

# The Global Economy and South Asia: Crisis Impact and Policy Options

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# Outline

1. Global Crisis
2. Impact on Asia
3. South Asia's Challenges
4. Policy Options
5. Flashback to 1930's: Is history repeating?

# 1. Global Crisis

- Global financial imbalances combine with product innovation, hunt for yield, seamless international markets, and lax regulation...
  - ...to form asset bubbles, unsustainable leverage, shadow financial system, and widely dispersed risk
- 
- Why US subprime went global (or “How did the tail wag the dog?”)
  - De-leveraging and credit crisis pummel real global economy
  - Are we headed for a “Great Recession?”

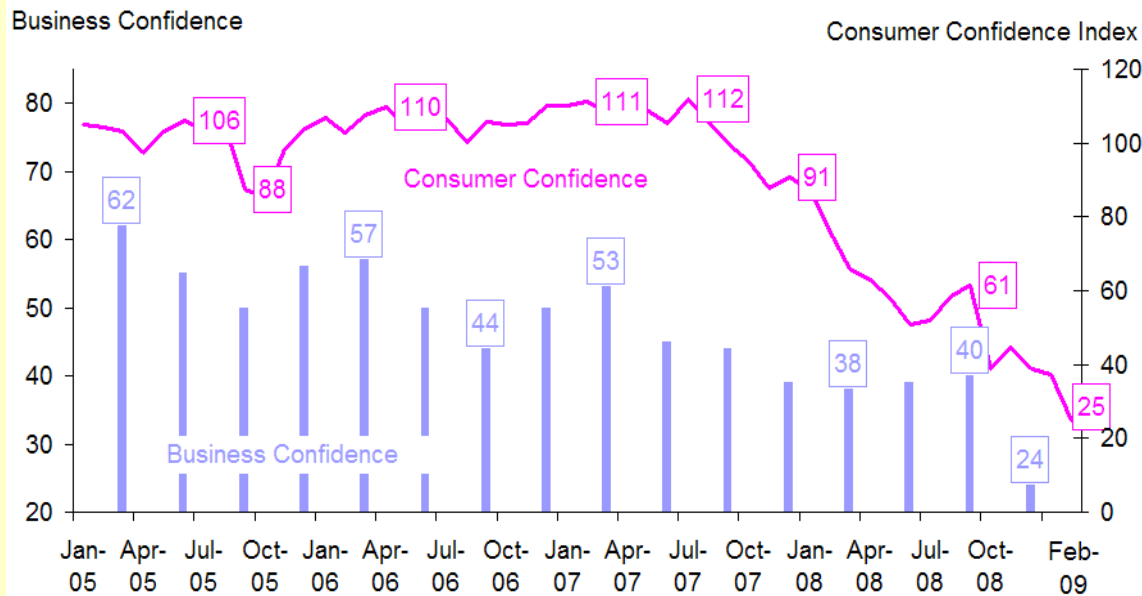
# Why US subprime went global (or How did the tail wag the dog)?

US subprime only 3% of US financial assets—  
why was everyone affected?

- Excess global leverage—\$1 of subprime-related losses forced \$12 to \$50 of asset liquidation
- Asymmetric information—panicked sell offs hit other asset classes
- It was always global—European banks were even more highly leveraged
- Flight to quality—volatility meant return of exchange rate risk

# US economy still dominates... (with a quarter of global GDP)

## US Business and Consumer Confidence Indexes



Notes:

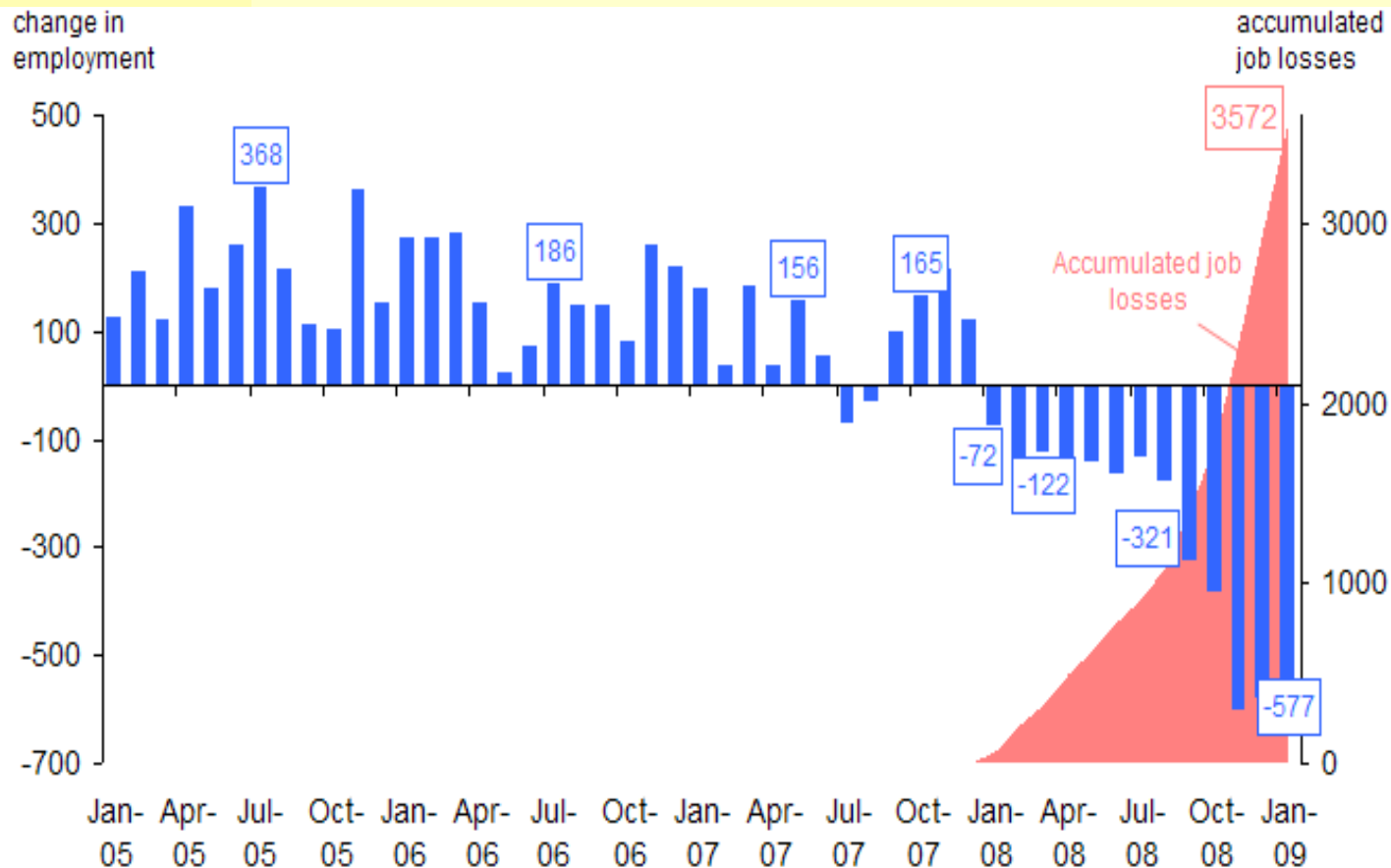
1. Consumer Confidence (1985 = 100).
2. A business confidence index above 50 means there are more positive than negative responses.
3. Consumer Confidence is monthly, business confidence is quarterly.

Source: Datastream.

