

How is the Global Financial Crisis Affecting Emerging Economies?

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Introduction

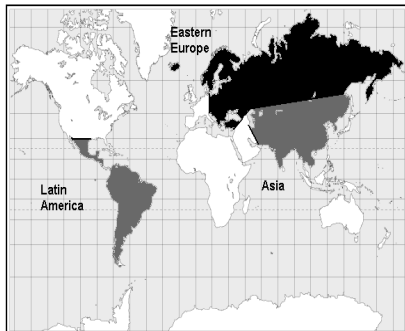
Emerging economies, following decades of homegrown economic crises, were thought to have "decoupled" their economic growth and stability from the trajectory of developed economies. However, the current global financial crisis has revealed that emerging economies, no matter how apparently sound, are still highly vulnerable to financial crises and downturns in investor confidence originating in developed economies.

Global Summary

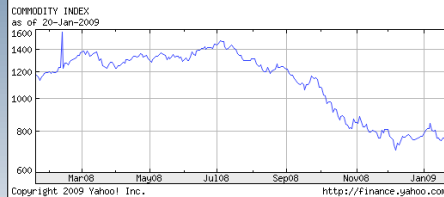
The global financial crisis has dramatically affected emerging economies in 2008 and 2009. The local origins of the crisis—subprime mortgages and credit crises in the U.S. and western Europe—have radiated to the rest of the world, affecting international financial flows to emerging economies and revealing those economies' dependence on foreign capital. Below are the crisis' primary effects on emerging economies:

- **Capital and investment outflows from emerging economies, endangering those with budget deficits and high sovereign debt**
- **Credit crunches and bank hesitance to resume lending**
- **Currency depreciations and the corresponding depletion of foreign exchange reserves**
- **Stock market crashes**
- **Decreasing demand for exports as well as commodities price decreases**
- **A renewed role (need) for the IMF as a lender of last resort**
- **An increasing prominence and importance in the global economy for emerging economies (e.g. the G20)**

Regions Most Affected



Commodities Price Fall



Eastern Europe

- Eastern European economies had experienced a surge of investor goodwill in recent years as they reformed their economies and experienced high economic growth rates.
- But many Eastern European economies run large current account deficits and they are therefore dependent on foreign capital and loans to continue their operations.
- During the crisis, moves by investors to pull money out of emerging economies and into perceived safer investments—a "flight to quality"—pushed these economies toward risk of government default.
- Some countries desperate for cash have turned, reluctantly, to the International Monetary Fund.
 - With a large banking sector and volatile capital flows, **Iceland** became the first major casualty of the spread of the global financial crisis. This quickly continued to Eastern Europe.
 - **Hungary, Pakistan, Serbia, Ukraine, and Belarus** have also asked for IMF loans due to their severe economic problems.

Impact Focus:

Russia



- Russia's economy has been heavily affected by the crisis:
1. Its stock market has fallen so rapidly that trading has been suspended several times.
 2. Its ruble currency has quickly lost value.
 3. It has been forced to use 1/3 of its foreign exchange reserves.
 4. Investors have quickly pulled foreign capital out of Russia.
 5. Global prices of its major export commodities (oil and natural gas) have fallen sharply since summer 2008.

Asia

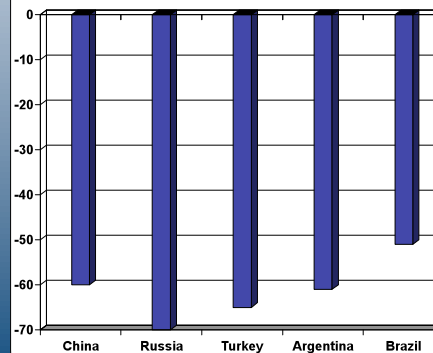
- Rapid-growth economies such as those of **China, India, South Korea, and Indonesia** have experienced pullouts of foreign capital, plunging stock markets, and declining currency values.
 - One index that measures stock market performance in the entire Asian region lost half its value in 2008.
- In contrast to the 1997 Asian Financial Crisis, the current crisis did not originate from within Asia.
 - Asian economies are better equipped than in 1997 to respond to the current crisis.
 - Asian economies have built up 7 of the 10 largest foreign exchange reserves in the world, allowing them to better defend their currencies' value.
- Many Asian economies dependent on exports, such as that of **China**, are hurt by weakening global demand.
 - **China** has responded with a nearly \$600 billion stimulus plan, which is intended to jumpstart the economy through massive infrastructure and construction spending.

Latin America

- In contrast to the other regions, Latin America's banks remain well-capitalized and its governments (except for **Ecuador**) are not at significant risk of default on their debt obligations.
- Nevertheless, Latin American countries such as **Mexico, Brazil, and Argentina** have experienced sharp stock market drops and declining currency values.
- **Mexico and Brazil** have also suffered from oil prices that are dramatically lower than just a few months ago (\$40 a barrel from \$150 a barrel).

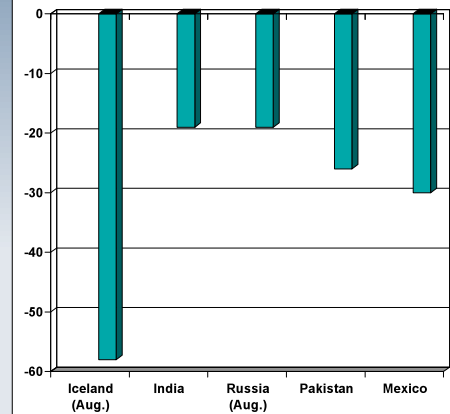
Stock Market Losses

percent drop in value in 2008



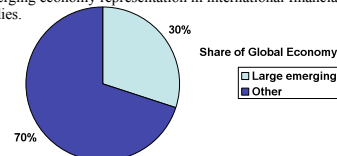
Currency Value Drops

percent drop in value in 2008 (or since indicated month)



G20 and Beyond

- Emerging economies are expected to play a large role in the global recovery from the financial crisis.
 - In 2009, emerging economies are expected to constitute the vast majority of global economic growth due to negative growth in many developed countries.
- The G20 (which includes both traditional economic powers and emerging economies) meeting in November 2008 signified that emerging economies are recognized as essential to a new global financial infrastructure.
 - The G20 meeting affirmed the importance of emerging economies and their voices in a globally coordinated response to the crisis.
 - The Declaration from the G20 summit called for greater emerging economy representation in international financial bodies.



- Recovery of the emerging economies will be essential to global growth, as **China, Russia, India, Brazil**, and other large emerging economies now make up 30% of global GDP, and as **China** has recently passed **Germany** to become the third-largest economy in the world.