CROATIAN NATIONAL BANK

Emerging markets during the crisis: why this time was different?

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How much did we understand?

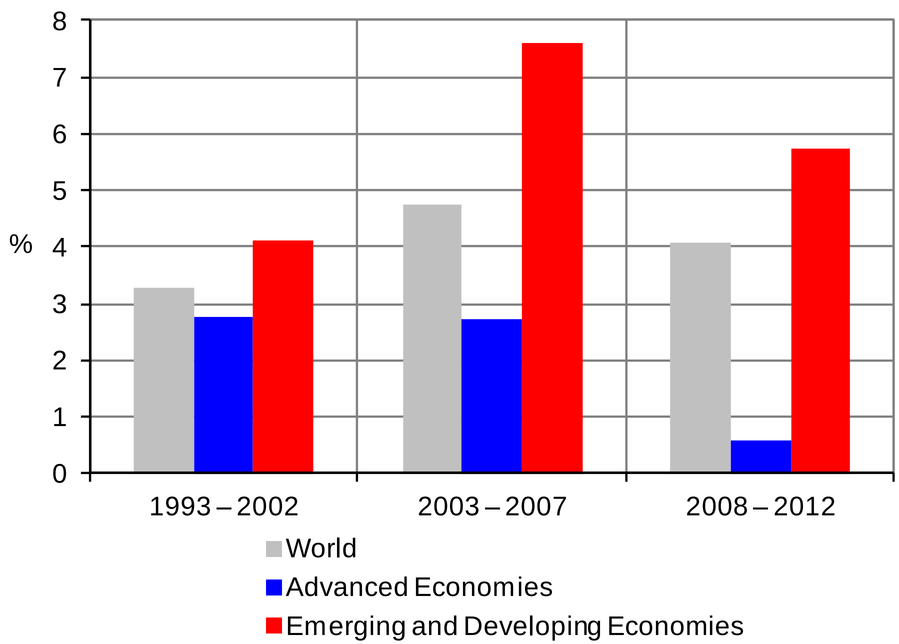
- Advanced world crisis and emerging world, a brief sequence of thoughts:

1) first...was the ”decoupling” story (2007-8)
2) well, maybe not..(2008-9)
3) ooops, it’s worse than we thought: financial flows will dry out (2009)
4) hm, maybe not (2010)
5) QE2 will flood the EM’s with capital, ER appreciation and asset price bublles?..another crisis!?..(2010)
6) ….? (2011)

Growth in emerging/developing economies resilient and catch-up untouched

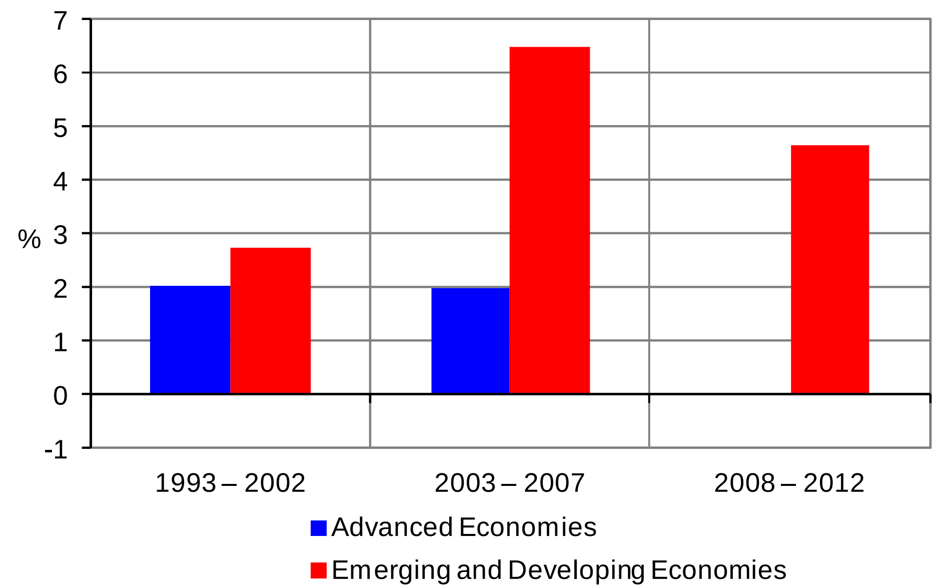
Real GDP growth,

period averages



GDP per capita growth rate,

period averages

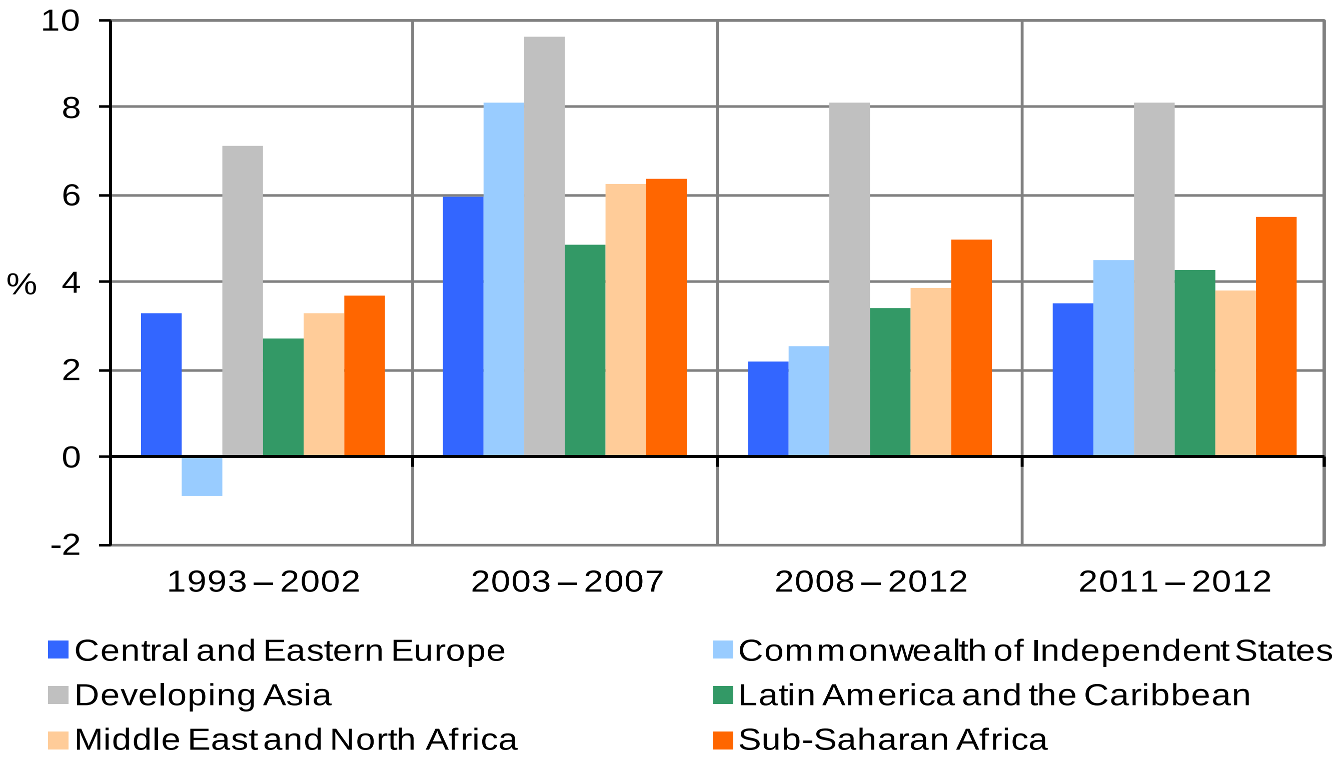


Source: IMF WEO, September 2011

...while Asia outperforms other regions, all expect solid growth, the most afffected being the CEE..

