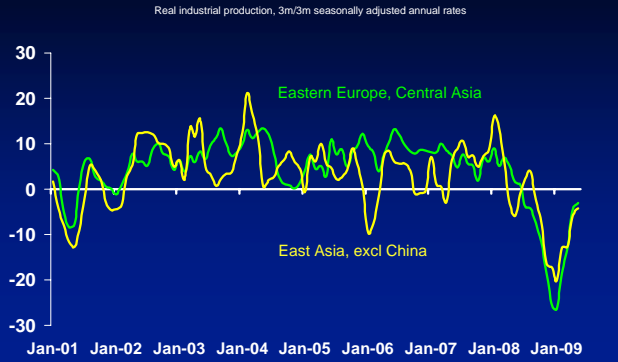


Emerging-market output growth slowing sharply

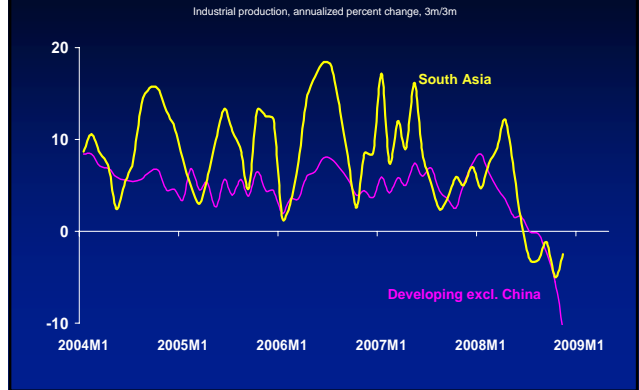
Industrial production, annualized percent change, 3m/3m



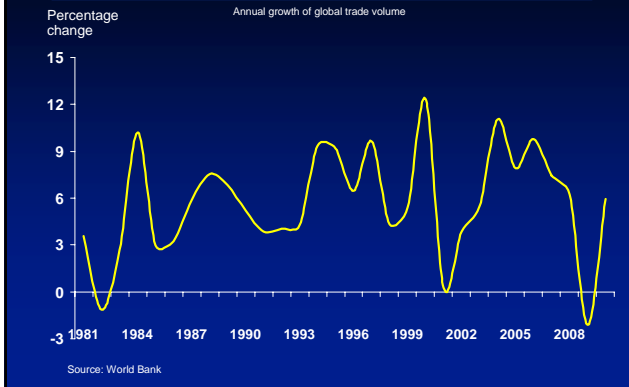
East Asia & Eastern Europe hit hardest



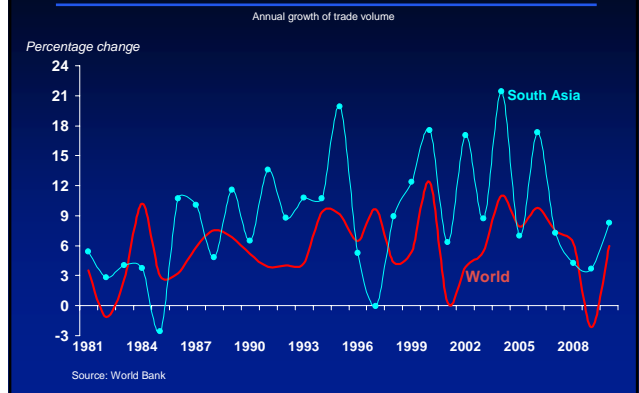
Output growth slowing sharply in South Asia

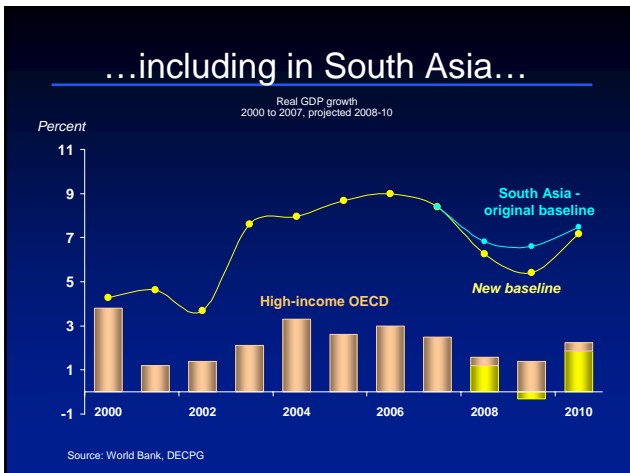
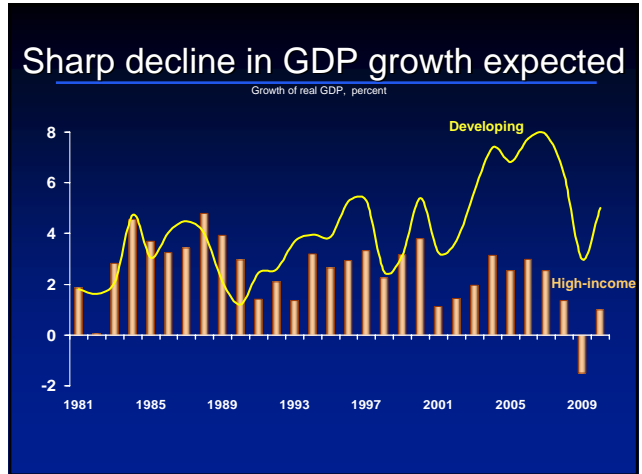


