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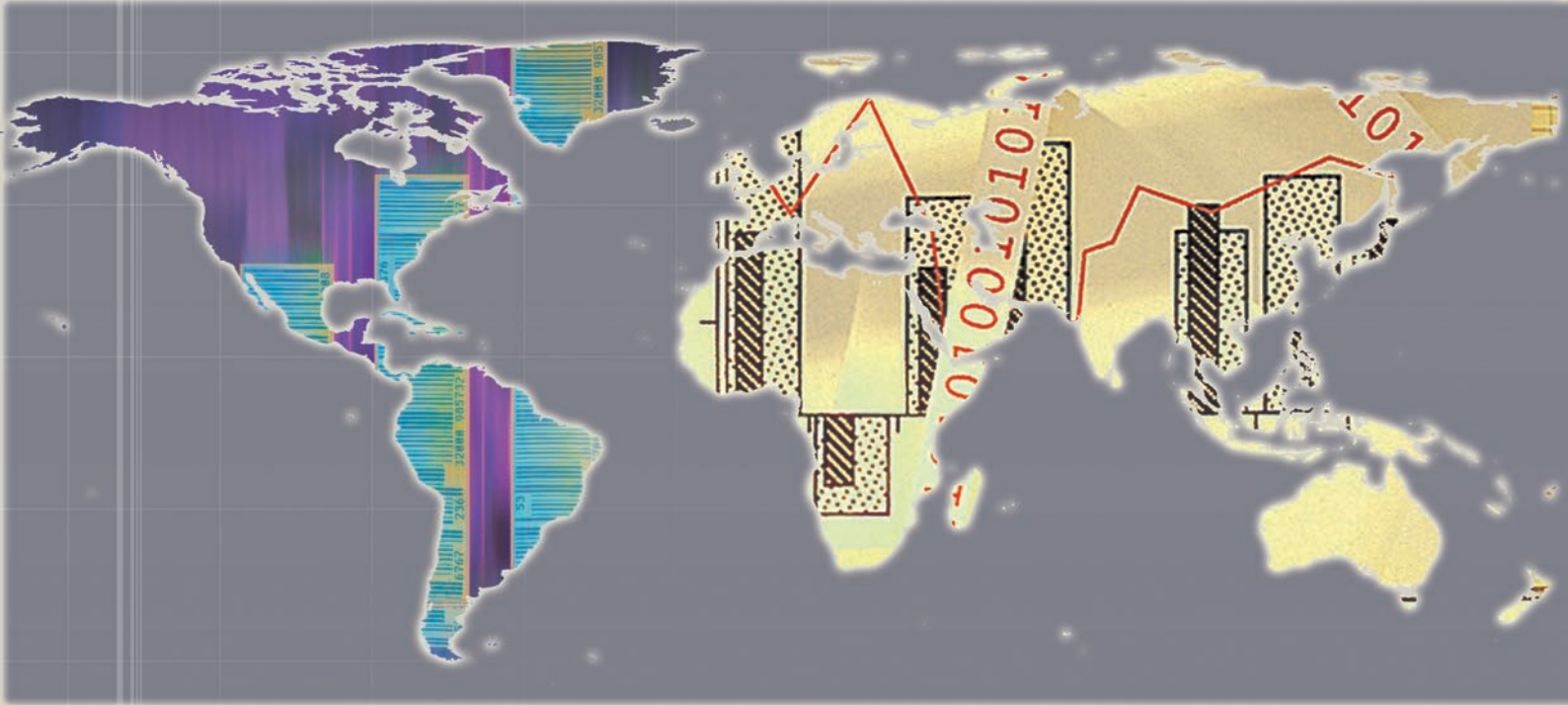
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The Global Financial Crisis and the Developing World: Transmission Channels and Fall-outs for Industrial Development



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The Global Financial Crisis and the Developing World: Transmission Channels and Fall-outs for Industrial Development

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Executive Summary

Over the last three decades, globalization has largely proceeded based on the belief in the self-regulatory capacity of markets without adequate structures and systems in place to govern the process. By mid-2007, this has led, to the appearance of large cracks threatening the stability of the world economy on two fronts: the sharp hike of primary commodity prices and the global financial crisis. The latter is the consequence of the global savings glut and the associated global macroeconomic imbalances, which evolved since the financial crises in the 1990s that severely disrupted economic growth and development in a large number of emerging economies in Asia, Latin America and transitional economies. The flow of large savings into the United States economy, facilitated by the easy monetary condition, led to the housing and credit boom, which had eventually ended in the sub-prime mortgage debacle. Unsurprisingly, in the context of contemporary financial globalization, this seemingly localized phenomenon could not be contained within the United States financial system and rapidly spread to the other major financial centres.

For a year or so since mid-summer 2007, the financial turmoil, with its severe liquidity and credit crunch, seemed to be confined more or less to financial markets and institutions in the United States and Western Europe. On the whole, the world economy managed to maintain its momentum on the back of the buoyant economic growth posted by emerging market economies as well as resource-rich developing economies that enjoyed a commodity boom. However, a series of events that hit major financial institutions on Wall Street in mid-September 2008 shocked the world and altered radically the fate and the course of the globalized economies. The fear of accelerating inflation and fuel and food shortages worldwide was completely overtaken by a greater fear of possible worldwide recession and depression engulfing all economies in the developing world, including emerging market economies in Eastern Europe, Latin America and Asia, as well as low-income developing countries in Africa, Asia and the ECLAC region with limited financial market linkages. No country has been in a position to remain a mere bystander in the fast evolving financial crisis any longer.

By the end of 2008, the world economy had rapidly entered a phase of globally synchronized slowdown and, in the first quarter of 2009, headed towards a global recession. The speed at which the world economy had fallen victim to the recessionary wave of financial turmoil in the United States and Europe caught everyone by surprise. In the second quarter of 2009, some signs were emerging indicating that the worst might be over following the large-scale counter-cyclical policy

packages put in place by a number of larger developed and emerging market economies together with their massive liquidity injections into banking systems to mitigate the scale and depth of the recession. Yet, enormous damage has already been inflicted on the real sector activities resulting, in particular, in a worldwide contraction of industrial production due to the severe global credit crunch and fall in world trade unprecedented in the post-war era.

This paper evaluates the effects of the on-going global financial crisis on the developing world, focusing particularly on possible implications for its industries and welfare. After presenting a brief summary of how the crisis originated and is unfolding, the immediate impact of the financial crisis on the emerging market economies and developing countries is considered. The key transmission channels are examined for emerging market economies filtered through financial market linkages: large scale of currency depreciation, collapse of stock markets prices, escalating cost of bond and debt financing available to them, sharp reduction in international issuance of bonds and syndicated loans as well as in private debt and equity capital flows to these countries and continued high volatility characterizing their asset and currency markets. The key channels, through which the effects of the unfolding financial crisis were transmitted to low-income developing countries, are then examined: precipitous fall in commodity prices, escalating cost of trade finance and their severe difficulties in accessing trade credit altogether in the aftermath of the financial turmoil and marked reduction in remittance flows.

The analysis, then, turns its attention to the recessionary effects of the financial crisis on real economic activities focusing on actual and possible effects on industrial production and welfare implications. After reporting the significant downward adjustments made in prospects for global economic growth, the recent reduction is considered in global trade and industrial production of 44 per cent and 15 per cent, respectively, in the last quarter of 2008, as well as the negative growth rate of manufacturing production in emerging economies, of 12 per cent towards the end of 2008. The paper goes on to make some preliminary assessments of the impact of such conditions on future investment and industrial production.

Investment can be expected to be cut continuously and substantially in the coming months in developing countries, as financial resources underpinning it will be either not available or remain too costly for many corporations and firms. Further, the continued uncertainty in global economic prospects will dampen investment with considerable sunk costs worldwide. As corporate bonds have become a very expensive source for financing, large-scale investment in infrastructure

building or fixed investment in productive capacity will be certainly hit hard in the next few years. Under such conditions, domestic demand weakens, in addition to an expected significant reduction in external demand. Growth in private sector credit or bank lending proves to be always pro-cyclical. Moreover, a number of emerging market economies have responded to massive capital outflows from their markets by tightening monetary policy in the immediate aftermath of Wall Street panic in September-October 2008. This has already worsened domestic credit conditions and reduced balance-sheets of domestic corporations and small-medium enterprises alike, leading to a further dampening of investment demand. In addition to the direct contagion effects from outside, there is a danger in developing economies that a credit crunch could take place in no time, with internally generated forces affecting the domestic banking system through its linkage to asset market prices.

The paper presents a preliminary assessment of the effects of the financial crisis on industries on the basis of limited disaggregated data by industrial subsectors for a number of emerging countries. The paper notes that the fall-outs from the global financial crisis have been felt throughout a wide range of industrial activities irrespective of their nature and size of operations. The analysis also points to some common patterns across countries. Motor vehicles and transport equipment, basic metals and steel, chemical and chemical products, rubber products and construction materials appear commonly in the list of severely affected sectors. These require high rollover financial requirements of considerable size and, hence, tend to be exposed to a vagary of credit crunches. Naturally, significantly weakened domestic investment and consumption demand in the face of high uncertainty is behind the marked decline in production in these sub-sectors. They are typically the sectors that constitute a mainstay of their industrial activities, producing strategic industrial inputs, in the form of intermediate goods such as basic metals or non metal products or steel, as well as consumer durables, such as motor vehicles or electrical and electronic products. The marked contraction in a number of strategic sectors for a relatively short space of time, of some five to six months, presents evidence of the severity of the synchronised recessionary effects as well as a worrying prospect of ripple effects for other activities in the coming months. On the other hand, sectors producing basic consumer non-durables, such as foods and beverages, have so far escaped a contraction in production in all countries examined.

The paper discusses the effects of a considerable slowdown in FDI flows to developing countries. As a particular consequence of the on-going financial crisis, large transnational corporations in

developed countries have been severely affected in their financial capability to invest and expand. Finally, the effect of the financial crisis on the poor is examined, with significant increases in working poverty and vulnerable employment.

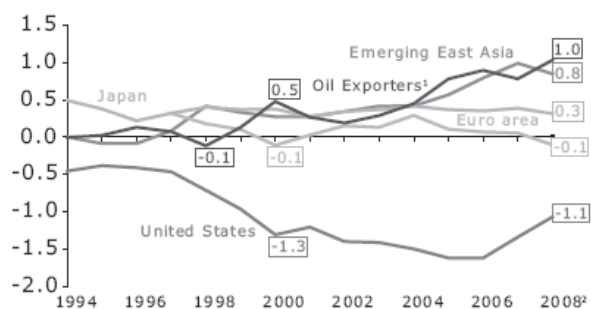
The analysis indicates the extent and the scale of collateral damage that the present financial crisis has inflicted on the developing world, as well as the much more extensive damage entailed by the globally synchronized slowdown and the ensuing global recession. Drawing on the analysis, the paper concludes that the current financial crisis is the outcome of governance as well as market failure. The international monetary and financial system under the current regime is grossly inadequate to take on a task of financial intermediation for productive investment and economic development in the developing countries. From this perspective, the global financial system needs to be reformed and a new international architecture for governing financial globalization created.

1. Introduction

Over the past decades, the world economy has been going through, more or less continuously, a series of strains and stresses in the current wave of globalization. Until recently, however, most of the downside risks of globalization have been borne largely by the developing world. In the 1980s, middle- and low- income developing countries went through a severe debt crisis. The majority of low-income countries had to wait for the resolution of their protracted debt crisis until the heavily indebted poor countries (HIPC) debt relief had culminated in a major reduction of their debt stock under the Multilateral Debt Relief Initiative (MDRI) in 2005. In the early 1990s, most middle-income countries, together with the newly formed transitional economies, were reintegrated into the international capital markets as emerging market economies, through the market-based debt restructuring process under the Brady Plan.

However, emerging market economies have been exposed repeatedly to financial crisis at the mercy of investors' instant decision to withdraw and follow the herd. In particular, they have suffered bitter experiences with currency attacks and collapses, adversely affecting the balance sheets of their financial institutions, corporations and households due to a high degree of liability dollarization, thus, deepening and prolonging the crisis further. Extremely disruptive to economic growth and development, these experiences have made policy makers in emerging market economies aware of the enormous costs that they have to bear from the periphery by participating in the financial globalization process. Consequently, many of them have opted to hold large amounts of international reserves for self-insurance purposes, far in excess of any shortfalls foreseen as a result of current account transactions (Kaltenbrunner and Nissanke, 2009; Jeanne, 2007; Miller and Zhang, 2007). Coupled with the special status accorded to the United States dollar in the international monetary and payment system in the post-Bretton Woods era, the global savings glut (Bernanke, 2005) has led to emergence of global macro imbalances. From the early 2000s the United States economy had become the largest debtor in the world by building up massive deficits in both fiscal and current account balances, which led to the global financial crisis in 2007-2008 (figure 1).

Figure 3 Current account balances (Percentage of world GDP)



¹The oil exporters are Algeria, Angola, Azerbaijan, Bahrain, Republic of Congo, Ecuador, Equatorial Guinea, Gabon, I.R. of Iran, Kazakhstan, Kuwait, Libya, Nigeria, Norway, Oman, Qatar, Russia, Saudi Arabia, Syrian Arab Republic, Turkmenistan, United Arab Emirates, Rep. Bolivariana de Venezuela, and Republic of Yemen.
² Figures for 2008 are estimates.

Source: *World Economic Outlook*, International Monetary Fund.

Source: Asian Development Bank (2008), figure 53.

The flow of large amounts of savings into the United States economy under the easy monetary condition led to the housing and credit boom, which eventually ended in the sub-prime mortgage debacle. Unsurprisingly, in the context of contemporary financial globalization with fully integrated money and capital markets worldwide, this seemingly localized phenomenon could not be contained within the United States financial system. The first global financial crisis of the twenty-first century was in the making for some time, with its epicentre firmly located in the United States economy - at the heart of the global capitalist system.

By mid-2007, over-dependence on market forces and mechanisms without proper and workable regulatory mechanisms and systems in place to govern the globalization process, led to the appearance of large cracks threatening the stability of the world economy on the two fronts: the sharp hike of primary commodity prices and the global financial crisis.¹ Many primary commodities have registered a steep rise in prices since 2002, reaching an all-time high in 2007-2008, with extreme volatility. The soaring key commodity prices hit the world economy at a time when most Western economies were struggling to escape a sharp economic downturn and recession amidst the credit crunch that had gripped the financial institutions and markets in the United States and Western Europe.

¹ Climate change induced by green-house effects is another great challenge facing the global community in the twenty-first century, requiring urgent collective and coordinated action.

The fear of inflationary pressure, particularly jeopardizing macroeconomic stability in Western economies, creates a major dilemma for the central banks and monetary authorities of these economies. The belief that any inflationary expectation could be dispelled timely and successfully by adopting an institutional framework of inflation targeting faced a severe test. Inflation targeting with fine-tuning of a single policy instrument of interest rates was ill-equipped to deal with cost-push inflation associated with a sudden increase in imported commodity prices involving structural shifts in relative prices. In particular, rapidly increasing prices of basic consumer goods such as fuel and food, the prices of which are exogenously determined in world commodity markets, had sparked off social-and political unrest across the globe. Since mid-2007, policy makers in developing countries, particularly those with a high degree of dependence on imported oil and foods, became acutely concerned with the detrimental effects of the rising fuel cost and food shortages on the livelihood of the urban and the rural poor as well as internal and external macroeconomic balances.