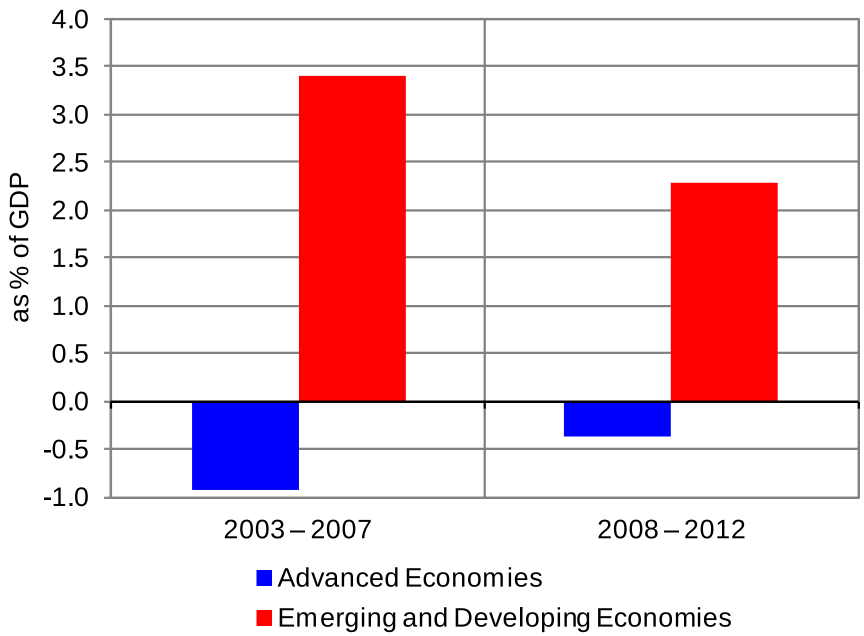
Real GDP growth,

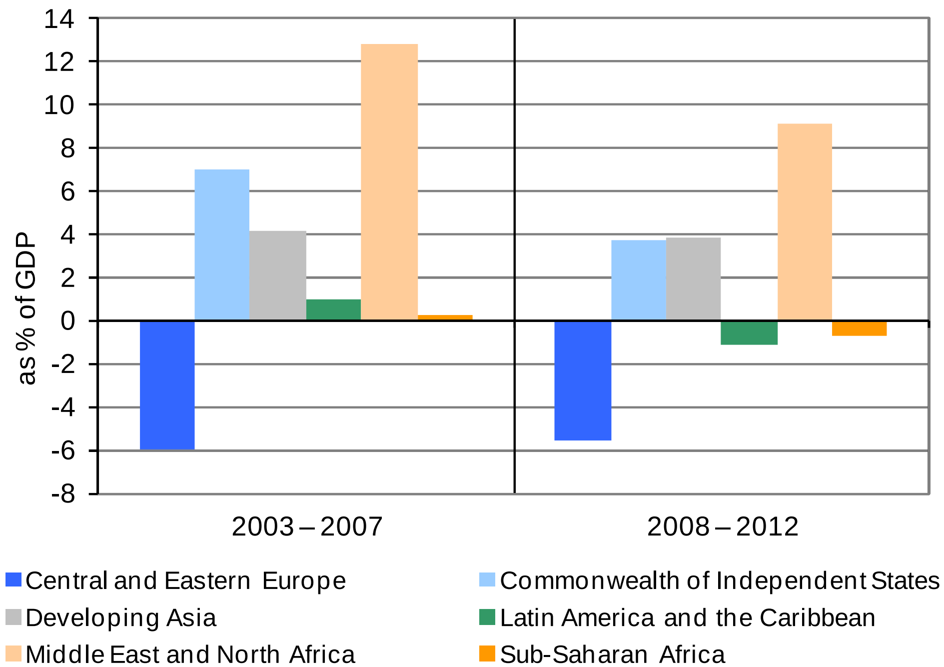
period averages



CA imbalances are reduced, but still there

Current account balances by region,



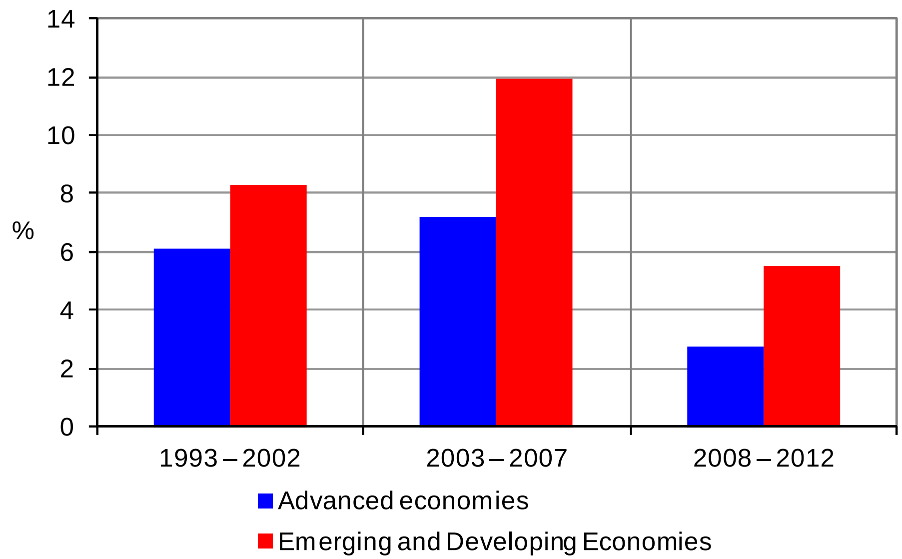


Source: IMF WEO, September 2011

Export growth affected most but terms of trade gains still there ...

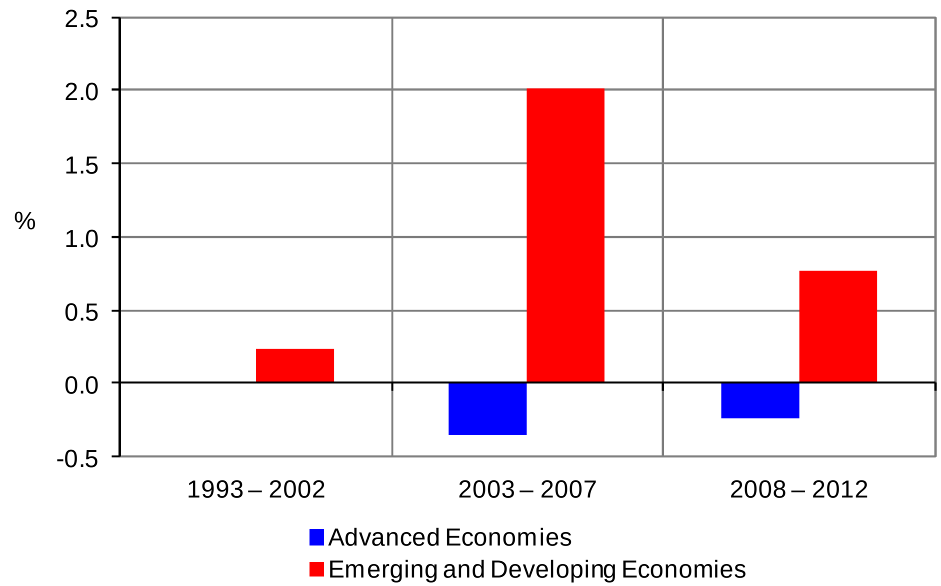
Export Volumes of Goods and Services

% change, period averages



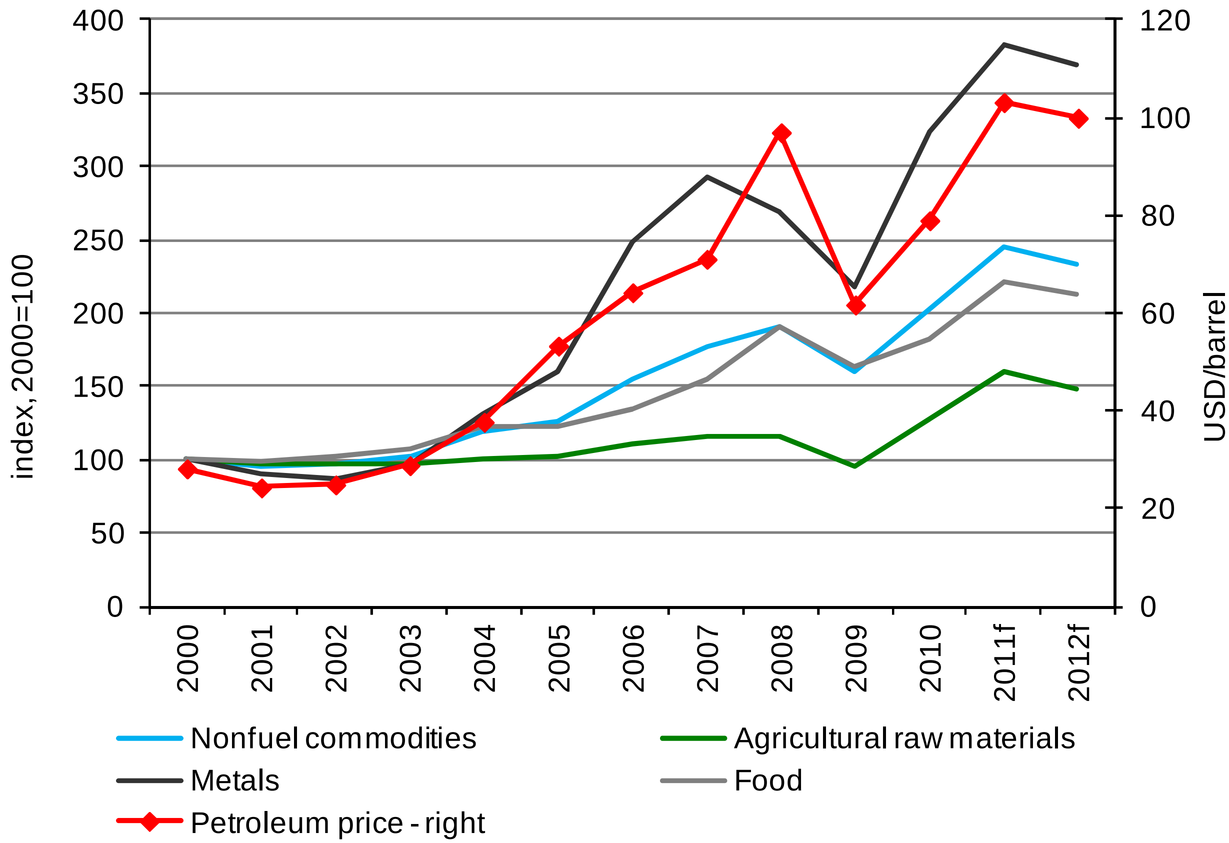
Terms of Trade of Goods and Services,

% change, period averages



Source: IMF WEO, September 2011

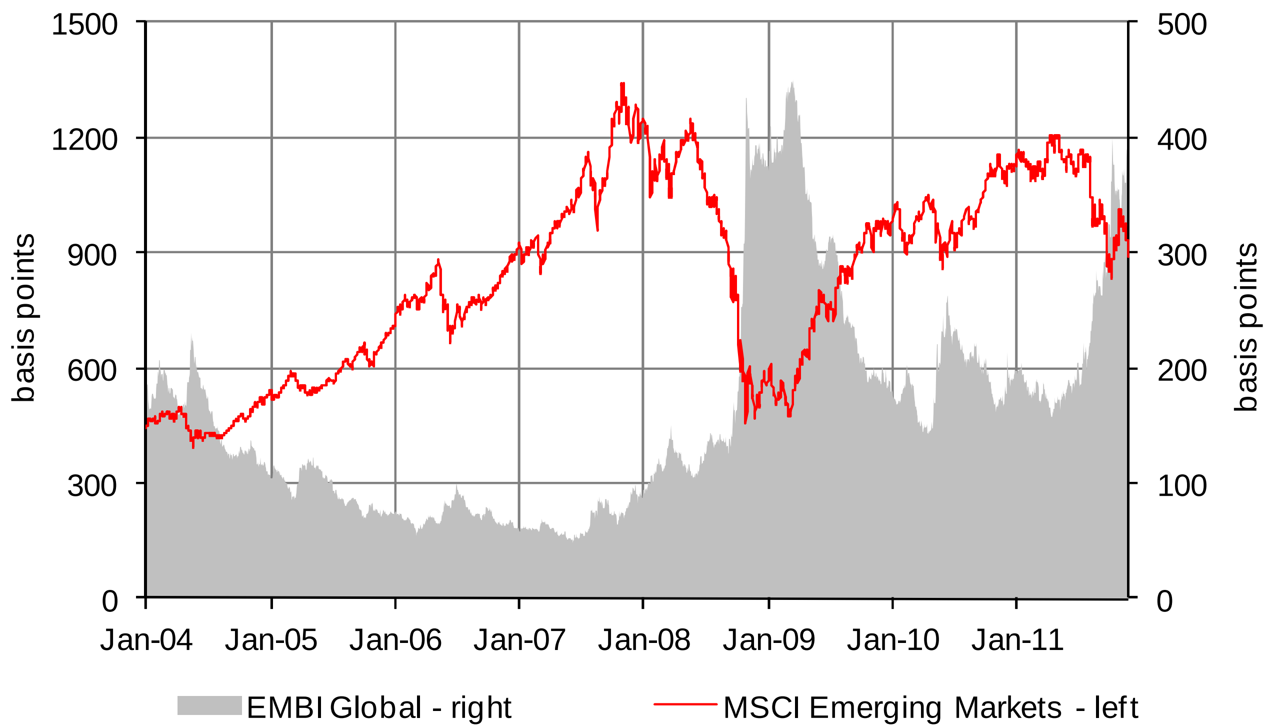
... largely related to commodity price increases ...