World trade expected to contract for first time since 1982



...with a slowdown for South Asia





A competition of misery: global GDP growth

Growth of real GDP, percent

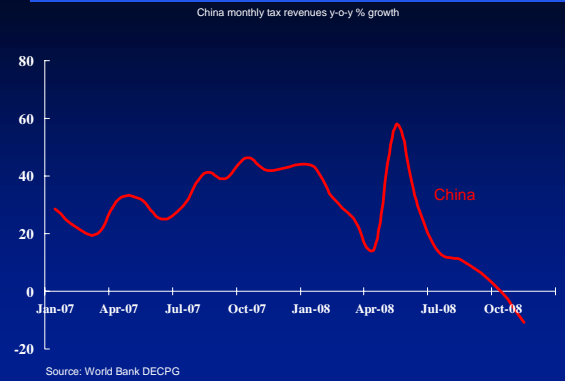
	Consensus estimate for 2009 (made in June 2008)	Consensus estimate for 2009 (made in Dec 2008)	Worst case 2009	2010
World at ppp	3.7	0.7	0.0/-0.5	2.2
USA	+1.2	-1.8/-2.2	-2.5/-3.0	0.7/1.3
Japan	+1.5	-1.6	-2.5	0.2
Eurozone	+1.3	-1.8/-2.5	-3.5	0.6
Germany	+1.7	-2.5%	-3.8	0.4
France	+1.3	-1.5/-2.5	-2.8	0.4
Italy	+0.8	-1.8/-2.5	-3.5	0.3
Spain	+1.2	-1.3/-2.3	-4.0	0.4
UK	+1.1	-2.3/-2.7	-3.8	0.2
China	+9.6	+7.3/6.0	+5.0	+7.0
India	+8.3	+6.1/+5.6	+4.5	+6.5
Russia	+5.5	+2.5/+1.5	0.0/-1.5	+3.0
Brazil	+3.8	+2.4/+1.8	+0.5	+3.0
Turkey	+2.5	+1.0/0.0	-3.0	+2.0
Poland	+3.8	+2.2/+1.2	+0.5	+2.0
Hungary	+0.8	-1.5/-2.0	-3.3	+0.5
Czech Republic	+4.3	+2.8/+2.5	+1.0	+2.5
South Africa	+3.5	+2.3/+1.8	+0.8	+2.5

Source: Global Economic Outlook 2009-10, Economist Intelligence Unit, Corp. Network, Jan 2009.