For a year or so from mid-summer 2007, the financial turmoil, with its severe liquidity and credit crunch seemed to be confined, more or less, to financial markets and institutions in the United States and Western Europe. On the whole, the world economy managed to maintain its momentum on the back of the buoyant economic growth posted by emerging market economies as well as resource-rich developing economies that enjoyed a commodity boom of a longer duration than any in recent times. However, the series of events that hit major financial institutions on Wall Street in mid-September 2008 shocked the world and altered radically the fate and course of our globalized economies altogether. The fear of accelerating inflation and fuel and food shortages worldwide was completely overtaken by a greater fear of possible worldwide recession and depression engulfing all economies in the developing world, including emerging market economies in Eastern Europe, Latin America and Asia, as well as low-income developing countries in Africa, Asia and countries of the Economic Commission for Latin America and the Caribbean (ECLAC) region with limited financial market linkages. No country has been in a position to remain a mere bystander in the fast evolving financial crisis any longer.

By the end of 2008, the world economy had rapidly entered a phase of globally synchronized slowdown and, in the first quarter of 2009, headed towards a global recession. As time passed, there was a growing fear that the on-going financial crisis might well turn into a global depression of the twenty-first century. The speed at which the world economy has fallen victim to the

recessionary wave of the financial turmoil in the United States and Europe caught everyone by surprise. In the second quarter of 2009, some signs were emerging indicating that the worst might be over following the large-scale counter-cyclical policy packages put in place by a number of larger developed and emerging market economies together with their massive liquidity injections into banking systems to mitigate the scale and depth of the recession. Yet, enormous damage has already been inflicted on real sector activities resulting, in particular, in a worldwide contraction of industrial production due to the severe global credit crunch and fall in world trade unprecedented in the post-war era.

Against this background, this paper evaluates the effects of the on-going global financial crisis on the developing world with a particular focus on possible implications for industries and welfare. Next section presents a brief summary of how the crisis came into being and how it is unfolding today. Section 3 discusses the immediate impacts of the current crisis as felt by the emerging market economies and developing countries since September 2008, by examining key channels and transmission mechanisms. Section 4 presents an assessment of the real-economy side effects of the financial crisis on these economies, as global recession has unfolded to date. The final section offers concluding remarks, including policy implications of the discussion and analysis.

2. Events leading to the great financial crisis of the twenty-first century

Awash with plentiful liquidity flowing into the United States economy from the rest of the world against the background of the global macroeconomic imbalances discussed above, the United States consumers and households were at the ultimate receiving end of a large proportion of the global savings glut, under the easy monetary regime pursued by the Chairman of the Federal Reserve Board, Alan Greenspan, in response to the dot-com bubble of 2000-2001 and the 9/11 event of 2001. As often happens, this led to rapid expansion of consumer credit and uncontrolled acceleration of asset inflation in the United States. In particular, after the dot-com bubble, the asset inflation had taken the form of a housing boom in the United States. Although the boom was also prevalent in other European countries, such as, Ireland, Spain and the United Kingdom since the early 2000s, the United States housing boom had a special toxic element for future troubles in the form of sub-prime mortgages, which were sold aggressively, in particular since 2002-3, to low-income people with no down payments. They were often packaged at floating or adjustable flexible rates, with a one- or two-year resets clause. The share of the sub-prime loans in the United States mortgage markets was estimated to have reached some 23 per cent in 2006. As

expected, once the interest rates were adjusted upwards or the reset clause kicked in, many sub-prime mortgages became delinquent or were defaulted on outright leading to rising foreclosures.

Unfortunately, the sub-prime debacle was not contained within the United States housing market, since sub-prime housing loans were repackaged as structured credit products, such as collateralized debt obligations (CDOs) or special purpose vehicles (SPVs) or other innovative financial instruments, through multi-layered securitizations of underlying assets. These were traded globally through closely interlinked and poorly regulated financial markets and over-the-counter transactions. Led by executives, which were driven by distorted incentives for extortionate salary compensation with stock options at the core, financial institutions opted en masse for excessive risk-taking.² They adopted a dynamic originate-to-sell trading model of securitization in place of a traditional buy-and-hold model. Leverage ratios of some of financial institutions increased as much as 30, well above the ceiling of ten generally imposed on deposit banks (UN, 2009).

In the process, potential default risks of original sub-prime mortgage products were overlooked, as they were reshuffled many times over and hidden from their balance sheets. The failure to demand transparency in their off-balance sheet activities on the part of regulatory and supervisory oversight agencies as well as the collusive practices and incompetence of the credit rating agencies to factor in market-wide systemic risks aggravated the situation. Credit risks were massively under-priced by all parties, given easy money and overly liquid markets as well as the availability of default risk insurance offered to debt holders by insurance companies through credit default swap (CDS) facilities. Although financial markets became irrational with systemic risks building up (Kindleberger, 2000), individual market participants, driven by instant pay-offs and profit taking, believed that their decisions were based on rationality backed up by sophisticated financial modelling.

With sub-prime mortgage defaults accelerating since 2006, the inevitable crash of housing price bubbles in the United States led to an initial freezing of credit and money markets in the United States and Europe in July-August 2007. Despite immediate interventions through a series of large-scale liquidity injections by the Federal Reserve and the main central banks in Europe, inter-bank money markets have been largely frozen since then, leading to liquidity crunch in inter-bank money markets and credit crunch in many financial institutions. With problems

² Senbet (2008) reports that average real CEO pay for S&P companies grew to \$15 million in 2007, 400 times average employee compensation, up 40 times from 1980.

stemming from asymmetric information and adverse selection looming, banks and financial institutions have ceased to trust and lend one another. Several over-leveraged banks and financial institutions in the United States and Europe were the first to go bankrupt, and some of them were nationalized after the governments were forced to become a major equity holder.

Despite the anxieties and tensions reflecting huge uncertainty and a crisis of confidence that gripped global financial markets and sectors during the intervening period, between the summers of 2007 and 2008, the continuing buoyant economic growth of several emerging market economies, such as Brazil, Russia, India and China (BRICs), sustained an optimistic growth prospect for the world economy for some time. Many oil-exporting and commodity-dependent economies in the Gulf States, Latin America and Africa recorded an economic growth rate that was historically high, largely due to the commodity boom induced by the rising demand for natural resources, particularly from the emerging Asian economies. A number of Asian economies escaped the impact of the initial wave of the present financial turmoil, since they have managed to reconstruct their banking and financial systems after the Asian Crisis of 1997-8, with generally robust balance sheets of financial institutions and non-financial corporations.

However, unprecedented events of an unimaginable scale in the Wall Street in mid-September 2008, abruptly and completely changed the course of economic policy debate as well as immediate prospects for the world economy. The early bankruptcy of Bears Stearns and its take-over by JP Morgan-Chase in March 2008 and the collapse of other banks and financial institutions in the United States and Europe indicated the depth of the crisis and credit freeze impeding the normal operation of financial markets in these economies. These proved to be precursors to what would follow. In early September, the government of the United States sponsored mortgage buyout of Freddie Mac and Fannie Mae, which together accounted for some half of United States mortgage loans, amounting to \$5 trillion. The two were practically nationalized after the early rescue package failed to shore them up. Then came the news of the bankruptcy of Lehman Brothers - one of the four big Wall Street investment banks - immediately followed by the take-over of Merrill Lynch by Bank of America and a \$85 billion rescue package hastily arranged for American Insurance Group (AIG) which made everyone wake up to the scale of the problems on the Wall Street.

Due to instant flight-to-quality by investors worldwide, which switched from equity markets to purchases of safe investment, stock markets began to tumble globally. Financial papers such as

money market funds and commercial papers, which are usually regarded as liquid and low-risk, were no longer seen as safe assets. Carry trade related flows, predicated on betting on exchange rate movements and interest rate differentials between major currencies and emerging market currencies were fast unwinding. With these swift portfolio adjustments, a large reversal of relative positions between the three major currencies- United States dollar, euro and yen - took place in a matter of days and weeks.

The global financial crisis has rapidly become a reality, with the real-economy side-effects being felt imminently worldwide. No country has been immune to the cascading effects of the crisis. For the first six months after September 2008, the possibility of the repeat of the Great Depression was feared, becoming no longer just an academic question. The hazardous combination of the negative wealth effects stemming from the price collapse of financial and real estate assets, deteriorating balance sheets of banking and other financial institutions and borrowing-constrained household and corporate sectors amidst severe credit crunches, has been depressing further both consumption and investment demand. This is a classical recipe for triggering a deflationary tendency, according to the debt deflation theory advanced by Irving Fischer, to explain the Great Depression in the 1930s (Fisher, 1933). By the end of 2008, it had become clear that the crisis could quickly result in a deeper, globally synchronized slowdown, leading to a possible prolonged recession in the world economy, unless effective and concerted policy measures were deployed in a timely, coordinated manner globally to prevent such a powerful tidal wave. Although the imminent danger of depression has been somewhat receding since the G20 summit in London in April 2009, the global economy still faced a high degree of uncertainty that it may endure prolonged recession.

Against this background, in the next two sections I examine how fast the spillovers from the global financial crisis have been transmitted to the developing world by the end of 2008, and how developing countries have been affected by the global recession triggered by the on-going financial crisis over the past six months.

3. Transmission channels of immediate financial spillovers

3.1 Emerging market economies

Emerging market economies have posted sizeable current account surplus for the past several years reaching \$435 billion in aggregate in 2007. As shown in table 1, emerging market economies in Asia and the Gulf Cooperation Council countries (GCC) posted a huge current account surplus of \$420 billion and \$206 billion, respectively, in 2007. As shown in table 1, foreign exchange reserves collectively held by emerging economies had been accumulating at a steady rate in 2006-2008.

Table 2 Current account balances and changes in international reserves: emerging market economies and GCC countries (Billions of US dollars)

	2006	2007	2008 ^e	2009 ^f
A) <i>Current Account Balance</i>				
Emerging market economies	383.7	434.9	387.9	322.7
Emerging Europe	24.9	-23.5	-29.8	-117.2
Emerging Asia	289.5	420.2	386.4	474.5
Latin America	54.4	27.2	0.3	-64.6
Africa and Middle East	14.9	11.0	31.0	30.0
GCC countries	210.6	206.1	315.7	20.6
Emerging market economies incl. GCC countries	594.3	640.1	703.1	343.4
B) <i>Changes in international reserves</i> (- sign indicates an increase)				
Emerging market economies	-554.8	-948.7	-444.3	-245.9
Emerging Europe	-130.7	-193.5	25.5	219.6
Emerging Asia	-337.5	-587.8	-373.1	-448.3
Latin America	-49.3	-129.1	-36.8	38.4
Africa and Middle East	-37.4	-38.7	-63.0	n/a
GCC countries	-82.9	-142.6	-127.3	-1.8
Emerging market economies incl. GCC countries	-637.7	-1095.12	-571.6	-247.6

Source: Compiled from tables 1, 8-11 in the Institute of International Finance (2009), except for Africa and Middle East, figures are from the Institute of International Finance (2008).

Note: e – estimates, and f - IIF forecast.

<i>Country groupings</i>				
<i>Emerging Asia</i>	<i>Latin America</i>	<i>Emerging Europe</i>	<i>Africa and Middle East</i>	<i>Gulf Cooperation Council</i>
China	Argentina	Bulgaria	Algeria	Bahrain
India	Brazil	Czech Republic	Egypt	Kuwait
Indonesia	Chile	Hungary	Morocco	The Sultanate of Oman
Malaysia	Colombia	Poland	South Africa	Qatar
Philippines	Ecuador	Romania	Tunisia	Saudi Arabia
Republic of Korea	Mexico	Russian Federation		United Arab Emirates
Thailand	Peru	Slovakia		
	Uruguay	Turkey		
	Venezuela	Ukraine		

According to the most recent estimates of the Institute of International Finance, released at the end of January 2009, net private capital flows to emerging market economies was sustained for several years and accelerated from \$565 billion in 2006 to a high level of nearly \$929 billion in 2007 (table 2), of which \$518 billion is known to have flowed to BRICs (Institute of International Finance 2009). Thus, initially, emerging market economies as a group appeared to have weathered the storm of the financial markets of the United States and Western Europe throughout 2007.

Table 3 Net private capital flows to emerging market economies (Billions of US dollars)

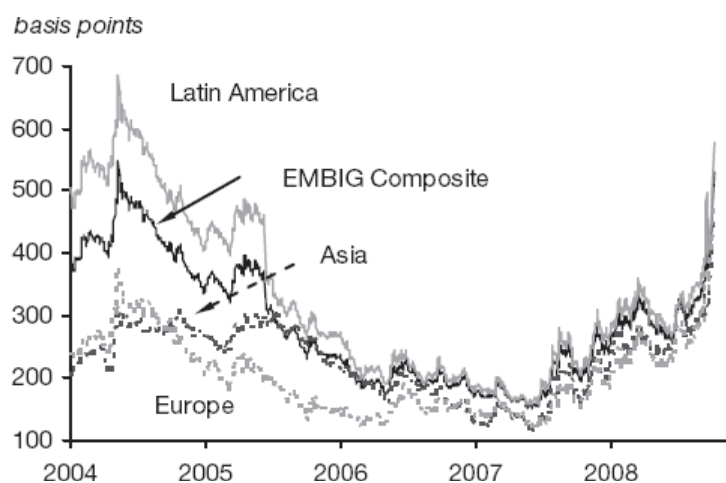
	2006	2007	2008e	2009f
<i>Emerging market economies</i>				
Private flows	564.9	928.6	465.8	165.3
Equity investment	222.3	296.1	174.1	194.8
Direct investment	170.9	304.1	263.4	197.5
Portfolio investment	51.5	-8.0	-89.3	-2.7
Private creditors	342.6	632.4	291.7	-29.5
Commercial banks	211.9	401.3	166.6	-60.6
Non-banks, net	130.7	222.2	125.1	31.1
<i>Emerging markets - Europe</i>				
Private flows	226.3	392.8	254.2	30.2
Equity investment	50.2	81.1	50.3	48.6
Direct investment	49.5	74.9	69.0	54.1
Portfolio investment	0.7	6.2	-18.7	-5.5
Private creditors	176.2	311.7	203.9	-18.4
Commercial banks	109.8	216.9	122.7	-27.2
Non-banks	66.4	94.8	81.2	8.8
<i>Emerging markets - Asia</i>				
Private flows	258.2	314.8	96.2	64.9
Equity investment	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
Private creditors	136.3	201.9	38.2	-20.8
Commercial banks	90.5	155.7	29.8	-25.3
Non-banks	45.8	46.2	8.4	4.5
<i>Emerging markets - Latin America and the Caribbean</i>				
Private flows	51.5	183.6	89.0	43.1
Equity investment	28.9	81.5	48.4	42.0
Direct investment	26.2	65.7	58.9	43.7
Portfolio investment	2.7	15.7	-10.6	-1.7
Private creditors	22.6	102.1	40.7	1.0
Commercial banks	9.0	30.8	8.6	-11.7
Non-banks	13.5	71.3	32.1	12.8
<i>Emerging markets - Africa and the Middle East</i>				
Private flows	28.3	37.4	26.4	27.2
Equity investment	20.7	20.6	21.5	N/A
Direct investment	8.1	14.9	22.6	N/A
Portfolio investment	12.6	5.7	-1.1	N/A
Private creditors	7.4	17.2	14.4	N/A
Commercial banks	2.5	7.2	5.6	N/A
Non-banks	4.9	10.0	8.8	N/A

Source: Compiled from tables 1, 8-11 in the Institute of International Finance (2009); except for Africa and Middle East, figures in detailed categories are from Institute of International Finance (2008).

Note: e – estimates, and f - IIF forecast.

In 2007-2008, however, the investors' appetite for emerging market funds began to surge as a gradual increase in emerging market sovereign bond spreads. This was followed by a sharp rise in spreads in September/October 2008 (figure 2). Foreign exchange reserves of 18 main emerging economies, which had been increasing at an average of US\$40 billion monthly between January 2007 and June 2008, experienced a sharp net decline of some US\$25 billion already in August 2008 (figure 3). According to estimates from the Institute of International Finance, an increase in international reserves (a net addition to stocks) held by emerging market economies and GCCs halved, from more than US\$1 trillion in 2007 to US\$571 billion in 2008 (table 1).