- Falling income and financing constraints dampen business and consumer confidence
- G3 well into recession. IMF predicts world growth at 0.5% or even negative in 2009

# ...with increasing job loss crimping consumer spending

## Change in US Non-Farm Employment<sup>1</sup> (in thousands)



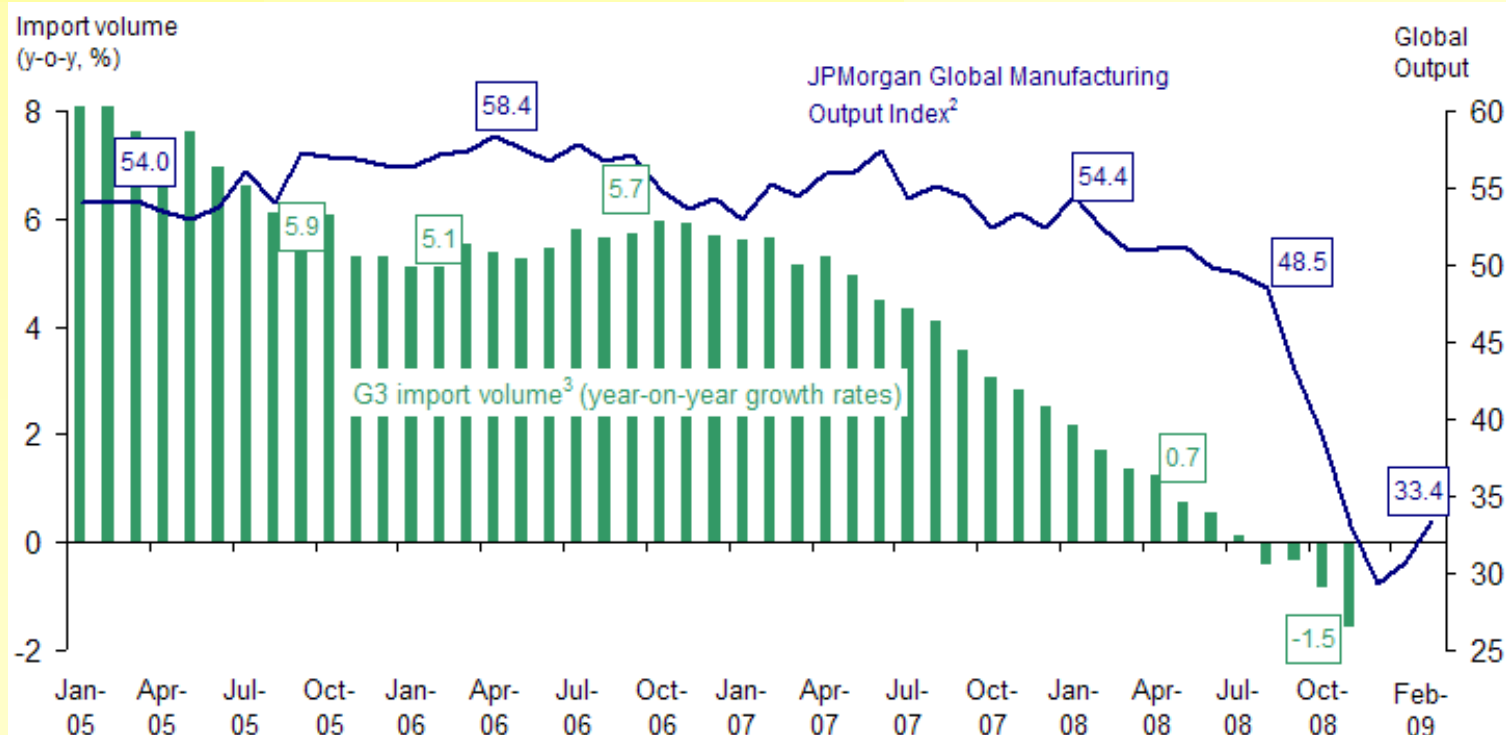
<sup>1</sup> Accumulated job losses since December 2007. December 2008 & January 2009 figures are preliminary.

Source: OREI staff calculations based on US Department of Labor Bureau of Labor Statistics data.



# World trade slows sharply as G3 demand weakens...

## Global Manufacturing Output and G3 Import Volume<sup>1</sup>



<sup>1</sup> Annual growth rate.

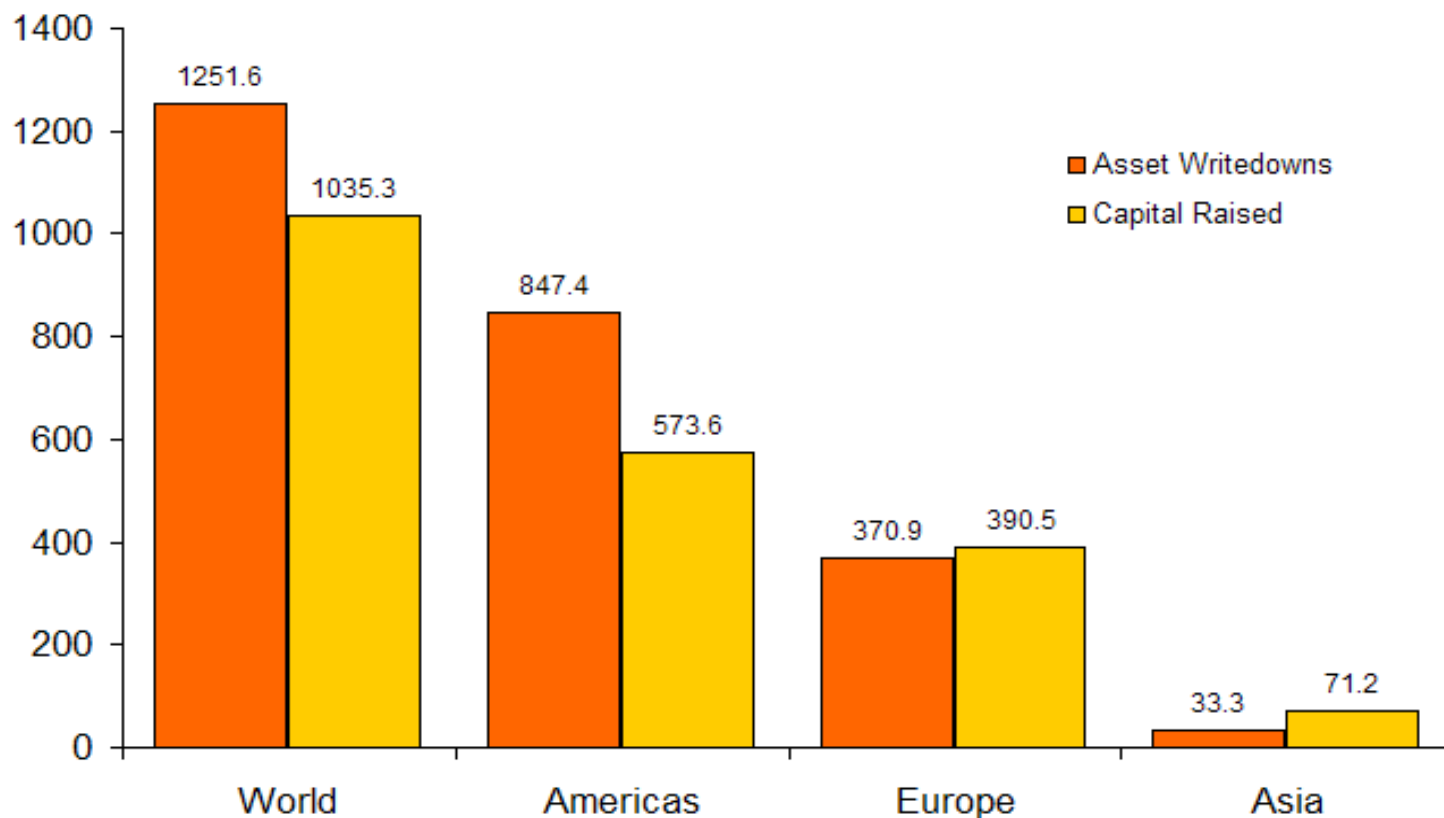
<sup>2</sup> A component of the JPMorgan Global Manufacturing Purchasing Managers' Index (PMI), which serves as an indicator of global manufacturing business conditions, based on data collected from surveys around the world. A reading above 50 indicates an increase in the variable since the previous month and below 50, a decrease.

<sup>3</sup> G3 12-month moving average growth rates were aggregated using import values in US\$.

Sources: OREI staff calculations based on data from *International Financial Statistics*, International Monetary Fund; Bloomberg; JP Morgan; and Datastream.

# Direct and indirect losses from US subprime go global—but with less effect on Asia

Writedowns and capital raised by major banks since the third quarter of 2007<sup>1</sup>  
(\$ billions)



<sup>1</sup> As of 19 March 2009  
Source: Bloomberg.



