

Impact of the Global Financial Crisis on Central Asia

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November 2008

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Outline of presentation

- Global economic background
- Main transmission channels to Central Asian countries
- Policy conclusions and risks

Global economic outlook

- Difficulties that started in the US mortgage market in mid 2007 initially affected advanced countries and a few emerging markets (including Kazakhstan)
- Since September 2008, problems are rapidly spreading globally
- Policy measures introduced in many countries (including Kazakhstan, China) have helped to stabilize financial markets
 - Liquidity support
 - Bank recapitalization
 - Public guarantees
- But the impact on real economic performance is only now starting to be felt. The global economy is at the start of a major downturn

Financial stress leads to deeper recessions

Cumulative Output Loss during Slowdowns and Recessions 1/
(median; percent of GDP) - 1980s - 2000s

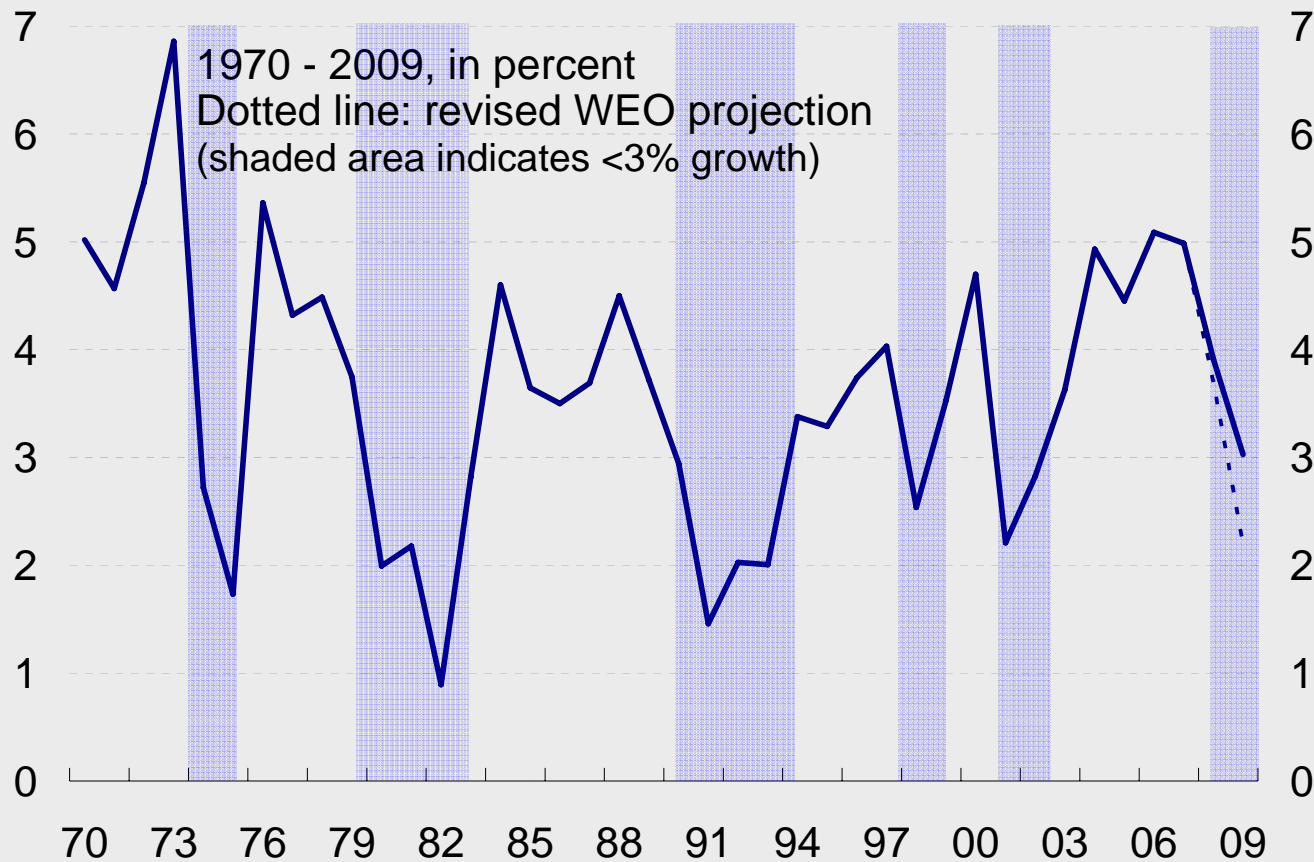


Source: World Economic Outlook, Chapter 4, October 2008.