Figure 4 Emerging markets sovereign bond spreads by region

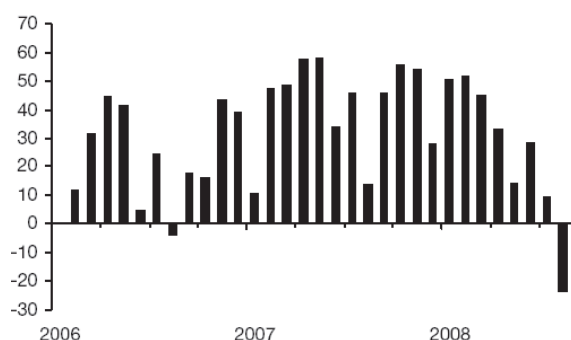


Source: Institute of International Finance (2008), Chart 4.

As expected, emerging market economies that had closely integrated into global financial markets were the first developing countries to experience the immediate impact of the near-collapse of global financial markets. These occurred in wake of the high profile collapse of Lehman Brothers and the hurried mergers of several others and rescues of a number of financial institutions in the United States and Europe in September 2008. A number of heavily indebted emerging market economies that had developed considerable current account deficits with unsustainable levels of short-term debt financing were hit the hardest and were the first to fall. In the immediate aftermath of the financial meltdown of September 2008, according to World Bank (2009), 20 developing countries experienced severe distress, of which six were in Europe and Central Asia and eight in Latin America and the Caribbean. A number of countries, such as Hungary and Ukraine, required emergency lending from the IMF.

Figure 3 Changes in foreign exchange reserves by main emerging market economies

\$ billion, 18 countries, monthly, not seasonally adjusted



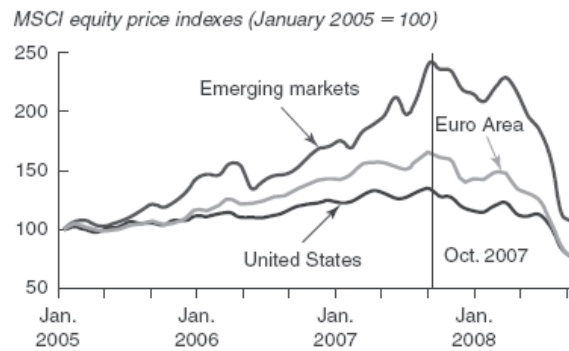
Source: Institute of International Finance (2008), Chart 6.

Emerging market economies in other developing regions that had enjoyed sustained economic growth over several years, with buoyant export and domestic demand and investment boom up to mid-summer 2008, saw their currencies fast depreciate while stock market prices tumbled and collapsed within days and weeks. After years of excessive risk taking and under-pricing of both credit and market-wide systemic risks, extreme risk aversion had returned to characterize the behaviour of portfolio investors and financial institutions. As a result, the US dollar - the currency of the country where the troubles originated - sharply appreciated against the euro and other major currencies, except the yen.

According to the World Bank (2009), since mid-September, currencies of developing countries declined by more than 20 per cent by November. Some currencies that had appreciated strongly for two years before summer 2008 experienced a larger depreciation in the immediate aftermath. The Brazilian real and South African rand depreciated against the US dollar by 40 per cent and 60 per cent, respectively, though they regained a part of the fall subsequently. The emerging stock market, measured by the Morgan Stanley Composite Index (MSCI), fell by more than 60 per cent between mid-September and mid-November 2008 (figure 4.a).³ Figure 4.b shows that MSCI fell sharply in emerging market economies in all regions. Figure 4.c shows that equity markets in emerging markets have not experienced a recovery as much as those in developed economies in the first quarter of 2009. Equity prices in Brazil, China and India all posted a drop by over 60 per cent (See also Appendix figure A.1).

³ A larger fall in equity prices was reported in a number of Eastern European countries, with Bulgaria at 75 per cent, Romania at 75 per cent, Russia at 73 per cent and Ukraine at 80 per cent.

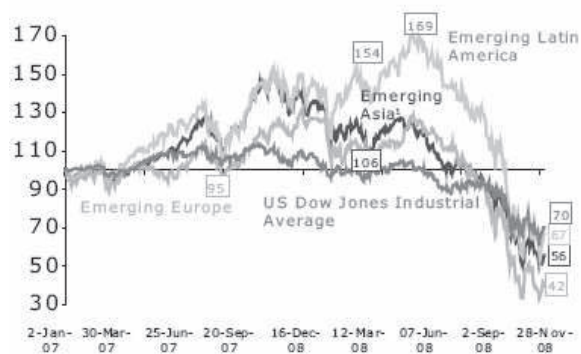
Figure 4.a Stock market price indices



Source: Morgan-Stanley, Standard & Poor's.

Source: World Bank (2009), figure1.2.

Figure 4.b Stock market price indices by region (2 January 2007 = 100)



¹Includes 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 Bloomberg.

Source: Asian Development Bank (2008), figure 55.

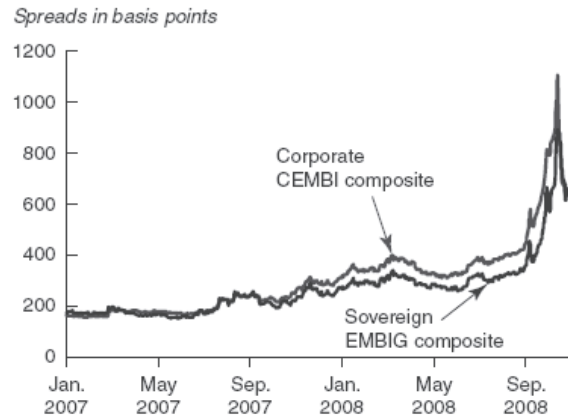
Figure 4.c Stock market price indices by region (2001 = 100)



Source: International Monetary Fund, *World Economic Outlook* (2009), figure 1.3.

Emerging market sovereign bond spreads rose by more than 700 basis points while spreads on commercial debt papers jumped by more than 1,000 basis points, up from levels than 200 basis in June 2008 (figure 5.a). The rise in bond spreads for all emerging economies, as shown in figure 5.b, reflects the radical shift in investors' risk perception towards emerging market across boards. New international issuance of foreign currency, denominated emerging market bonds as well as syndicated loans to them recorded a sharp reduction in the second half of 2008, though there was a sign of some recovery in the first quarter of 2009 (figures 6.a and b)). The net increase in international reserves began slowing down or depleting in a number of emerging market economics across regions (see table 1).

Figure 5.a Emerging market bond spreads: corporate bonds and sovereign bonds

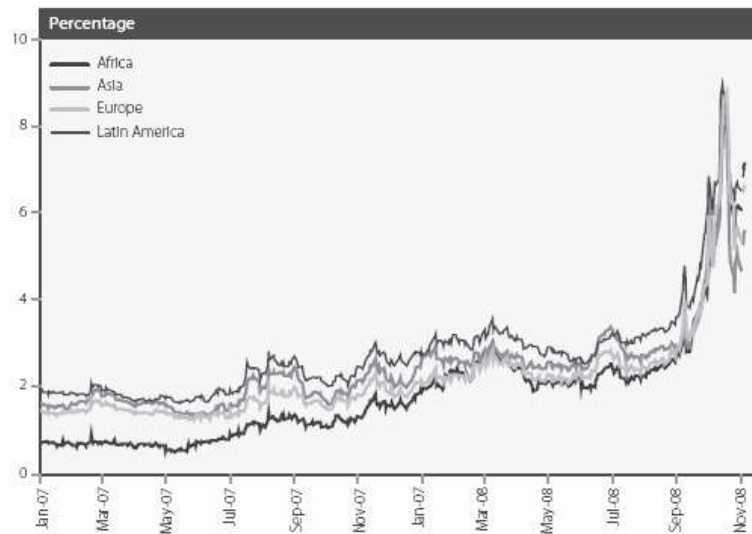


Source: JPMorgan-Chase.

Note: CEMBI = Corporate Emerging Markets Bond Index;
EMBIG = Emerging Markets Bond Index Global.

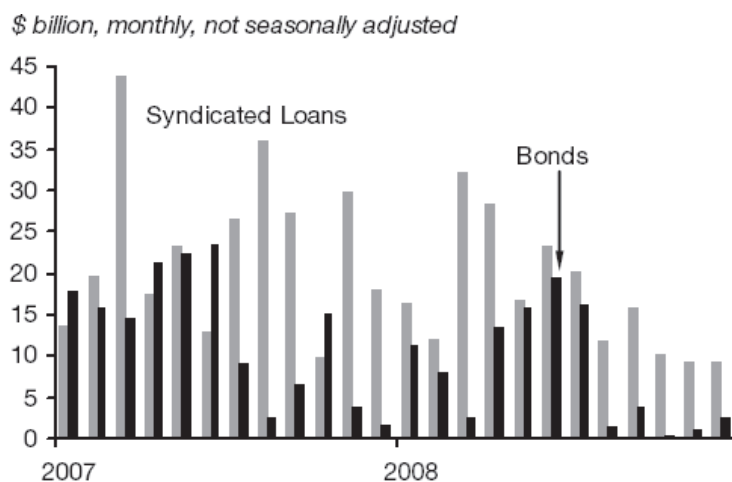
Source: World Bank (2009), figure 1.3.

Figure 5.b Emerging market sovereign bond spreads by region, 2007-2008 (Daily yield spreads)



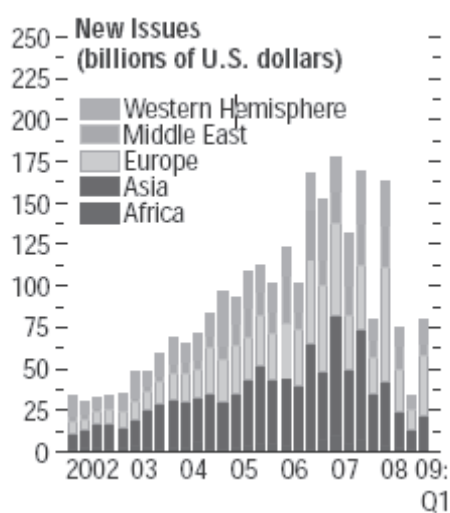
Source: UN Report 2009, Figure 1.5 (Original source: Emerging Market Bond Index supplied by JP Morgan Chase.
Note: Last observation - 14 November 2008).

Figure 6.a Foreign currency denominated international issuance by emerging market economies



Source: Institute of International Finance (2009), Chart 3.

Figure 6.b Foreign currency denominated international issuance by emerging market economies by region

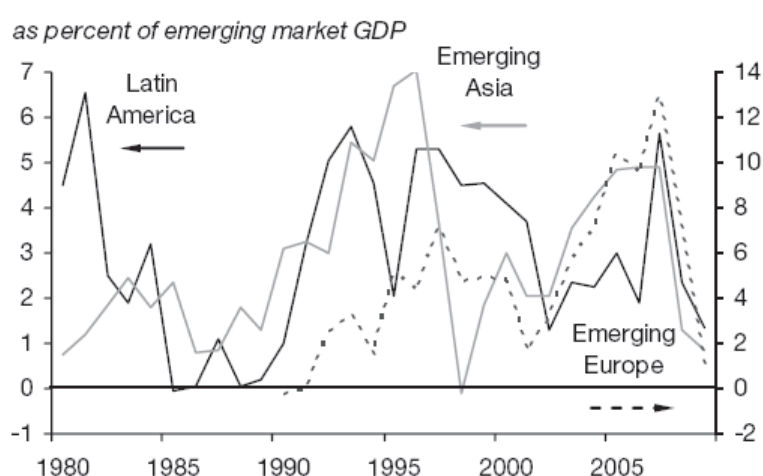


Source: International Monetary Fund, *World Economic Outlook* (2009), figure1.3.

Despite some resilience posted in the first six months after the initial outbreak of the financial crisis, in summer 2007, the turmoil continued and intensified in major financial centres. This started to significantly affect private debt and equity capital flows to emerging economies in 2008. On account of the marked deterioration in September 2008, this trend has since accelerated (figure 7). As shown in table 2, the Institute of International Finance estimates that net private

capital flows to emerging market economies declined by nearly half, from US\$929 billion in 2007 to \$466 billion in 2008. A decline of this magnitude was observed across all categories of private capital flows. The drastic reduction appears to have occurred in emerging market economies in Latin America and Asia, where it declined from US\$184 billion in 2007 to US\$89 billion in 2008 in the former and from US\$315 billion in 2007 to US\$96 billion in 2008 in the latter. Figure 7 shows the historical trend in net private capital flows by major regions as a percentage of their GDP. It confirms its marked reduction in 2008 as well as a very high volatility throughout the period spanning the last three decades.

Figure 7 Net private capital flows by major regions

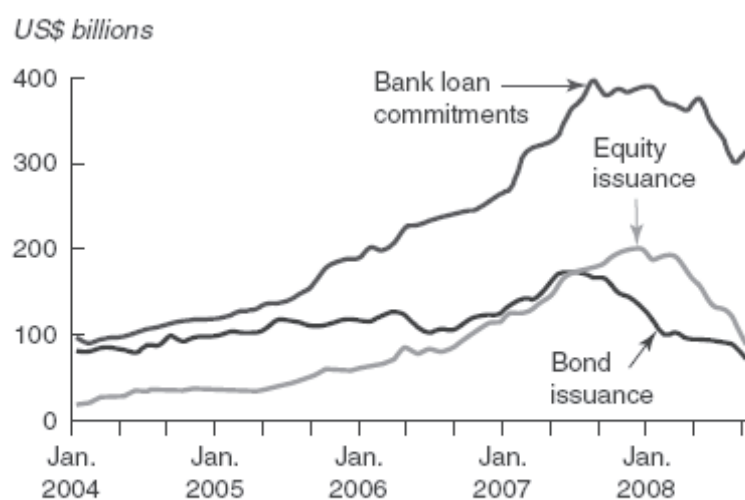


Source: Institute of International Finance (2009), Chart 7.

Figure 8.a shows the trend in private capital flows reported by the World Bank. Thus, the World Bank (2009) estimates that cross-border syndicated loans declined to US\$315 billion in October 2008, from US\$400 billion the previous October. The UN (2008) estimates the volume of bank loans to emerging markets declined by about 40 per cent from 2007 levels, as a consequence of the freeze in inter-bank lending worldwide. Bond issuance by emerging market economies decreased to US\$72 billion in October 2008, from US\$170 billion in June 2007. Corporate bond issuance fell by US\$15.6 billion in South Africa, US\$12.8 billion in India and US\$9.4 billion in Russia, whereas equity issuance posted a similar fall. Some 91 international public offerings were withdrawn and postponed in 2008. Private capital flows in all forms have been fast drying up since. World Bank forecasts a reduction of private capital flows by US\$400-500 billion dollars in 2009-2010. Figure 8.b shows the IMF medium-term projection on net capital flows to emerging

market and developing economies in a historical context.⁴ IMF predicts that private flows would experience some recovery in 2010 but remain subdued for many years as global deleveraging continues. It predicts that emerging economies in Asia and Middle East will experience significant outflows, while other regions will have lower rates of inflows than in the pre-crisis period.