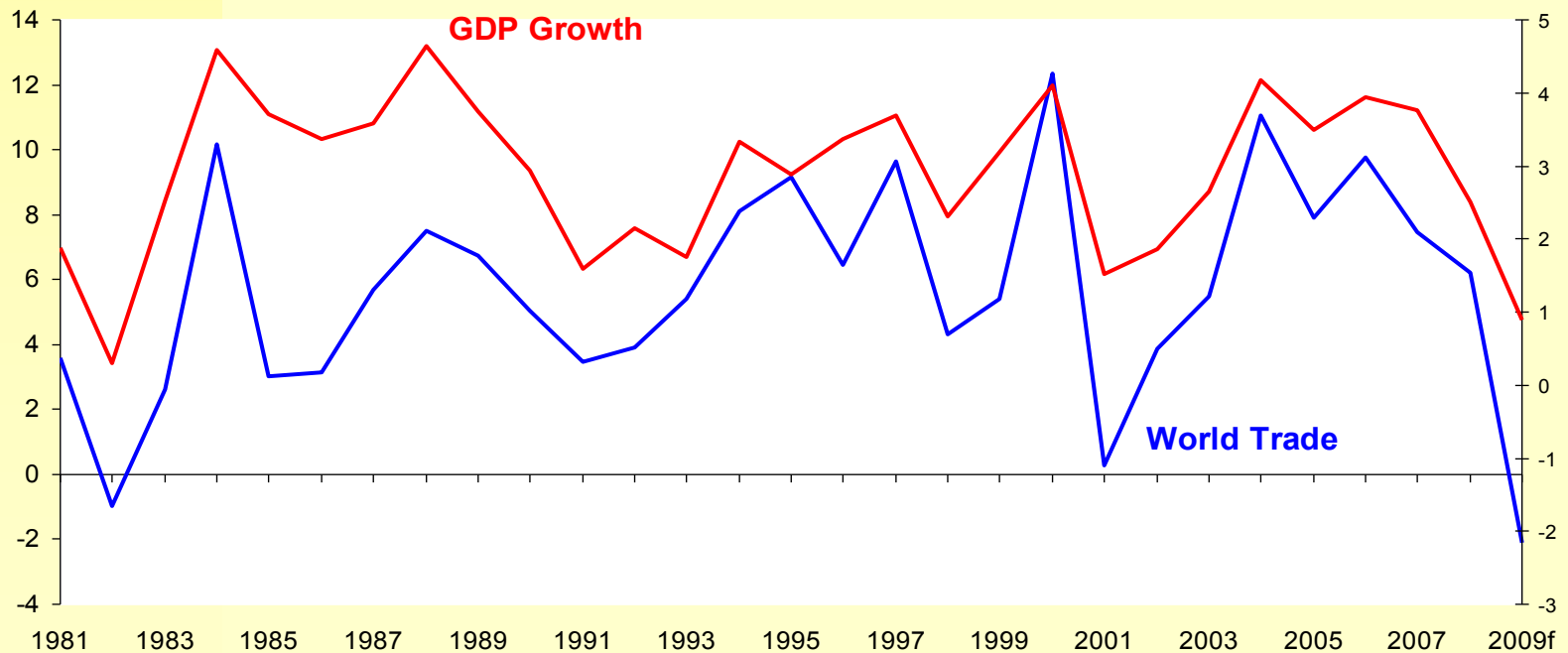


# What can we expect globally?

- Global downturn could be deep (and may be prolonged)
- Turnaround expected late 2009 or early 2010
- World trade volumes expected to contract for the first time since 1982
- Immediate pressure for coordinated stimulus from G20
- Intensified talks on regulatory framework

# Worst recession since WWII...for now

World Trade Volume<sup>1</sup> and GDP(y-o-y change, %)



<sup>1</sup> Export Volume.

Source: World Bank, Global Economic Prospects 2009.

## 2. Impact on Asia

- The more integrated and globalized, the harder the crisis hits
  - Growth down as slow export demand affects industrial production
  - Capital flows become volatile
  - Stock prices plummet
  - Currencies tumble against the US dollar and more so against yen
  - Sovereign bond spreads widened, indicating heightened credit risk

# GDP growth to slow further in 2009...

## Annual GDP Growth Rates (%)

			ADB Forecasts December 2008		IMF Forecasts January 2009	
	2006	2007	2008	2009	2009	2010
<b>Developing Asia</b>	8.9	9.0	6.9	5.8	3.1	5.9
<b>Emerging East Asia</b>	8.7	9.0	6.9	5.7	2.7	5.8
China, People's Rep. of	11.6	11.9	9.5	8.2	6.7	8.0
NIEs-4	5.5	5.6	3.5	2.4	-3.9	3.1
ASEAN-5	5.7	6.3	5.2	3.8	2.7	4.1
<b>South Asia</b>	8.9	8.6	6.8	6.1	...	...
India	9.6	9.0	7.0	6.5	5.1	6.5
Pakistan	5.8	6.8	5.8	3.8	...	...
<b>Central Asia</b>	13.4	11.6	7.3	7.7	...	...
<b>Pacific</b>	2.2	2.4	4.8	3.4	...	...
<b>Japan</b>	2.0	2.4	0.5	-0.2	-2.6	0.6
<b>US</b>	2.9	2.2	1.4	-0.7	-1.6	1.6
<b>eurozone</b>	2.8	2.6	1.2	-0.5	-2.0	0.2

... = not available

Sources: Asian Development Bank; World Economic Outlook Update, International Monetary Fund (January 2009); and various national government sources.



# ...a sharper US recession could reduce Asia's growth even further

## Change in GDP growth from previous year

Recession Period <sup>a</sup>	Year	US	EU <sup>b</sup>	Japan	India	China, People's Rep. of	ASEAN 4 <sup>b</sup>	NIEs 4 <sup>b</sup>	Developing Asia <sup>c</sup>	
									Median	Mean
<b>Dec 1969 to Nov 1970</b>	1970	-2.45	-1.34	-1.77	-1.38	2.50	-0.03	-2.26	<b>-0.38</b>	<b>-0.51</b>
<b>Nov 1973 to Mar 1975</b>	1974	-6.35	-3.00	-9.26	-2.13	-5.60	-3.61	-7.99	<b>-5.22</b>	<b>-5.55</b>
<b>Jan 1980 to Jul 1980</b>	1980	-3.42	-2.42	-2.67	11.98	0.20	0.23	-4.26	<b>-0.56</b>	<b>0.03</b>
<b>Jul 1981 to Nov 1982</b>	1982	-4.50	0.01	-0.17	-2.53	3.90	-3.50	-1.77	<b>-1.77</b>	<b>-1.80</b>
<b>Jul 1990 to Mar 1991</b>	1991	-2.05	-0.83	-1.85	-4.47	5.40	-1.25	1.04	<b>0.08</b>	<b>-0.16</b>
<b>Mar 2001 to Nov 2001</b>	2001	-2.93	-1.98	-2.55	1.19	-0.10	-3.58	-7.05	<b>-4.43</b>	<b>-5.01</b>
<b>Average for all recessions</b>		-3.62	-1.59	-3.04	0.44	1.05	-1.96	-3.71	<b>-2.05</b>	<b>-2.17</b>
<b>Ratio to US average for all recessions</b>		<b>1.00</b>	<b>0.44</b>	<b>0.84</b>	<b>-0.12</b>	<b>-0.29</b>	<b>0.54</b>	<b>1.03</b>	<b>0.57</b>	<b>0.60</b>

Notes:

<sup>a</sup>Recession intervals defined by NBER.

<sup>b</sup>Computed using GNI Atlas method as weights.