1/ Measured as the cumulative output loss when output was below the Hodrick-Prescott trend for slowdowns and cumulative output loss until recovery of recessions.

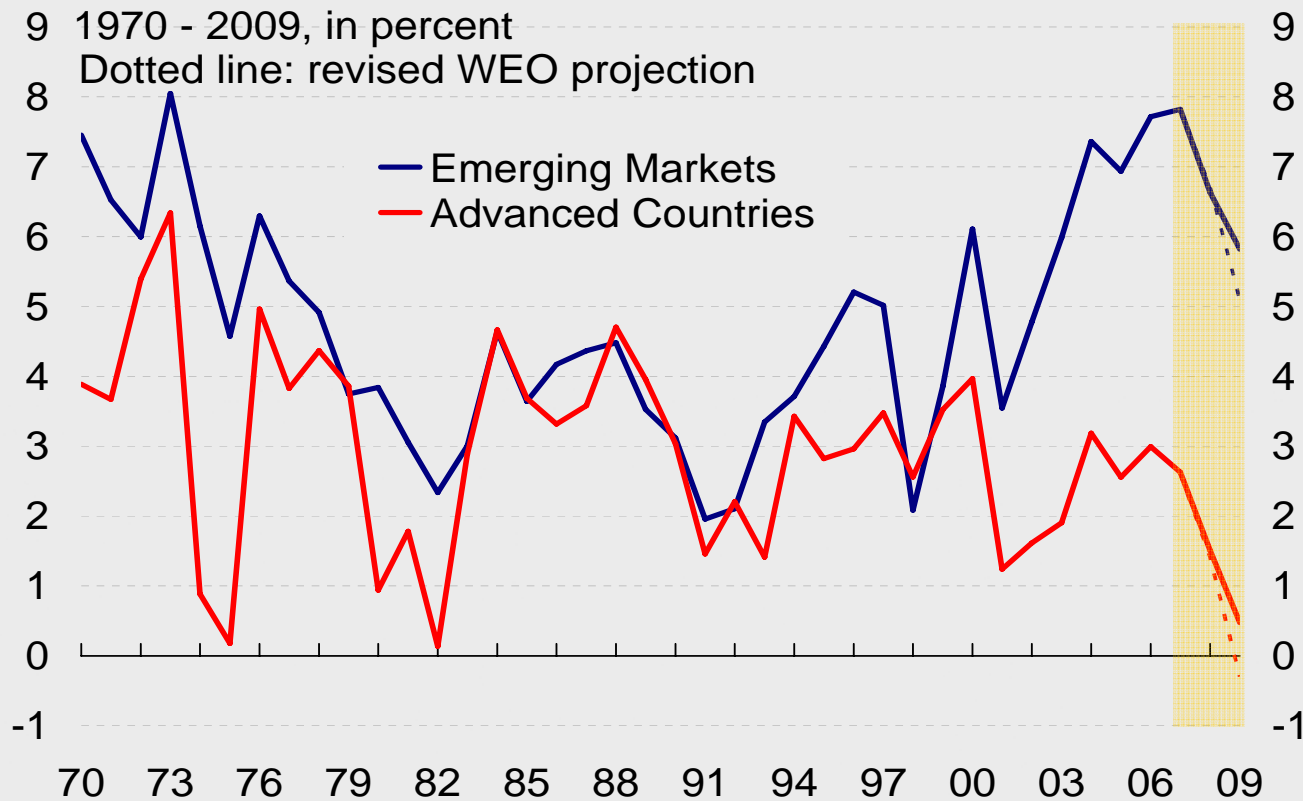
- Banking sector distress is associated with severe and protracted downturns
- Impact amplified when preceded by the rapid expansion of credit, run-up in house prices, and heavy private sector borrowing

