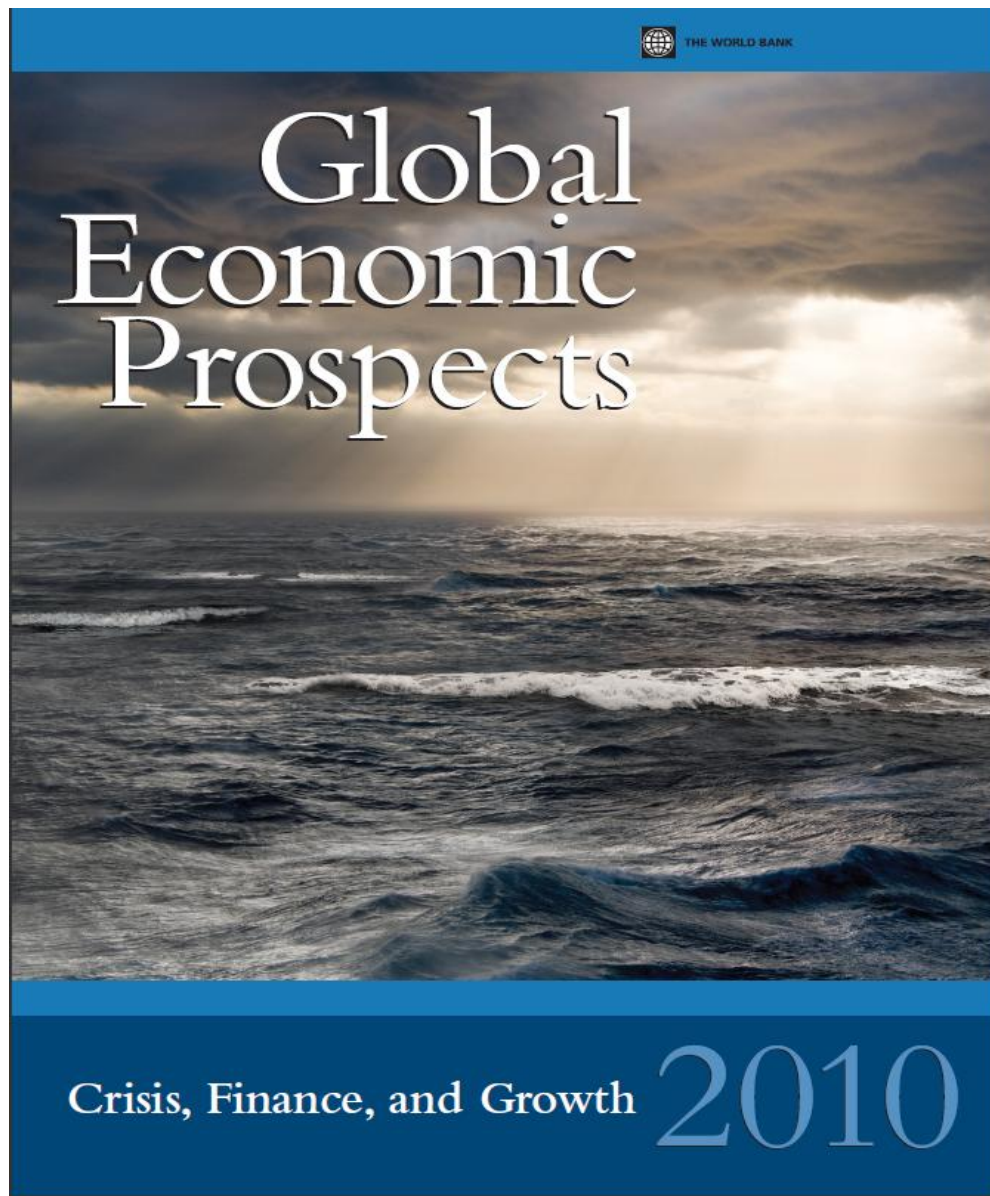




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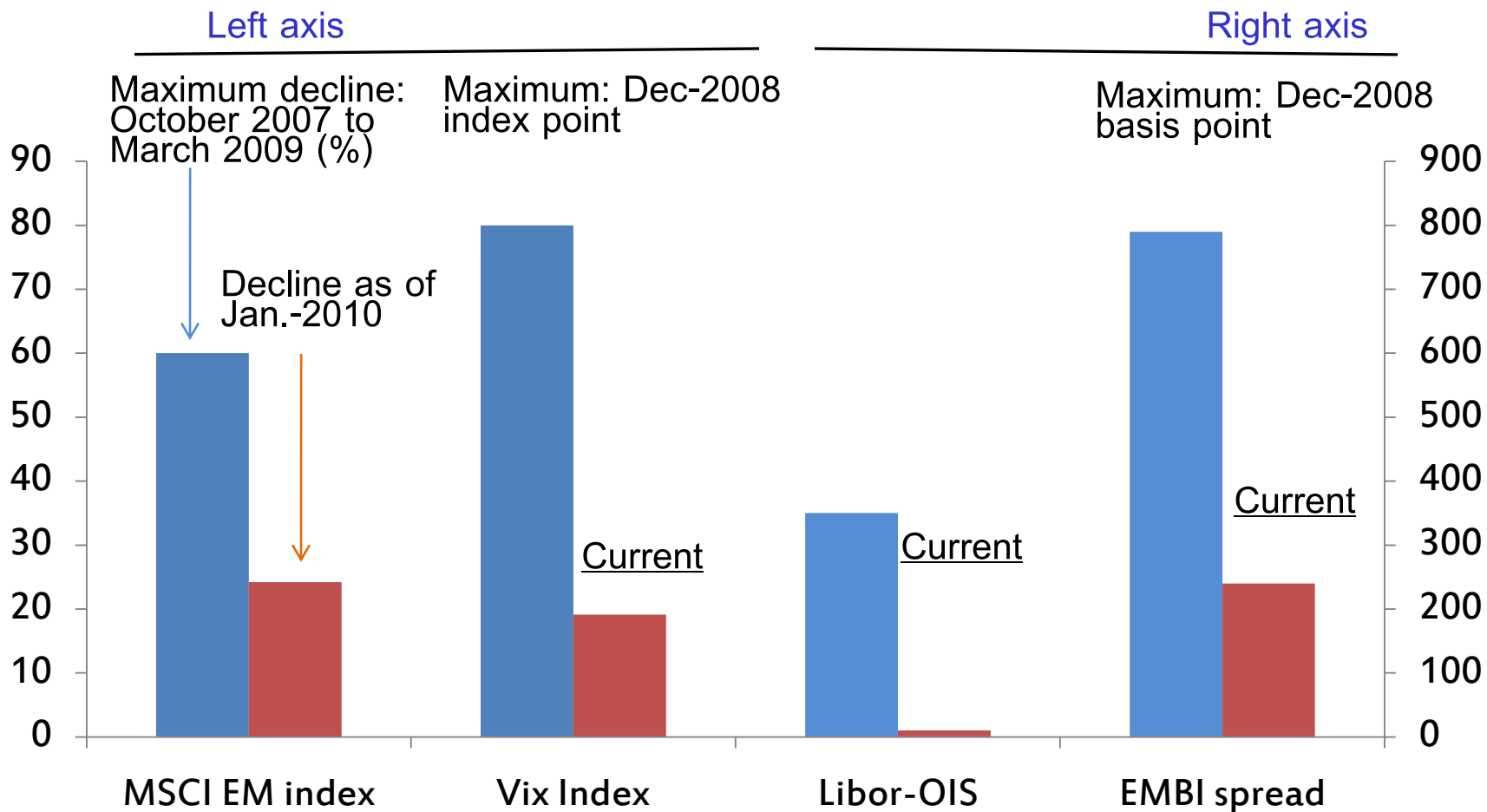
Crisis, finance and growth

- The acute phase of the crisis is over, but a muted recovery it will take several years to undo the damage
- Just as low capital costs contributed to growth boom in 2003-07, higher capital costs in the future will lower potential output and slow growth
- Developing countries may overcome the medium term impacts by strengthening their domestic financial markets