Figure 8.a Private debt and equity flows to emerging market economies

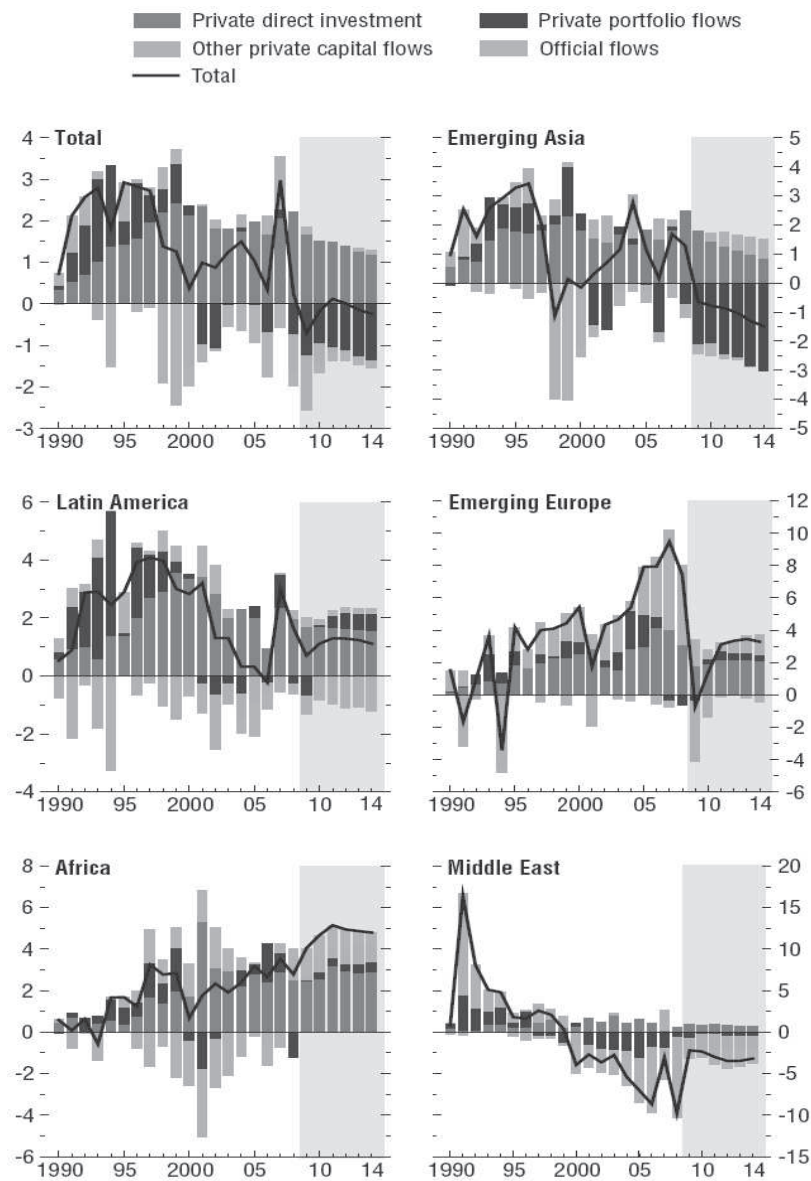


Source: Dealogic Analytics.

Source: World Bank (2009), figure 1.4.

⁴ IMF data on capital flows are significantly different from those reported by the IIF in table 1 (above) due to the different country coverage and definitions used. However, the general trends reported by both are similar.

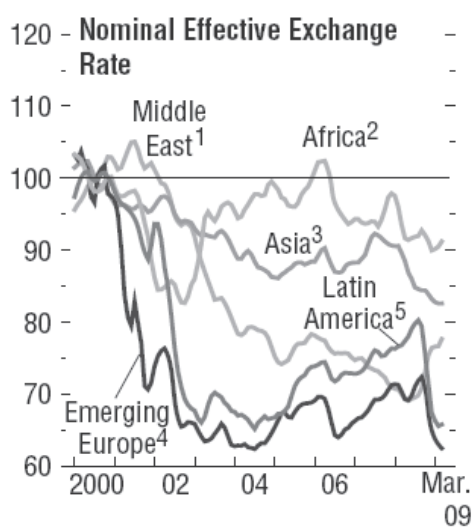
Figure 8.b Projections on net capital flows to emerging and developing economies



Source: International Monetary Fund, *World Economic Outlook* (2009), figure 1.13.

Asset and currency markets in emerging market economies have continued to exhibit extreme volatility to date, as elsewhere in the world (Figures 4.c and 9). Most currencies of emerging and developing countries have experienced a sharp depreciation. The scale is large in emerging economies in Asia, Latin America and Europe, which have fuller capital market linkages with the financial centres of developed countries (figure 9). Initial public offerings are reported to have nearly disappeared in the aftermath of the financial turmoil.

Figure 9 Currencies of emerging and developing countries (Index 2000=100, three month moving average)



Sources: IMF, *International Financial Statistics*; and IMF staff calculations.

¹Bahrain, Egypt, I.R. of Iran, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates, and Republic of Yemen.

²Botswana, Burkina Faso, Cameroon, Chad, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Ethiopia, Gabon, Ghana, Guinea, Kenya, Madagascar, Mali, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Senegal, South Africa, Sudan, Tanzania, Uganda, and Zambia.

³Asia excluding China.

⁴Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, and Turkey.

⁵Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.

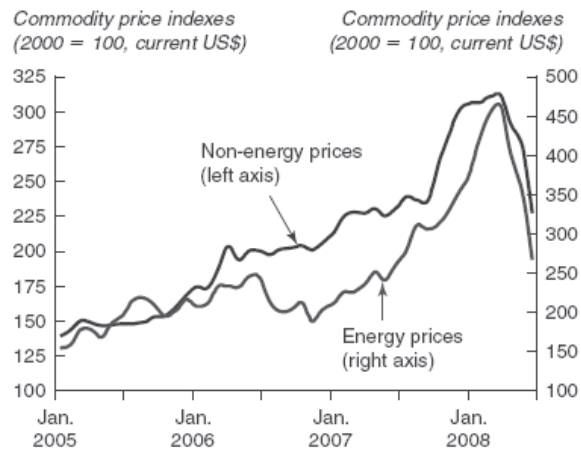
Source: International Monetary Fund (2009), figure 1.6.

3. 2. Other developing economies

Spillovers to commodity markets

For low-income developing countries, which were sheltered from the immediate direct impact of the global turmoil from financial market linkages, one of the most direct effects of the crisis was felt in price movements on commodity markets. After reaching an all time high in the April-July, 2008, commodity prices plummeted sharply, as the unprecedented turmoil and meltdown in financial centres across the globe hit the news headlines and pessimism began to dominate prospects for the world economy (figure 10).

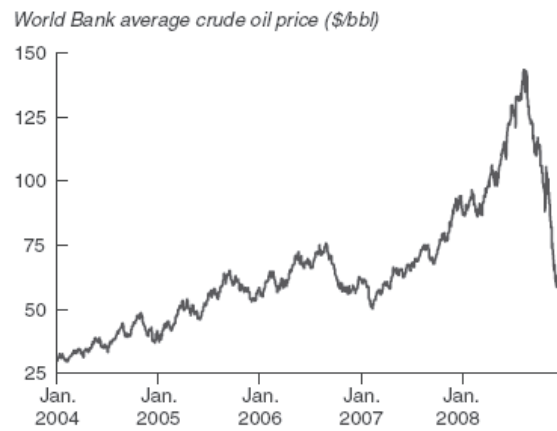
Figure 10 Commodity price Indices



Source: World Bank data.

Source: World Bank (2009), figure 1.27.

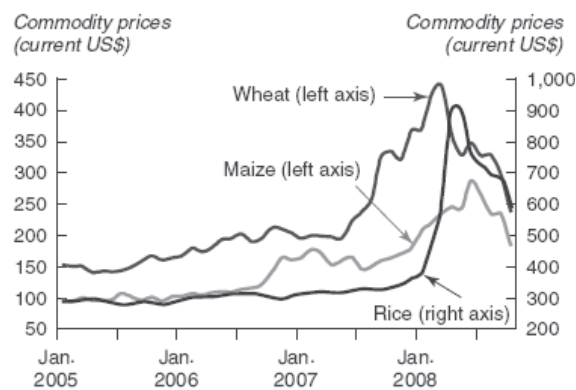
Figure 11.a Crude oil prices



Source: Datastream and World Bank.

Source: World Bank (2009), Figure 1.28.

Figure 11.b Grain prices



Source: World Bank data.

Source: World Bank (2009), figure 1.29.

Oil prices fell more than US\$140 in early July to below US\$50 in November-December 2008 and to US\$35-45 in February, 2009 (figure 11.a). A similar dramatic fall in prices was reported for a number of metals, such as nickel, zinc and copper, due to current and anticipated decline in world demand, notably, a drastic deterioration in global prospects for the construction and automobile industries. Grain prices declined significantly from the rise in the first half of 2008 to date, recording a fall of more than 30 per cent from April 2008 to November 2008. For example, wheat prices fell from US\$440 in March 2008 to US\$240 a ton in November 2008, while rice prices from US\$1,000 to US\$550 a ton for the same period (figure 11.b). In the early December 2008, the World Bank noted that commodity prices had lost, most of the increase of the past 24 months in a matter of two months, in the last quarter of 2008 (World Bank, 2009).

Table 3 below shows that, by early December 2008, non-fuel commodity prices had fallen 35 per cent compared the peak level reached in April 2008, while average monthly petroleum oil and food prices fell by more than 50 per cent and 30 per cent from their peak levels, respectively. Vegetable oilseeds and seeds, whose prices had shadowed petroleum prices in the recent past declined by 48 per cent. Minerals, ores and metals experienced a price decline of 41 per cent, while prices of agricultural raw materials and tropical beverages fell by 25 per cent and 15 per cent, respectively, for the second half of 2008. The prices of coffee arabica and cocoa dropped by 24 per cent and 27 per cent, respectively, since July 2008.

Table 4 Monthly average world primary commodity prices, 2002-2007, 2008 (Percentage change over previous year monthly average)

<i>Commodity group</i>	<i>2002-2007^a</i>	<i>2008 (1st half)^b</i>	<i>2008 (2nd half)^c</i>
All commodities	113	34	-35
(excluding crude petroleum)			
Food	65	51	-31
Tropical beverages	67	24	-15
Vegetable oilseeds and oils	93	-	-48
Agricultural raw materials	80	26	-25
Minerals, ores and metals	261	18	-41
Crude petroleum	185	52	-50

Source: UNCTAD secretarial calculations based on UNCTAD *Handbook of Statistics 2008* and UNCTAD commodity price statistics.

Table 1 of UNCTAD (2008).

Note: Price in current dollars.

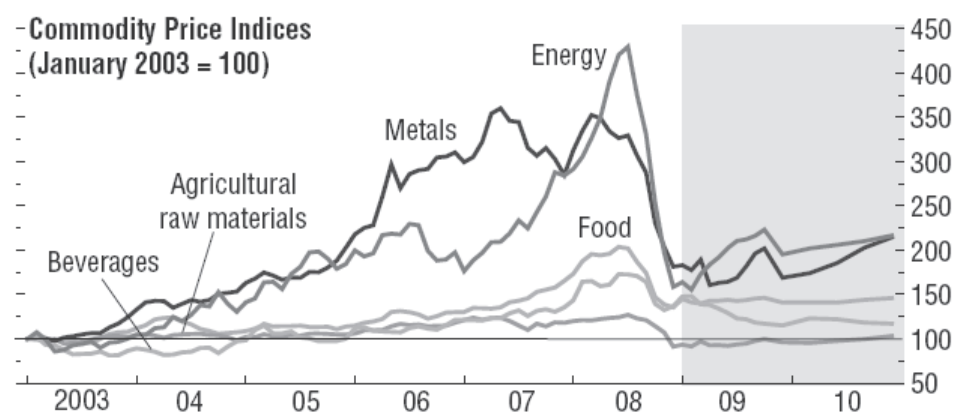
^a Percentage change between 2002 and 2007,

^b Average monthly prices for half of 2008 compared 2007 monthly average,

^c Percentage change from the peak monthly price recorded in 2008 in comparison with the November 2008 monthly price.

The precipitous fall of this magnitude in a number of commodity prices was a reflection of the actual and expected shift of demand-supply fundamentals, as the deepening financial crisis has inflicted on the real economy globally leading to a substantially weakened demand for commodities. It was also the result of a swift revision of expectations on the part of commodity exchange investors and traders about growth prospects for the world economy. In particular, it became clear that the high growth of emerging market economies in Asia, which was behind the commodity boom since 2002, could not be sustained. Consequently, there was a massive liquidation of long positions in commodity futures markets, leading to a precipitous fall of commodities across the board (UNCTAD, 2008). In December 2008, after speedy portfolio adjustments, commodity prices stabilized generally. Given the severity of the global recession, IMF predicted that commodity prices would register only a modest recovery for the next two years (figure 12).

Figure 12 IMF estimates of commodity and energy prices



Source: International Monetary Fund (2009) figure 1.17.

The rapid turn-around of commodity prices produced a new configuration of winners and losers among developing countries. For countries heavily dependent on imported oil and food, the downward trend in commodity prices was a relief. As result of the rising commodity prices up to the early summer-2008, one third of developing countries posted substantial current account deficits, equivalent to more than 10 per cent of GDP (World Bank, 2008). Their fiscal balances sharply deteriorated due to the increasing burden of policy measures such as domestic price subsidies to counter the adverse effects of the sharp increases in food and fuel prices on the poor as well as ease some of the socio-political tensions generated. Hence, the substantial fall in commodity prices in the second half of 2008 benefited these resource poor countries, by enabling them to reduce both internal and external macroeconomic imbalances as well as to ease inflationary pressures. However, the rapid depreciation of national currencies against the United States dollar has added upward pressure on domestic prices, which diminished or canceled out the positive effects of the reduced food and fuel prices on international commodity exchanges.

Commodity exporting countries have naturally lost out from the price decline, though many middle-income countries, particularly oil-exporting ones, have accumulated large international reserves with the rising export revenues in recent years. Many of them have also established stabilization funds to manage macroeconomic balances over the commodity-price cycles (Nissanke, 2009b). These prudent measures taken during the boom are useful for softening immediate price shocks. However, many of the heavily commodity-dependent, low-income

economies in Africa and Latin America might slip quickly into financial distress, as their trade and production structures are not sufficiently diversified to withstand a prolonged recession superimposed by commodity-price cycles and external shocks (Nissanke, 2009b).

Other spillovers

The availability and cost of trade finance is another channel through which developing countries immediately felt the adverse effects of the severe credit crunch from the global financial system. The deterioration of availability and terms of trade credit was reported in the first half of 2008, but the situation significantly worsened since September 2008. Hence, a World Bank economist remarked then that, “at the moment what’s constraining world trade is not only falling global demand but lack of trade finance”.⁵ For developing countries, the pro-cyclical nature of trade finance is exacerbated by the Basel II Accord, whereby balance-sheet exposure to least developed countries could cost banks three times as much as exposure to developed countries, creating a considerable asymmetry in access to trade finance.⁶ According to the estimate by the World Trade Organization (WTO) in November 2008, the liquidity gap in trade finance amounted to US\$25 billion. Export credits were fast drying up and export insurance became more expensive or disappeared altogether for exporters in developing countries.

For many low-income countries, remittance flows constitute a significant share of GDP. For example, they account for more than 8 per cent of GDP for poor countries in South Asia such as Bangladesh, Nepal and Sri Lanka. Remittance flows globally are estimated to have reached US\$283 billion in 2008, well above some US\$100 billion of total official development assistance (ODA). One of the fall-outs of the global financial crisis has taken the form of substantially reduced remittances, as the expected slowing down of host economies---both high-income and oil-rich---has suppressed demand for migrant labours as well as reduced their income. World Bank reported that remittance flows have declined from 2 to 1.8 per cent of recipient country GDP already between 2007 and 2008 and would decline further to 1.6 per cent of GDP. However, the net effect of reduction in remittances on home economies may be moderated by exchange rate depreciations of these currencies against those of host countries.

⁵ A remarks made by Danny Leipziger, Vice-President of the Poverty Reduction and Economic Management network at World Bank, at a pre-meeting at the International Conference on Financing for Development in Doha.

⁶ Working Group on Trade, Debt and Finance at WTO. Expert Meeting on Trade-Finance. Note by the Secretariat. WT/WGTDF/W/38. 14 July 2008.