World GDP growth slowing sharply



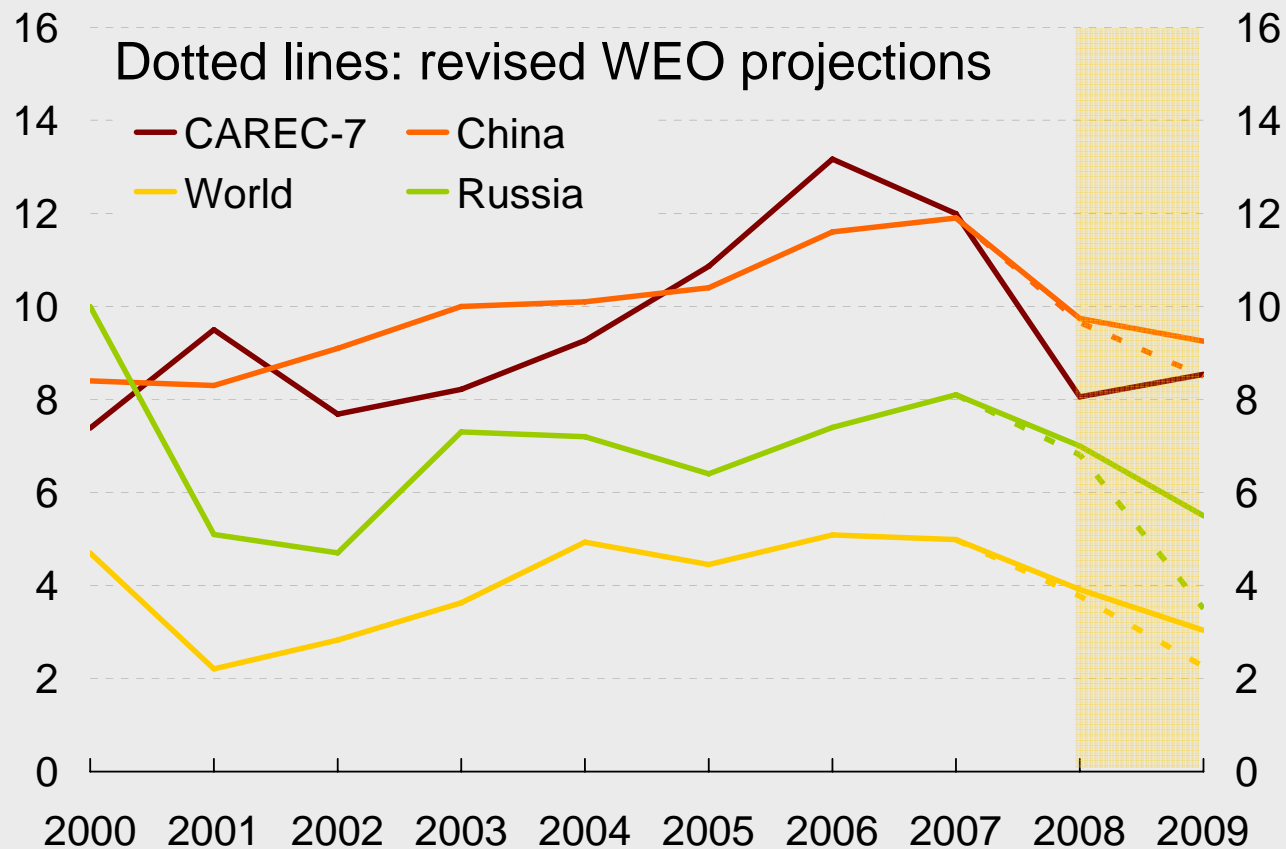
- World growth projected to be weakest since 2001
- Significant downside risks—forecasts being revised down rapidly

Growth in advanced and emerging countries



- Growth in advanced countries may be negative in 2009—weakest performance for decades
- Emerging market growth expected to hold up better