Source: IMF GAS

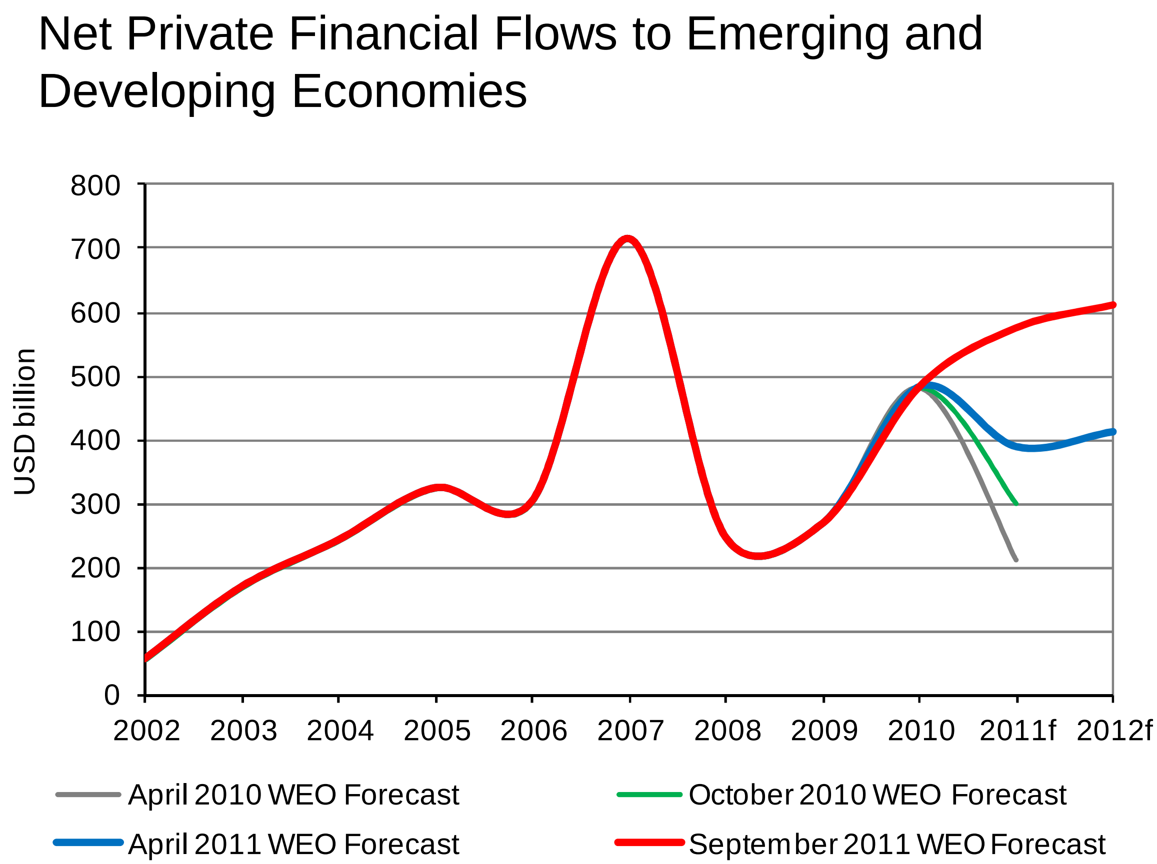
Equity market has recovered rapidly, FED/bubble? But re-pricing of risk there to stay!

Equity market and bond spread indices



Source: Bloomberg

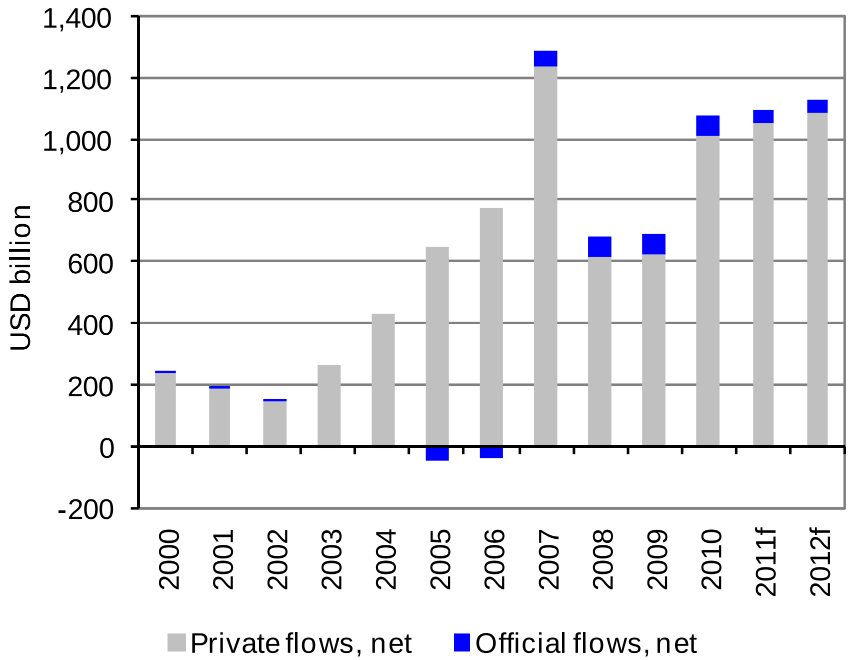
Capital flows much less affected by the crisis than was feared



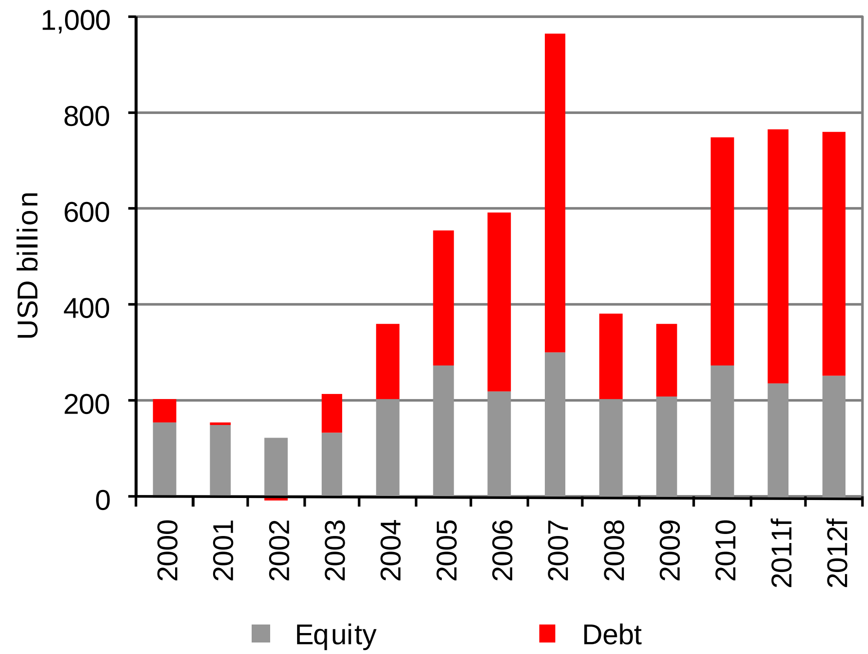
Source: IMF WEO

Capital flows over pre-crisis levels (2007 outlier)

Capital flows to emerging economies



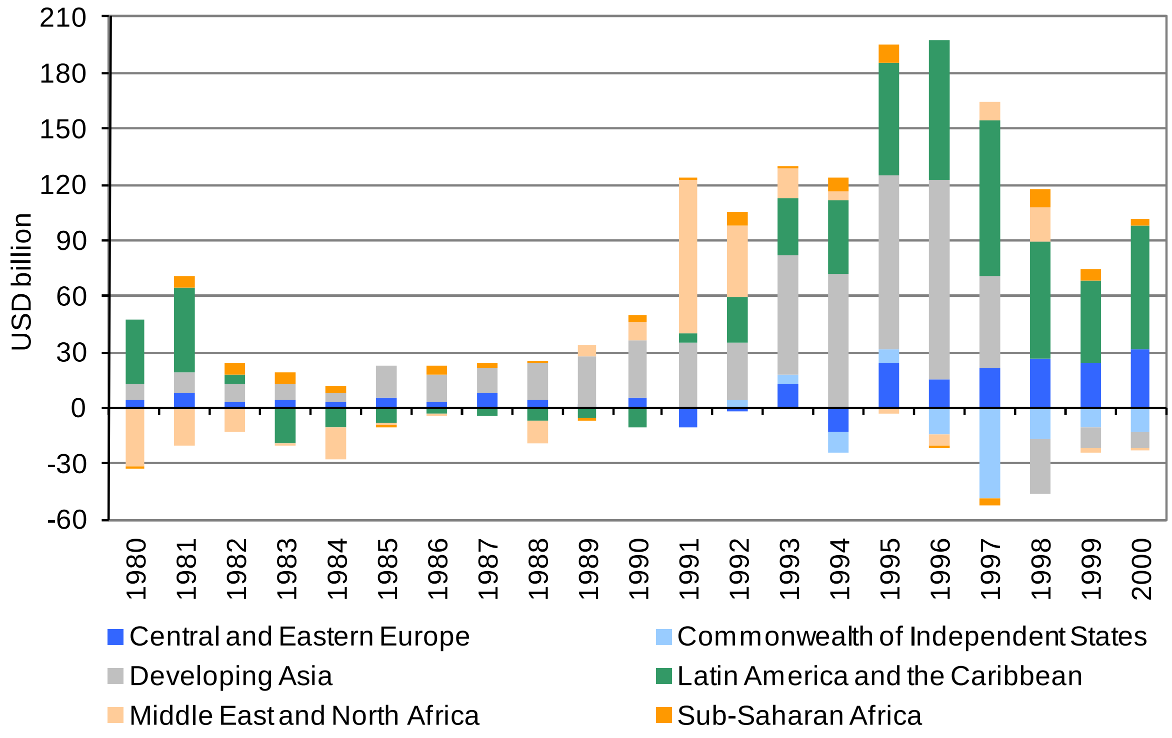
Composition of private capital flows, net



Source: IIF

Net capital inflows much lower and more volatile in 80's/90's

Regional breakdown of private capital flows (net) to emerging economies 1980 - 2000

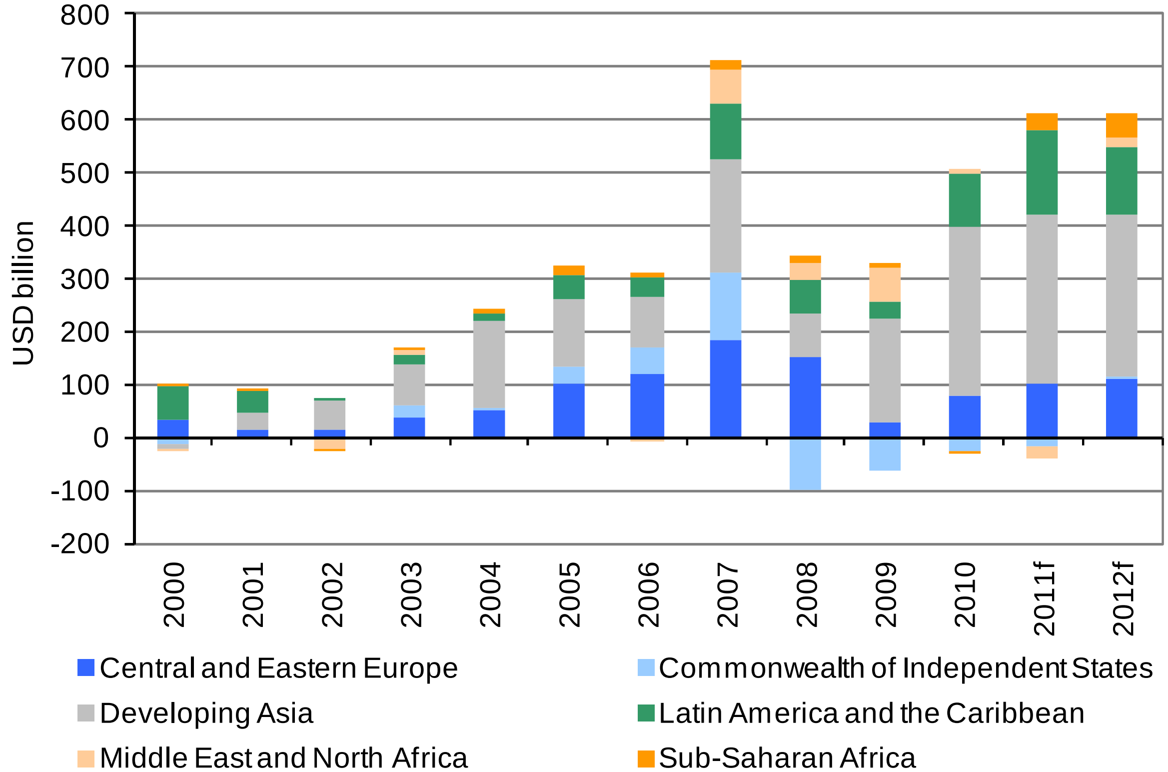


Note: Data on CIS available only since 1992

Source: IMF WEO, September 2011

... than in the last 8 years, in spite of the recent crisis, CEE/CIS most affected..