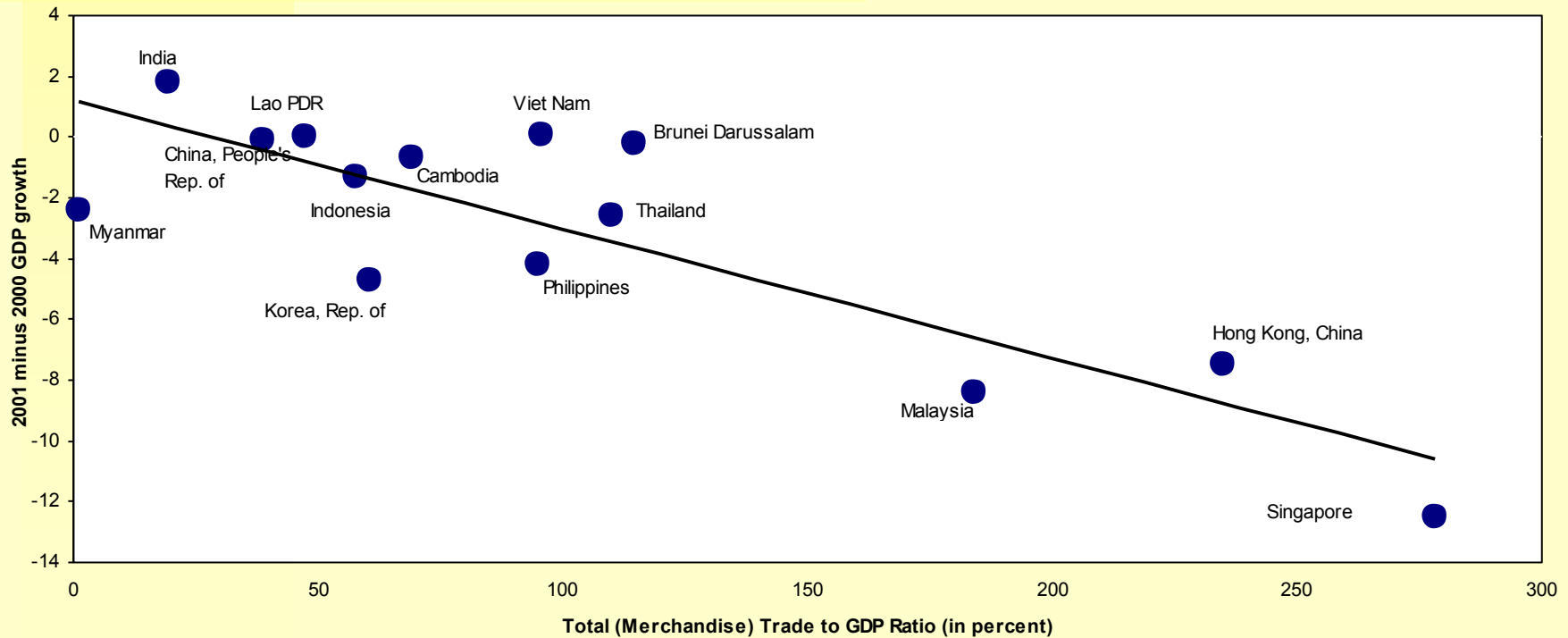
<sup>c</sup>Developing Asia includes China, People's Rep. of; India, NIEs4; and ASEAN4.

Sources: World Bank Indicators Online, and CEIC.



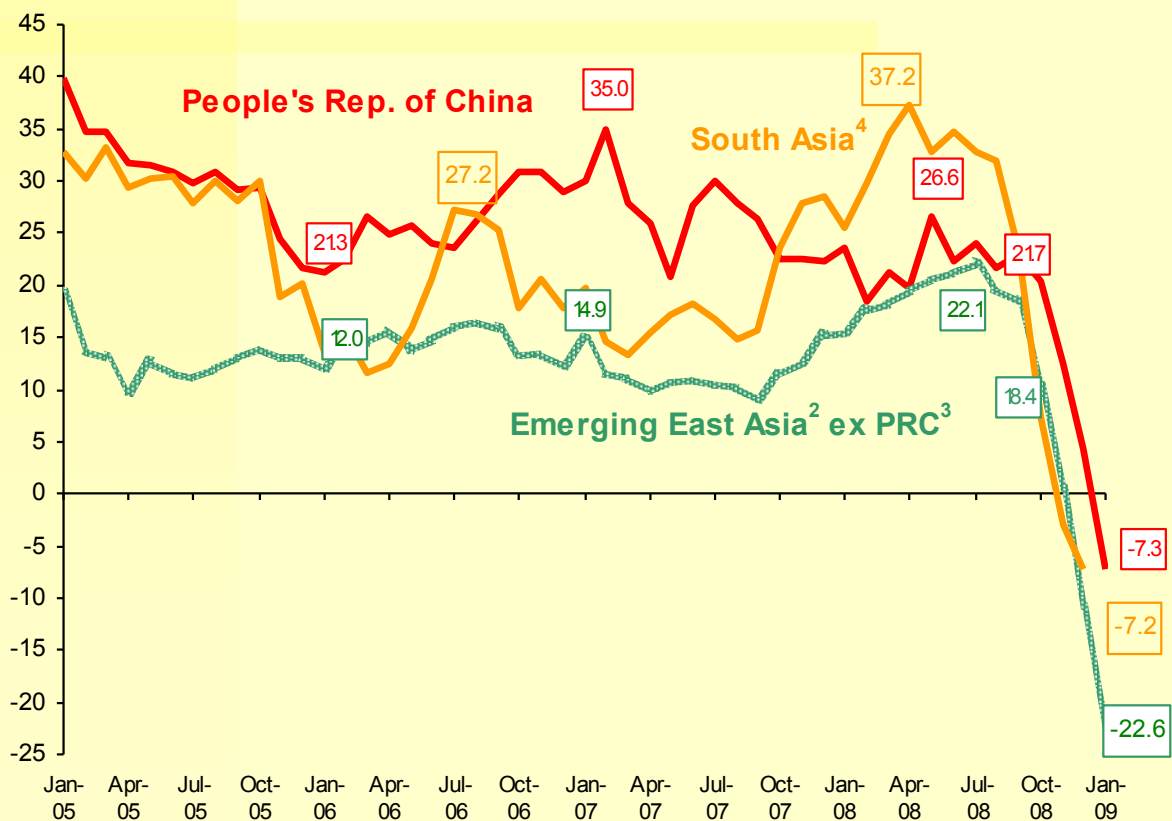
# Historically, exporters slow more...

## Growth Slowdown and Openness



# ...as export demand falters...

Merchandise Export Growth<sup>1</sup> (\$ value, y-o-y, %)



<sup>1</sup>13-month moving average.

<sup>2</sup>Refers to NIEs, ASEAN-4, and Viet Nam; does not include Brunei Darussalam, Cambodia, Lao People's D Myanmar, for which monthly data are not available.

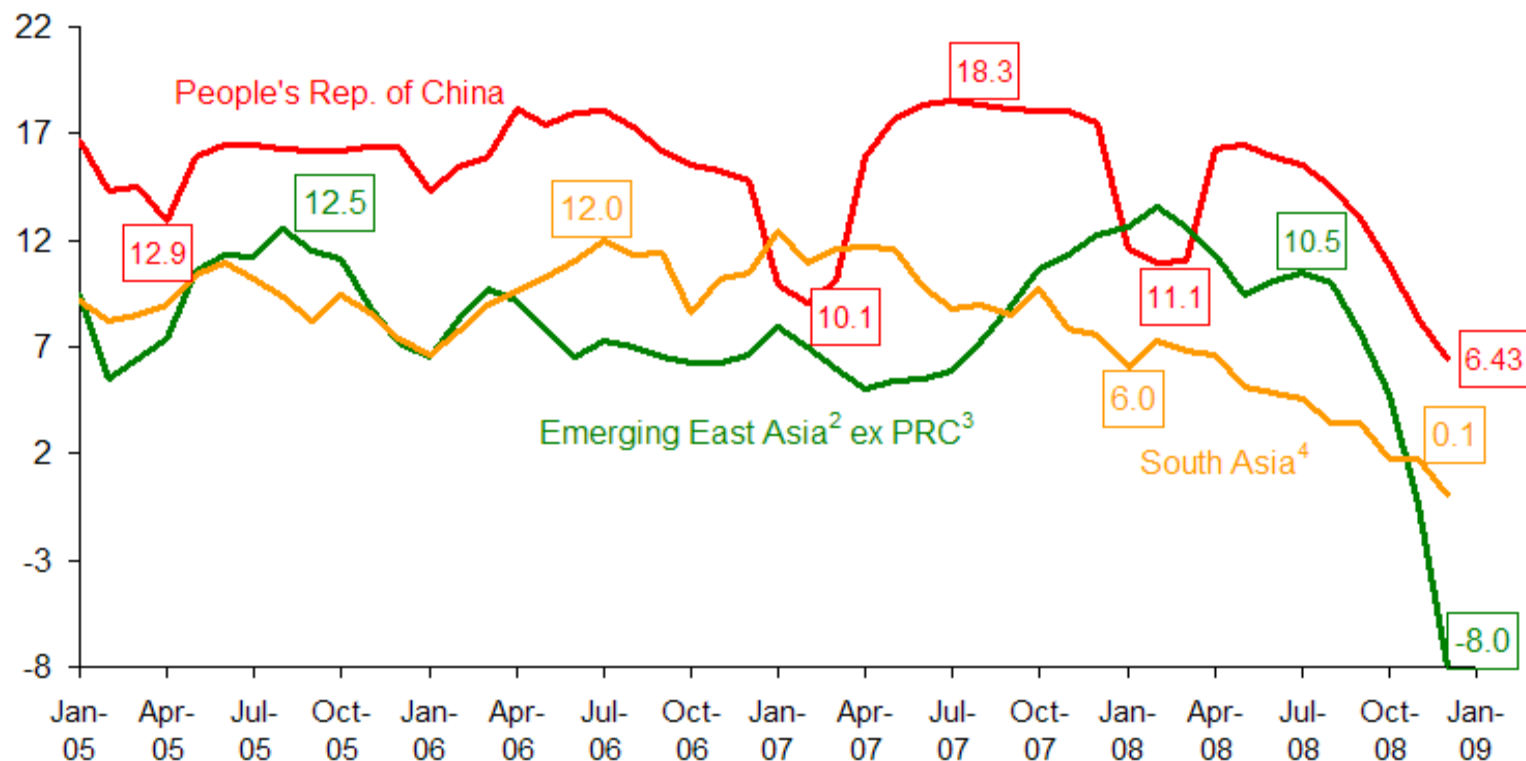
<sup>3</sup>PRC = People's Rep. of China