Financial conditions have stabilized

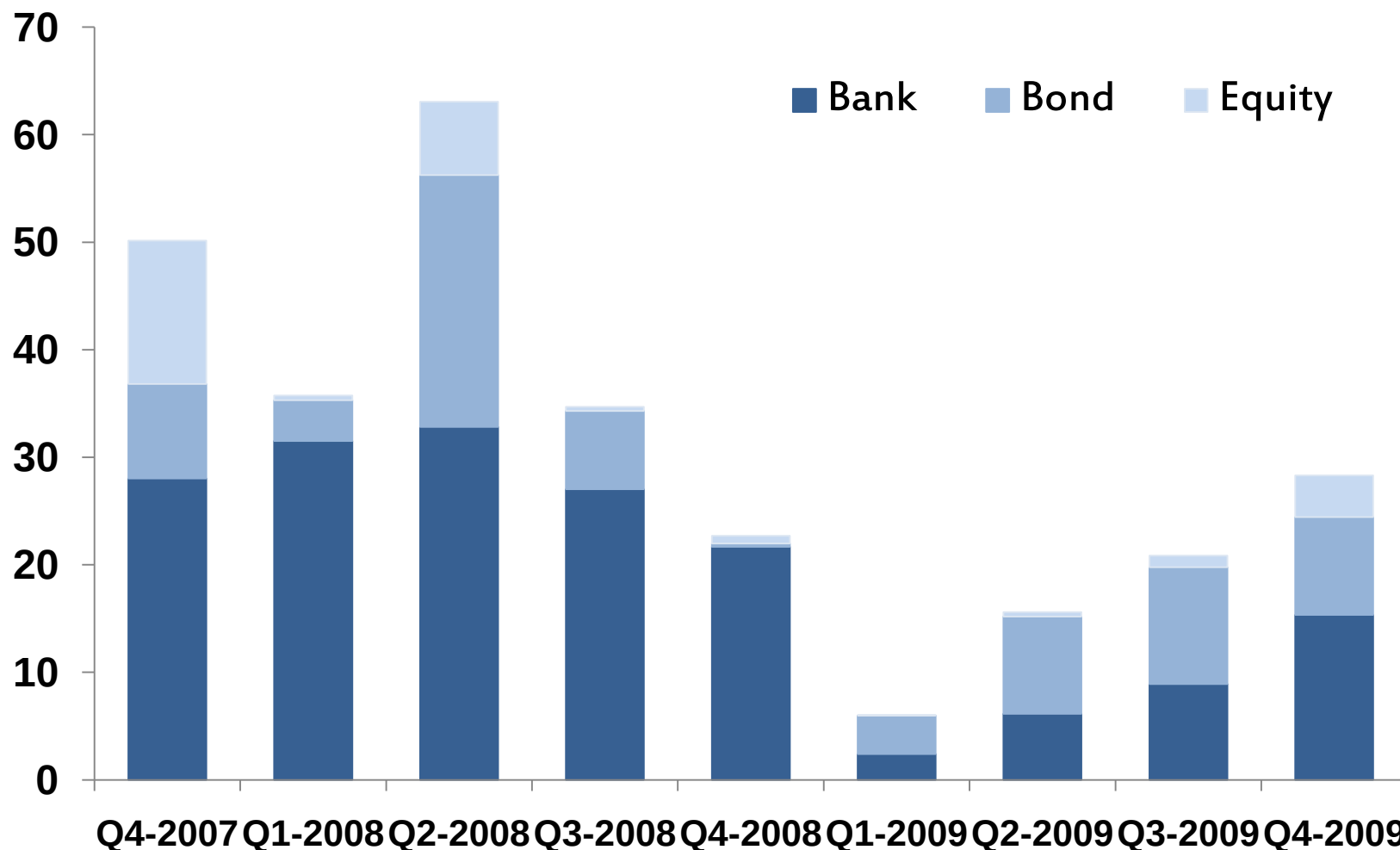
change from recent peak to current levels





Although recovering capital flow to Europe & Central Asia remain weak

Billions U.S. dollars

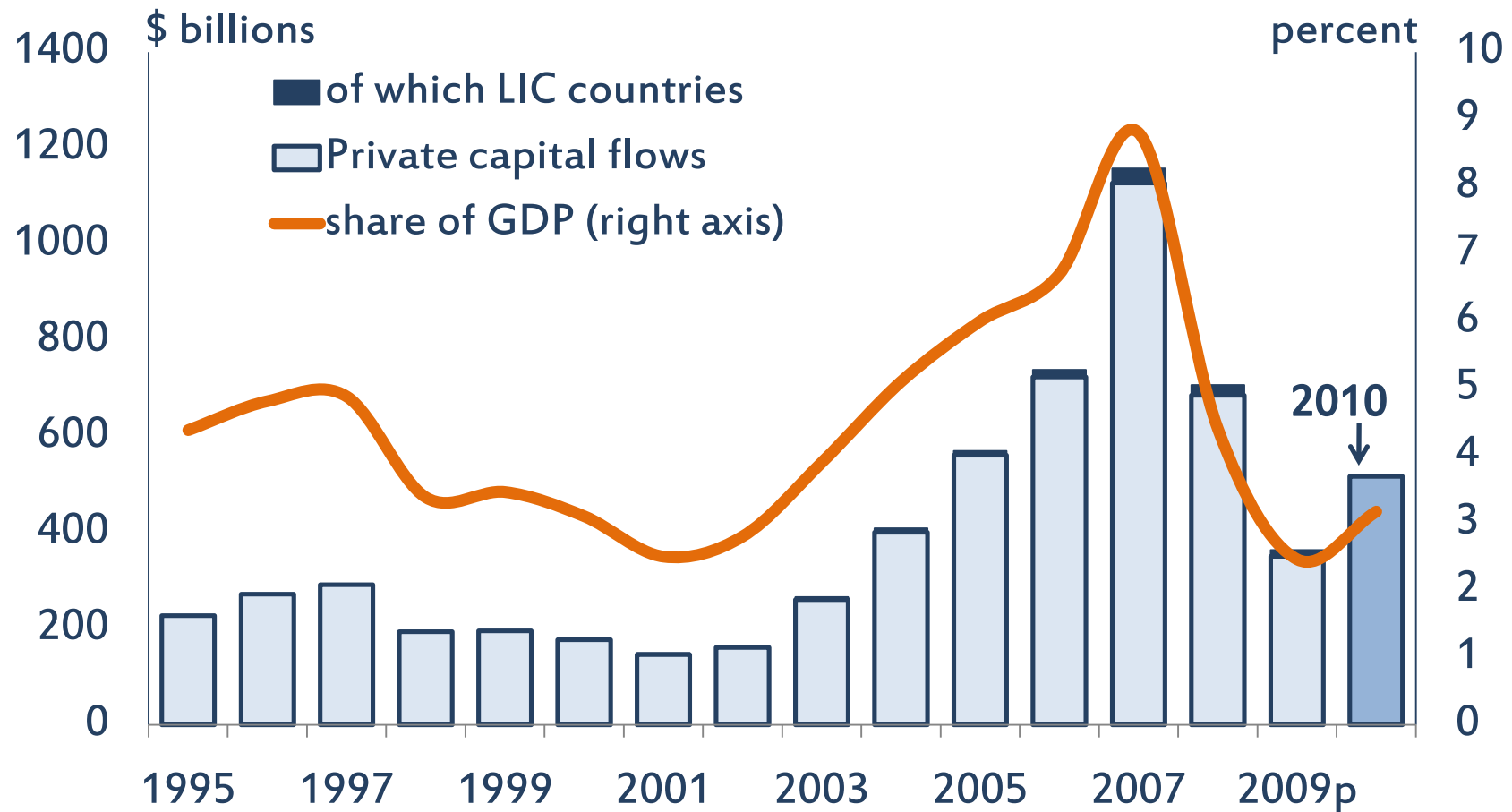


Sources: Dealogic: Bondware, Loanware and World Bank.