Though many low-income countries have so far not integrated fully into global financial markets, a number of them had been actively engaged in the process of financial integration in the years immediately prior to the current financial crisis. For example, a Note by the African Development Bank Note (2008) remarked that, thanks to the sustained economic growth achieved over recent years across the continent, several African countries started attracting a wide range of financing from external sources, including portfolio flows, remittances, FDI and trade credits at the time that the financial crisis broke out. It made the following observations:

- In 2007, Africa received nearly US\$35 billion in FDI and some US\$15.7 billion in portfolio flows, while trade credit lines have played a critical role in financing imports and investments.
- The entry into the sovereign bond market as a source of finance for infrastructure development was growing in a number Africa countries.
- Remittances from the African diaspora were estimated at US\$27.8 billion for 2007 alone.
- Africa attracted interest in African debt and equity markets from traditional as well as emerging sources, such as China and India.

The Note observed that the financial crisis had made Africa vulnerable to reversal of nascent capital flows as investor sentiments changed, adversely affecting trade credits and planned sovereign bond issues. In fact, the African Development Bank estimated that portfolio flows to Africa declined to US\$5.9 billion in 2008, compared to US\$15.7 billion in 2007. African stock market indices experienced a melt down elsewhere, and foreign exchange markets continued to exhibit high volatility. Thus, low-income economies by no means have been immune to financial contagion effects from the global financial crisis.

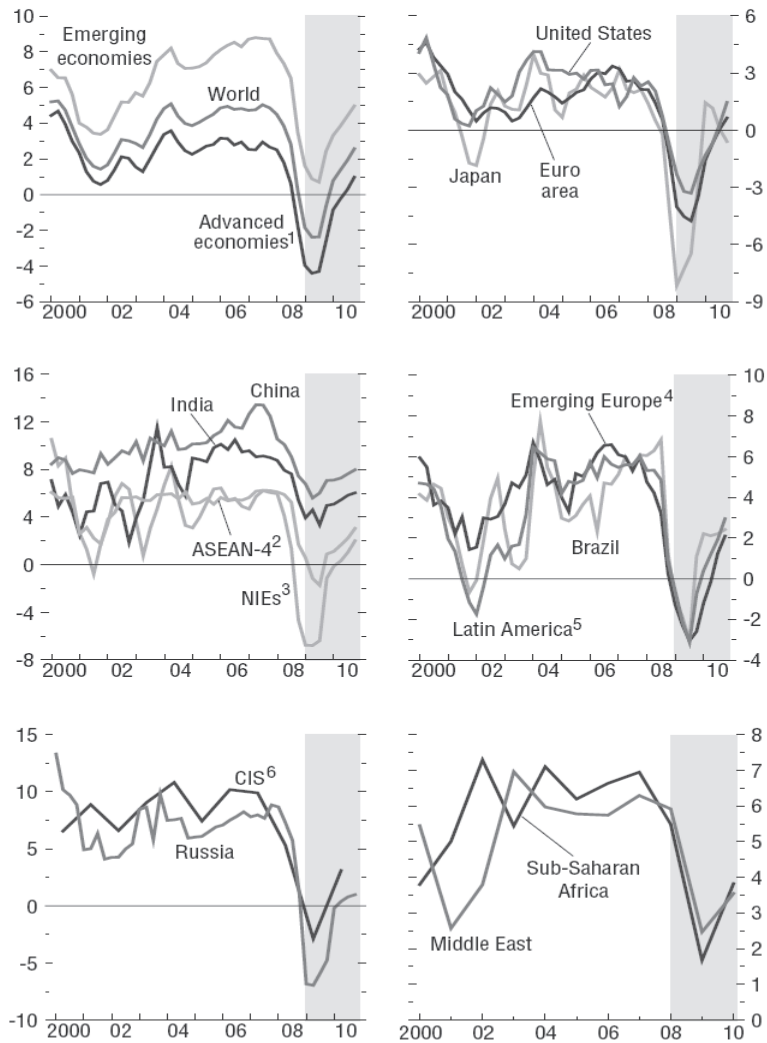
4. Recessionary effects of the global financial crisis

Recessionary effects on the global economy

The financial turmoil in the United States and Europe in September 2008, with the subsequent credit crunch unleashed a powerful recession worldwide, leading to a sharp fall in real economic activities. According to IMF's latest available data, real GDP of developed and emerging economies contracted 7.5 per cent and 4 per cent, respectively, on an annual basis in the last quarter of 2008, through both financial and trade linkages. With such a sharp deterioration, the growth prospects for the global economy in 2009-2010 were adjusted downward constantly during the past six months since September 2008, on account of the continuously weakening export demand and the severe financial squeeze. As of April 2009, IMF predicted that world

output would decline by 1.3 per cent in 2009 and rise by only 1.9 per cent in 2010 (see figure 13 and Appendix table A.1). These represent a downward revision by 1.8 per cent and 1.1 per cent to the IMF estimates made at the end of January 2009 for these two years respectively. While advanced economies are expected to contract by 3.8 per cent, emerging and developing economies as a group are to grow only at 1.6 per cent in 2009, down from 8.3 per cent in 2006 and 6.1 per cent in 2007.

Figure 13 World output growth



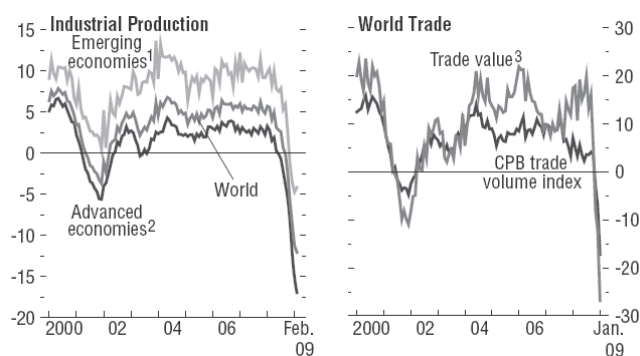
Sources: Haver Analytics; and World Economic Outlook (WEO) database.
¹Australia, Canada, Czech Republic, Denmark, euro area, Hong Kong SAR, Israel, Japan, Korea, New Zealand, Norway, Singapore, Sweden, Switzerland, Taiwan Province of China, United Kingdom, and United States.
²Indonesia, Malaysia, Philippines, and Thailand.
³Newly industrialized Asian economies (NIEs) comprise Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.
⁴Estonia, Hungary, Latvia, Lithuania, and Poland.
⁵Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.
⁶Commonwealth of Independent States.

Source: International Monetary Fund (2009) figure 1.8.

The rapidly deteriorating economic outlook and continued disruption to financial services produced a sharp contraction in world merchandise trade and industrial production in the last quarter of 2008 and first quarter of 2009. By January 2009, world trade had contracted by nearly 30 per cent on an annual basis (figure 14). As of April 2009, the IMF predicted that world trade

volume would contract by 11 per cent in 2009, which represents a downward adjustment to its own prediction of 8 per cent made in January 2009 (table A.1). While imports and exports for advanced economies are expected to decline 12.1 and 13.5 per cent, respectively, in 2009, emerging and developing economies are predicted to experience a reduction of imports and exports by 8.8 and 6.4 per cent, respectively.

Figure 14 Industrial production and world trade (Percentage change from a year earlier)



Sources: CPB Netherlands Bureau for Economic Policy Analysis for CPB trade volume index; for all others, NTC Economics and Haver Analytics.

¹Argentina, Brazil, Bulgaria, Chile, China, Colombia, Estonia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Romania, Russia, Slovak Republic, South Africa, Thailand, Turkey, Ukraine, and Venezuela.

²Australia, Canada, Czech Republic, Denmark, euro area, Hong Kong SAR, Israel, Japan, Korea, New Zealand, Norway, Singapore, Sweden, Switzerland, Taiwan Province of China, United Kingdom, and United States.

³Percent change from a year earlier in SDR terms.

Source: International Monetary Fund (2009), figure 1.4.

Global industrial production plummeted 12 per cent on an annual basis by February 2009 (figure 14). Though a contraction of industrial production is sharper in advanced economies, with a reduction of 20 per cent, an abrupt end to its recent growth in emerging economies - 10 per cent to minus 5 per cent in a matter of 5 to 6 months – indicates the degree of strain on industrial activities in these economies caused by the present global crisis.

Impact of the global financial crisis on industrial production in emerging and developing economies

Industrial production is largely susceptible to shifts in prevailing confidence on the part of investors and consumers as well as operations of financial services to support activities. At times of a major economic crisis such as the current one, investment is cut quickly and substantially, as

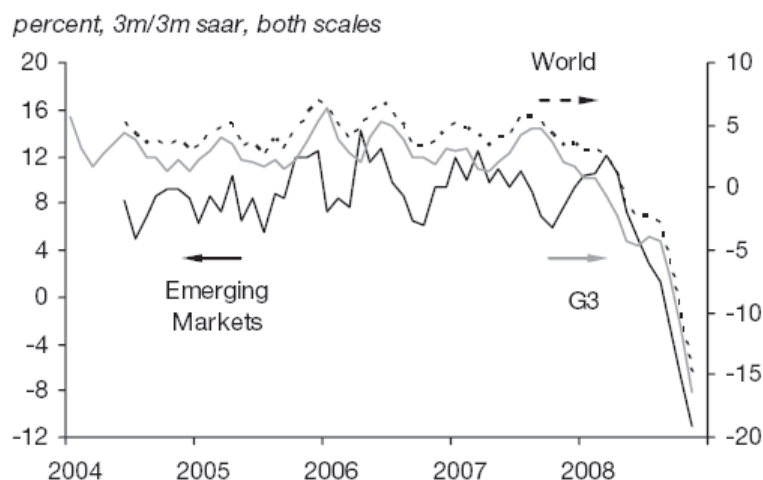
financial resources underpinning investment are either not available or remain too costly for many corporations and firms. The continued uncertainty in global economic prospects has dampen investment with considerable sunk costs worldwide, including emerging and developing countries. As corporate bonds become an expensive source for financing, large-scale investment in infrastructure building or fixed investment in productive capacity is likely to be scrapped in the absence of a counteracting injection of public financial resources.

Growth in private sector credit or bank lending proves to be always pro-cyclical. Hence, domestic demand could weaken, in addition to a significant reduction expected in external demand. In the immediate aftermath of the Wall Street panic in September-October 2008, a number of emerging market economies, including Brazil, India, the Philippines, Russia and Thailand responded to massive capital outflows from their markets by tightening monetary policy. This worsened domestic credit conditions as well as balance sheets of domestic corporations and small and medium enterprises, leading to a further dampening of investment demand.

Furthermore, besides the direct effects of financial contagion from outside, there is a growing danger in developing economies that a credit crunch could take place, with internally generated forces affecting the domestic banking system through its linkage to asset market prices. For example, the recent plummeting of stock and other asset prices generated sizeable negative wealth effects on corporate and household spending in these countries. As Bernanke and Gertler (1989, 1990 and 1995) and Bernake, Gertler and Gilchrist (1996 and 1999) suggest, the ensuing reduction in borrowers' net worth is known to result in a credit crunch in the domestic banking sector through the financial accelerator mechanism in a downturn phase of business cycles. In addition, a considerable depreciation of national currencies can reduce their balance sheets if banks and corporations have a high portion of dollarised liability. All these elements give rise to a classical scenario of currency collapse and banking crisis, which occurred in a number of emerging market economies in the 1990s (Nissanke and Stein, 2003).

Global manufacturing production growth slowed down substantially in 2008 (figure 15). Though the decline in manufacturing production was larger in G3 countries, emerging marketing economies experienced a sudden fall of 10 per cent in the fourth quarter of 2008.

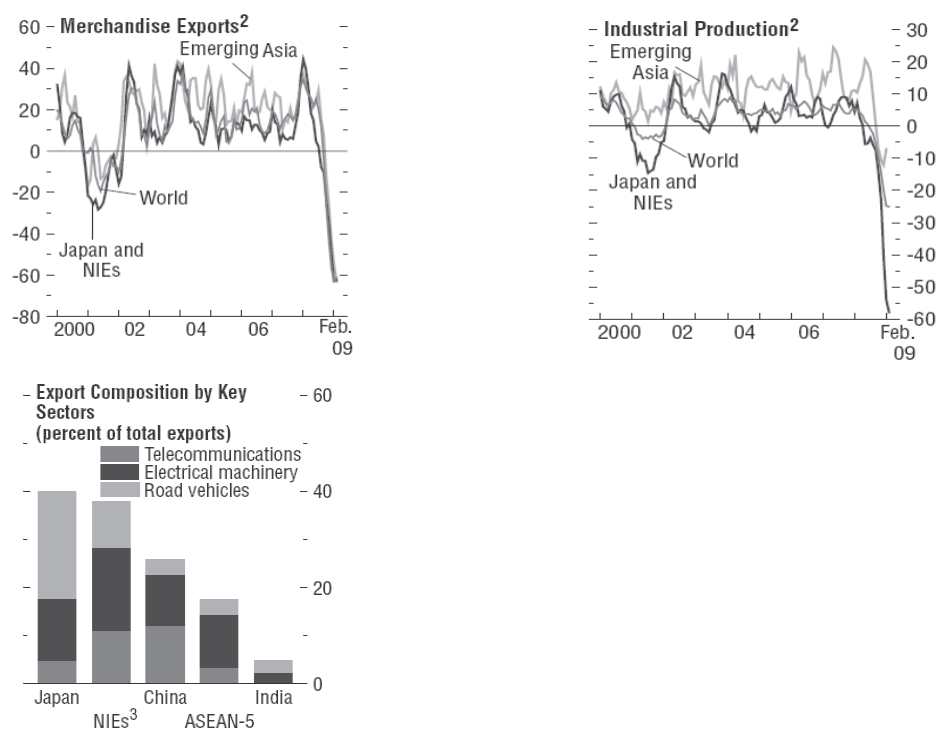
Figure 15 Global manufacturing production



Source: Institute of International Finance (2009), Chart 5.

In particular, Asian economies have turned out to be most vulnerable to the recessionary impact of the financial crisis, as global trade collapsed in the final quarter of 2008 due to their heavy reliance on export demand, in particular for manufactured goods. This is ironic since these Asian economies, both advanced and emerging, were relatively shielded from the financial turmoil in the initial period up to September 2008, on account of their smaller exposure to United States securitized assets, strong macroeconomic fundamentals and relatively sound bank and corporate balance sheets. A number of emerging economies in Asia, in particular, the two large emerging market economies, China and India, have been the engine of world economic growth for several years in this decade. The first two charts in figure 16 show that both merchandise exports and industrial production nearly collapsed during the last quarter of 2008 and the first months of 2009. The scale of the reduction was much larger than the global contraction shown in figures 14 and 15. These Asian economies have been hit particularly hard because of the sharp drop in global demand for consumer durables, such as automobiles, electronics and capital goods, where their specialization of manufacturing exports lies, as shown in the last graph in figure 16.

Figure 16 Merchandise exports and industrial production in Asia¹



Sources: Bloomberg Financial Markets; Dealogic; Haver Analytics; United Nations Comtrade Database; and IMF staff estimates.

¹Newly industrialized Asian economies (NIEs) comprise Hong Kong SAR, Korea, Singapore, and Taiwan Province of China. ASEAN-4 countries comprise Indonesia, Malaysia, Philippines, and Thailand. ASEAN-5 countries comprise ASEAN-4 countries and Vietnam. Emerging Asia comprises China, India, Indonesia, Malaysia, Philippines, and Thailand.

²Annualized percent change of three-month moving average over previous three-month average.

³Excluding Taiwan Province of China.

Source: International Monetary Fund (2009), Figure 2.2.