<sup>4</sup>South Asia includes India, Pakistan, and Sri Lanka.

Source: OREI staff calculations based on CEIC data.

# ...with visible impact on regional production

## Industrial Production<sup>1</sup> (y-o-y, %)



<sup>1</sup> 3-month moving average.

<sup>2</sup> Refers to ASEAN-4; Korea, Rep. of; Singapore; and Thailand; does not include Hong Kong, China; Brunei Darussalam; Cambodia; Lao People's Democratic Republic; Myanmar; and Viet Nam, for which monthly data are not available.

<sup>3</sup> PRC = People's Rep. of China

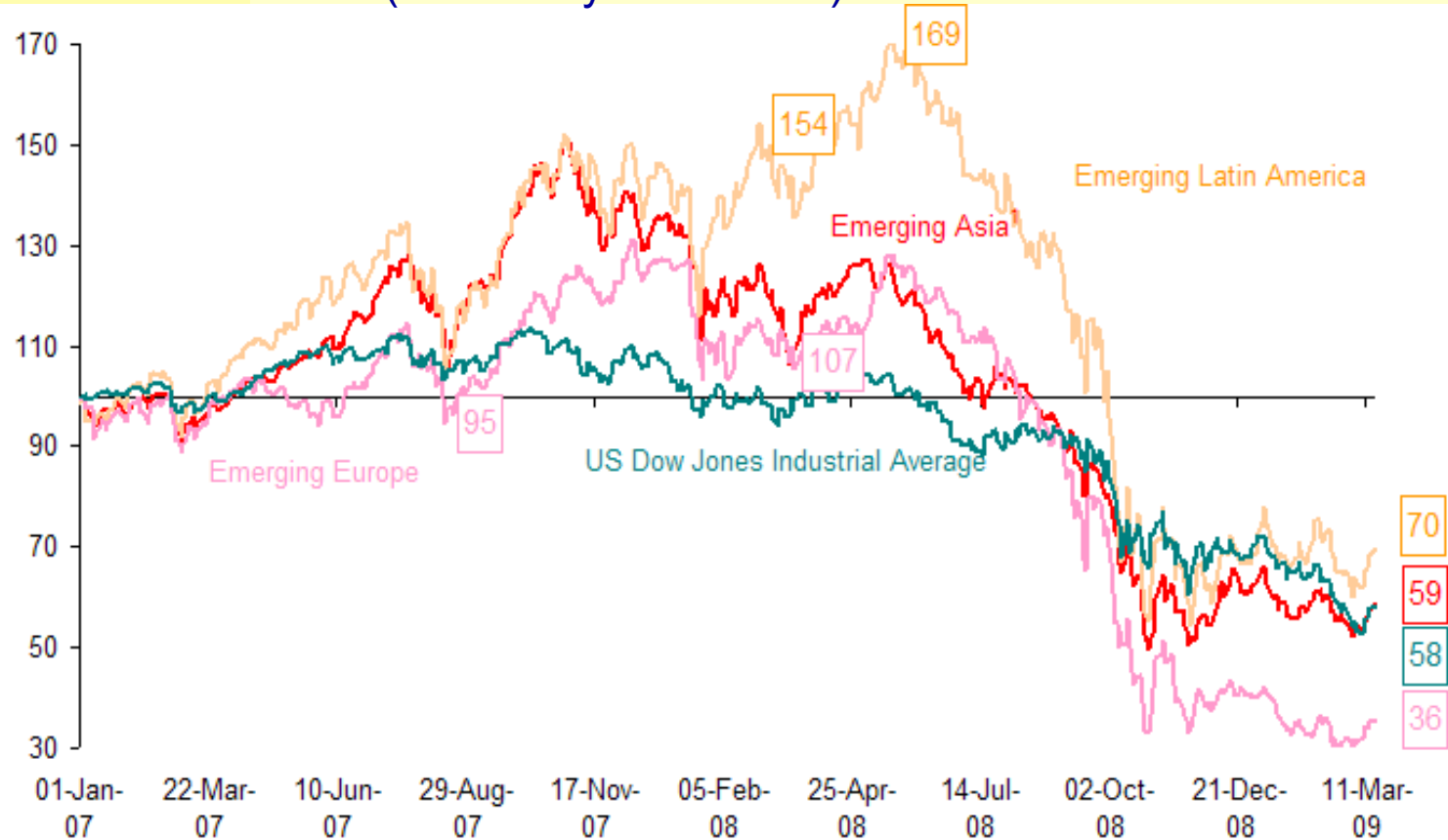
<sup>4</sup> South Asia includes India, Pakistan and Sri Lanka

Source: OREI staff calculations based on Datastream and CEIC data.



# Repricing risk pushes global stocks down

MSCI Indexes (2 January 2007=100)



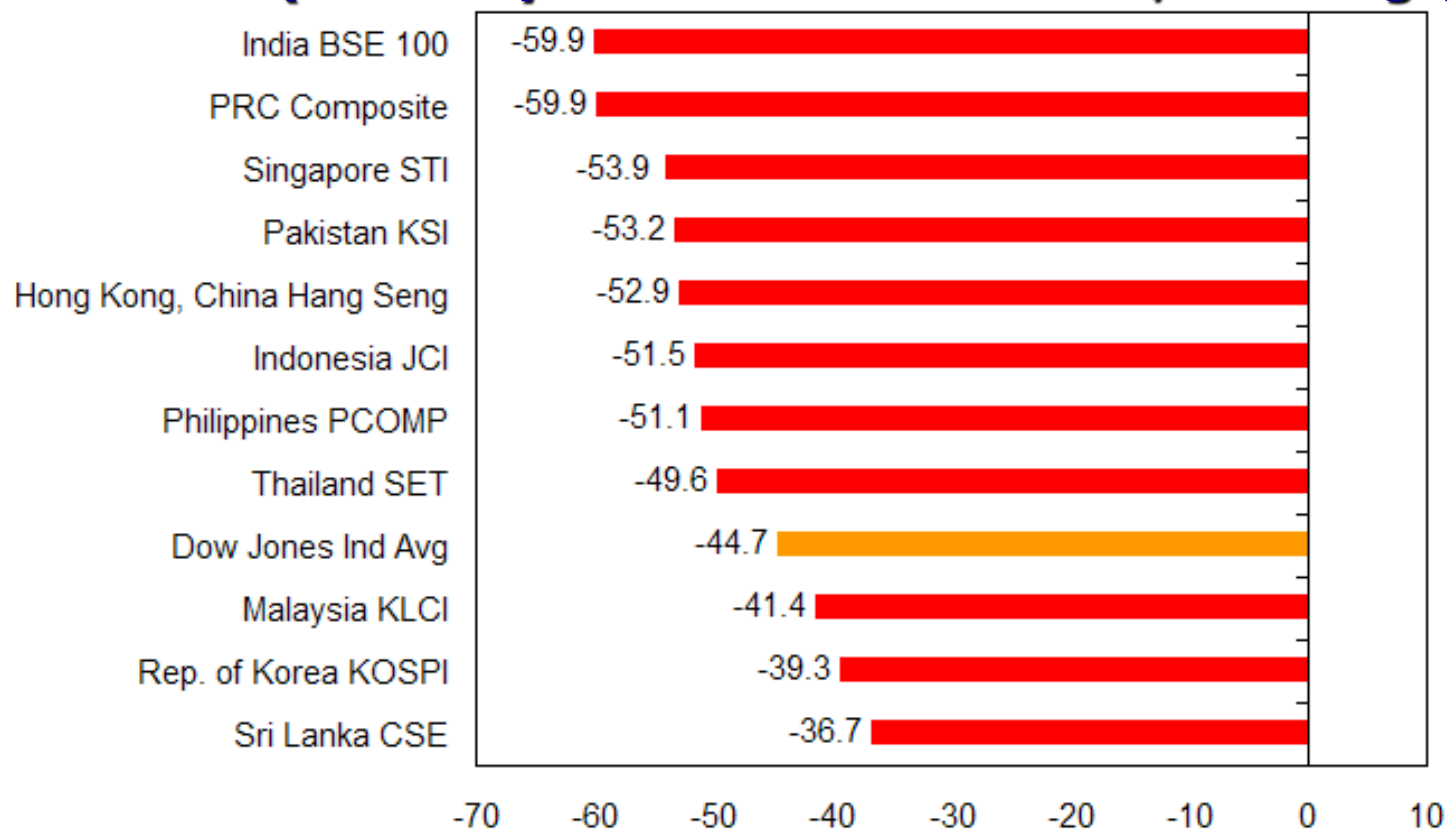
<sup>1</sup> Includes China, People's Rep. of, India; Indonesia; the Republic of Korea; Malaysia; Pakistan; Philippines; Taipei, China and Thailand.