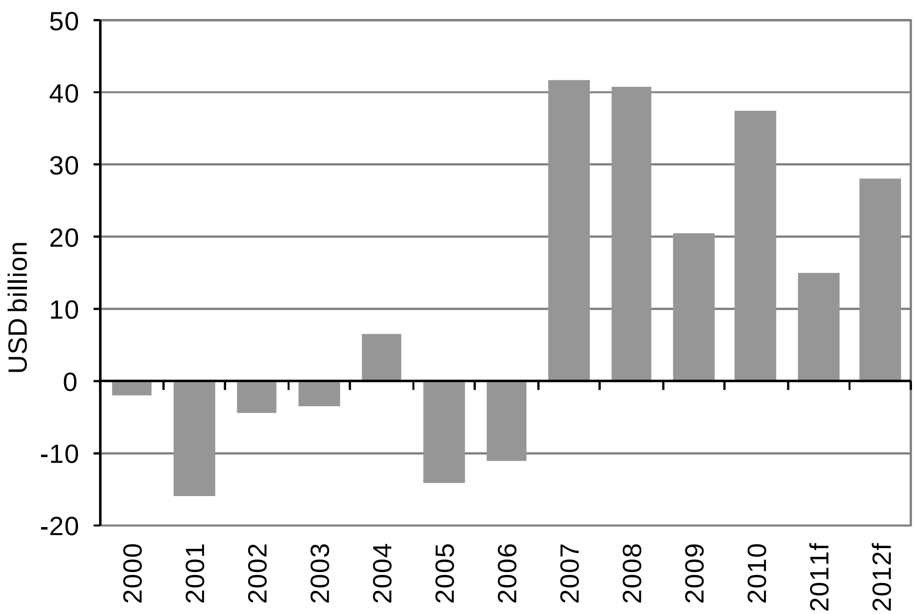
Regional breakdown of private capital inflows (net) to emerging economies 2000 - 2012



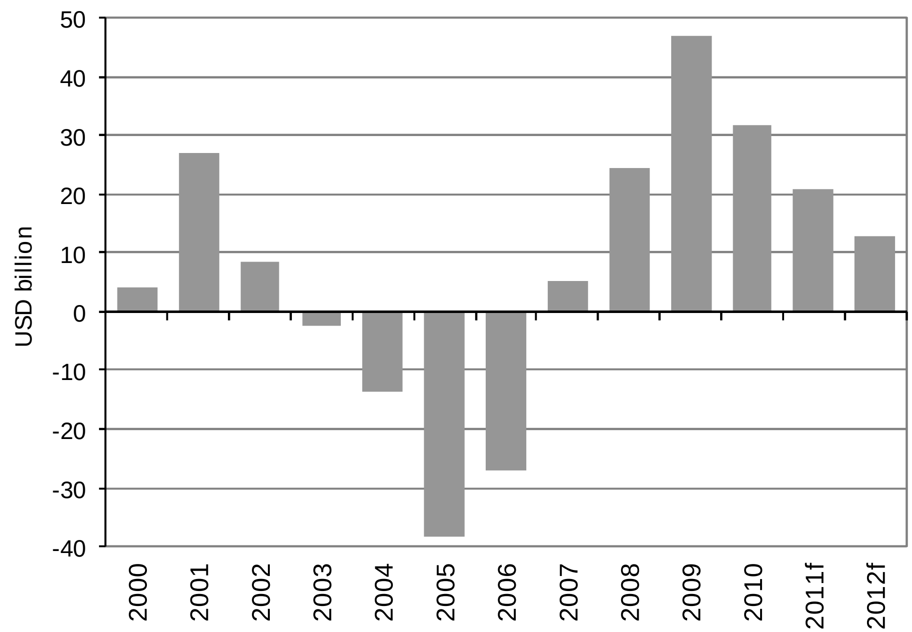
Source: IMF WEO, September 2011

… and, as usual with the crisis - official money is back in the game ...

Official bilateral creditors, net



International financial institutions, net



Source: IIF

But, this time around, most of the money goes to advanced countries

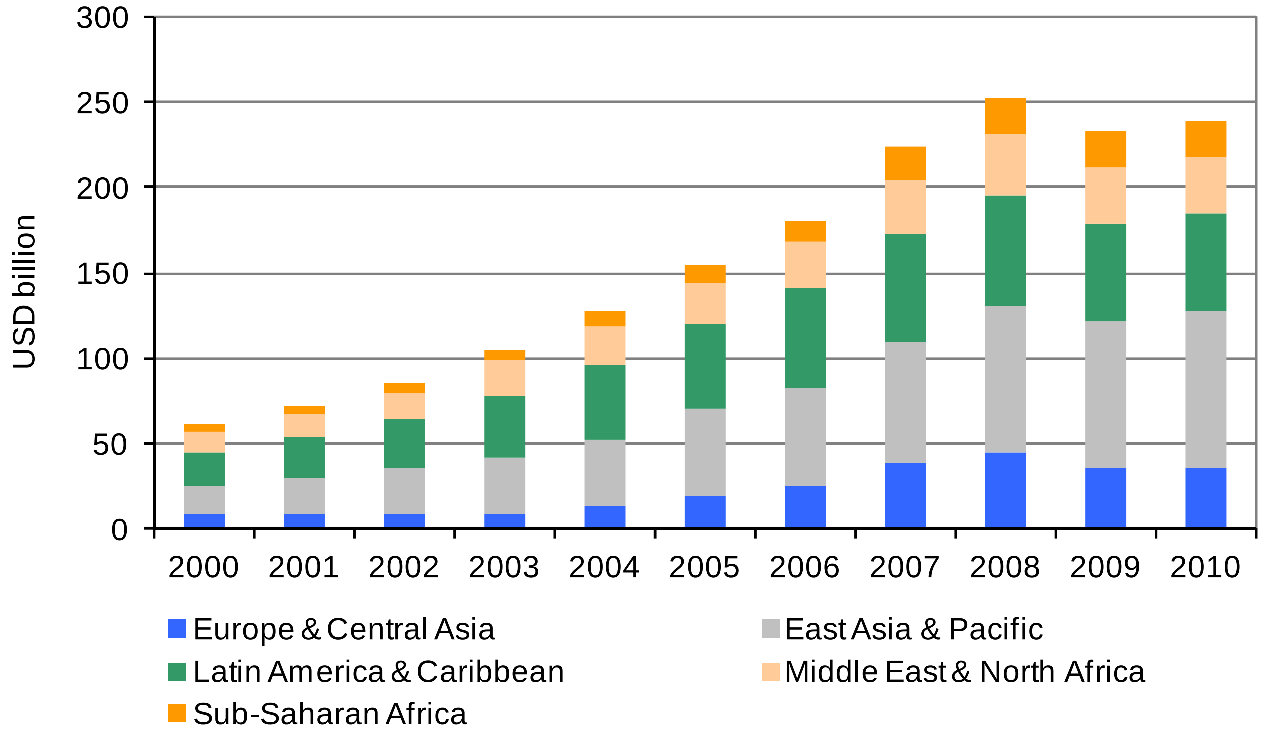
- Portugal in May 2011 has received $110bn (78 bn euros), cca **45%** of GDP
  - two-thirds from other eurozone states and a fund backed by the EU budget (cca 30% of GDP)
  - 26bn euros by the IMF (cca 15% of GDP)
- Greece alone has received cca **60%** of GDP in support money in 2010:
  - cca $90bn from ECB's Securities Market Program (cca 38% of GDP)
  - over $38bn from the IMF/EU (over 16% of GDP)
- EFSF 750 bn euros
- Greece + Ireland = 195bn euros

- Compared with:

- 1995: Mexico – cca 8% of GDP
- 1998: Thailand (cca 12%) Indonesia (cca 8%), Korea (cca 3%)
- 1999: Brazil – cca 2% of GDP
- 2001: Argentina (cca 3%) and Turkey (cca 6%) of GDP

Remittances suprisingly resilient, decline in LatAm and ECA

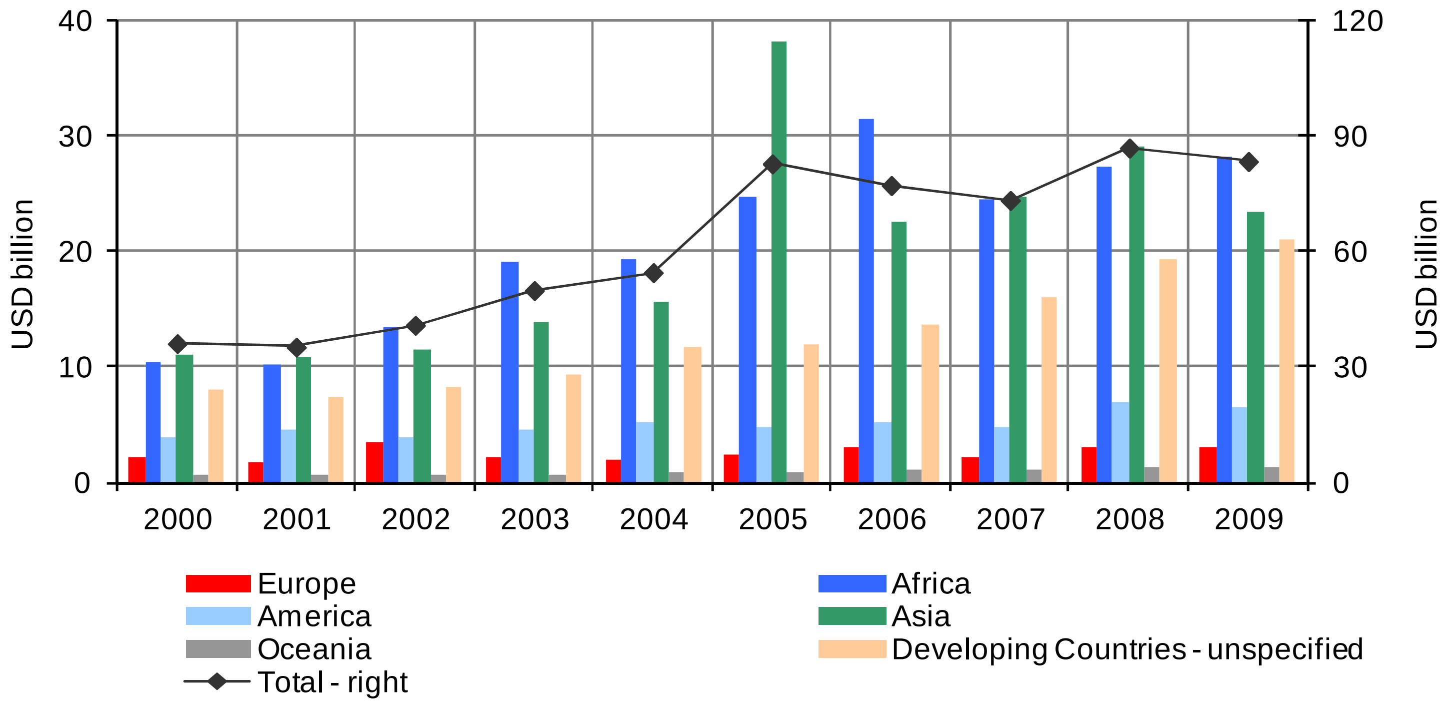
Remittances to Developing Countries



Source: World Bank, Global Development Finance Databank

… and ODA actually increased, again against the expectations …

Official Development Assistance to Developing Countries (all donors)