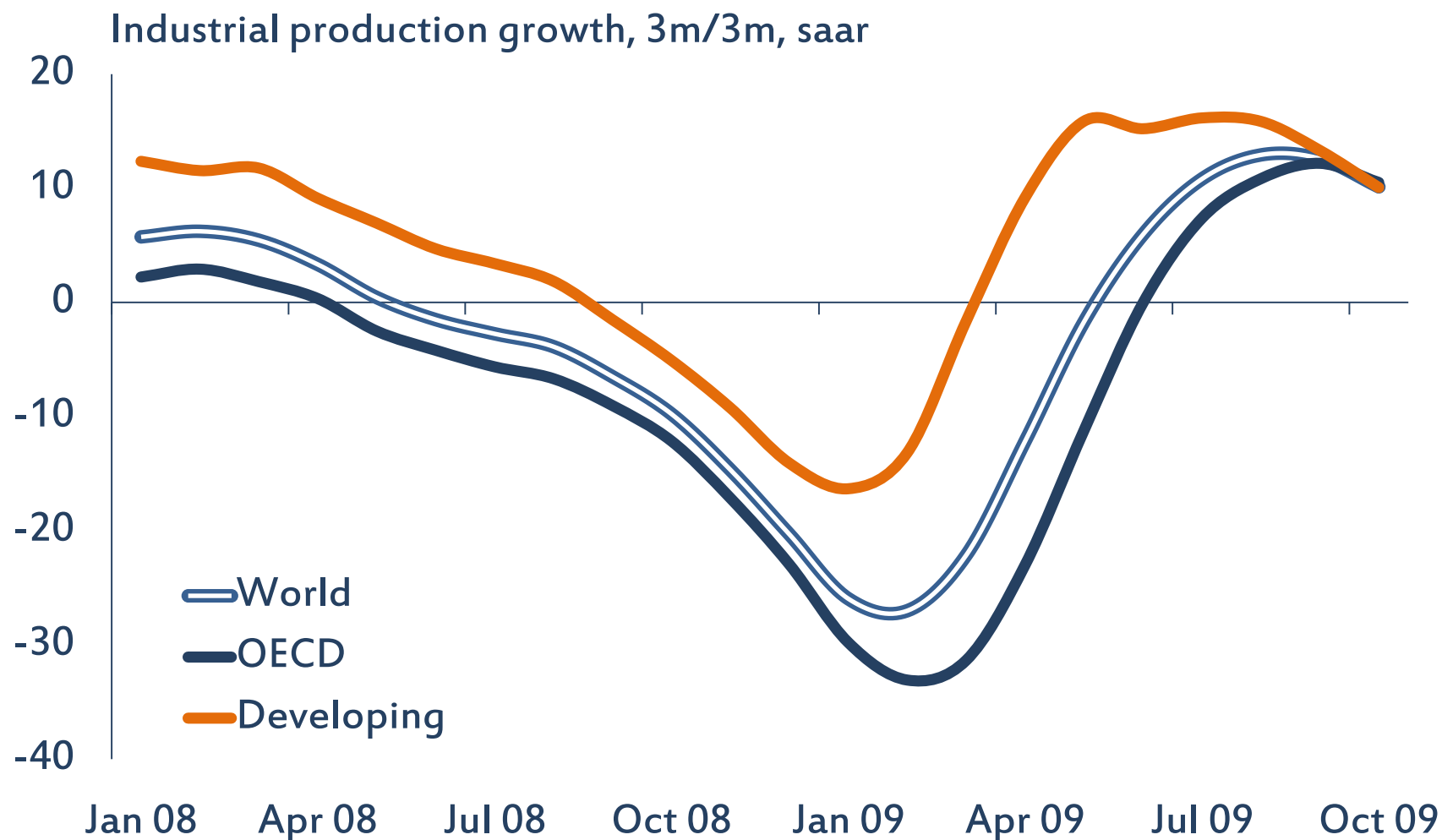
Private capital flows are unlikely to recover to the pre-crisis levels for some time

Net private capital flows to developing countries





Rebound in industrial production growth is easing

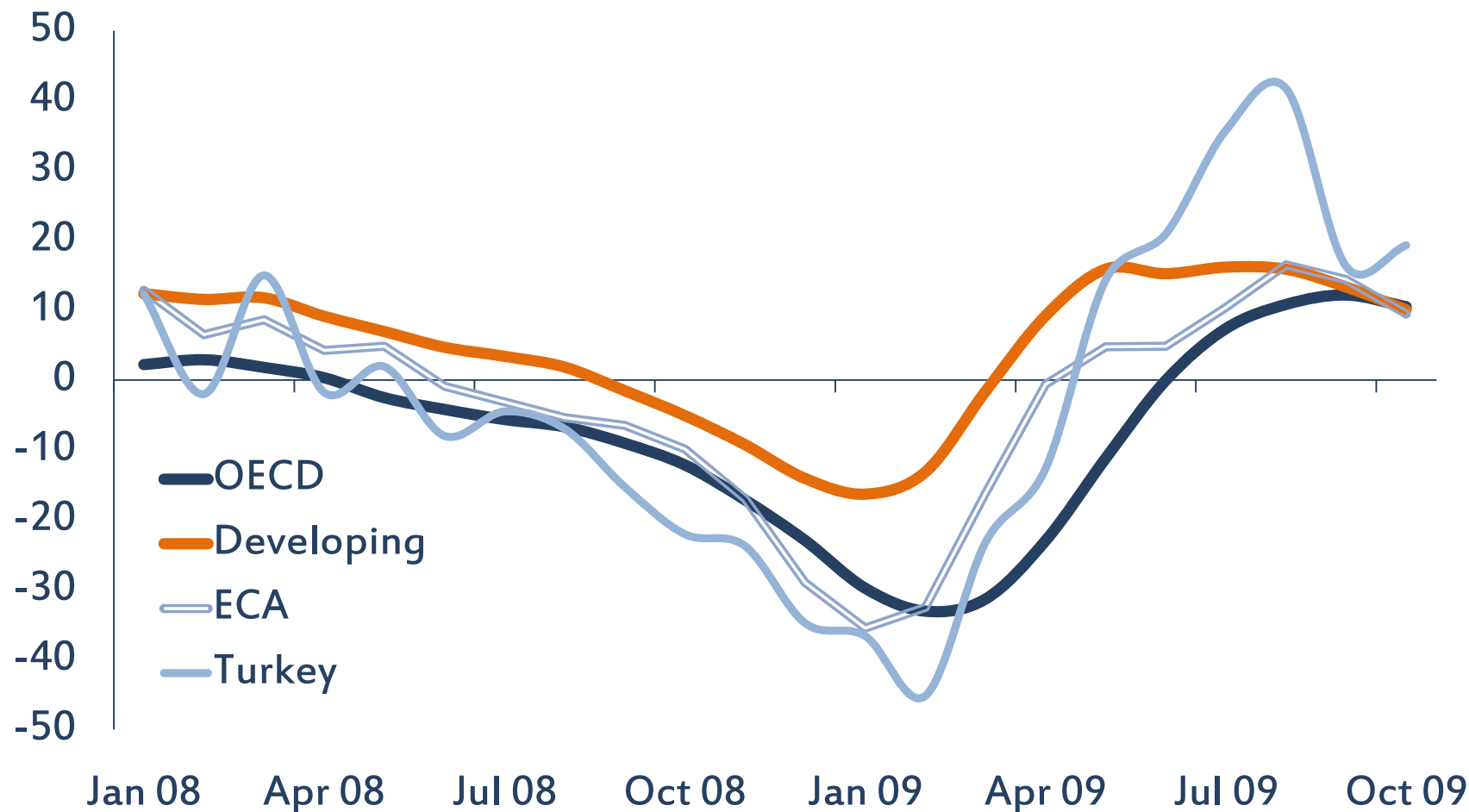


Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth



Rebound in industrial production growth is easing

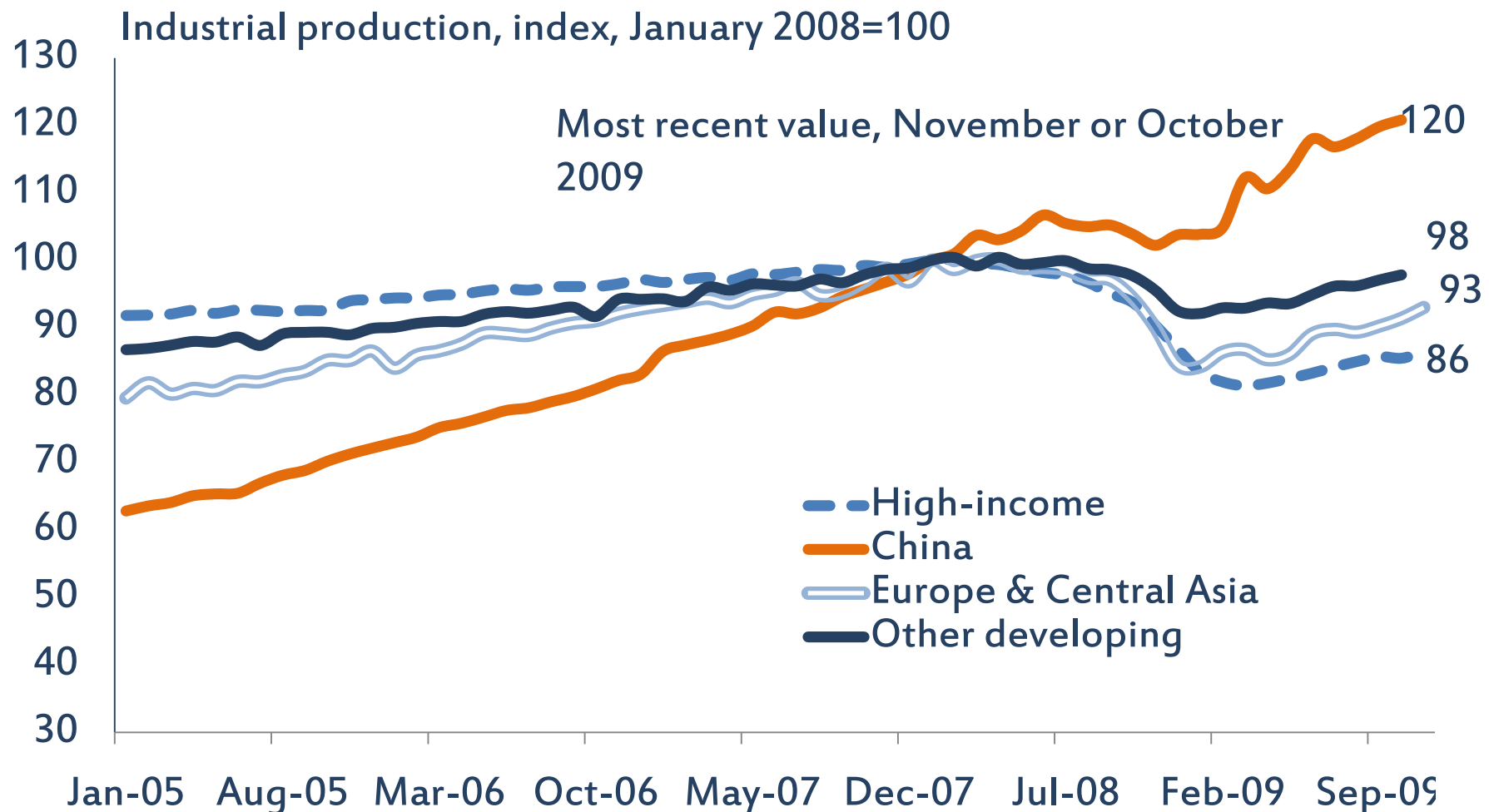
Industrial production growth, 3m/3m, saar