Sources: Morgan Stanley Capital International (MSCI) Barra and Datastream.

# Emerging Asian equities hit hard

Stock Price Indexes

**(2 January 2008 to 16 March 2009, % change)**

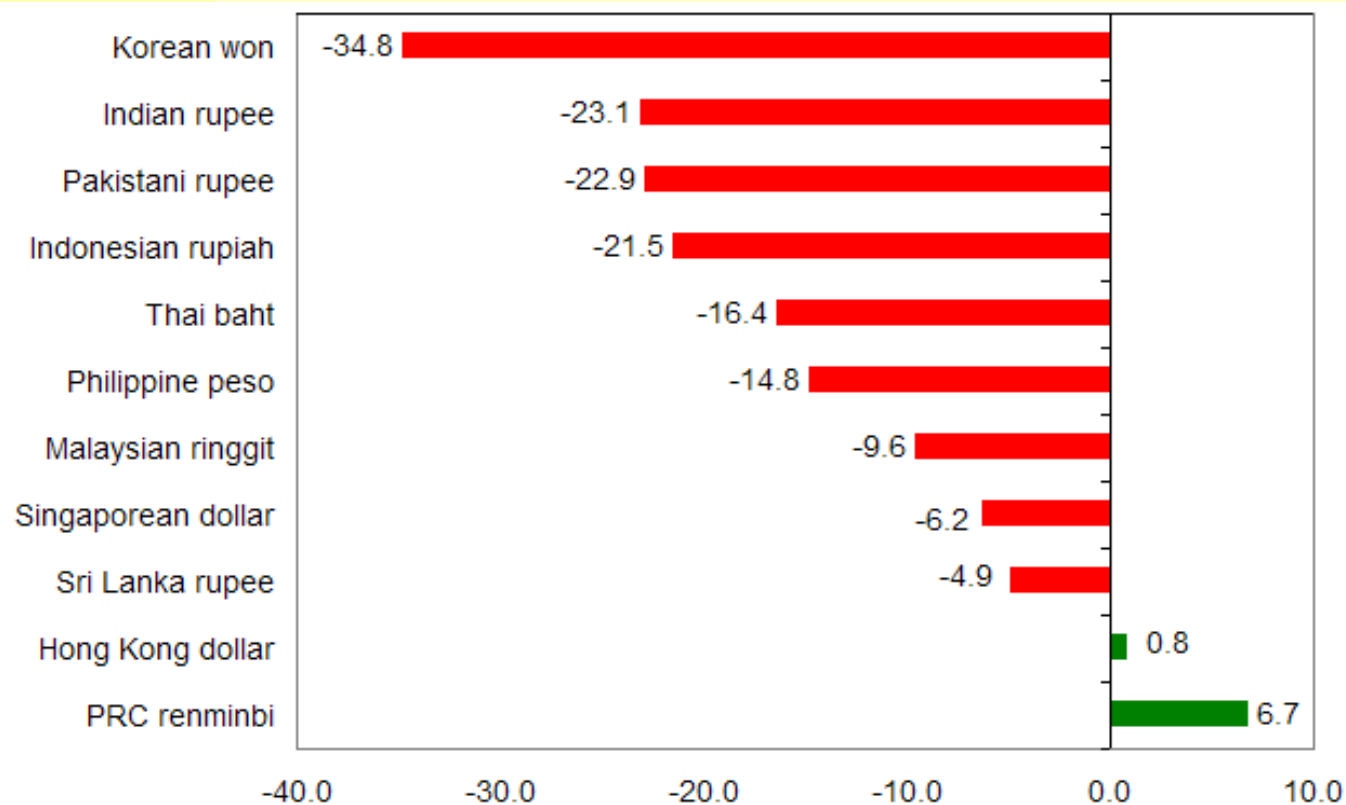


\* In 2008, global stock markets shed close to 50% of its value (or about \$30 trillion);  
Asia's equity markets lost about 51% (or about \$8 trillion).

Source: OREI staff calculations based on Reuters and Bloomberg data.

# Currencies tumble amid flight to safety

Regional Currencies\*  
(2 January 2008 to 16 March 2009, % change)



\* Latest closing as of 16 March 2009, based on the US\$ value of local currency. Negative values indicate depreciation of local currency.

Source: OREI staff calculations based on Reuters data.

### 3. South Asia's Challenges

- Growth decelerating—is there fiscal space?
- Inflation easing, but still a problem for some
- Vulnerabilities remain in several economies
- Transmission channels—trade, tourism, remittances, capital flows (FDI and portfolio)
- Pace of poverty reduction to slow

# Growth decelerating— Inflation easing

	GDP (% y/y)		Inflation (% y/y)		Current Account (% of GDP)	
	2008	2009	2008	2009	2008	2009
Bangladesh	6.2	6.5	9.9	9.0	0.9	0.5
Bhutan	14.4	7.2	10.0	7.0	10.1	2.4
India	7.4	7.0	11.5	7.5	-3.1	-3.6
Maldives	6.5	7.0	11.0	6.0	-50.9	-40.0
Nepal	5.6	5.0	7.9	8.5	1.9	1.5
Sri Lanka	6.0	6.0	24.0	18.0	-8.2	-8.4

Source: ADB ADO Update, Sep 08

Note: *Asian Development Outlook 2009* will be published 31 March...expect significant reduction in growth forecasts.

# Trade channel: G7 dominant destination for South Asia

Exports to the G7, India and PRC China (2006)

% of total exports	G7	India	PRC China	Developing Asia
Bangladesh	71.0	1.6	0.8	5.1
Bhutan	0.1	81.9	0.0	—
India	33.3	-	6.3	20.6
Maldives	30.5	1.8	0.0	48.8
Nepal	NA	66.4	NA	69.5
Sri Lanka	54.9	6.7	0.4	14.3

Source: Collated by Centennial Group from various statistical websites, CEIC and ADB Asian Development Outlook

# Merchandise Trade (% of GDP)

<b>South Asia</b>	<b>2007</b>	<b>Emerging East Asia<sup>1</sup></b>	<b>2007</b>
Bangladesh	18.8	China, People's Rep. of	37.2
Bhutan	54.7	Korea, Rep. of	38.5
India	13.1	Singapore	185.9
Maldives	15.5	Indonesia	26.4
Nepal	9.9	Malaysia	97.5
Sri Lanka	23.9	Philippines	35.0
Pakistan	13.5	Thailand	62.0
<b>South Asia</b>	<b>13.6</b>	<b>Emerging East Asia</b>	<b>49.8</b>

<sup>1</sup> Aggregate value for emerging East Asia includes Brunei Darussalam; Cambodia; People's Republic of China; Hong Kong, China; Indonesia; Republic of Korea; Lao PDR; Malaysia; Myanmar; Philippines; Singapore; Taipei,China; Thailand; and Viet Nam.