GDP growth by regions



- Russian growth slowing sharply; China holding up better
- October IMF forecasts projected continued strong growth in CAREC countries
- But downward revisions are likely

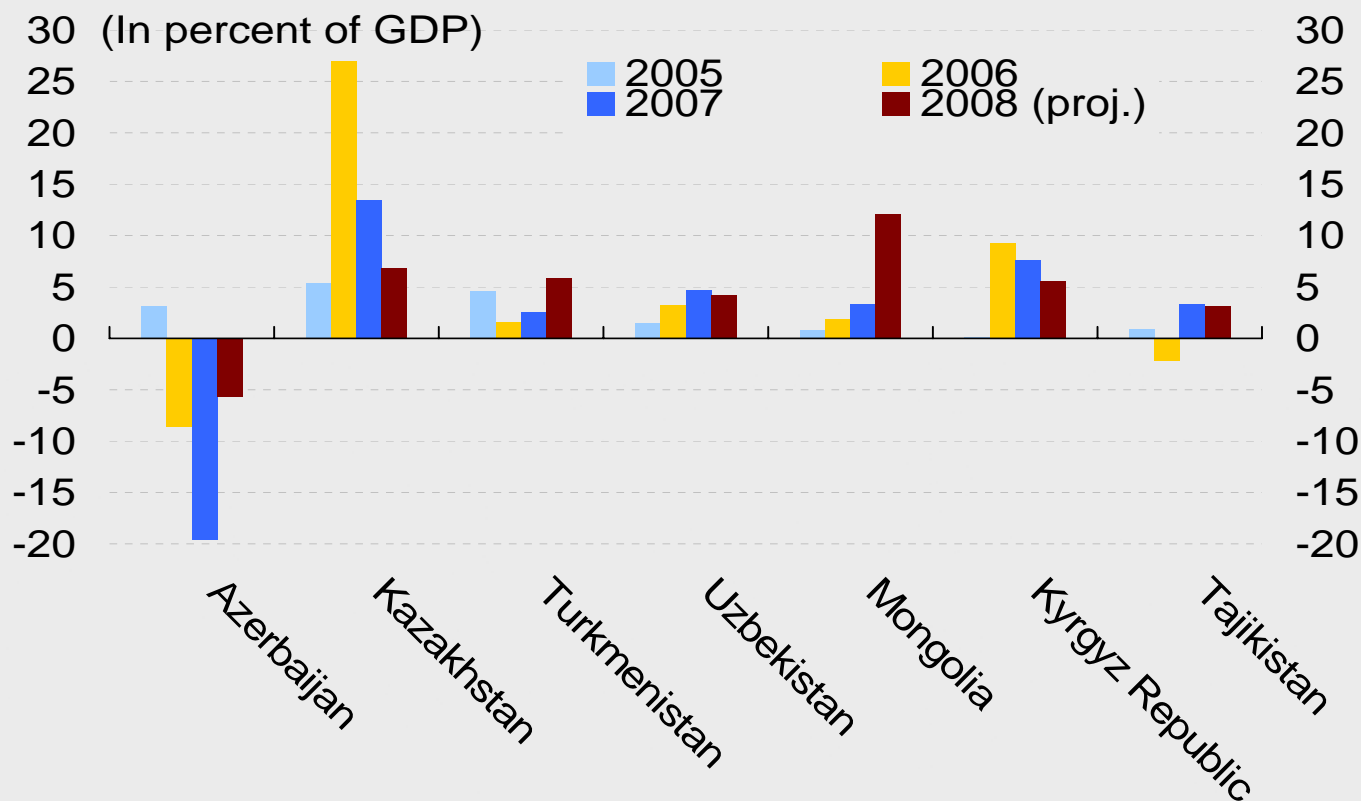
Major transmission channels

- Financial links and capital flows
 - More difficulty in obtaining external financing
- Lower oil and commodity prices
 - Impact differs across countries, but negative for region as a whole
- Lower remittances
 - Especially from Russia
- Trade flows
 - Weaker growth in key trading partners