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth



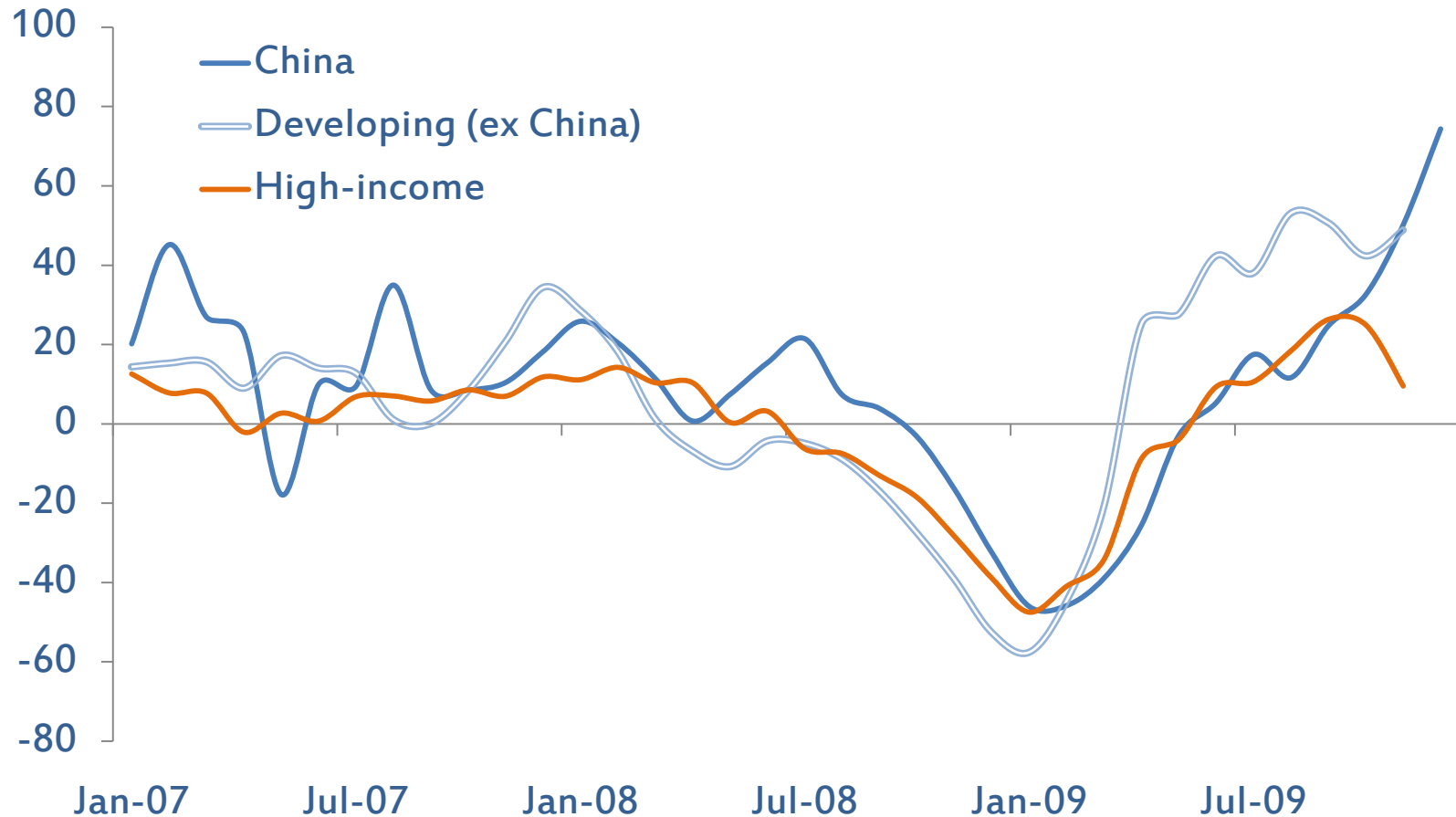
For much of the world industrial production has yet to recover pre-crisis levels





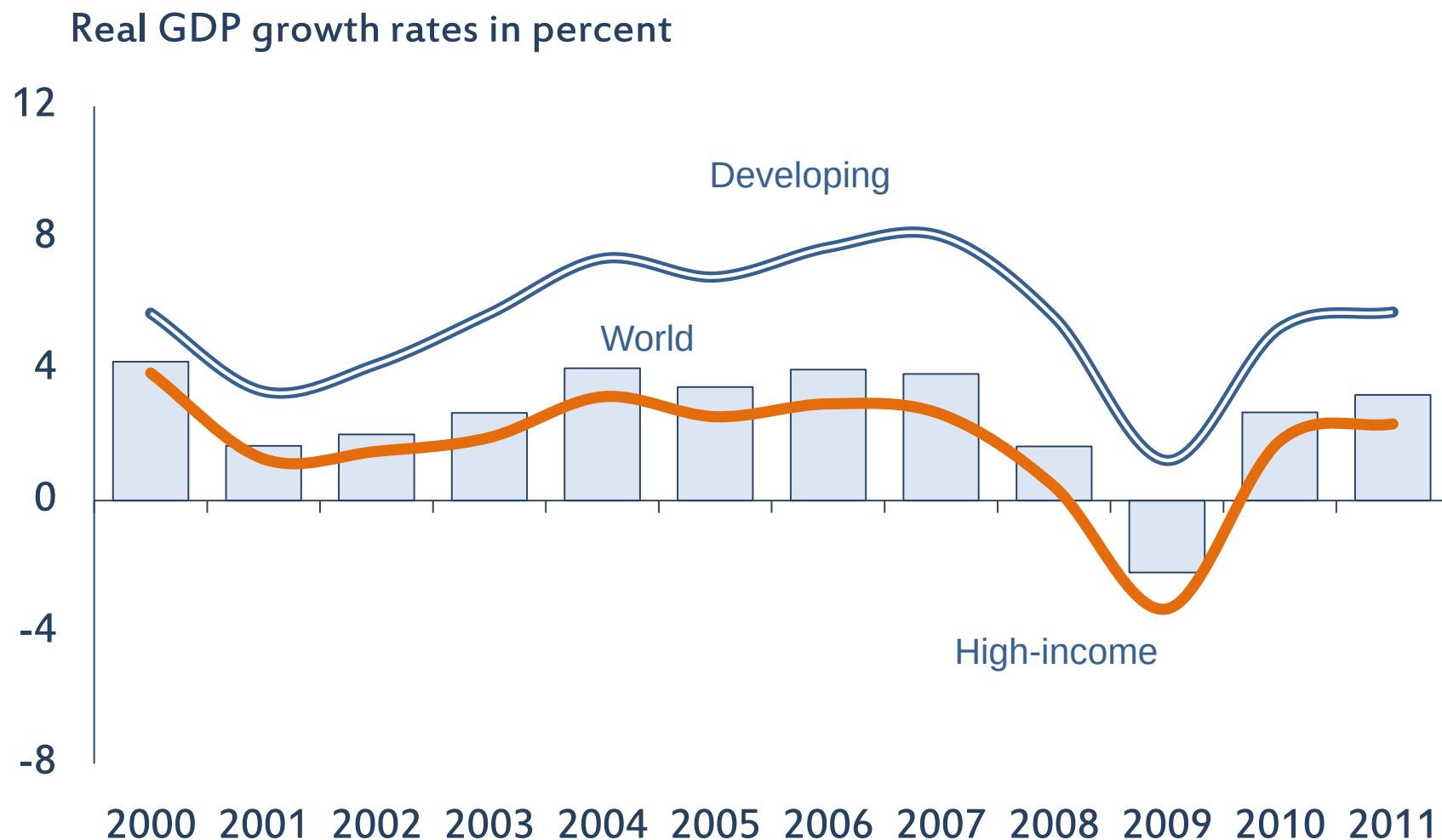
Global trade is also recovering very rapidly