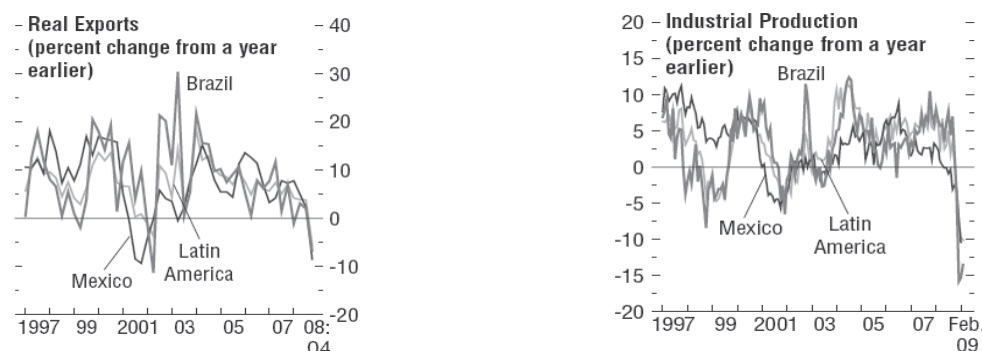
Emerging and developing economies in the ECLAC region suffered from the immediate impacts of the global financial crisis through the financial markets and commodity markets linkages discussed in the above section, in the form of:

- Reduced private capital inflows;
- Large spillover in equity, bond and currency markets from the de-leveraging in financial centres;
- Collapse of commodity prices.

Figure 17 shows the recent performance of real exports and industrial production in the ECLAC region. Though many economies in the region have always been prone to external shocks and experienced several economic crises since the 1980s, the contraction in exports and industrial

production resulting from the on-going crisis is one of the largest during the past decades. Many transitional emerging economies in Eastern Europe also posted a large contraction in economic activities due to their dependence on capital flows for economic growth in the pre-crisis period.

Figure 17 Contraction in exports and industrial production in the ECLAC region



Source: International Monetary Fund (2009), figure 2.7.

Three graphs in figure A.2 of the Appendix show the industrial or manufacturing production index for a number of emerging economies, for which more detailed country-specific data are available from the Economic Intelligence Unit.⁷ Table A.2 lists the sectors hit particularly hard as the global financial crisis has intensified since September 2008. The three graphs in Figure A.2 show that industrial and manufacturing production experienced a sharp decline in most countries. Among emerging countries in Latin America, Brazil and Peru experienced the sharpest decline of 30 points or more in the aggregate index. In Asia, all countries reported a decline of 20 to 30 points. In all countries with economies in transition in Eastern Europe, the fall in industrial activities was larger than in other two regions, of more than 30 to 40 points in the aggregate index.⁸

The sectors that experienced a severe contraction in output, shown in Table A.2, indicates that the fall-out effects of the global financial crisis have been felt throughout wide range of industrial activities, irrespective their nature and size of operations. The list reveals some variations across

⁷ These data are not quite compatible across countries by sector classifications. Furthermore, seasonally adjusted data, which are more appropriate for examining the fall-outs of the deepening global financial crisis since September 2008, are not available for most of countries. A further consideration is required to assess the full impact of the financial crisis on the industrial sector at this stage, since some of these monthly data are as a rule subject to considerable revision in the coming months. For many countries, data are available only up to January and February 2009.

⁸ Data available from China do not allow an examination across sectors on a comparable basis as for other countries.

countries, reflecting country-specific conditions and structural features in domestic and export demand, as well as financial arrangements that corporations and enterprises might have. For example, export industries specific to countries, such as processing and preserving of fish and fish products or fruit and vegetable (Chile), textiles and leather products (Czech Republic) or electric machinery and electronic products (Singapore), have been severely affected by the weakened export demand.

Yet, several common patterns can be noted. Motor vehicles and transport equipment, basic metals and steel, chemical and chemical products, rubber products and construction materials appear commonly in the list of affected sectors across most countries. These industries require high roll-over financial requirements of considerable size and, hence, tend to be exposed to the vagary of credit crunches. Significantly weakened domestic investment and consumption in the face of high uncertainty must have also influenced the marked decline in production in these sub-sectors. They are typically those that constitute a mainstay of industrial activity, producing strategic industrial inputs, such as basic metals, non-metal products and steel, as well as consumer durables, such as motor vehicles and electrical goods. The gathering domestic credit crunch in these economies appeared to have more negatively affected sectors producing consumer durables in many countries, including Brazil, Chile, Mexico, and the Republic of Korea. Thus, demand for investment goods and consumer durables are hit particularly hard by credit disruption and rising inventory build-up as well as plummeting confidence and increasing anxiety on the part of consumers and investors worldwide. On the other hand, sectors producing basic, consumer non-durables such as foods and beverages, have so far escaped a severe contraction in production in all countries examined. The marked contraction in a number of strategic sectors for a relatively short space of time of five to six months is an indication of the severity of the synchronized recessionary effects as well as a worrying prospect for ripple effects for other activities in the coming months.

The slow-down has by now affected all sectors in a number of emerging economies in Asia and Eastern Europe, where most industries have experienced a sharp fall of more than 30-40 per cent in their activities. For these economies, table A.2 lists representative sectors that have experienced a sharp decline. By contrast, many sectors in India and China have registered continuously positive rates of growth, even though they have declined considerably since September 2008. The aggregate index shows the subdued level of activities in several key sectors. More recently, there are signs that the two large Asian drivers might have managed to avoid

further deterioration and contraction through large-scale stimulus packages, aimed at increasing domestic demand.

In the case of India, disaggregate analysis by different industrial sectors can be corroborated by detailed statistics available from the government sources in addition to the EIU data set. In earlier statistics, released in mid-February 2009, the Government report pointed to several warnings of sharp decline in industrial activities in the last quarter of 2008. It reported that aggregate industrial output posted a negative growth rate of 2 per cent on an annual basis in December, while the manufacturing sector posted a negative growth rate of 2.6 per cent. The report noted that the reduction in factory output was the first in India since 1994. The weakened activities were attributed to a combination of external and domestic factors, including reduced global demand, lagged effects of earlier interest rate rises and emergence of a domestic credit crunch. Many companies in India began to use measures such as sabbaticals and shorter working weeks to cut production and postpone lay-offs of workers. Industries such as automobiles were also hit hard. While the sharpest decline was reported in construction and textiles, in October, car sales dropped by nearly 20 per cent in November - the worst fall for India in eight years. In December, the industrial grouping of jute and other vegetable fibre textiles except cotton, recorded a negative growth of 66.4 per cent, followed by the negative growth rates of 20 per cent in wood and wood products; furniture and fixtures and 17.9 per cent in transport equipment and parts. As per use-based classification, the sectoral growth rates in December 2008 compared to December 2007 were 1.7 per cent in basic goods and 4.2 per cent in capital goods, while intermediate goods experienced a negative growth rate of 8.5 per cent. Consumer durables and non-durables recorded negative growth of 12.8 and 0.1 per cent, respectively.

In the first quarter of 2009, the aggregate industrial production index of India posted a negative growth rate of 2.3 per cent on an annual basis in March, while the manufacturing sector posted a negative growth rate of 3.3 per cent. Five out of 17 industrial groupings had positive growth in March. These included beverages, tobacco and related products, which had the highest growth, at 15.1 per cent, followed by 8.3 per cent in basic chemicals and chemical products and 7 per cent in transport equipment and parts. However, as per use-based classification, the sectoral growth rates for capital and intermediate goods were negative at 8.2 per cent and 4.4 per cent, respectively, in March 2009 compared to March 2008, while consumer durables managed to post a positive growth rate of 8.3 per cent.

Effects of the projected reduction in private capital flows

The outlook for private capital flows to developing countries has worsened significantly in recent months. As shown in table 2, the Institute of International Finance (IIF, 2009) currently expects that net private capital flows to emerging economies will be cut to US\$196 billion in 2009, from US\$929 billion in 2007 and US\$466 billion in 2008, amounting to a decline of 82 per cent from 2007. No region will escape from a severe reduction in private capital flows to emerging economies. All forms of private flows---debt and equity---are expected to slow down significantly. Net bank lending, for example, is expected to have a net outflow of US\$61 billion in 2009, from an inflow of US\$410 billion in 2007 and US\$167 billion in 2008. The reduction in direct investment flows to these economies is expected to be US\$197 billion in 2009, from US\$263 billion in 2008. This is because foreign direct investment in the past was known to be more resilient to business and credit cycles. The projected slow-down in FDI would adversely affect industrial production and other economic activities, as many emerging economies managed to attract a significant portion of inward investment by transnational corporations in the recent past.

A conspicuous feature of the on-going financial crisis is that large transnational corporations in developed countries, which have been one of the key driving forces behind the current wave of corporate-led globalization, have been severely affected in their financial capability for further investment and expansion. Both internal and external financial sources have increasingly dried up, due to a decline in corporate profits as well as reduced availability and higher cost of finance at the time of the severe credit crunches (UNCTAD, 2009). According to an UNCTAD estimate, global FDI flows were expected to have declined by 21 per cent in 2008. In developed countries, FDI inflows fell by 33 per cent, while developing economies and countries with economies in transition experienced a slower annual growth rate of 3.6 per cent and 6.2 per cent, respectively, in 2008 compared to 2007, as shown in table 4.

Table 4 FDI inflows and cross-border M&As by region and major economy, 2007-2008

Region/economy	FDI inflows			Cross-border M&As		
	2007	2008 ^a	Growth rate (%)	2007	2008 ^a	Growth rate (%)
World	1,833.3	1,449.1	- 21.0	1,637.1	1,183.7	-27.7
Developed economies	1,247.6	840.1	- 32.7	1,454.1	981.8	-32.5
Europe	848.5	562.3	- 33.7	825.0	548.7	-33.5
United States	232.8	220.0	- 5.5	379.4	314.9	-17.0
Japan	22.5	17.4	- 22.6	21.4	19.1	-10.8
Developing economies	499.7	517.7	3.6	152.9	177.0	15.7
Africa	53.0	61.9	16.8	10.2	26.3	157.0
Latin America and the Caribbean	126.3	142.3	12.7	30.7	29.5	-3.8
Asia and Oceania	320.5	313.5	- 2.2	112.0	121.2	8.2
West Asia	71.5	56.3	- 21.3	30.3	31.5	4.0
South, East and South-East Asia	247.8	256.1	3.3	81.5	89.4	9.7
Transition economies	85.9	91.3	6.2	30.1	25.0	-17.0

Source: UNCTAD.

^a Preliminary estimates.

Note: World FDI inflows in 2008 are projected on the basis of data for 103 economies for which data were available for part of 2008 as of 19 December 2008. Data for 2008 are estimated by annualizing the data available, in most cases for 6–10 months of 2008, except for France, Germany, Greece, the Netherlands, Poland, Romania, Spain, Sweden, Canada, United States, Australia, Japan, Pakistan, Kazakhstan and Ukraine where FDI flows in last few months of 2008 are assumed to be negligible. The proportion of inflows to these economies in total inflows to their respective region or subregion in 2007 is used to extrapolate the 2008 data. For cross-border M&As, estimates were made on the basis of data available as of 5 January 2009.

Source: UNCTAD (2009), table 1.

As the global financial crisis deepened, transnational corporations began to adjust significantly current operations as well as investment. Many large multinational corporations in high-income economies announced considerable cuts in their operations, involving closure of production sites across the globe. High-profile mergers and acquisitions were aborted or postponed. A wide range of industries were affected, including mining, automobiles, aircraft and steel, to name a few, in various locations in developed and developing countries.

FDI in developing countries was curtailed in 2008: That to India, for example, was reported to have declined by 40 per cent from the first to the second quarter of 2008. FDI to China dropped to US\$6.6 billion in September 2008, a 20 per cent reduction from the monthly 2008 average. In autumn 2008, a high profile M&A was postponed in South Africa. Thus, the continued severe credit crunch could depress the level of FDI to developing countries for some time. The earlier estimate of a 15 per cent drop in FDI to developing countries for 2009 seems to be on the optimistic side by now. Currently, the prospect for a quick recovery of FDI flows to developing countries in 2009-2010 appears grim.

In low-income developing countries, the effects of reduced capital flows due to the global financial crisis are much less pronounced so far. However, even the prospective effects of reduced private capital flows to low-income countries may not be negligible if a hypothetical counterfactual scenario is taken into account. In this context, The African Development Bank (2008) argues that, as the world economy slows, investment flows that have supported growth in the region in recent years would decline.

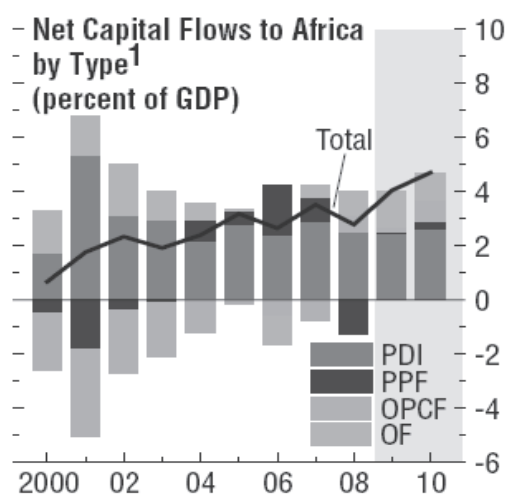
“Risk averse foreign direct investors, hedge funds, private equity, and international companies, are already pulling funds out of Africa to deal with redemptions, slower fundraising, and lower profits. International banks will be tempted to cut-off trade lines (both import and export) to preserve capital. There is already evidence that the crisis is making external credit harder to secure for African banks. Commercial banks have seen their lines of credit shrink while fund-raising for new initiatives appear to be in jeopardy. Also, countries that were planning to issue sovereign bond for long-term financing for infrastructure development may have to put it off for some time. As a result, African governments will face major macroeconomic adjustments not of their making and not in their control. (African Development Bank, 2008:3)”

Massa and te Verde (2008) further evaluate potential financial channels through which the current financial crisis could affect private capital flows to countries in sub-Saharan Africa:

- Several countries in sub-Saharan Africa, such as South Africa, Kenya, Nigeria and, possibly, Ghana have been negatively affected by the reduction in, or the withdrawal of portfolio flows to their stock markets.
- Countries with a high share of foreign bank ownerships such as Mali, Rwanda and Mozambique, United Republic of Tanzania and Uganda are exposed to a potential risk of capital withdrawals by parent banks in home countries.
- There would be a significant reduction in FDI flows to the continent, as evinced by the reported hold-ups or cancellation of FDIs in the mining sector in Zambia and South Africa as a result of the financial crisis.

IMF predicts that Africa would receive reduced financial flows in the form of portfolio flows and private remittances in 2009, though this may be somewhat compensated for by larger official aid flows (figure 18).

Figure 18 Net capital flows to Africa



Sources: Bloomberg Financial Markets; and IMF staff calculations.
¹PDI: private direct investment; PPF: private portfolio flows; OPCF: other private capital flows; OF: official flows.

Source: International Monetary Fund (2009), figure 2.9.

The effects of the financial crisis on low-income countries would come through other channels, such as the slow-down in world demand for their exports, lower commodity prices; reduced remittances, decline in tourism and reduced or unpredictable aid inflows. Cali, Messa and te Verde (2008) report that several remittance-dependent countries have already experienced a significant fall in flows from the United States so far. Remittances from Mexican migrant workers fell by 12 per cent on an annual basis in 2008, whereas the Kenyan Central Bank forecasted that remittance flows would fall by 38 per cent this year. Overall, Cali et.al (2008) predict that the remittance flows would decline by 20 per cent, or US\$40 billion, globally as a consequence of the ongoing financial crisis. Furthermore, a significant number of low- and middle-income countries are predicted to suffer from a reduction in receipts from tourism, another vital source of their service income.

It is too early to assess the effects of the global financial crisis on ODA flows. Because of considerable strains placed on governments of donor countries by large-scale rescue operations and ensuing fiscal retrenchments required to reduce mounting public debt in future, aid flows are likely to suffer substantially. Many of the country experts who participated in a recent IDS survey-study (IDS, 2008) indicate that aid from rich countries is declining as governments

reassess their priorities, with serious implications for low-income countries, in particular, those in sub-Saharan Africa.