Sources: International Financial Statistics, Direction of Trade Statistics and World Development Indicators.

# Tourism expected to stagnate if not decline in 2009

International tourist arrivals (UNWTO)

% y/y	2008			2007
	Jan-Jun	Jun-Dec	Jan-Dec	
World	5.4	-1.3	1.8	6.9
Europe	3.4	-2.5	3.4	5.2
Asia and Pacific	6.3	-2.8	1.6	10.5
South Asia	9.2	-1.1	4.3	9.8
Americas	6.8	1.1	3.6	4.9

Source: Collated by Centennial Group using UN World Tourism Organization data



# Several South Asian economies rely heavily on remittances

## Remittances Outlook - World Bank Forecasts

	Remittance flows in developing countries					
	USD Bn			% annual growth		
	2008	2009	2010	2008	2009	2010
Developing countries	283	280	297	6.7	-0.9	6.1
% of GDP	1.8	1.6	1.5	-	-	-
East Asia and Pacific	62	63	66	7.5	0.4	6.1
Europe and Central Asia	54	53	57	5.4	-0.1	6.4
Latin America and Caribbean	61	61	64	0.0	-0.2	4.4
Middle East and North Africa	35	32	34	7.6	-6.7	5.7
South Asia	51	51	55	16.2	-0.1	8.2
Sub Saharan Africa	20	20	21	6.3	-1.3	5.3

Source: World Bank, Migration and Remittances Team, Development Prospects Group.

Note: The report was released on 11<sup>th</sup> Nov 08.

# FDI may take longer to recover

## FDI Inflows in Emerging Market Countries

USD Bn / % chg	FDI Inflows			Cross border M&As		
	2007	2008	% chg	2007	2008	% chg
World FDI	1833.3	1449.1	-21.0	1637.1	1183.7	-27.7
Developing economies	499.7	517.7	3.6	152.9	177.0	15.8
Asia	247.8	256.1	3.3	81.5	89.4	9.7
PRC China	83.5	92.4	10.7	15.5	20.3	31.0
India	23.0	36.7	59.6	5.6	11.2	100.0
Malaysia	8.4	12.9	53.6	4.5	5.5	22.2
Thailand	9.6	9.2	-4.2	2.9	0.6	-79.3
Singapore	24.1	10.3	-57.3	8.8	17.0	93.2

Source: UNCTAD Press release on 'Assessing the impact of the current financial and economic crisis on global FDI'

Note: Asia refers to South, East and South East Asia

# Net capital flows fell 70% in 2008— What about this year?

Capital Flows into Emerging Asia

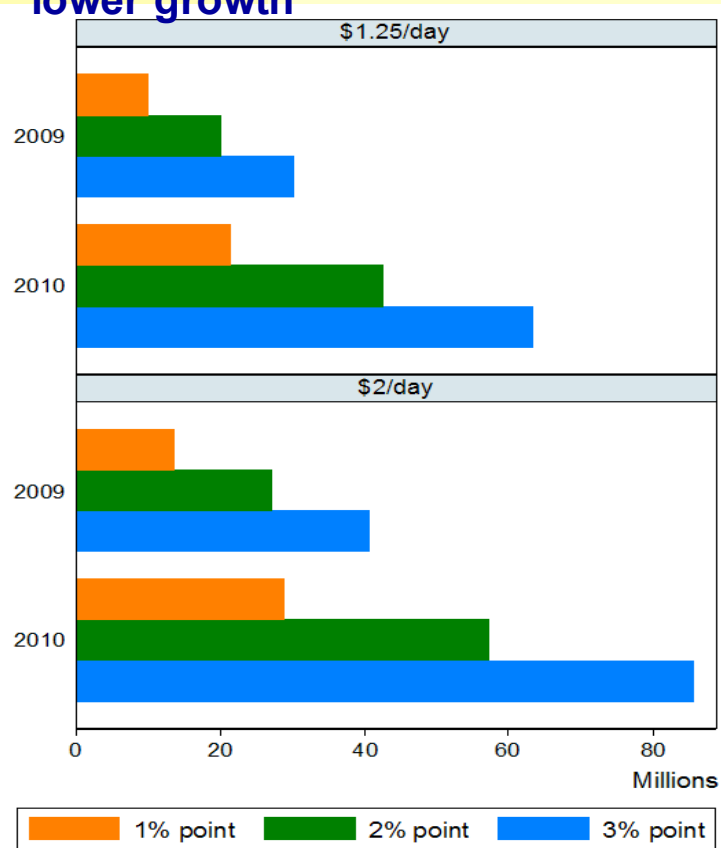
USD bn	2006	2007	2008	2009
External financing	258.9	314.8	96.2	64.9
Private flows, net	122.6	112.9	57.9	85.7
Equity investment, net	122.6	112.9	57.9	85.7
Direct investment	87.2	148.6	112.7	79.3
Portfolio investment	35.5	-35.7	-54.7	6.5
Reserves (Negative implies increase)	-337.5	-587.8	-373.1	-448.3

Source: Capital Flows to Emerging Market Economies, Institute of International Finance, 27<sup>th</sup> January 2009,

Note: Emerging Asia includes PRC China, India, Indonesia, Malaysia, Philippines, Korea, Thailand, Negative flows imply increase in reserves in the year.

# Pace of poverty reduction expected to slow

## Additional number of poor due to lower growth



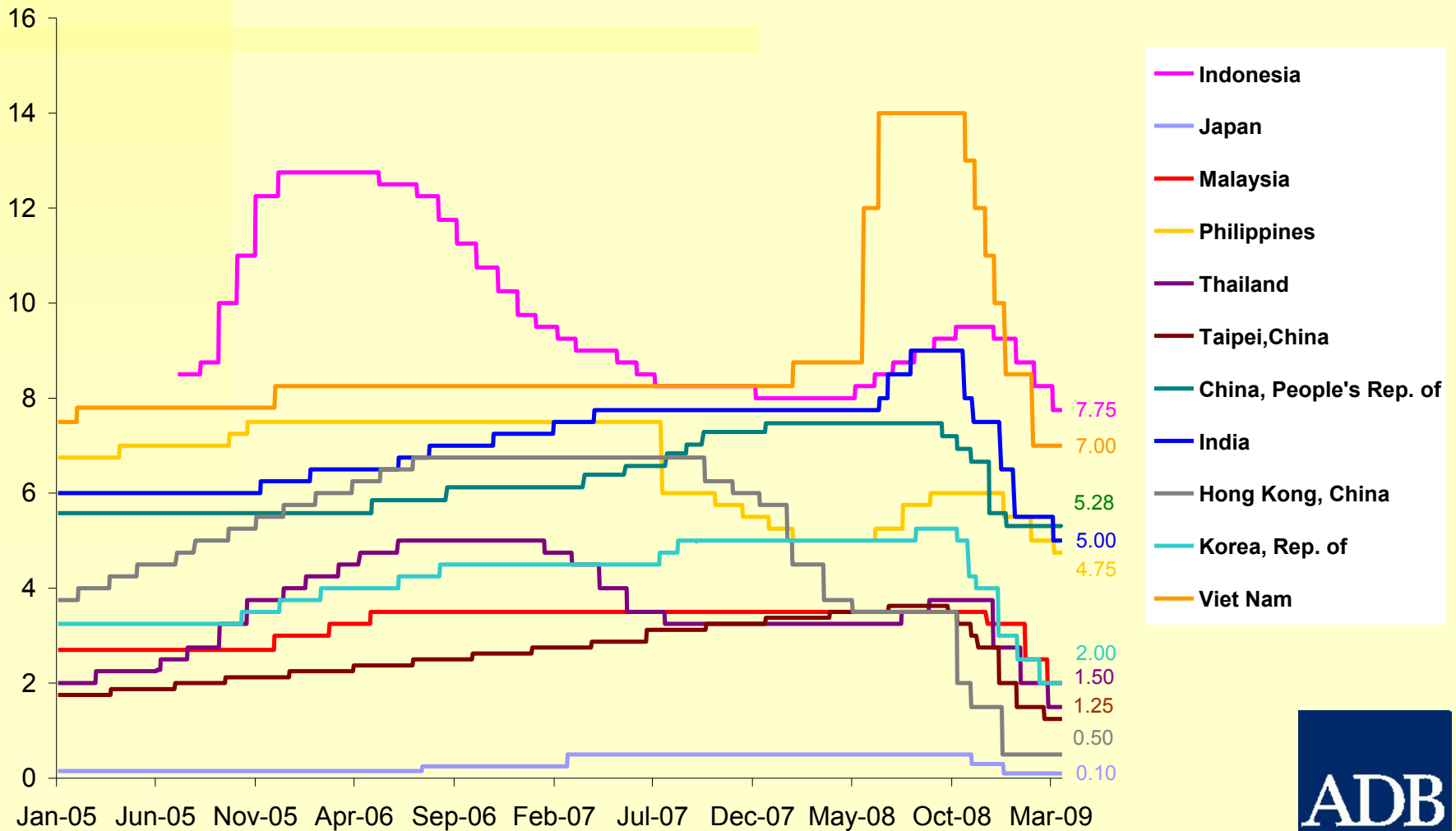
- Simulations show lower GDP growth in 2009 and 2010 will push tens of millions into poverty
- The effects are more dramatic at the \$2/day level than \$1.25/day benchmark