Financial links

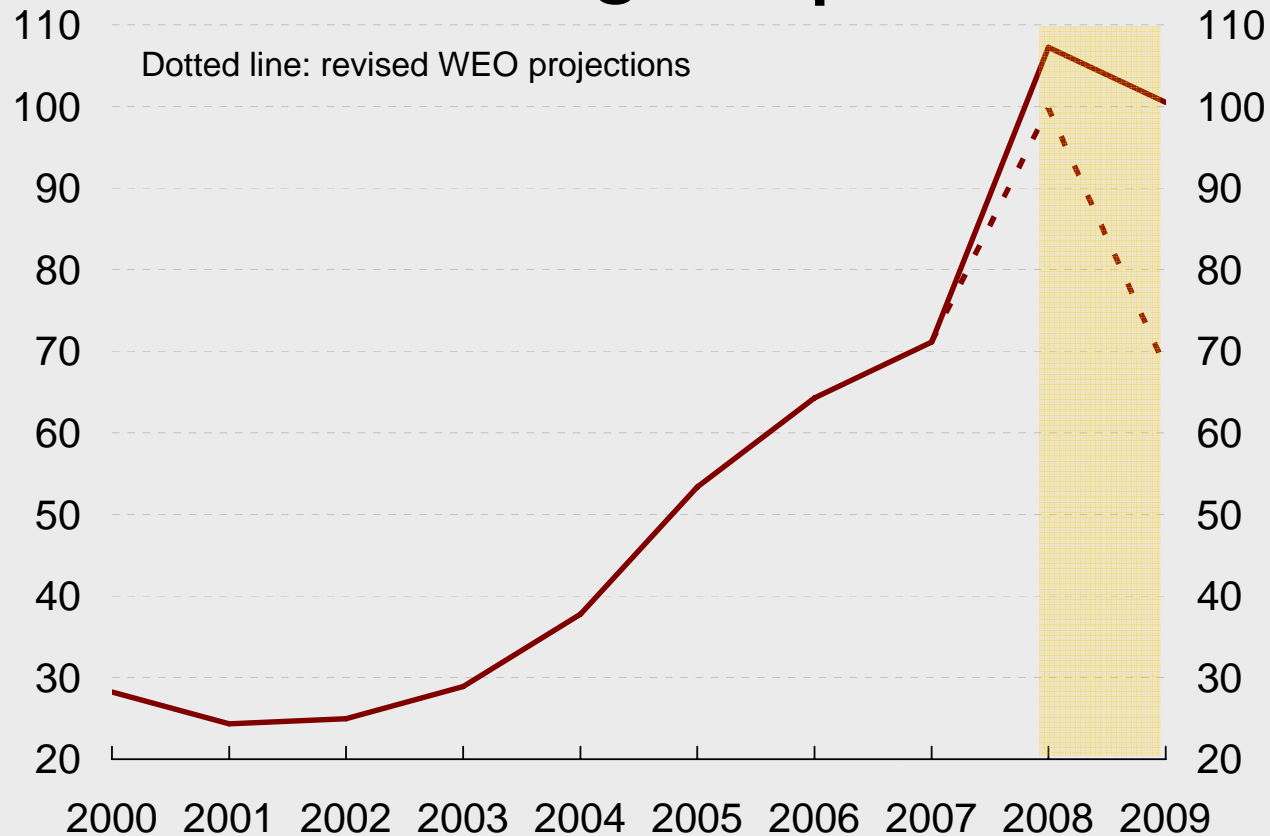
- **Direct exposure to distressed assets**
 - No significant exposure to sub prime mortgages
 - Some exposure to other CIS countries (Russia, Ukraine, Georgia)
 - Possible impact from global exchange rate adjustments and equity price collapse (sovereign wealth funds)
- **Difficulties in obtaining external financing**
 - Potential debt rollover problems—banks and potentially non-bank corporates
 - Kazakhstan significantly affected; limited impact in Azerbaijan
 - But no substantial exchange rate depreciations; commodity exporters and China have ample foreign exchange reserves
- **Regional spillovers**
 - Kyrgyz financial sector has close links with Kazakh banks