This reduction in these flows, together with the marked slow-down of economic growth in developing countries as a result of the global financial crisis, will adversely affect the prospect of achieving the Millennium Development Goals, including that of achieving a sizeable reduction in poverty. Economic growth, in particular job-creating growth, is a potent means for poverty reduction worldwide. Indeed, it is difficult to reduce poverty without economic growth (Nissanke and Thorbecke, 2006 a and b and 2008). However, not all economic growth may contribute to poverty reduction in an equal measure. As discussed in Nissanke and Thorbecke (2006 a and b), a high degree of inequality attenuates the growth elasticity of poverty, with growth declining in proportion to the extent of inequality (Ravallion, 2002). Therefore, while growth may benefit the poor, the ultimate poverty reduction effects would depend on how the growth pattern influences income distribution. Hence, inequality is the interface between growth and poverty reduction. In this sense, the pattern of economic growth and development---rather than the rate of growth per se---may have significant effects on a country's income distribution and poverty profile, as growth can be pro-poor, distribution neutral or, even poverty promoting. There is much empirical evidence to suggest that the poor may benefit less than the non-poor or, in some instances, actually be hurt in the process of globalization-induced economic growth, when growth leads to an increase in income inequality (Nissanke and Thorbecke, 2008).

Clearly, the downside of globalization is most conspicuous at times of global financial and economic crises. In fact, the costs of financial crises fuelled by the globalization process have been borne overwhelmingly by the developing world in recent decades. This will be certainly the case with the current financial crisis if it lasts for a long period, even though the crisis originated in the financial centers of the United States and Europe, far away from countries where the most severe pains would be felt. Thus, the letter co-signed by Kofi Annan, Michel Camdessus and Robert Rubin states:⁹

“...when crises occur, the least responsible are usually the worst affected and the least able to cope.... Right now, the political focus is on protecting consumers and taxpayers in industrialized countries. But poor people and poor countries could soon end up paying the heaviest price for a mess they have had no hand in creating. A

⁹ *Financial Times*, 30 October 2008.

response to the crisis that does not take into account the needs of the world's poor – or, worse, that results in reduced levels of engagement – would be grossly unfair.... We all share responsibility for the persistence of poverty, hunger, disease and illiteracy on a vast scale. The sense of injustice they engender is a threat to economic and political security. The sense of responsibility that has galvanised western politicians into action to restore confidence in the financial system should, in a globalised world, also result in actions to accelerate achievement of the millennium development goals”.

A larger proportion of the eventual cost of the fall-out from the on-going global financial crisis could rest on the poor in the developing world, who are vulnerable to unemployment and/or loss of livelihood and opportunities for earning a meagre income from their insecure occupations. Small and medium enterprises, as well as micro-enterprises, are the first to be denied access to bank credits and loans or charged considerably higher rates and fees.

In addition to an expected substantial increase in unemployment worldwide as a direct consequence of the global financial crisis, the recent ILO Report (ILO, 2009) predicts that if it continues to deepen, the proportion of those in vulnerable employment---own-account workers or contributing family workers in small concerns---could rise to 56 per cent in 2009, from 50 per cent in 2007. The Report predicts that the share of those in extreme working poverty, earning less than \$1,25 per day would rise from 21 per cent in 2007 to 27 per cent in 2009, while those in working poverty earning less than \$2 daily, would increase from 41 per cent in 2007 to more than 50 per cent in 2009. Many in vulnerable employment and the majority in working and extreme working poverty are found in the developing world.

There is general agreement about the need to institute a programme of safety nets to protect the poor at times of financial crisis. However, the financial resources required for such a programme are generally scarce at national level when fragile economies are in a crisis situation. In issuing a stark warning, 12 February 2009, that the ongoing global financial crisis and the global slow-down could trap 53 million more persons in poverty, the World Bank proposed establishment of a special vulnerability fund for developing countries, by setting aside 0.7 per cent of the stimulus packages in developed countries.¹⁰

¹⁰ See: <http://go.worldbank.org/1FWPZ7KCJ0>

5. Concluding remarks

In order to resolve the growing financial crisis that has engulfed the world economy since July-August, 2007, large, unprecedented rescue packages involving trillions of dollars have been put in place worldwide to unlock the credit freeze and to restore confidence to the international banking system and financial markets through liquidity injections.¹¹ In the United States, nine banks have been partially nationalized and various debt and deposit insurances have been announced. In Europe, a similar process of massive bank restructuring has taken place, with several guarantee schemes having been announced to stem an anticipated wave of bank runs and panic.

Policy interest rates have been slashed in a concerted manner worldwide. The United States Federal Reserve Rate was cut to a 0-0.25 range in December 2008, while both the European Central bank and Bank of England have aggressively reduced their rates, to a historically low level. Having lost room for further interest rate cuts as a monetary policy instrument, many central banks have engaged in aggressive quantitative easing, by purchasing government bonds and commercial securities and creating an asset in the central banks account against which bank lending can be resumed. By increasing broad money supply through this channel, it is hoped to unlock frozen credit lines and restore confidence in financial markets and institutions.

Despite signs that the worst is over, the crisis of confidence continues in financial markets. Inter-bank lending rates continue to remain highly volatile, and corporate and sovereign interest spreads for developing countries remain at a historically high level. Both equity and currency markets continue to suffer extreme volatilities worldwide. Financial centres and markets are far from returning to normality. All major advanced economies are officially declared to be mired in a deep recession. A series of bankruptcies of high profile large corporations and high volumes of foreclosures and job losses have dominated the national and international news since September 2008, as the real economy worldwide has fallen victim to large-scale gambles taken by the financial sector for the last several years.

Given the sharply deteriorating economic conditions, many governments have turned to large fiscal stimulus packages to address the fall-out of the crisis on the real economy and to prevent the world economy from sliding into a deeper recession. For example, in the face of the rapidly

¹¹ It has been estimated that some US\$4-5 trillion have been spent globally by November 2008 to deal directly with the current financial crisis (UN, 2008).

escalating job losses over the recent months, the new Obama administration has had congressional approval for the fiscal stimulus package amounting to nearly \$800 billion over two years including large-scale public infrastructure projects.¹² Governments of a number of emerging market economies such as China, India, Mexico and Republic of Korea have mounted their own fiscal stimulus packages in order to mitigate the devastating effects of the current financial crisis on real economic activities and job losses. At least for now it appears that in place of supply-side economics, based on rational expectation or efficient market hypotheses that have dominated the economic policy debate over the last three decades, Keynesian macroeconomics is back in the main economic policy arena as a credible paradigm to govern and regulate market economies and to counteract sharp fluctuations in aggregate demand produced by market forces.

This paper has shown the extent and the scale of collateral damage that the present financial crisis has inflicted on the developing world so far and discussed the much larger damage inflicted by the globally synchronized slow-down and recession. IMF has established a new fast-track lending facility available to emerging market economies and developing countries without restrictive policy conditionality attached for the first time in its history. The World Bank Group---IBRD, IDA and IFC---has announced a significant enlargement of the envelop of financial resources available to assist the developing world to cope with difficult financial situations arising directly from the current global financial crisis. However, these measures may prove grossly inadequate to cover the true cost of the crisis that developing countries may have to bear in months and years ahead, if the current crisis deepens and is prolonged.

The crisis has demonstrated the scale of market failures prevalent in financial transactions, which is one of most established and accepted axioms in financial economics. Indeed, each time when emerging market economies underwent a financial crisis in the recent decades, number of forewarnings of the danger of unregulated market activities in finance has been given by experts and those concerned with the absence of adequate regulation and supervision. However, their advice and concerns have been conveniently ignored as soon as the global financial system has managed to emerge from the crisis. These warnings have often fallen on deaf ears among those politicians and policy makers who place too much trust in the illusory superiority of markets to allocate resources efficiently. Instead, it is the inadequacies and immaturity of the financial systems in developing countries, which have been identified as the chief culprit for the crisis, rather than the market failures ubiquitous in any financial system. Hence, lukewarm policy

¹² In the United States, 2.6 million workers lost their jobs in 2008, with 1.9 million in the last four months.

responses have been offered and accepted to reform the global financial system, without addressing the root cause of periodical crises. The UN Report rightly remarks:

“The crisis should have taken no one by surprise. That analysts and policymakers are now expressing bewilderment at the extent of the crisis suggests not only a gross underestimation of the fundamental causes underlying the crisis but also unfounded faith in the self-regulatory capacity of unfettered financial markets” (UN, 2008:p.6)

In this sense, the current financial crisis is the outcome of governance as well as market failure. Globalization has proceeded without adequate governance structures in place for far too long (Nissanke, 2007). It is high time for the global community to wake up to this reality and demand that policy makers and politicians make genuine efforts for globalization to work for all. In particular, the need for reforming the global financial system and creating a new international architecture for governing financial globalization, as a part of the new Bretton Woods II system, is paramount. The new system should be radically different from the current one of implementing marginal reform measures.¹³

The ongoing financial crisis has shown how ill-prepared the international monetary and financial system under the current regime is to take on a task of financial intermediation for productive investment and economic development. The system has disappointed the aspirations of many in developing countries to industrialize and diversify their economies as part of the structural transformation needed to build a solid foundation for sustained, broad-based economic development and substantial poverty reduction, which the international community has collectively committed to achieve in the Millennium Development Goals Declaration.

¹³ The UN Report released in early June 2009 contains a comprehensive set of reform measures to this effect.

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Appendix:

Table A.1 World Economic Outlook Predictions by IMF

(Percent change, unless otherwise noted)

	Year over Year										
			Projections				Difference from January 2009 WEO Projections		Q4 over Q4		
	2007	2008	2009	2010	2009	2010	Estimates	Projections	2008	2009	2010
World output¹	5.2	3.2	-1.3	1.9	-1.8	-1.1	0.2	-0.6	2.6		
Advanced economies	2.7	0.9	-3.8	0.0	-1.8	-1.1	-1.7	-2.6	1.0		
United States	2.0	1.1	-2.8	0.0	-1.2	-1.6	-0.8	-2.2	1.5		
Euro area	2.7	0.9	-4.2	-0.4	-2.2	-0.6	-1.4	-3.5	0.6		
Germany	2.5	1.3	-5.6	-1.0	-3.1	-1.1	-1.7	-4.4	0.0		
France	2.1	0.7	-3.0	0.4	-1.1	-0.3	-1.0	-2.2	1.4		
Italy	1.6	-1.0	-4.4	-0.4	-2.3	-0.3	-2.9	-2.9	0.2		
Spain	3.7	1.2	-3.0	-0.7	-1.3	-0.6	-0.7	-2.9	0.2		
Japan	2.4	-0.6	-6.2	0.5	-3.6	-0.1	-4.3	-2.7	-0.6		
United Kingdom	3.0	0.7	-4.1	-0.4	-1.3	-0.6	-2.0	-3.2	0.6		
Canada	2.7	0.5	-2.5	1.2	-1.3	-0.4	-0.7	-1.9	1.7		
Other advanced economies	4.7	1.6	-4.1	0.6	-1.7	-1.6	-2.7	-1.9	1.7		
Newly industrialized Asian economies	5.7	1.5	-5.6	0.8	-1.7	-2.3	-4.8	-1.5	2.0		
Emerging and developing economies ²	8.3	6.1	1.6	4.0	-1.7	-1.0	3.3	2.3	5.0		
Africa	6.2	5.2	2.0	3.9	-1.4	-1.0	...	...	...
Sub-Sahara	6.9	5.5	1.7	3.8	-1.8	-1.2	...	...	...
Central and eastern Europe	5.4	2.9	-3.7	0.8	-3.3	-1.7	...	...	...
Commonwealth of Independent States	8.6	5.5	-5.1	1.2	-4.7	-1.0	...	...	...
Russia	8.1	5.6	-6.0	0.5	-5.3	-0.8	1.2	-4.7	1.0		
Excluding Russia	9.9	5.3	-2.9	3.1	-3.2	-1.3	...	...	...
Developing Asia	10.6	7.7	4.8	6.1	-0.7	-0.8	...	...	...
China	13.0	9.0	6.5	7.5	-0.2	-0.5	6.8	6.9	7.9		
India	9.3	7.3	4.5	5.6	-0.6	-0.9	4.5	4.8	5.9		
ASEAN-5	6.3	4.9	0.0	2.3	-2.7	-1.8	2.1	1.2	3.3		
Middle East	6.3	5.9	2.5	3.5	-1.4	-1.2	...	...	...
Western Hemisphere	5.7	4.2	-1.5	1.6	-2.6	-1.4	...	...	...
Brazil	5.7	5.1	-1.3	2.2	-3.1	-1.3	1.2	1.1	2.4		
Mexico	3.3	1.3	-3.7	1.0	-3.4	-1.1	-1.7	-2.1	2.5		
<i>Memorandum</i>											
European Union	3.1	1.1	-4.0	-0.3	-2.2	-0.8	...	...	...
World growth based on market exchange rates	3.8	2.1	-2.5	1.0	-1.9	-1.1	...	...	...
World trade volume (goods and services)	7.2	3.3	-11.0	0.6	-8.2	-2.6	...	...	...
Imports											
Advanced economies	4.7	0.4	-12.1	0.4	-9.0	-1.5	...	...	...
Emerging and developing economies	14.0	10.9	-8.8	0.6	-6.6	-5.2	...	...	...
Exports											
Advanced economies	6.1	1.8	-13.5	0.5	-9.8	-1.6	...	...	...
Emerging and developing economies	9.5	6.0	-6.4	1.2	-5.6	-4.2	...	...	...
Commodity prices (U.S. dollars)											
Oil ³	10.7	36.4	-46.4	20.2	2.1	0.2	...	...	...
Nonfuel (average based on world commodity export weights)	14.1	7.5	-27.9	4.4	1.2	-2.9	...	...	...
Consumer prices											
Advanced economies	2.2	3.4	-0.2	0.3	-0.5	-0.5	2.1	-0.1	0.4		
Emerging and developing economies ²	6.4	9.3	5.7	4.7	-0.1	-0.3	7.7	4.4	4.0		
London interbank offered rate (percent)⁴											
On U.S. dollar deposits	5.3	3.0	1.5	1.4	0.2	-1.5	...	...	...
On euro deposits	4.3	4.6	1.6	2.0	-0.6	-0.7	...	...	...
On Japanese yen deposits	0.9	1.0	1.0	0.5	0.0	0.1	...	...	...

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during February 25–March 25, 2009. Country weights used to construct aggregate growth rates for groups of countries were revised.

¹The quarterly estimates and projections account for 90 percent of the world purchasing-power-parity weights.

²The quarterly estimates and projections account for approximately 77 percent of the emerging and developing economies.

³Simple average of prices of U.K. Brent, Dubai, and West Texas Intermediate crude oil. The average price of oil in U.S. dollars a barrel was \$97.03 in 2008; the assumed price based on future markets is \$52.00 in 2009 and \$62.50 in 2010.