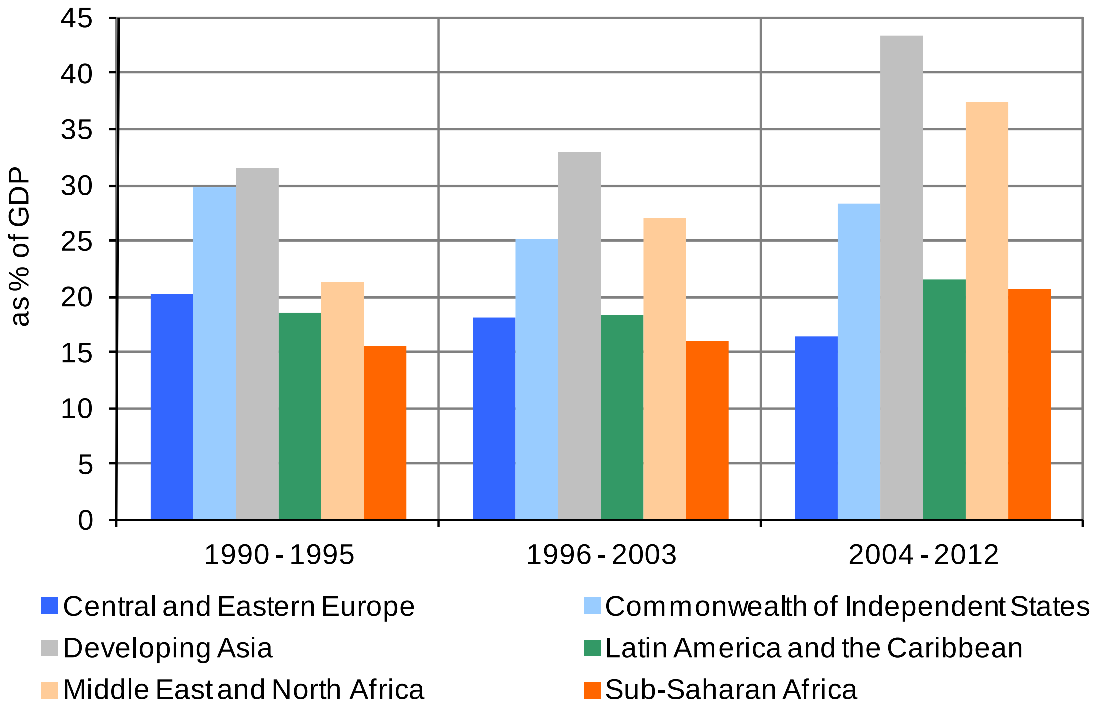


Source: OECD, Development Database on Aid

What makes developing world so resilient to this crisis?

Less dependendent on foreign savings (except the CEE)

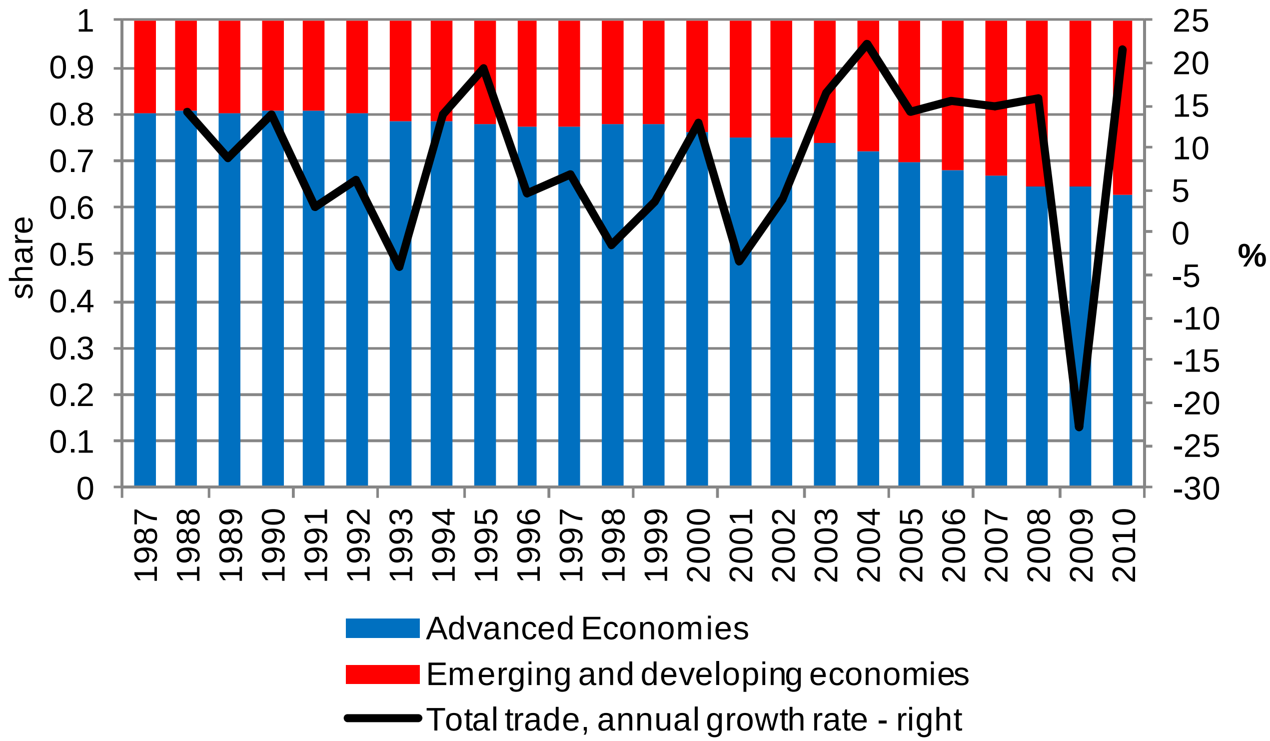
Gross national saving, as % of GDP



Source: IMF WEO, September 2011

Trade away from the advanced world (except for the CEE)