Net private capital flows



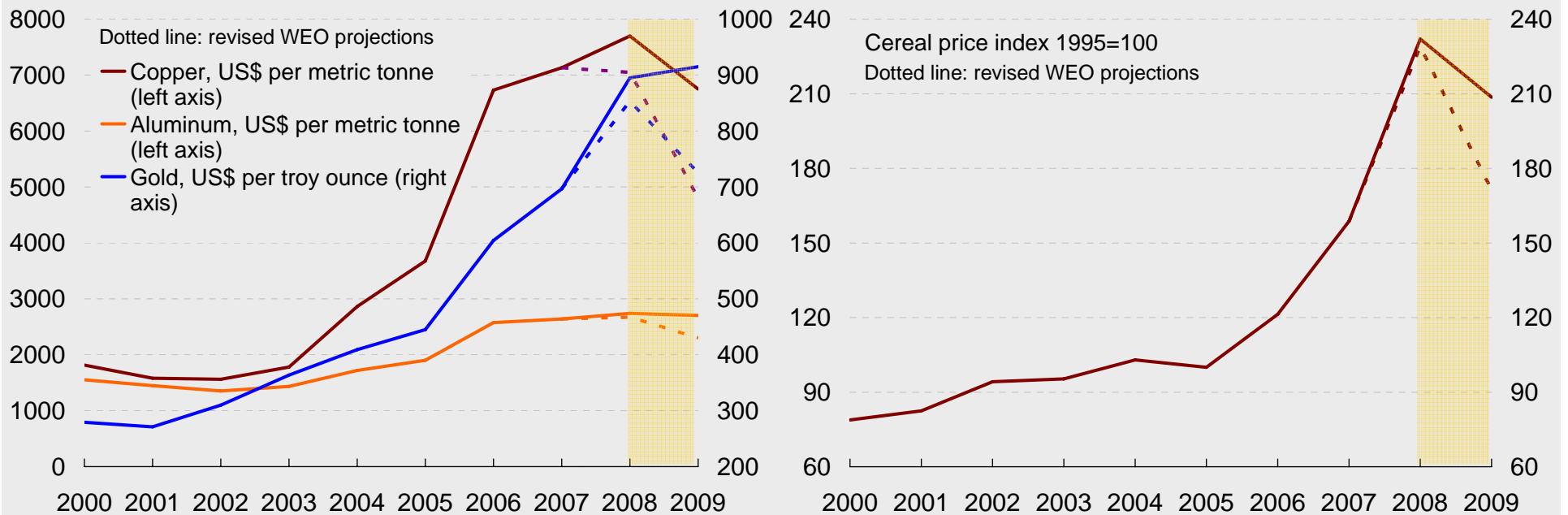
- Capital inflows to region are declining—especially to Kazakhstan and Kyrgyz Republic
- Exception is Mongolia, where FDI remains strong