Trade volumes, 3m/3m, saar





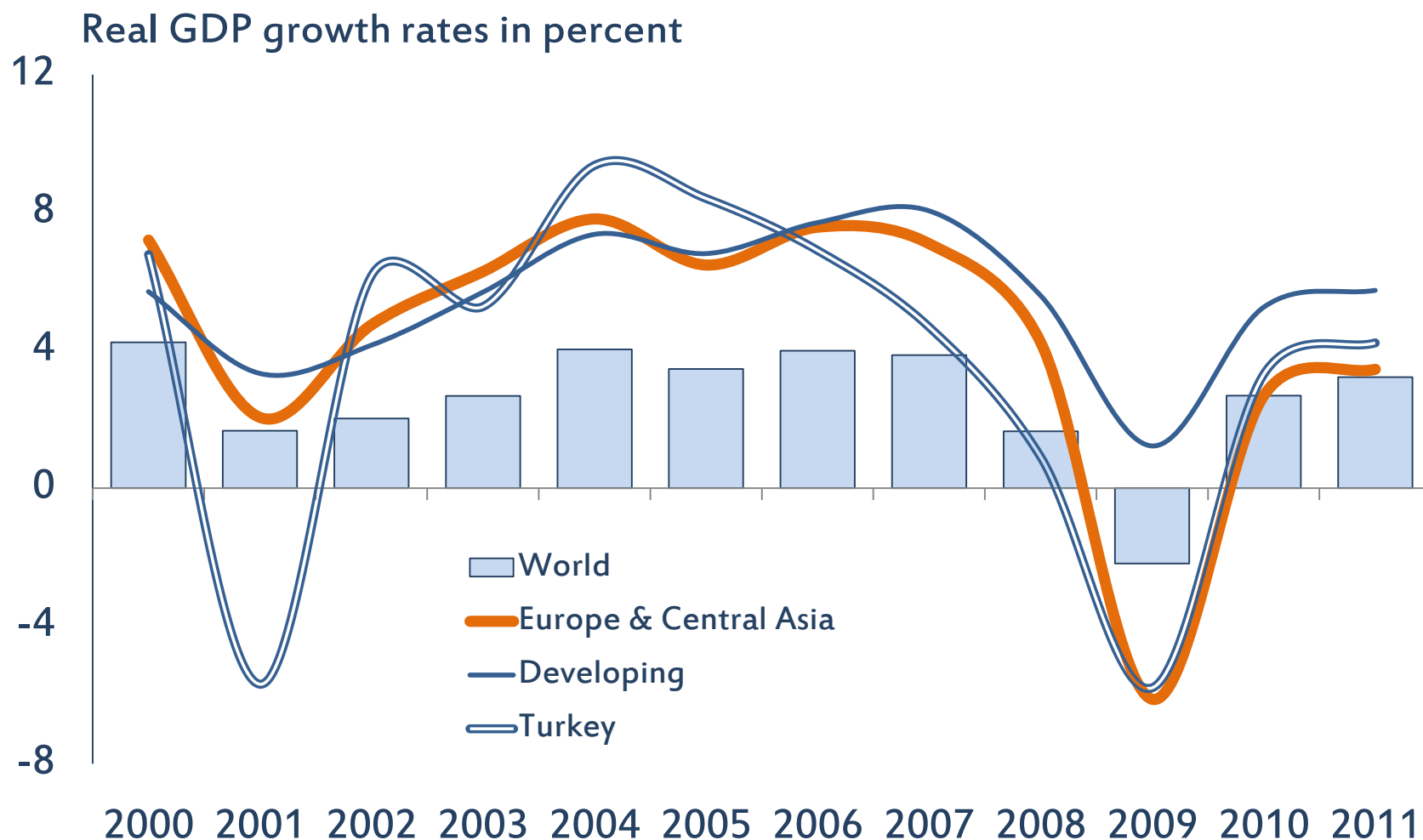
Continued financial-sector restructuring, implies a weak recovery