## 4. Policy Options

- Restore financial stability
  - Inject liquidity when needed
  - Revive public confidence
- Combat the growth slowdown
  - Ease monetary policy
  - Implement fiscal stimulus
  - Target physical and social infrastructure
- Revamp financial regulatory framework

# Monetary policy eases...

## Policy Rates (% per annum)



Source: Bloomberg and Datastream.



# Fiscal policy moves center stage...

Table 6: STIMULUS PACKAGES: Selected Countries

Country	Announced Amount of Stimulus	Gross Public Debt	Public Debt, net of International Reserves
	US\$ billion, annual	(% of GDP, 2008)	
China	300 (586) <u>1/</u>	7.1	18
Singapore	6.2	3.2	92
Indonesia	6.3	1.3	17
<b>Korea</b>	10.8	1.1	32
India	8.3	0.7	58

1/Estimated expenditure in 2009. Number in parenthesis reflects announced total package  
Sources: National data; Press Releases; IMF; Eurostat, and own estimates

# Fiscal Stimulus: The Guiding Principles

## Substantial; Timely; Targeted; Temporary

- Stimulus size matters, as does timing—avoid too little too late
- Target projects/programs that yield quick results
- Keep an eye on medium-to-long term fiscal and public debt situation
- The key challenge: Balancing fiscal pump-priming with fiscal sustainability (demand creation vs asset creation)
- Should we “dig” holes and “fill” them up? Perhaps, we can do better than that!



# ...but how much fiscal space in South Asia?

Table 7.2: Fiscal Balance

% of GDP	2003	2004	2005	2006	2007
Bangladesh	-3.4	-3.2	-3.3	-3.2	-3.2
Bhutan	-10.4	1.9	-6.9	-0.8	-3.4
India	-8.5	-7.5	-6.7	-6.4	-5.5
Maldives	-3.4	-1.6	-10.9	-6.7	-7.9
Nepal	-1.4	-0.9	-0.8	-1.6	-2.0
Sri Lanka	-7.8	-8.0	-8.5	-8.1	-7.7

Source: ADB Asian Development Outlook

# Revamp financial regulatory framework (lessons from the current crisis)

- Complexity is not innovation
- Leverage is not credit
- Risk dispersion is not risk reduction
- Market discipline is no substitute for regulation—voluntary regulation does not work
- In good times prepare for bad—case for countercyclical regulation

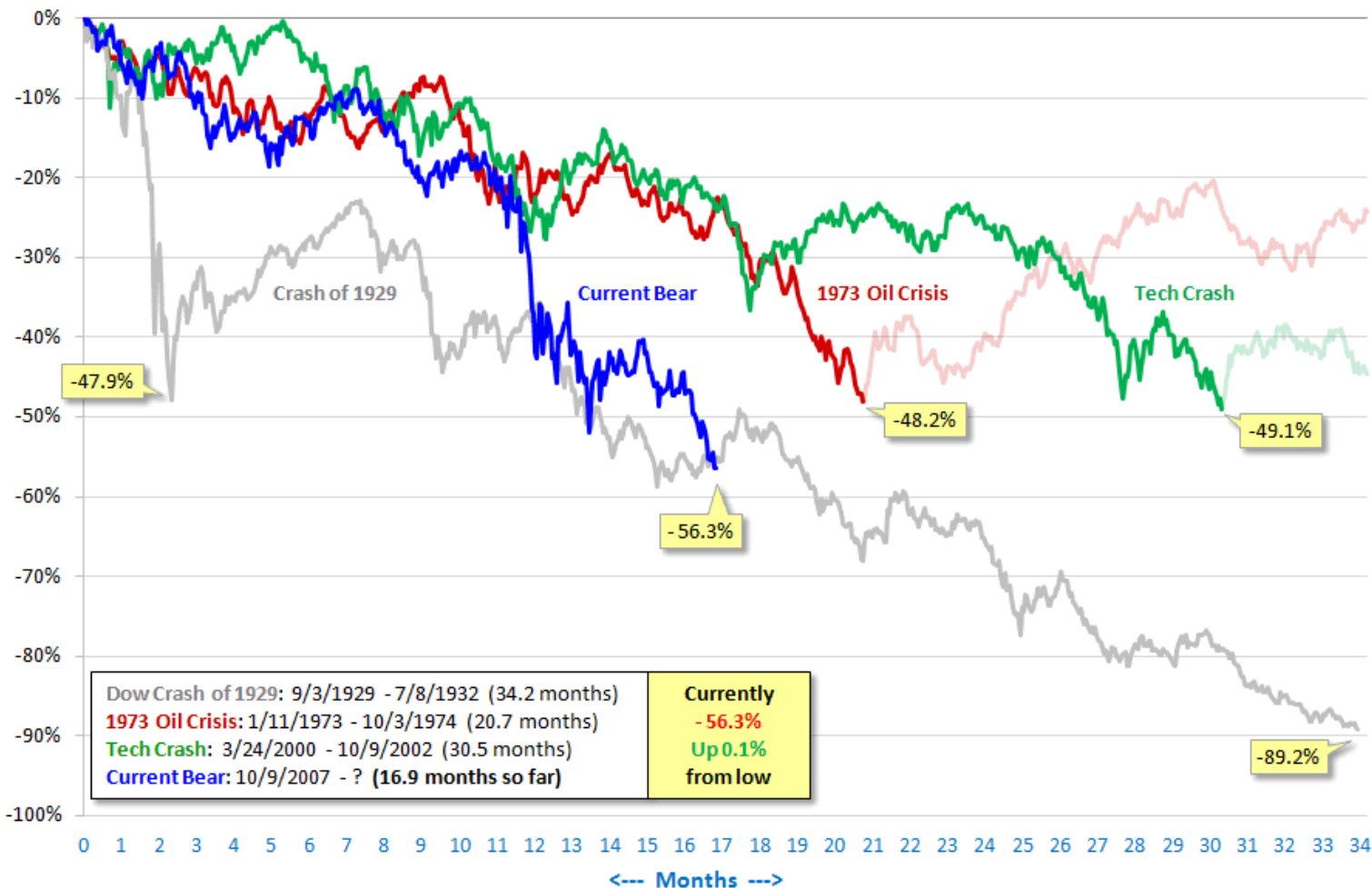
# 5. Flashback to 1930's: Is history repeating?

Four Bad Bear Markets

Dow in 1929-1932; S&P 500 in 1973-74, 2000-02, 2007-09

dshort.com

3/6/2009



# 1930s and Now

## (The Great Similarities)

- Stock market crash
- Bank troubles
- Synchronized global downturn—  
(Great Depression vs Great Recession)
- Sharp rise in unemployment—  
(25% then vs nearing 10% now)
- Loss of confidence

# 1930s and Now

## (The Great Differences)

### Then

- Liquidate
- Pre-Keynes

(passive versus active fiscal policy)

- Dogmatic  
(today better central banks, smarter central bankers)
- Protectionism

### Now

- Recapitalize
- Post-Keynes

Pragmatic

Globalization

# **Thank you!**

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