Declining oil prices



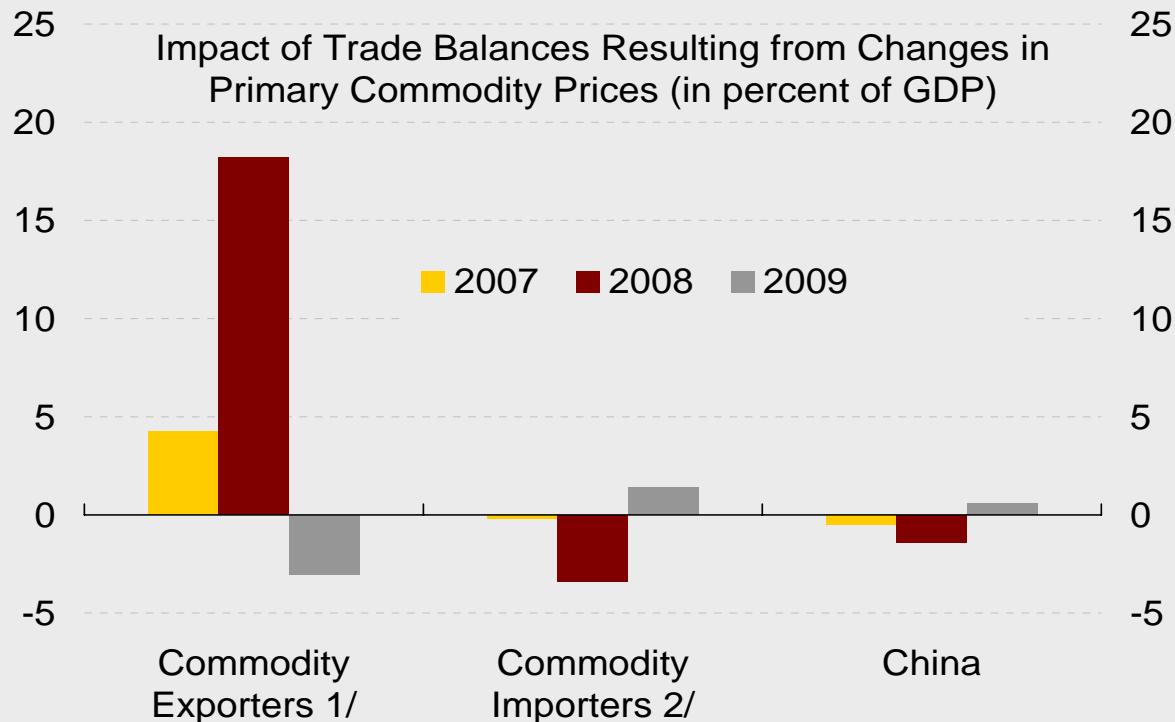
- Oil prices down sharply since the onset of the global crisis
- Now less than half their recent peak