Developing countries, trade by partner region

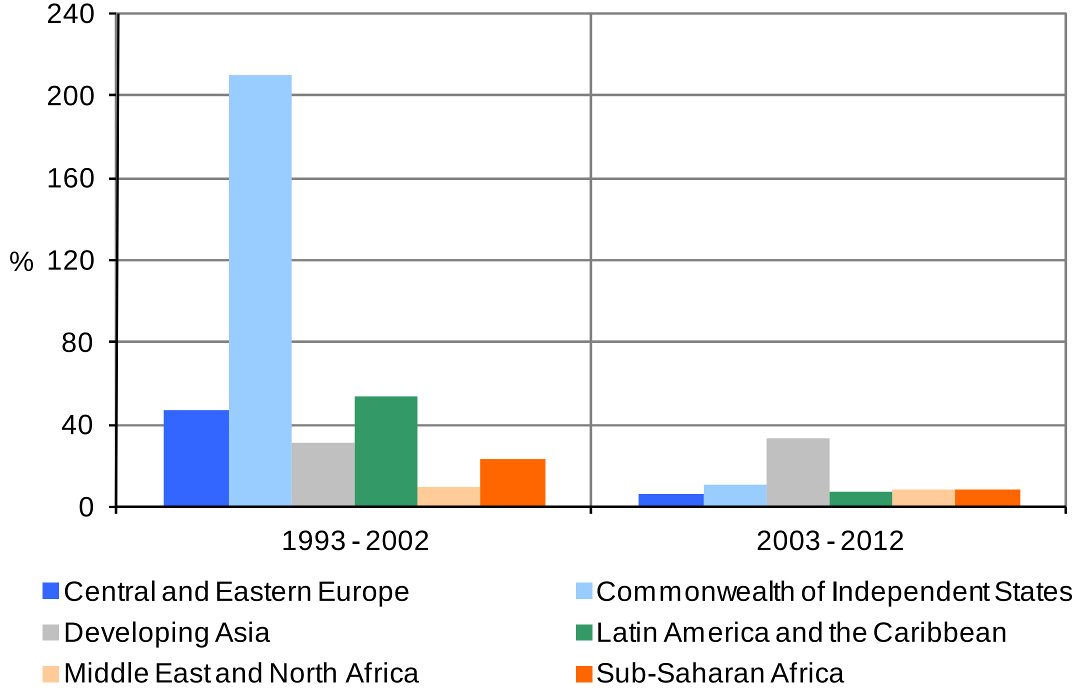


Source: IMF IFS

Good macroeconomic policies

Consumer Price Inflation, annual % change

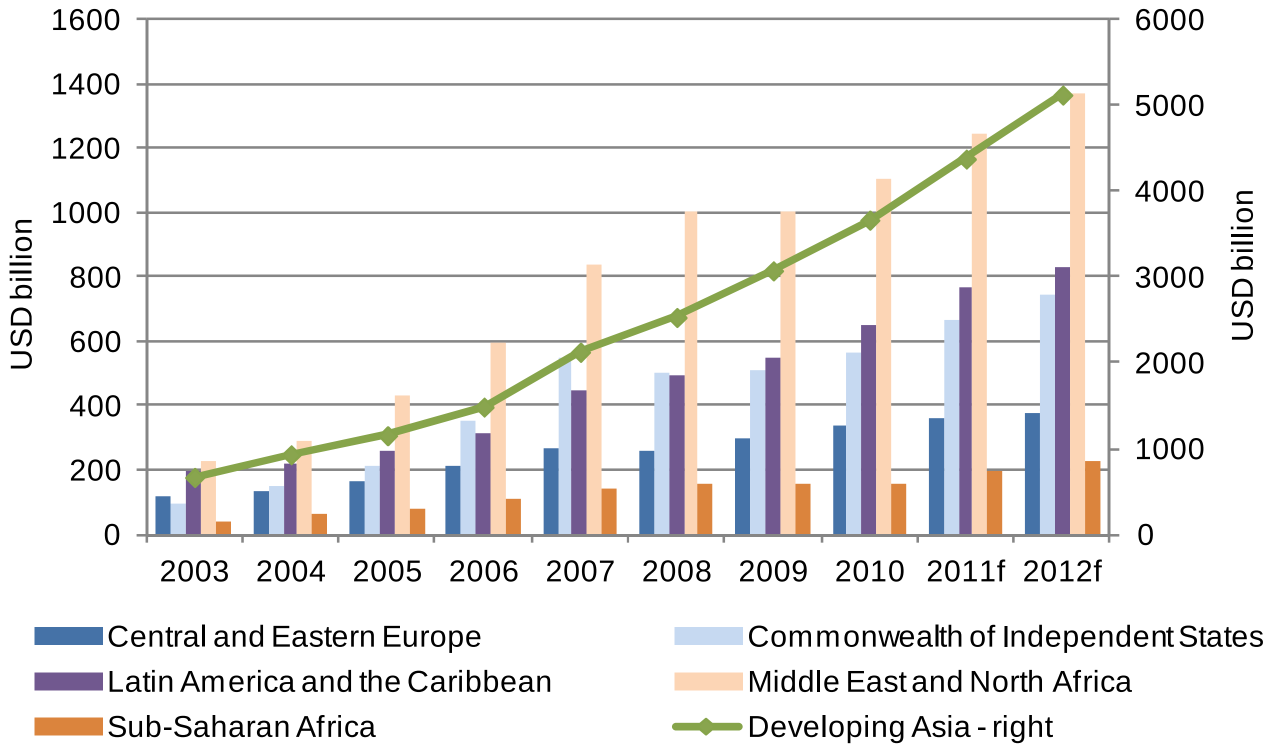
period averages



Source: IMF WEO, September 2011

Large buffers of rapidly increasing fx reserves, not affected by the crisis - “window effect”

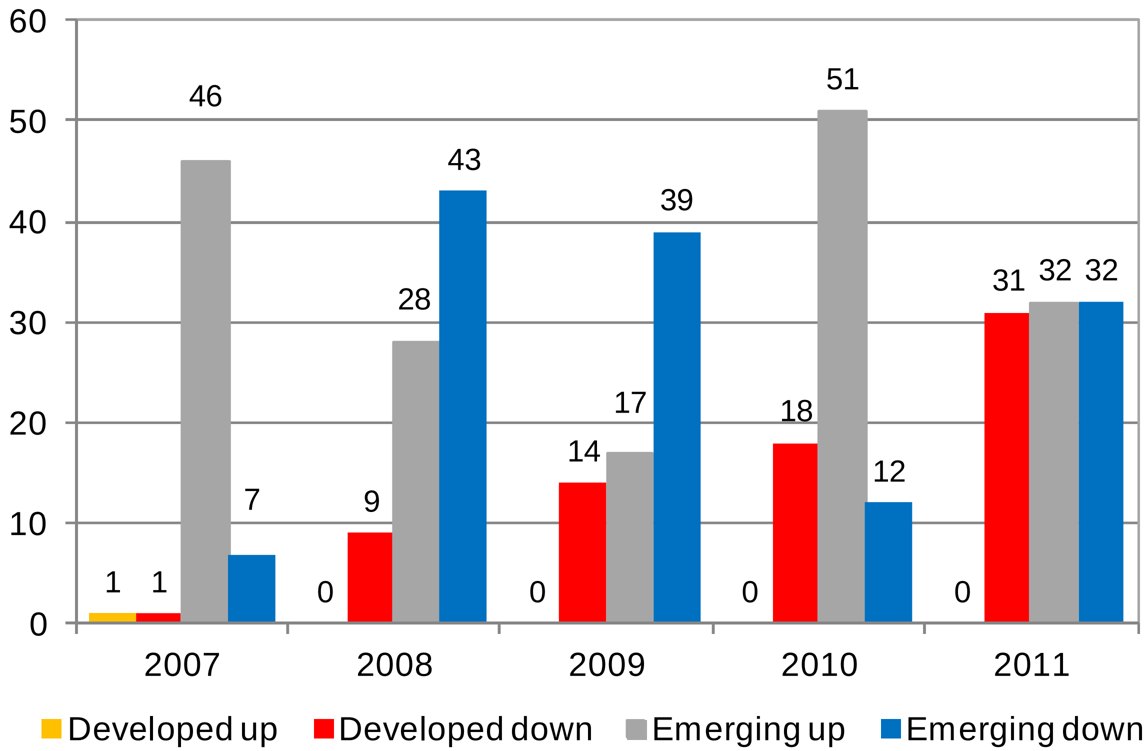
International Reserves, gross



Source: IMF WEO, September 2011

Developed and Emerging Market country ratings

Number of upgrades and downgrades



Sources: Moody's, Standard&Poor's; J.P.Morgan

So, things look quite good...

- Things have never looked better for the EM

- Growth prospects are, still, at historicaly high levels, catch-up with the advanced economies as well, macroeconomic policies are better than ever, dependence on foreign savings significantly reduced (even in the poorest places like Sub-Saharan Africa), foreign exchange reserves high and growing, financial flows back to the pre-crisis levels, ODA even increased during the crisis, EM financial markets have deepened and, thus, became more robust

- most affected by the crisis was Central and East Europe because it is most integrated with the advanced economies of Europe, both tradewise and in terms of financial flows

.. however, risks are still plentifull... they come from "inside"..

- it is not difficult to envisage a (financial) crisis in the developing world,
  - where markets are not properly regulated (Ireland, Iceland)
  - where, along with the financial lliberalization, asset price bubbles are not contained
  - where politics still play a large role in credit/assets distribution

- today the issue at hand is not the quantity, as was the case in the past, but quality of (intermediation) of finance for the EM – the good thing being the fact that they have where to learn from

- and that quality is about micro-management(1):
  - providing access for people and companies to financing in a manner that is both conducive to growth but, at the same time, reduces inequalities, particularly in countries where they are still huge
  - conclusion? how much, and in what ways, can a government intervention achieve in this area is still an open question (Gates project can help give some answers), microfinance...
- and, macro-management (2):
  - intermediation of capital (in)flows in an efficient manner, which requires a good institutional set-up, with prudent (macro)economic policies in order to avoid crisis episodes/volatility which hampers long-run growth
- and, yes, don't forget – politics play a large role

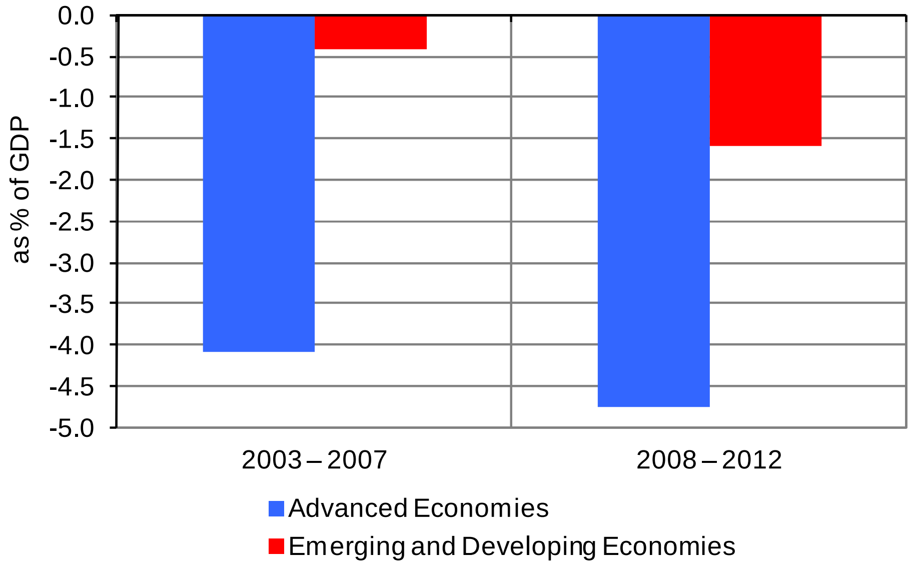
...and from the “outside”...

- as the crisis has nicely demonstrated, there is nothing like a perfect decoupling
- fiscal riks in both the US and Eurozone have increased during the crisis, which, if not managed very well, nad there are few good news there, can trigger another widespread financial crisis with dire consequences for growth prospects primarily in advanced economies, but also around the world