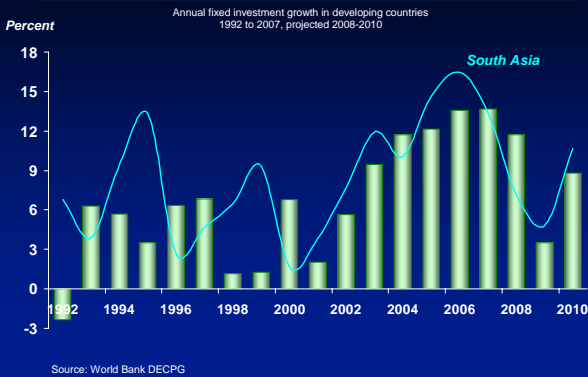
South Asia: GEP 2009 macro projections

Country forecasts (GDP measured in constant 2000 US\$)	Est.			Forecast			
	91-00	2005	2006	2007	2008	2009	2010
Bangladesh							
Real GDP growth (annual %)	4.8	6.0	6.6	6.4	6.2	5.7	6.2
Current account bal (% GDP)	-0.4	-0.3	2.0	1.2	0.8	0.7	0.7
India							
Real GDP growth	5.5	9.2	9.7	9.0	6.3	5.8	7.7
Current account bal	-1.2	-1.0	-1.0	-1.2	-3.1	-1.7	-1.9
Nepal							
Real GDP growth	5.0	3.1	3.7	2.6	5.5	3.8	4.9
Current account bal	-6.3	0.0	-0.1	-1.2	1.2	1.0	0.8
Pakistan							
Real GDP growth rate	3.9	7.7	6.2	6.0	6.0	3.0	4.5
Current account bal	-3.7	-3.3	-5.4	-5.8	-8.1	-4.6	-3.2
Sri Lanka							
Real GDP growth	5.2	6.0	7.7	6.8	6.3	4.0	5.5
Current account bal	-4.6	-3.2	-5.3	-4.4	-7.5	-5.7	-5.5

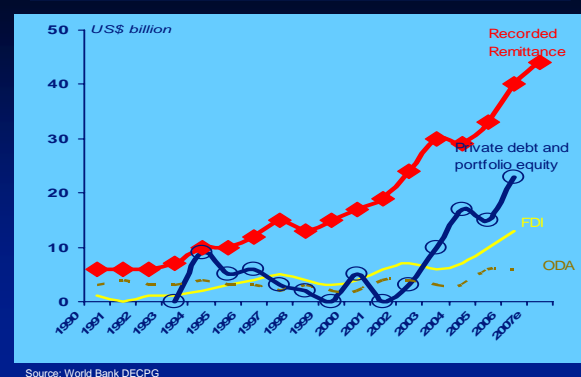
Tax revenues bound to fall sharply



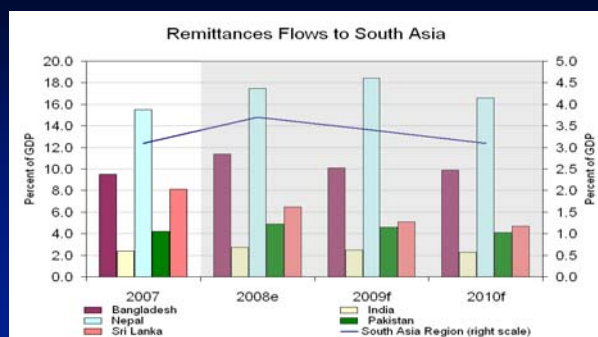
Investment will lose force in developing countries...



Remittances critical for South Asia



Outlook for remittance flows remains positive but could be impacted further



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Immediate policy responses

- Ensure adequate liquidity in both domestic & foreign currency, reduce scope for currency mismatches
- Deploy countercyclical fiscal policy to the extent feasible, particularly emphasizing infrastructure and safety nets
- New tax or revenue measures as part of fiscal stimulus packages – are they timely, temporary, and targeted?
- Strengthen crisis preparedness - contingency planning, reassess legal powers of authorities, close monitoring of financial institutions and re-examine deposit insurance/guarantees on bank debt
- Supplement with international policy coordination

Medium-term policy challenges

- Accelerate ongoing efforts to deepen and develop domestic financial markets; fill missing markets, make public expenditures more effective
- Address weaknesses in institutional and regulatory infrastructure
 - bank restructuring and asset resolution frameworks
 - credit bureaus and rating agencies
 - prudential regulations
 - payment and settlement systems
- Design and put in place well-targeted safety nets

Emerging lessons from the crisis

- South Asia's financial markets much more integrated with global markets than ever thought before
- Greater emphasis needed on domestic market reforms, improving investment climate, labor market functioning, financial market deepening, safety nets implementation, to respond to external shocks
- Financial supervision needs to keep up with financial innovation
- Public expenditure effectiveness a must and fiscal space should be built up systematically to deal with crisis
- Coordinated responses among governments, regulators, and countries can pay off

Risks for South Asia

- A deeper and more prolonged credit crunch and global recession
 - contraction in investment and exports (beyond a sharp slowdown in growth)
 - FDI and remittance inflows could fall-off markedly instead of moderately
 - Weaknesses in domestic banking sectors could emerge
- Quicker global recovery
 - Inflationary pressures could return to the forefront
- Failure to protect growth in either situation would have major adverse consequences for poor people

Thank you

For additional World Bank resources and information on the global financial crisis and for a free download of the

Global Economic Prospects 2009, please refer to

www.worldbank.org/gep2009

www.worldbank.org/gem