

# GLOBAL FINANCIAL TURMOIL AND POLICY RESPONSE: A Summary

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by

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\* These are the opinions of the author alone and should not be taken to represent the views of the IMF, its executive board, or its management.

# Overview

- World economic outlook
- United States and Europe: policy responses to financial turmoil
- China's situation
- Comparison with Asian crisis
- Some basic principles of crisis resolution

# World economic outlook

- Picture has worsened over past month.
- World growth: 3.9% (2008), 3.0% (2009), revised down from 4.1%, 3.9% (July).
- Mainly driven by U.S./Europe outlook.

# U.S. update: background and outlook

- Outline of crisis: monetary policy and easy regulation spurred credit and risk taking: sub-prime, derivatives, credit markets.
- Slowing economic activity (1.6% 2008, 0.1% 2009), gradual recovery next year

## U.S. financial sector potential writedowns (Oct 2008; U.S. \$ bns.); GFSR Oct 2008

|                    | Outstanding | Estimated losses |
|--------------------|-------------|------------------|
| Total loans        | 12,370      | 425              |
| Of which, subprime | 300         | 50               |
| Total securities   | 10,840      | 980              |
| Total              | 23,210      | 1,405            |

# U.S. update: policy response

- Problems: drying up of liquidity, eroded capital base, bad assets.
- Bailout necessary: alternatives were not working; is a **systemic** response.
- But needs to address solvency concerns (capital): so, recent action welcome.
- Risks: regional banks, feedback loops, solutions to solvency problems.

# Europe update

- Slowing growth outlook
- Different approaches: Ireland, Germany, UK on deposit guarantees
- Need **systemic**, pro-active approach
- UK showing the way
- Need joint commitments for: timely recapitalization, cross-border institutions/regulations, etc.

# China

- Slowing economy but still 9-plus %.
- Direct financial exposure to troubled institutions limited.
- But will face fall-out from slower exports, and capital flows, if U.S./EUR slowdown protracted.

# Similarities/differences versus Asian crisis

- Financial crisis versus financial-plus-f.x. crisis: different implications for **monetary policy**
- **Fiscal policy** easing: similar response
- **Financial sector**: similar responses: early loss recognition; liquidity support; support depositors; close non-viable institutions; AMCs; bank supervision
- **Trade/capital** liberalization: situations different; also, advice more focused.

# Some principles

- Restoring confidence 1<sup>st</sup> priority
- Requires comprehensive plan (not piecemeal/ad-hoc)
- Liquidity problems often turn out to be solvency problems
- Re-capitalization is key
- Use of public money has to come with safeguards for taxpayers