Fiscal developments in advanced economies

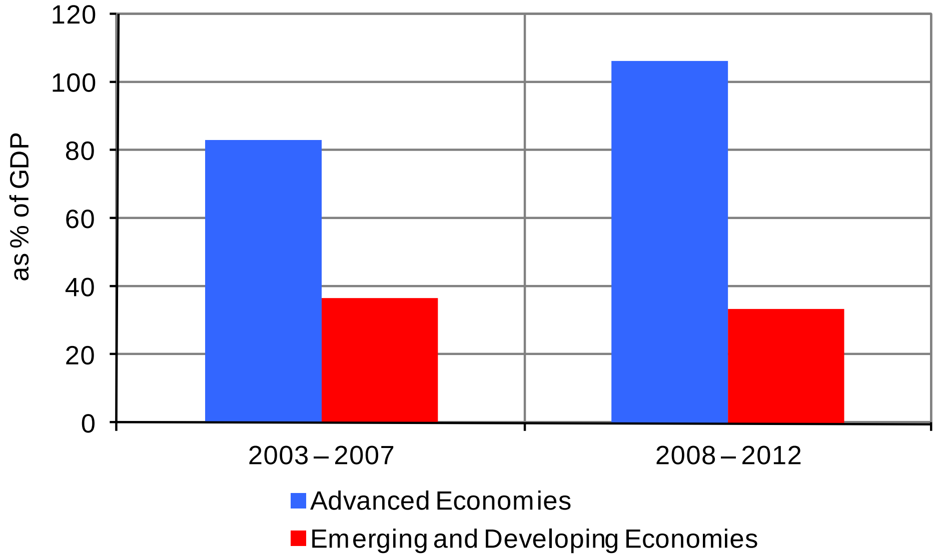
Fiscal balance,

period averages



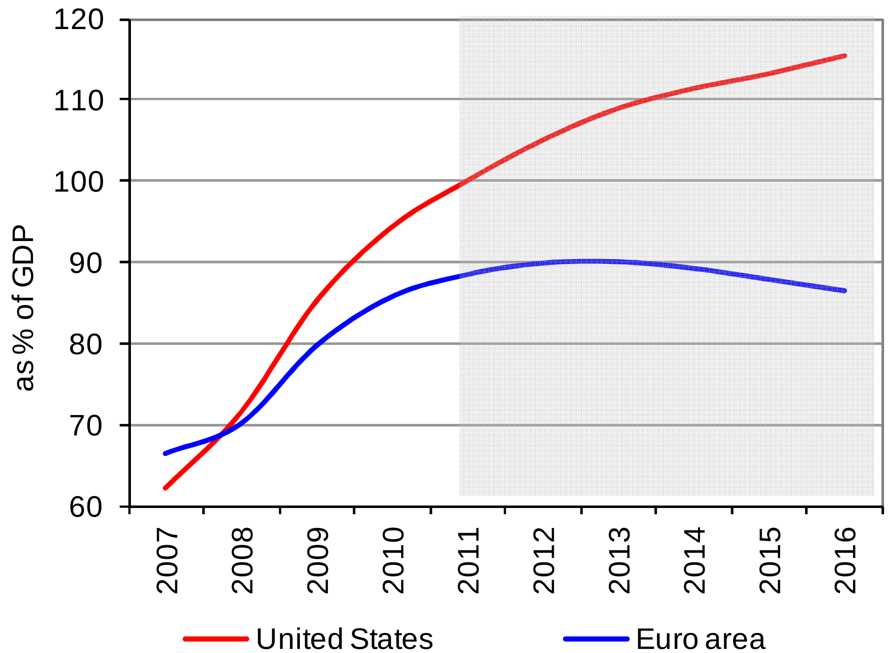
General govt. gross debt,

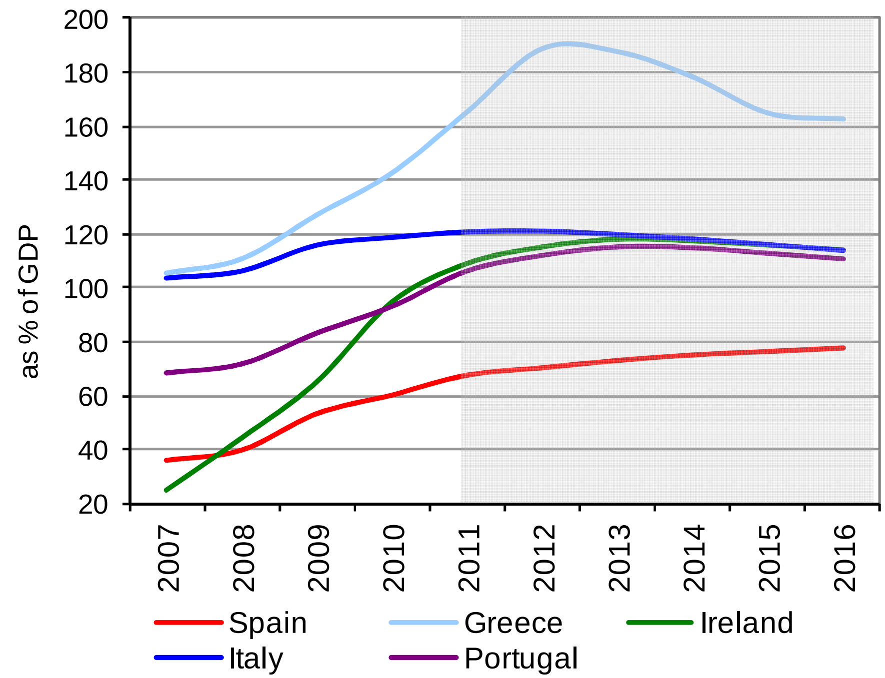
period averages



Source: IMF WEO, September 2011

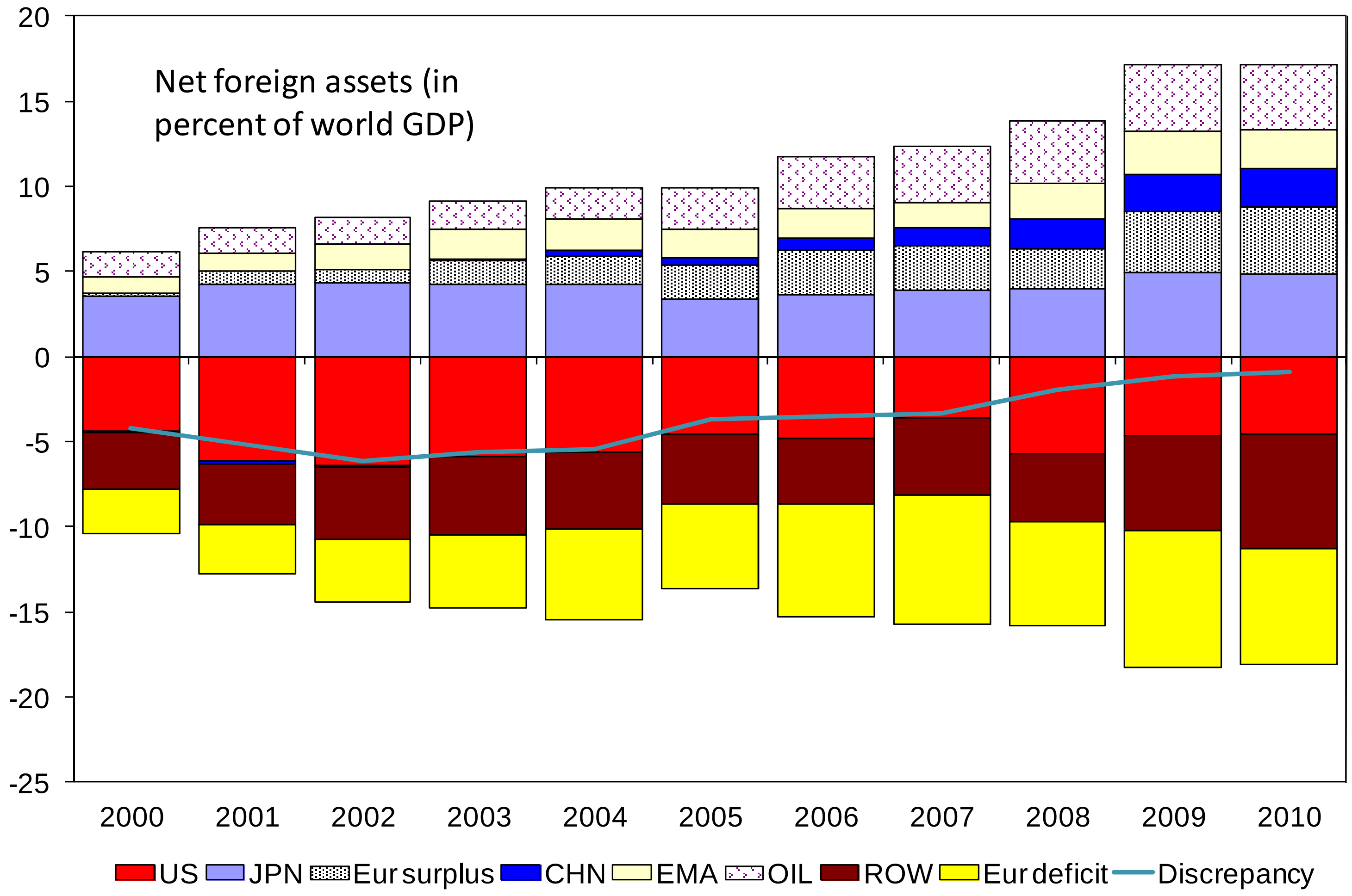
...will deteriorate further in US/slightly improve in EMU (optimistic scenario)..lessons for the developing countries



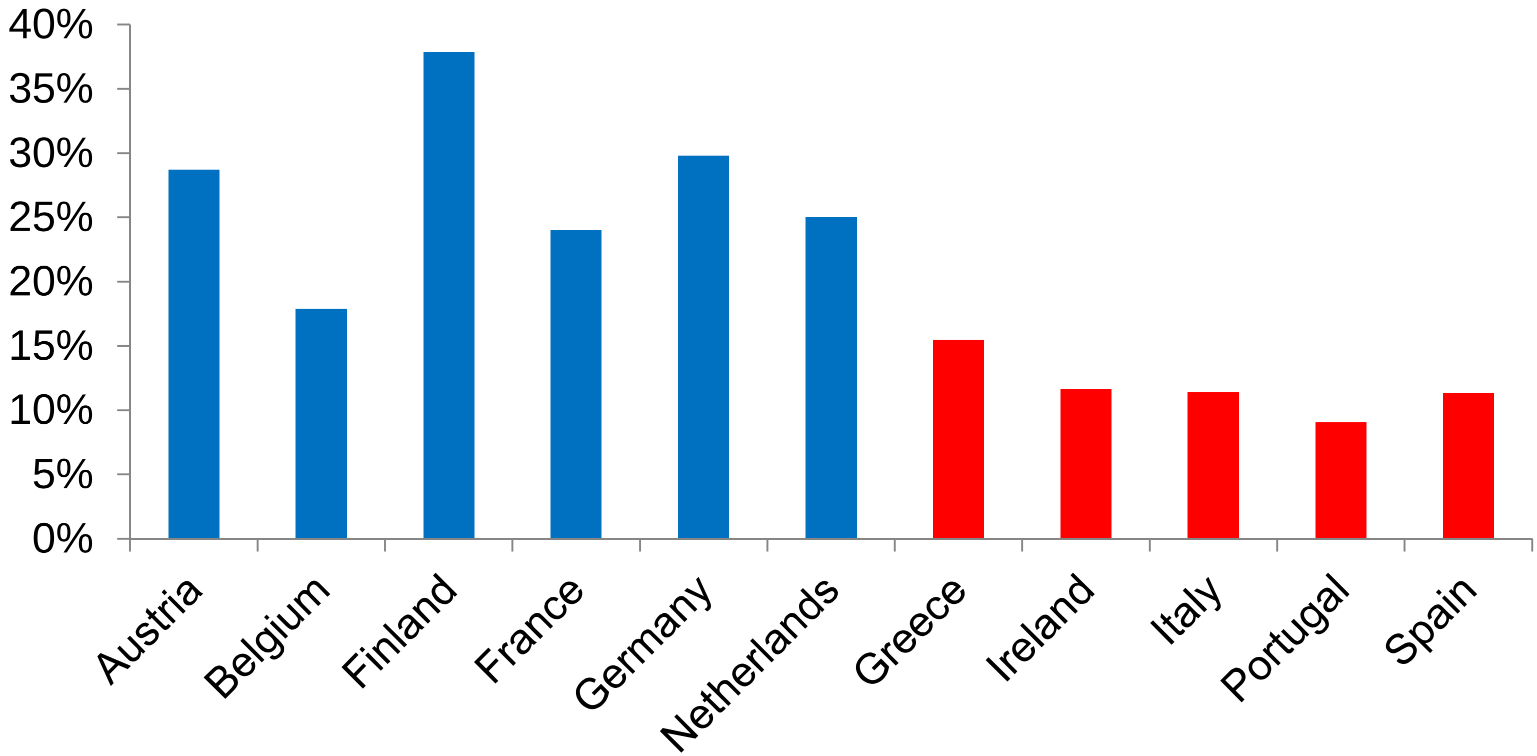


Source: IMF WEO, September 2011

Europe has its own large imbalances..



..financed from within - share of outstanding debt securities held outside the euro area (2008)..



Another DM crisis?