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth

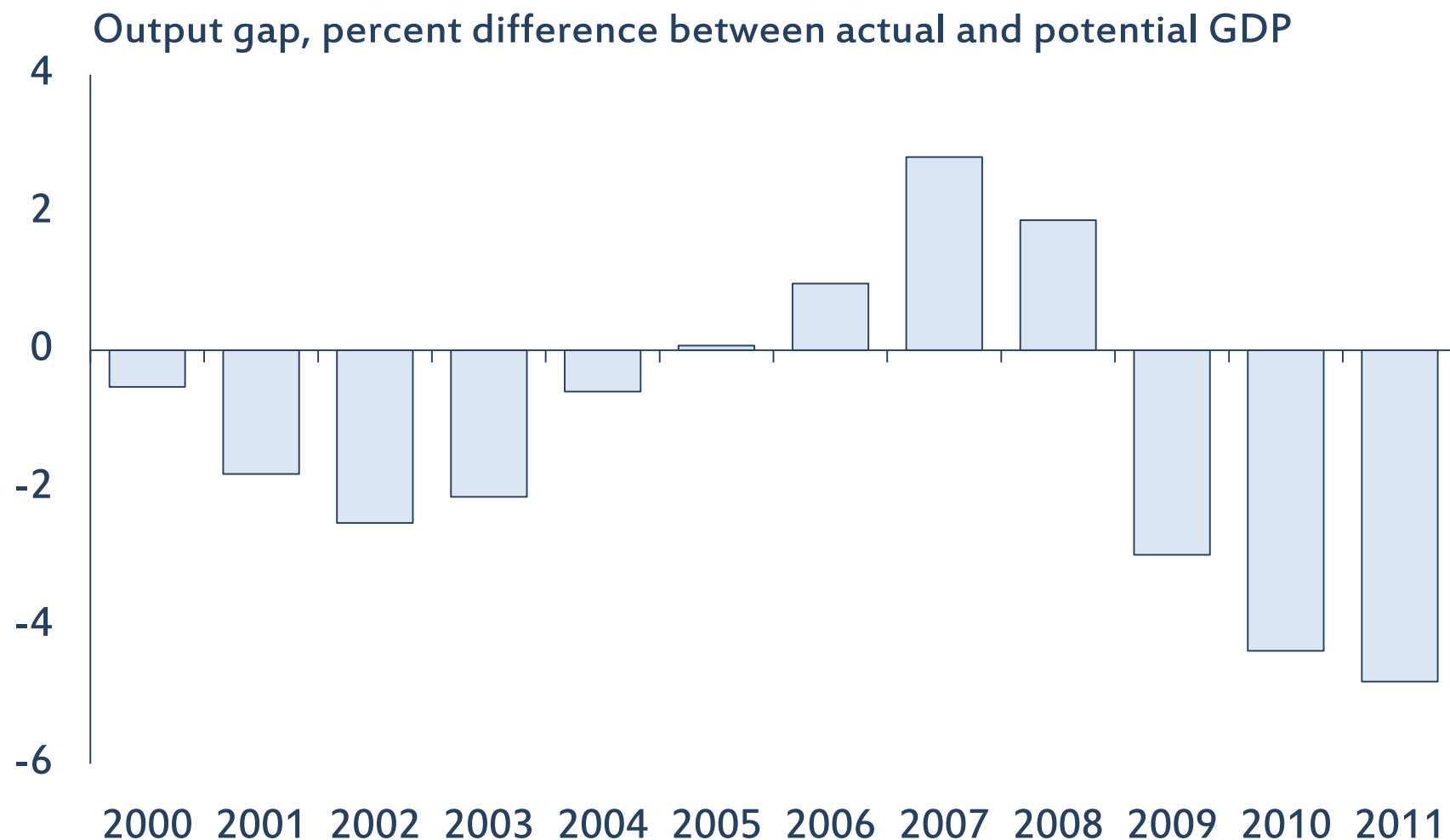


Regional growth: Turkey





Despite stronger growth, output will remain depressed for a long time



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth

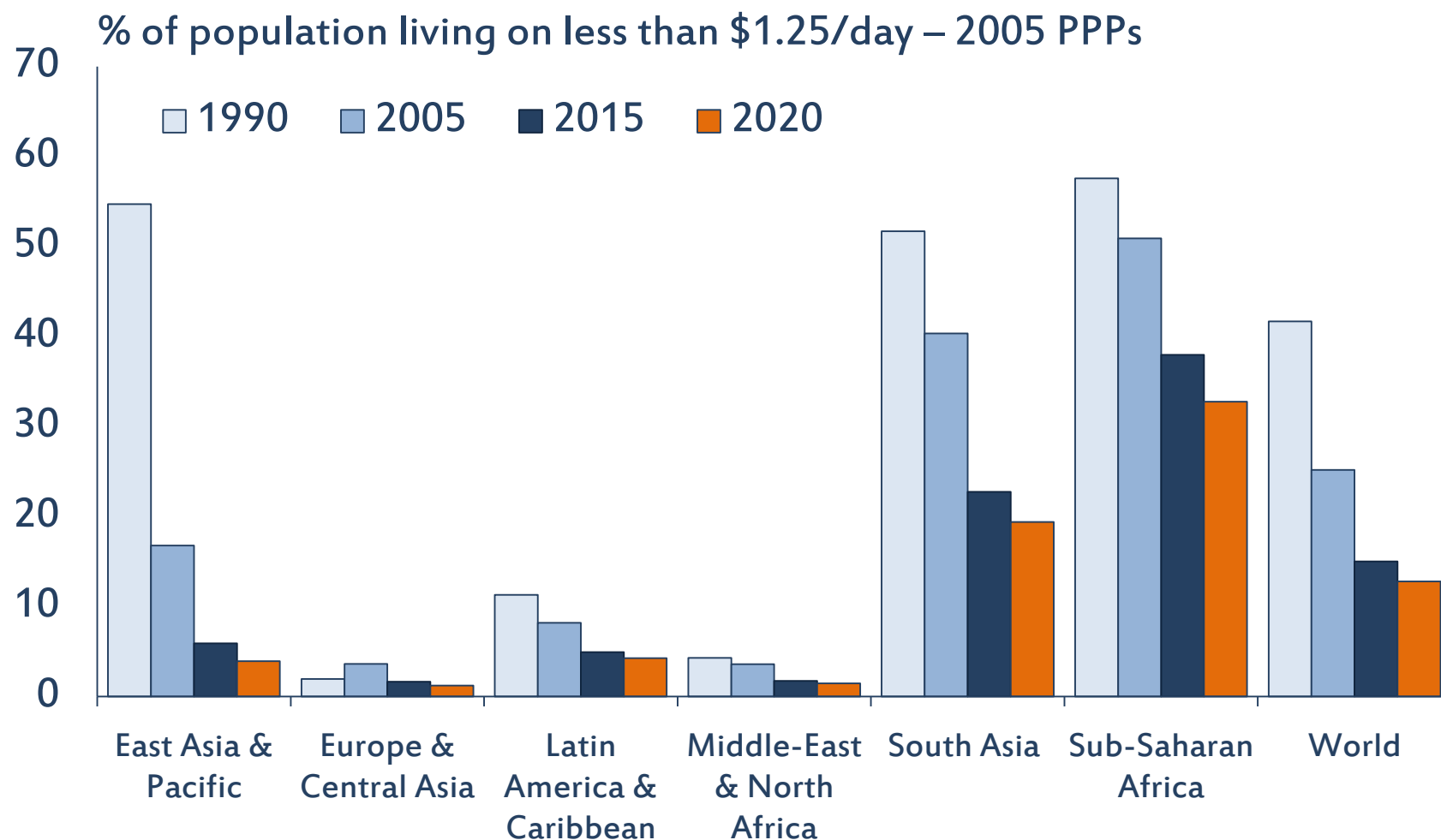


Crisis will have serious poverty impacts

- Increase in the global count of extremely poor of 64 million in 2010
- Increase of 10 million in Europe & Central Asia at the \$5/day level
- Possible 35-50,000 additional children in Africa may have died of malnutrition in 2009
- Unless aid is upped, program spending will have to fall even as need climbs



Nevertheless, progress toward MDGs will be made



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth



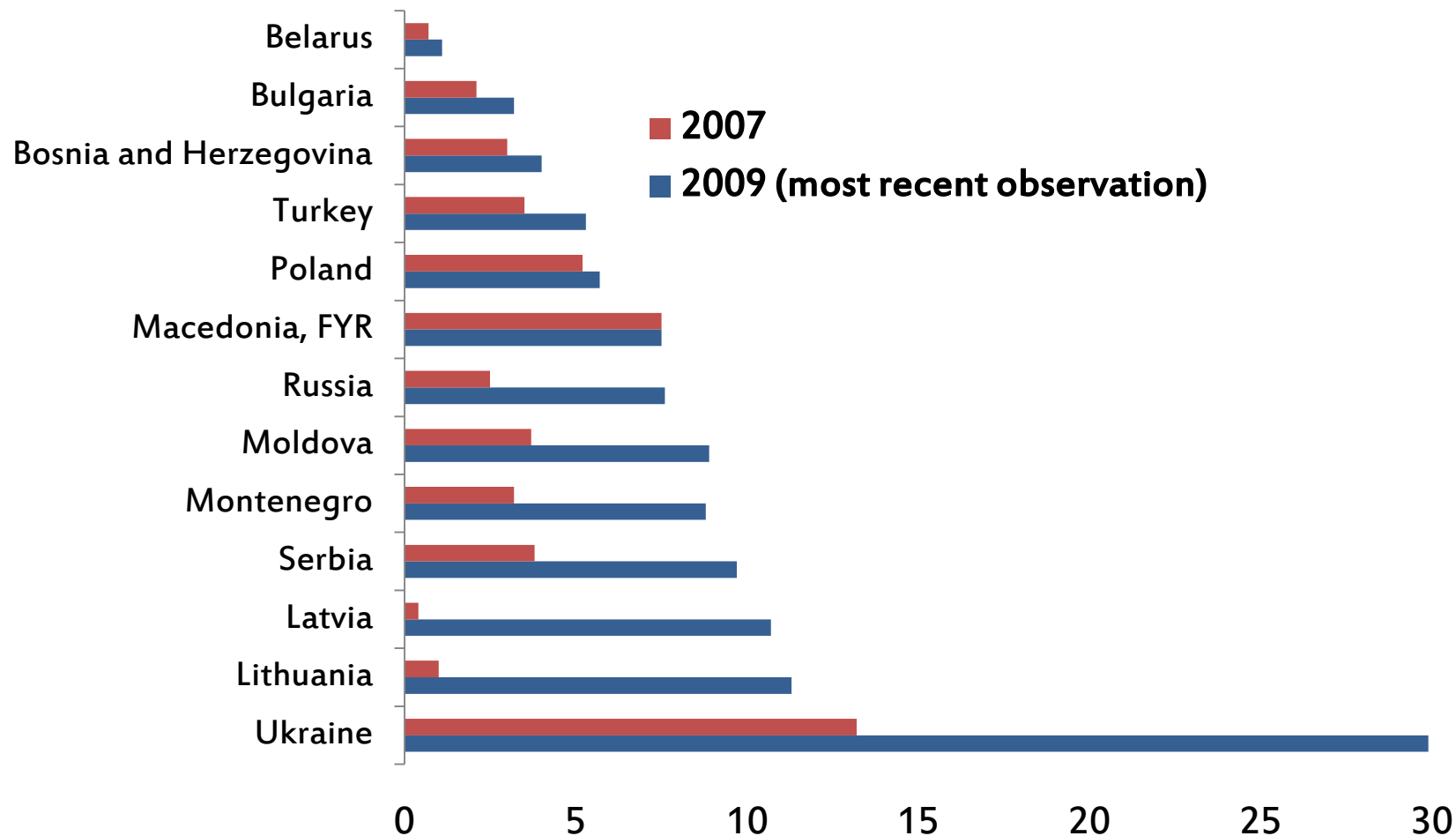
Risks

- Considerable uncertainty continues to cloud the outlook
 - Unwinding of fiscal and monetary stimulus
 - Strength of rebound in consumer and business demand
- Outturns could be as weak as 2.5 and 2.7 percent in 2010, 2011 or as strong as 3.1 and 3.4 percent
- Persistent unemployment and spare capacity may pressure governments into making policy errors



Non-performing loans rise across much of developing Europe and Central Asia (% share of total)

ranked by 2009, median for all reporting countries worldwide = 2.7% in 2007 and 4.4% in 2009