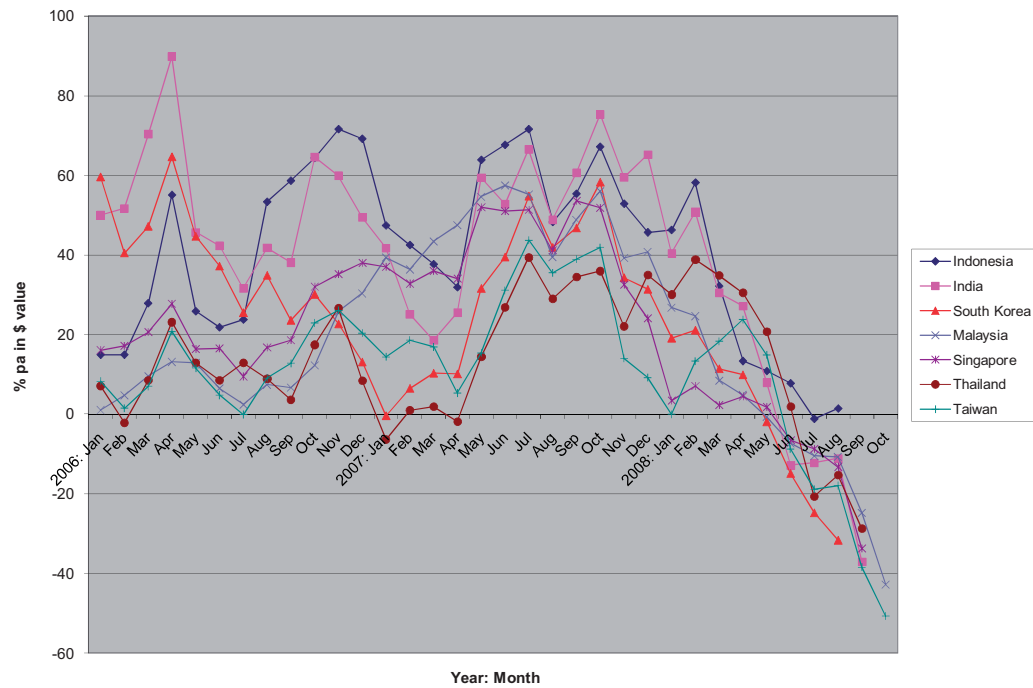
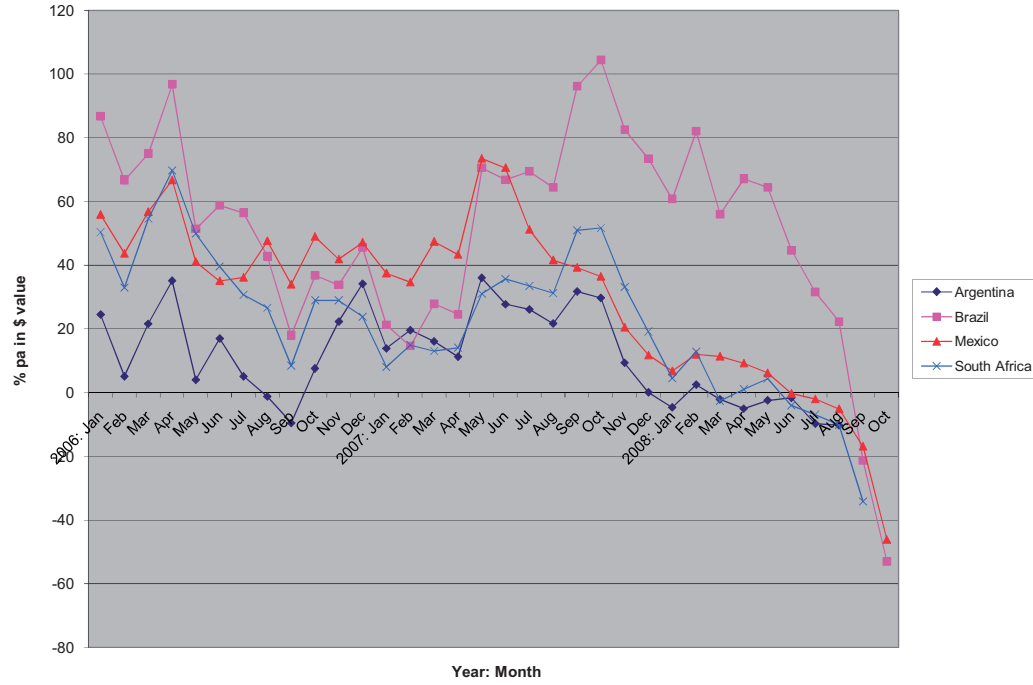
⁴Six-month rate for the United States and Japan. Three-month rate for the euro area.

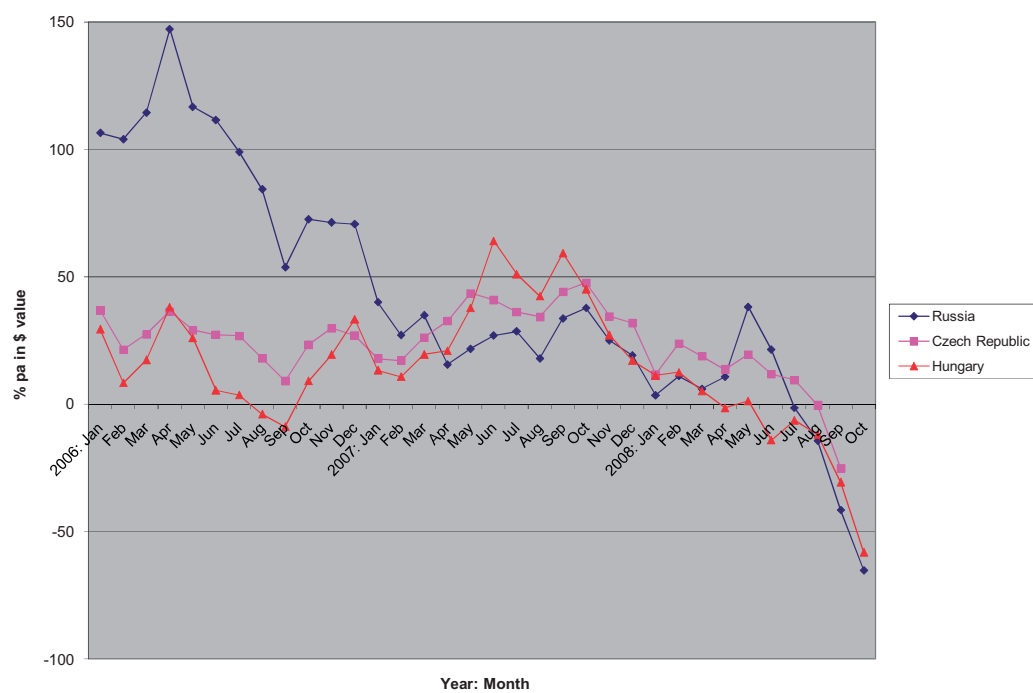
Source: International Monetary Fund (2009), World Economic Outlook Table 1.1.

Table A.2 Industrial sectors with a sharp reduction in production: selected emerging market economies (September 2008-February/March 2009)

<i>Countries</i>	<i>Example of sectors with more than 30 points reduction in index</i>
<i>Latin America</i>	
Argentina (to March)	Motor vehicles crude steel, textiles, basic metals
Brazil (to February)	Consumer durables, metals, electrics and communications, capital goods, intermediate goods, motor vehicles
Chile (to February)	Consumer durables, processing and preserving of fish and fish products, rubber products, basic iron and steel, motor vehicles and parts
Mexico (to March)	Motor vehicles
<i>Asia</i>	
India (to February)	Consumer durables, transport equipment and parts
Taiwan Province of China (to March)	Most industries, including basic and fabricated metals, textile mills, chemical materials and products, plastic products,
Thailand (to February)	Iron and steel products, electrical and electronic products, construction materials
Singapore (to January)	Most industries, basic metals, wearing apparel, chemicals and chemical products, electric machinery and electronic products
Republic of Korea (to February)	Intermediate goods, consumer durables
<i>Transition economies</i>	
Bulgaria (to February)	Most industries, including textiles wood products, motor vehicles, chemicals and chemical Products
Croatia (to February)	All industries, including consumer durables, capital goods, intermediate goods, consumer non-durables
Czech Republic (to February)	Most Industries, including basic metals, machinery and equipment, transport equipment, textiles, leather and leather products, pulp and paper products, rubber and plastics, non-metric mineral products, electrical and optical equipment
Hungary (to February)	Transport equipment, machinery, non-metric products

Figure A.1 Stock market indices for selected emerging market economies

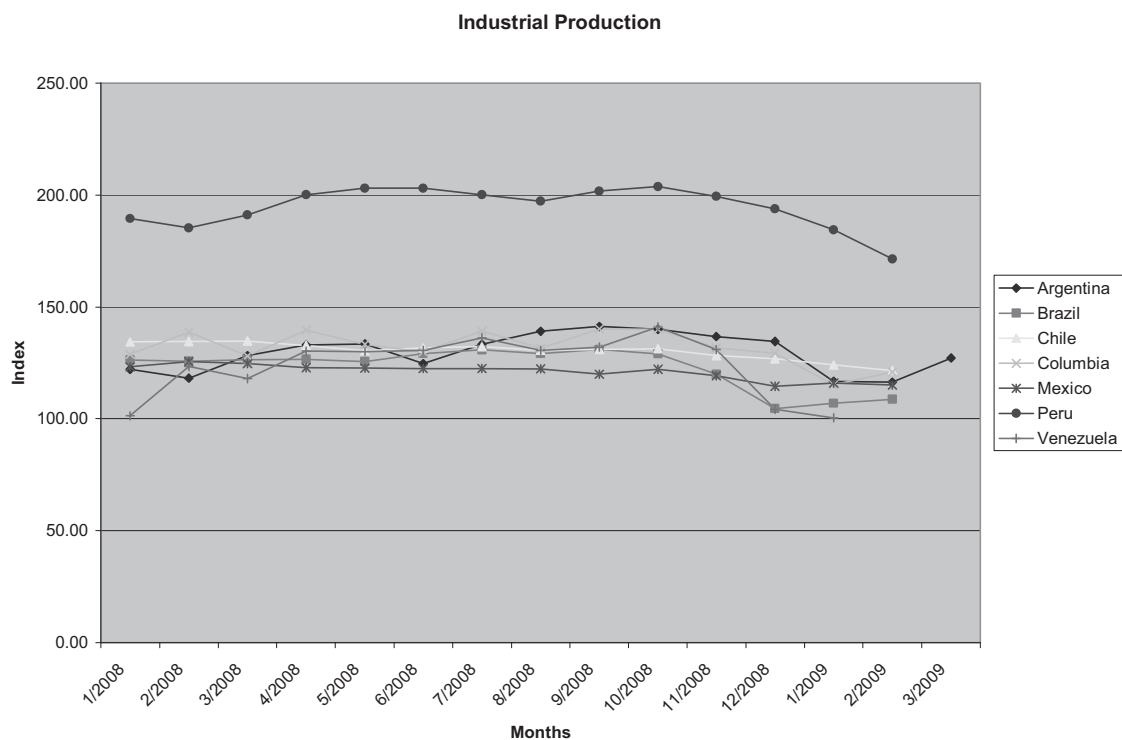




Source: EIU data set.

Figure A.2 Industrial or manufacturing production index for selected emerging market economies

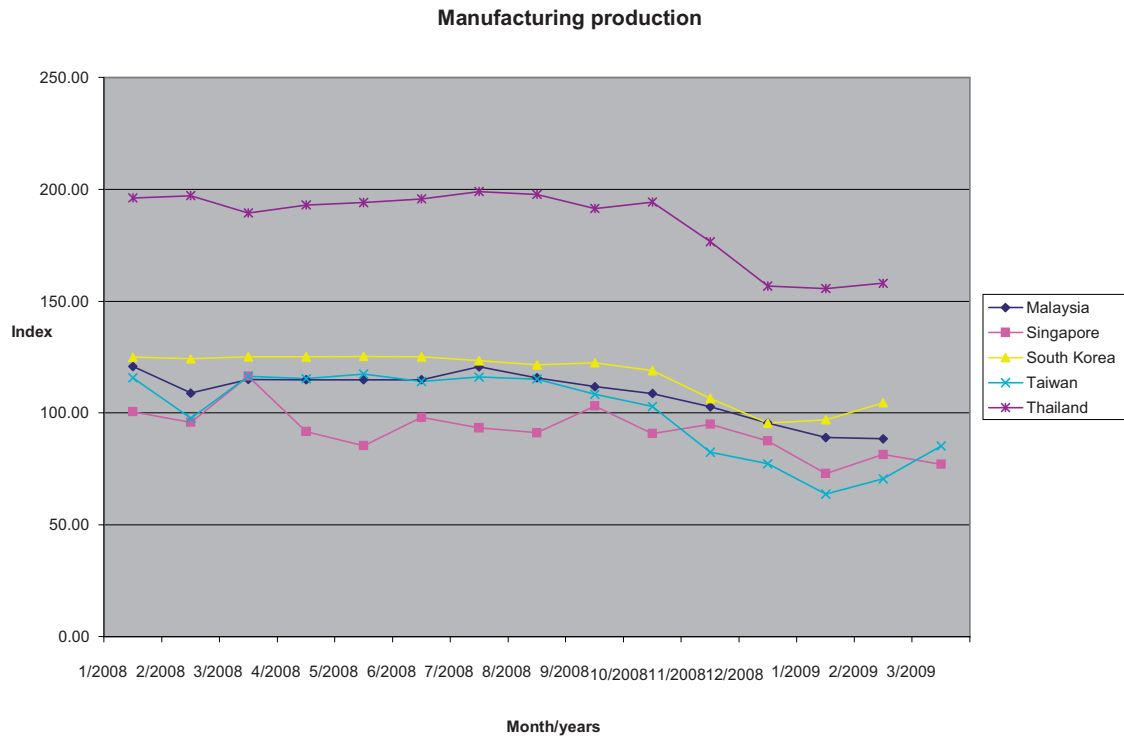
a) Latin American countries



Source: EIU data set.

Note: Monthly data not seasonally adjusted, except for Chile, where seasonally adjusted manufacturing production is reported.

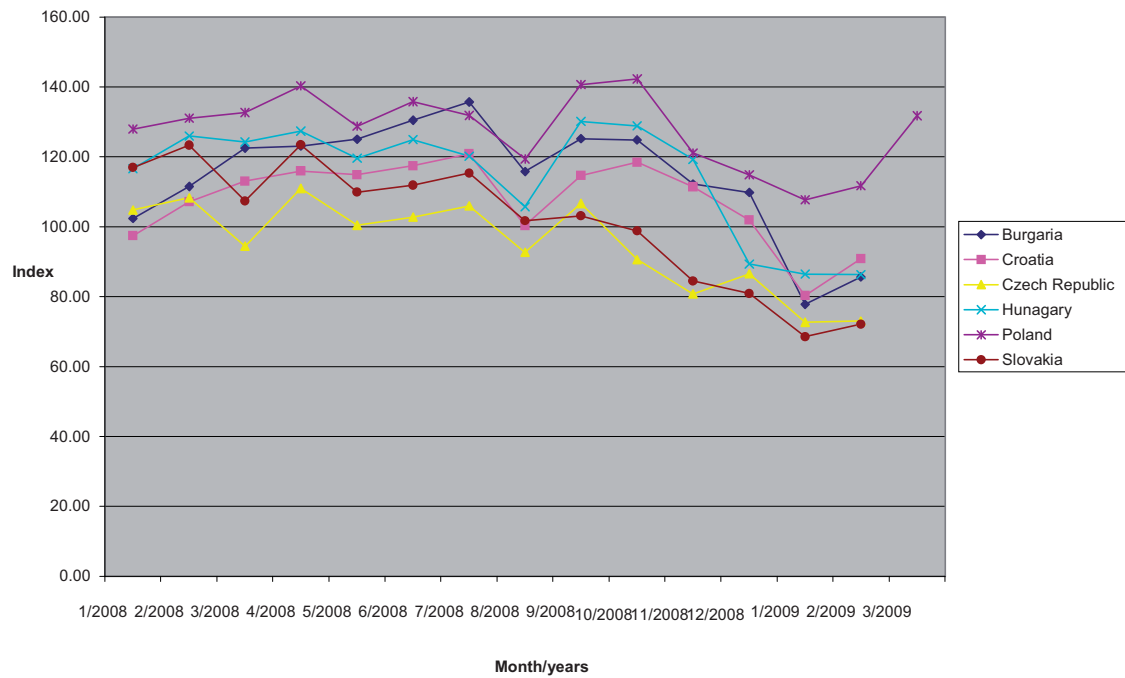
b) Asian countries



Note: Monthly data not seasonally adjusted, except for the Republic of Korea and Thailand, for which seasonally adjusted data are available.

c) Countries with economies in transition in Eastern Europe

Manufacturing production



Note: Monthly data not seasonally adjusted. Data for Slovakia is for industrial production.



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