- the way the things look like today – there is an increasing probability of a large catastrophe

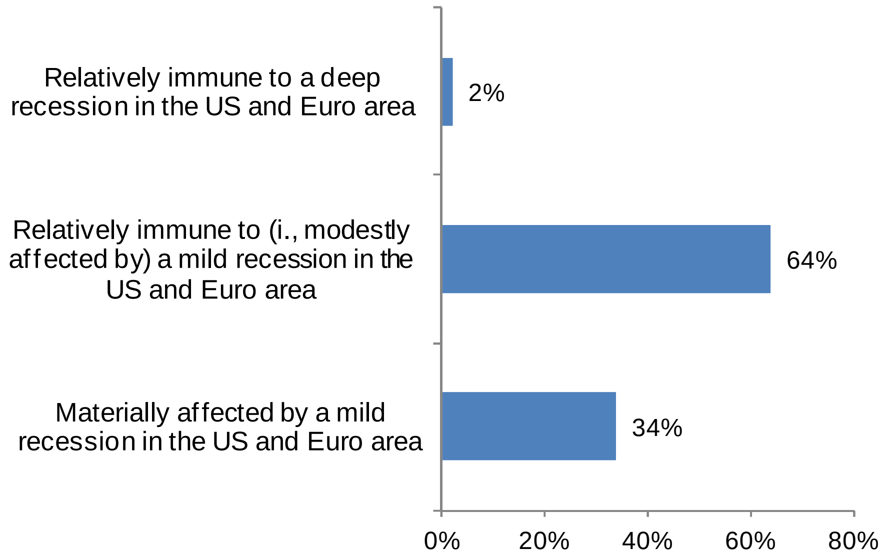
- if things, again, go wrong in the DM, spillovers will happen through different channnels

  - through demand/trade channel
  - through financial flows channel
  - through exchange rate channel which affects both trade and value of assets, whereby today's strenghts of EM countries might show up as weaknesses

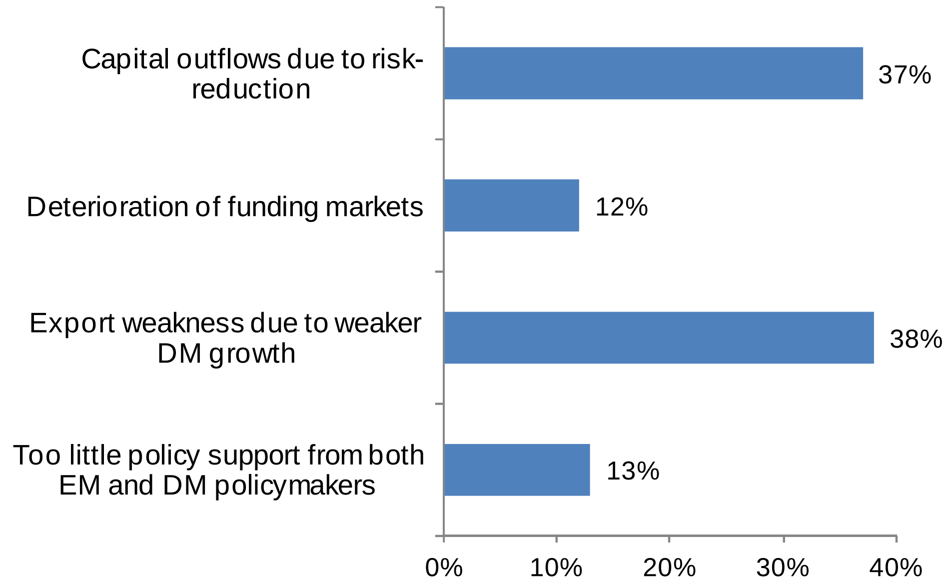
- or, there could be different other types of exogenous shocks, say in a commodity markets, where terms of trade gains for many countries might get wiped-out in the same way as they happened

Emerging markets

EM Growth will be …



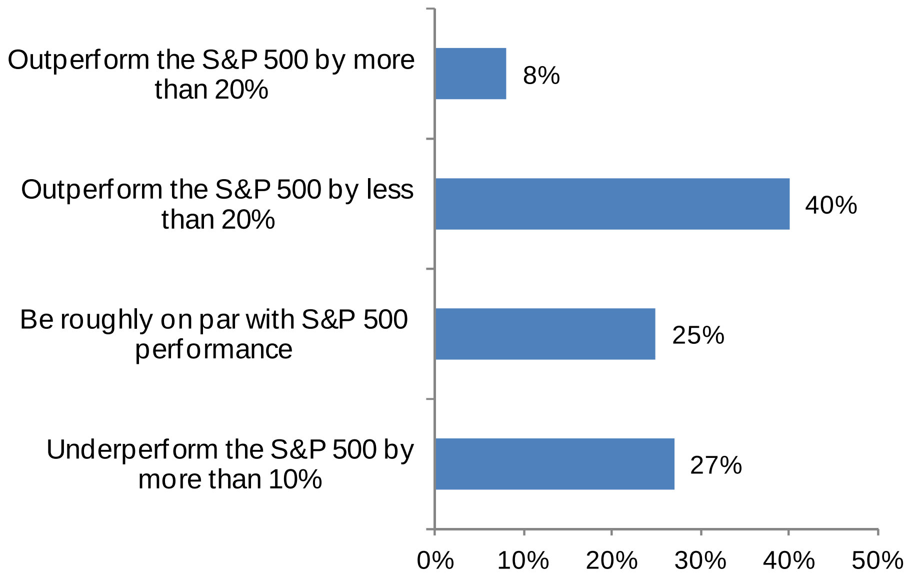
The biggest risk to EM growth comes from



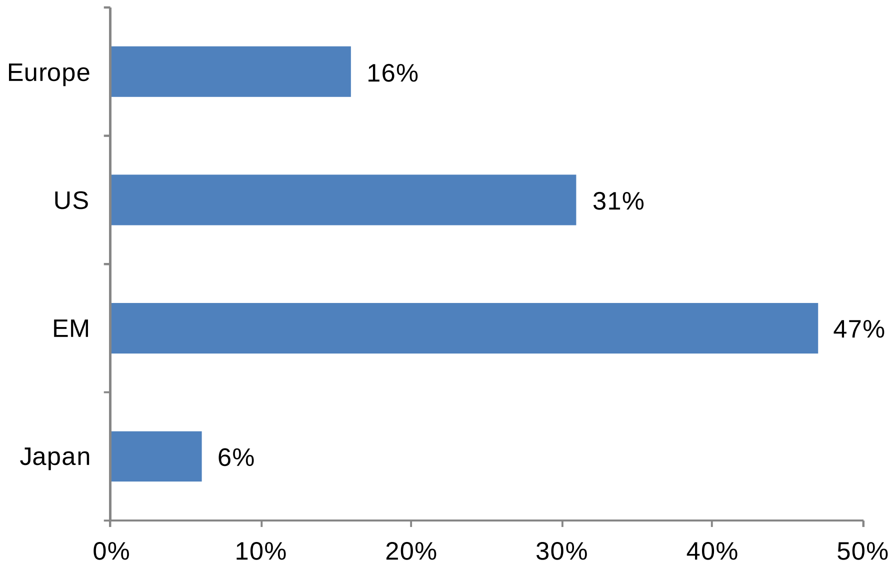
Source: Morgan Stanley

Equities

By mid-2012, EM equities will



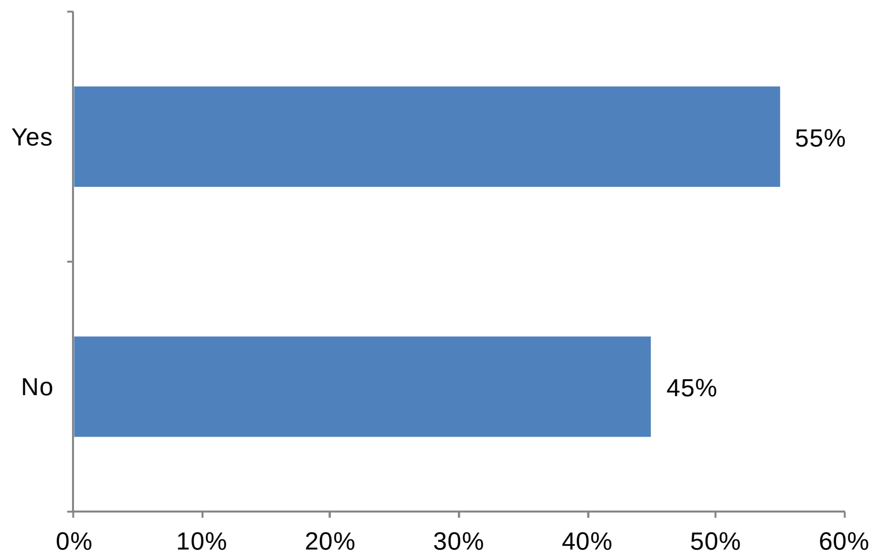
What is your most preferred equity region for next 12m?



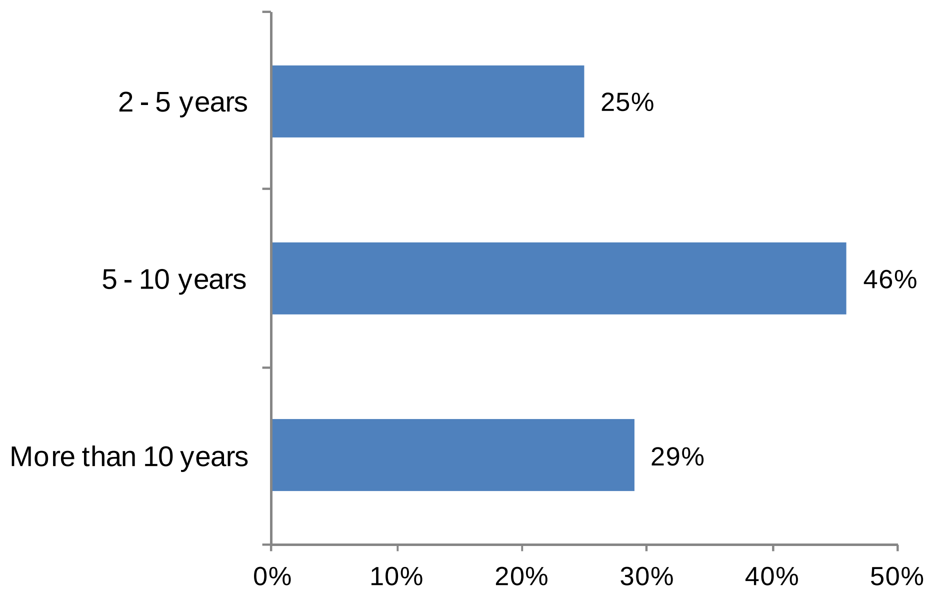
Source: Morgan Stanley

Emerging markets

Is China a bubble economy?



China's transition to consumer-led growth will occur in:



Source: Morgan Stanley

Instead of conclusion

- So, although things loook very good at the moment, I'm afraid we don't know much, i.e. over the last four years most of the economists were wrong on:
    - sub-prime
    - decoupling
    - inflation
    - commodity prices
    - financial flows
    - fiscal risks
    - EMU
    - need for the IMF
- Although crisis/post crisis performance of the EM/developing world points to a great deal of optimism, given many risks and uncertainties, I'll just conclude: let's see what will the world look like this time next year