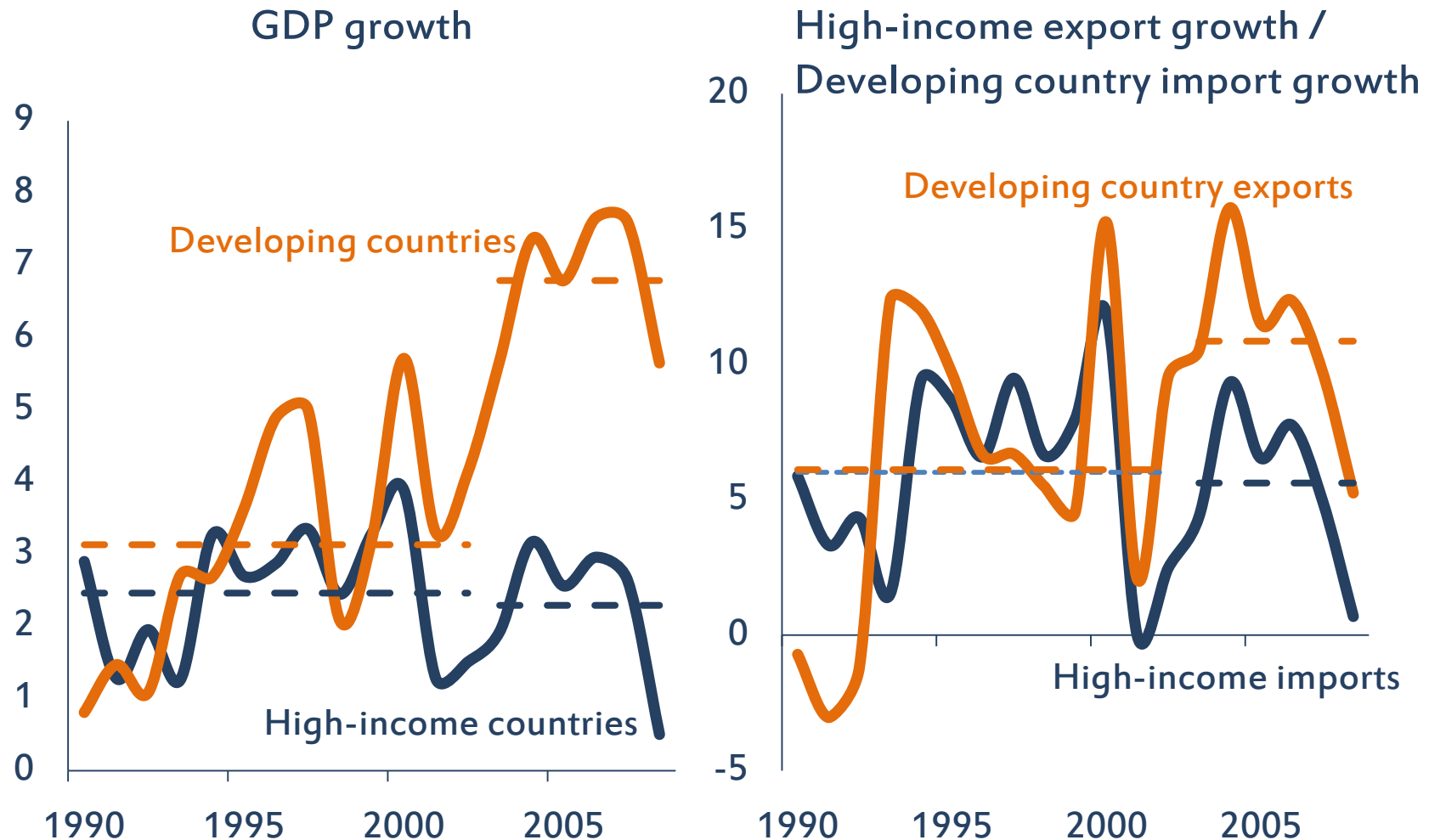


Understanding the boom period

- Real-side boom in developing countries was not due to strong demand in high-income countries
- Global liquidity increased international capital flows but also domestic intermediation
- Most countries were successful in transforming this into investment and non-inflationary increases in potential output
- Overall DC potential output growth rates increased 0.6 percentage points due to capital deepening

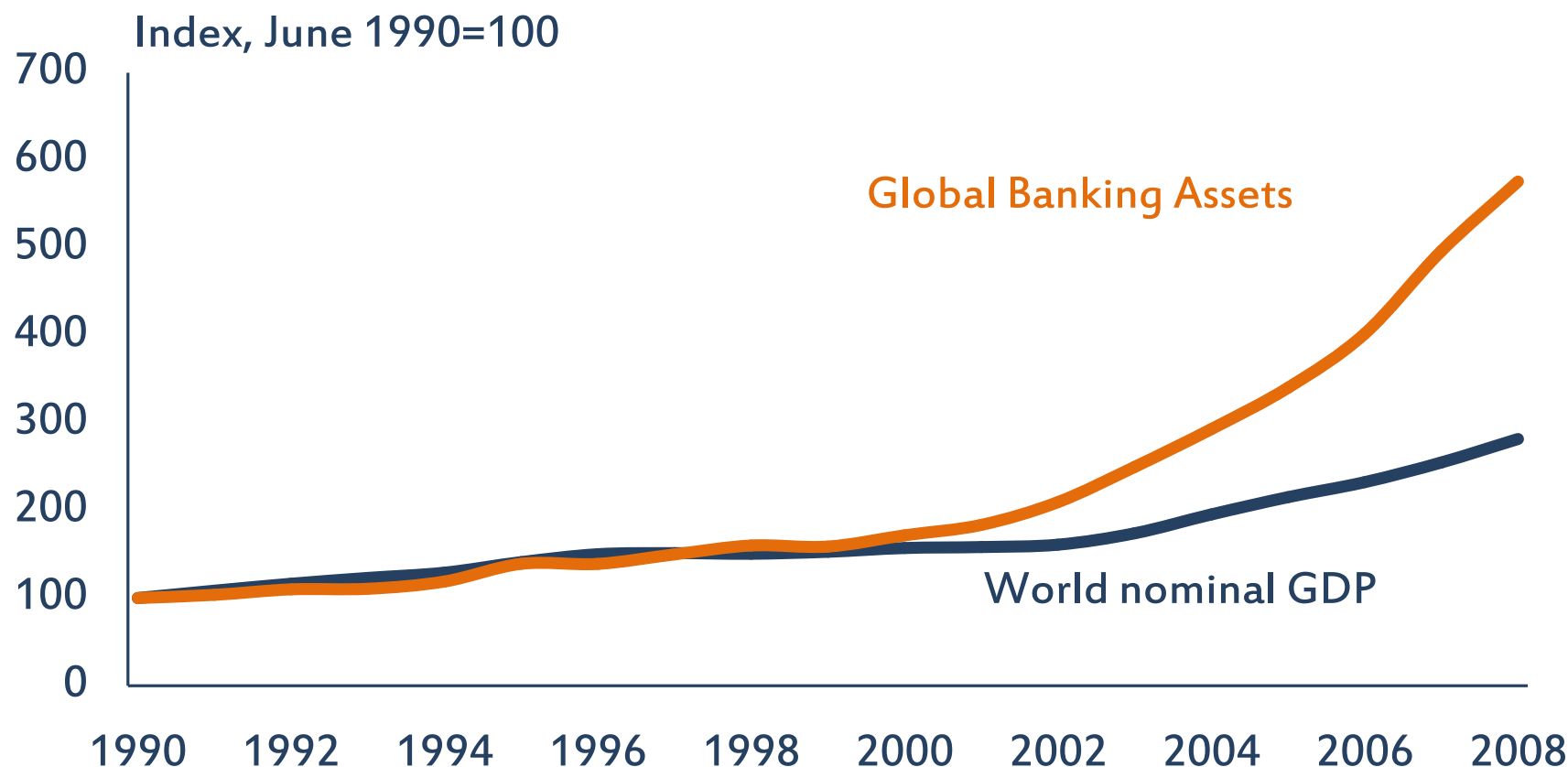


The boom did not reflect unusually strong demand from high-income countries



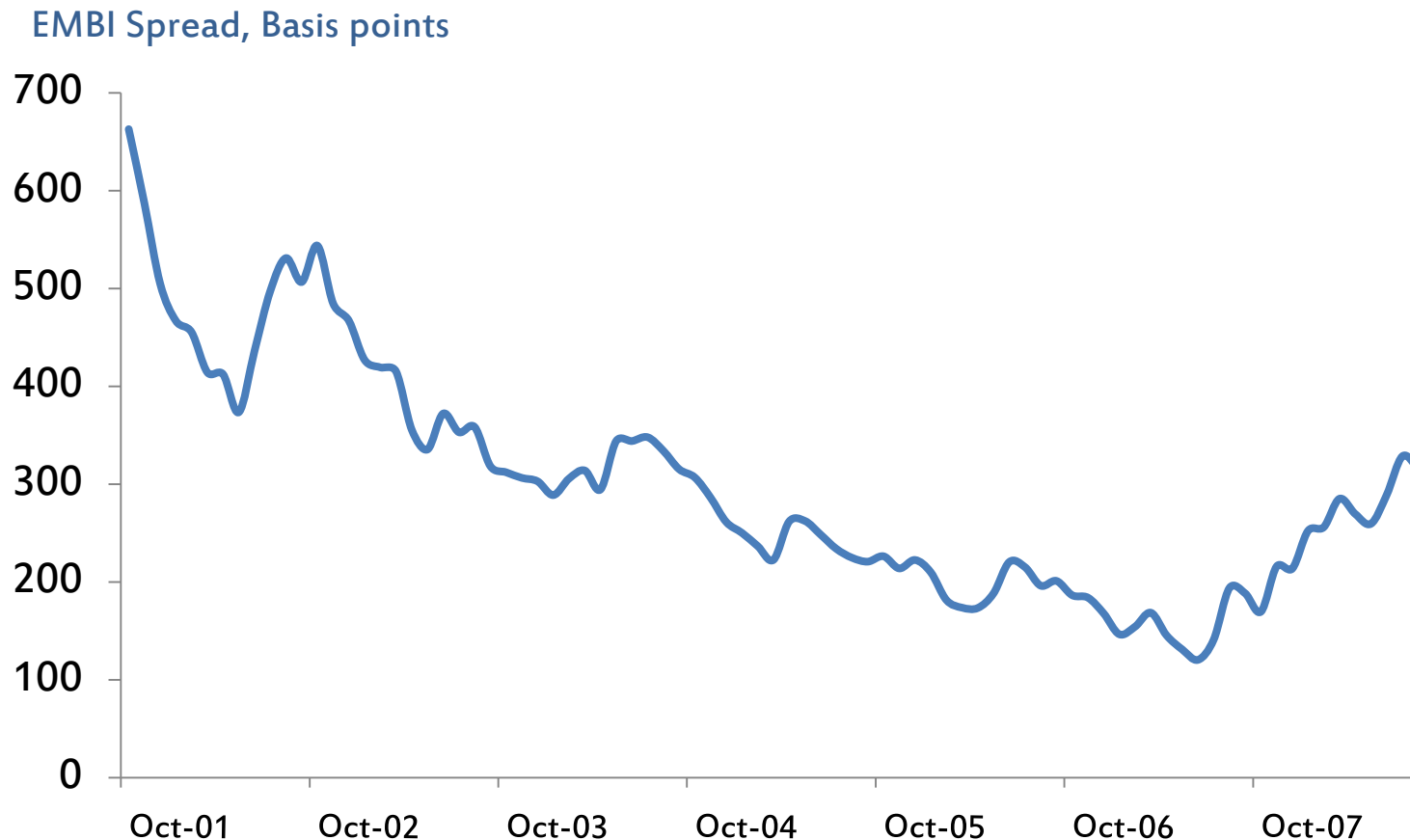


Since the early 2000s, credit expansion has grown more than twice as fast as nominal GDP





Developing country interest rates fell substantially during the boom period



Source: JP Morgan.



Liquid capital markets prompted surge in developing country finance and investment

Change in selected financial variables (2000-07)

	Global	Europe & Central Asia
Cost of capital (<i>basis points</i>)	-400	-866
(<i>% of GDP</i>)		
Capital inflows	5.0	12.0
Stock market capitalization	78.6	59.8
Private credit by deposits money banks	5.5	15.7
Investment	5.2	4.9



Falling capital costs were reflected in rising capital output ratios

Increase in capital output ratio (2000 – 2008)



Source: World Bank, Global Economic Prospects 2010: Crisis, finance, and growth



Medium-term impacts of crisis

Characteristics

- Tighter regulation
- Increased risk aversion
- Weakened financial center
- Increased government indebtedness

Consequences

- Higher capital costs
- Expansion of middle-income financial services
- Possible withdrawal from financial and trade globalization
- Less access to capital – especially for low income countries



Impact on potential output of a return to normal pricing of risk and higher base rates

	Transition impact on growth of potential	Long-term impact on level of potential output
Base rates at boom-period levels, spreads at October 2009 levels	-0.2	-3.4
Base rates at boom-period levels, spreads at “normal” levels	-0.4	-5.2
Base rates at 100 basis points higher than boom-period levels, spreads at October 2009 levels	-0.7	-8.0



Developing countries need to improve domestic intermediation to counteract tighter international conditions

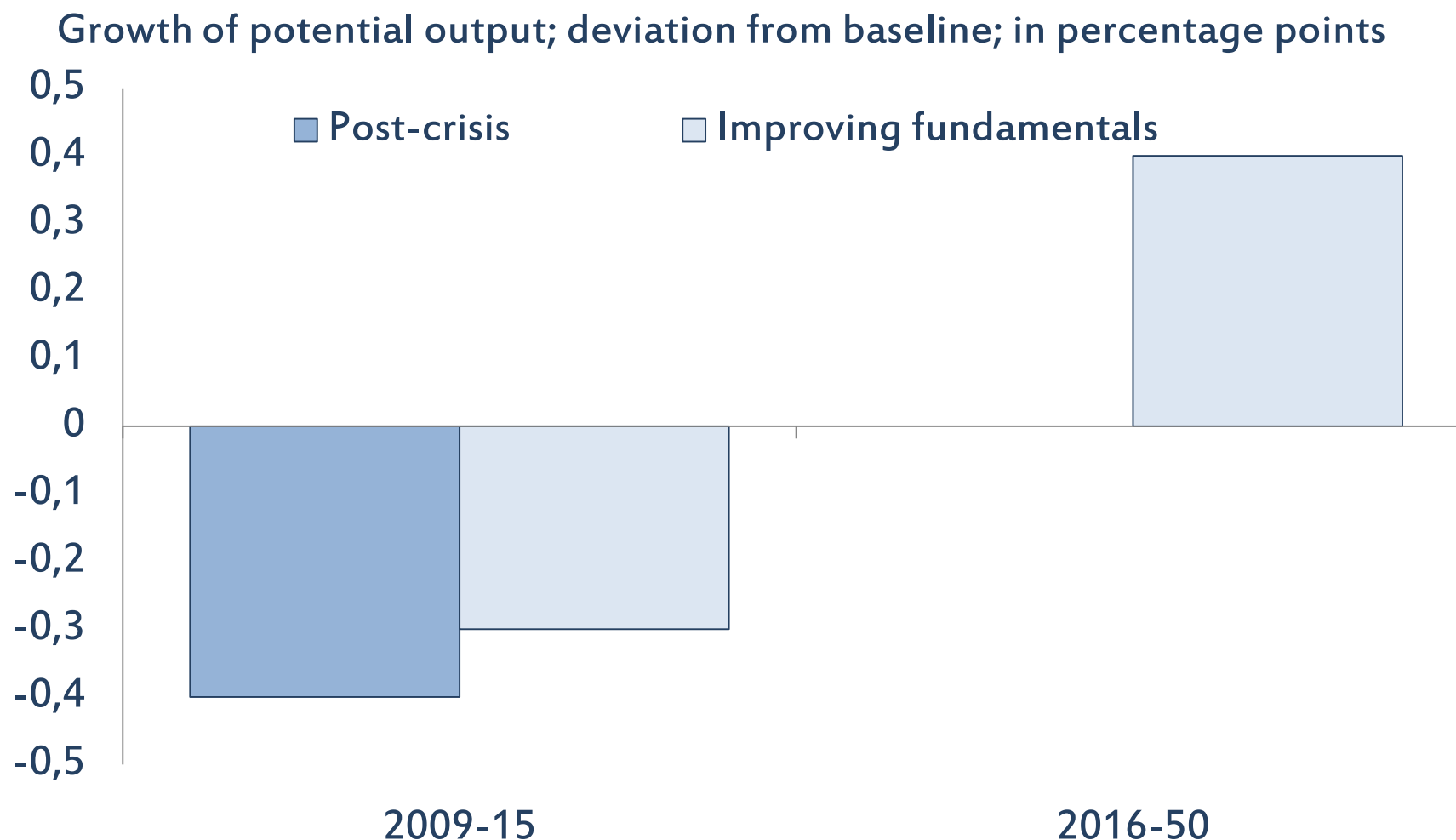
- Local borrowing costs often more than 10 percentage points higher than in high-income countries

Elements of a solution

- Increased competition
- Improved legal environment
 - Improve cadastres
 - Protection of property rights
 - Better contract enforcement (including bankruptcy law)



Impact of improved fundamentals on long-term growth prospects may counteract impact of crisis





Concluding remarks

- Recovery will be weak, but growth will nevertheless be stronger than during the 1990s, 1980s and 1970s – so inroads against poverty will continue
- Boom was a natural experiment -- developing countries can support even stronger growth rates without generating inflation or macroeconomic imbalance
- Although a tightening of international conditions is likely, policy can more than compensate by reducing local borrowing costs – but this will take time



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For more information visit:

www.worldbank.org/gep2010

www.worldbank.org/globaloutlook