Non-oil commodity prices



- Metals and food prices also down significantly

Trade balance and commodity prices

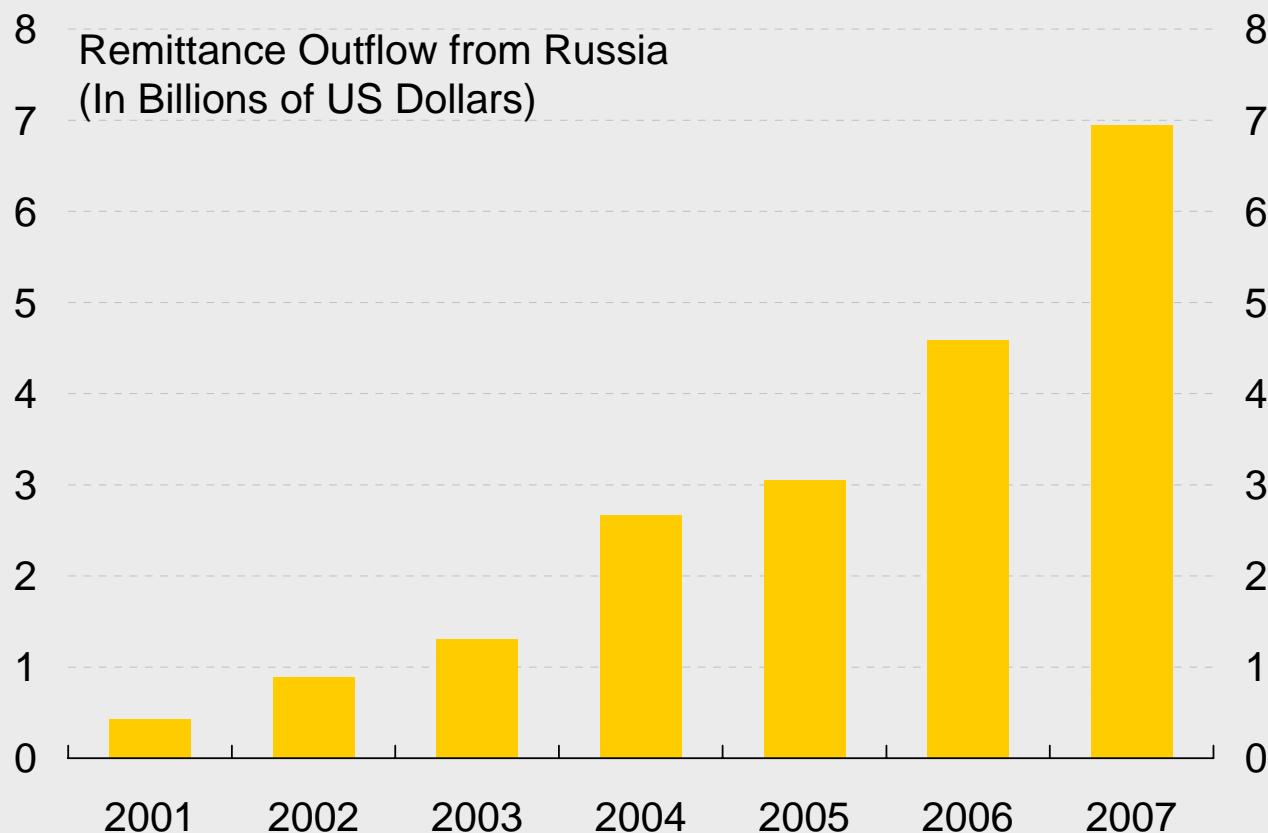


1/ Azerbaijan, Kazakhstan, Uzbekistan, Mongolia, and Turkmenistan.

2/ Afghanistan, Kyrgyz Republic, and Tajikistan.

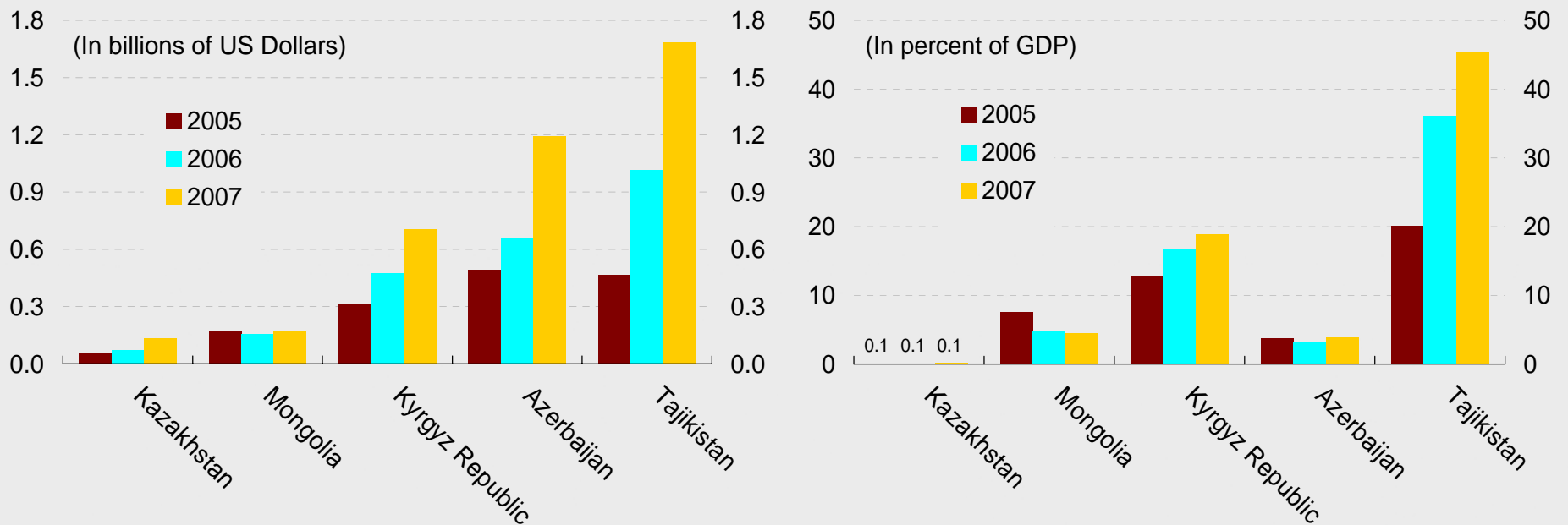
- China and other commodity importers will gain small benefit from lower global commodity prices
- But commodity exporters will be hit hard

Remittances



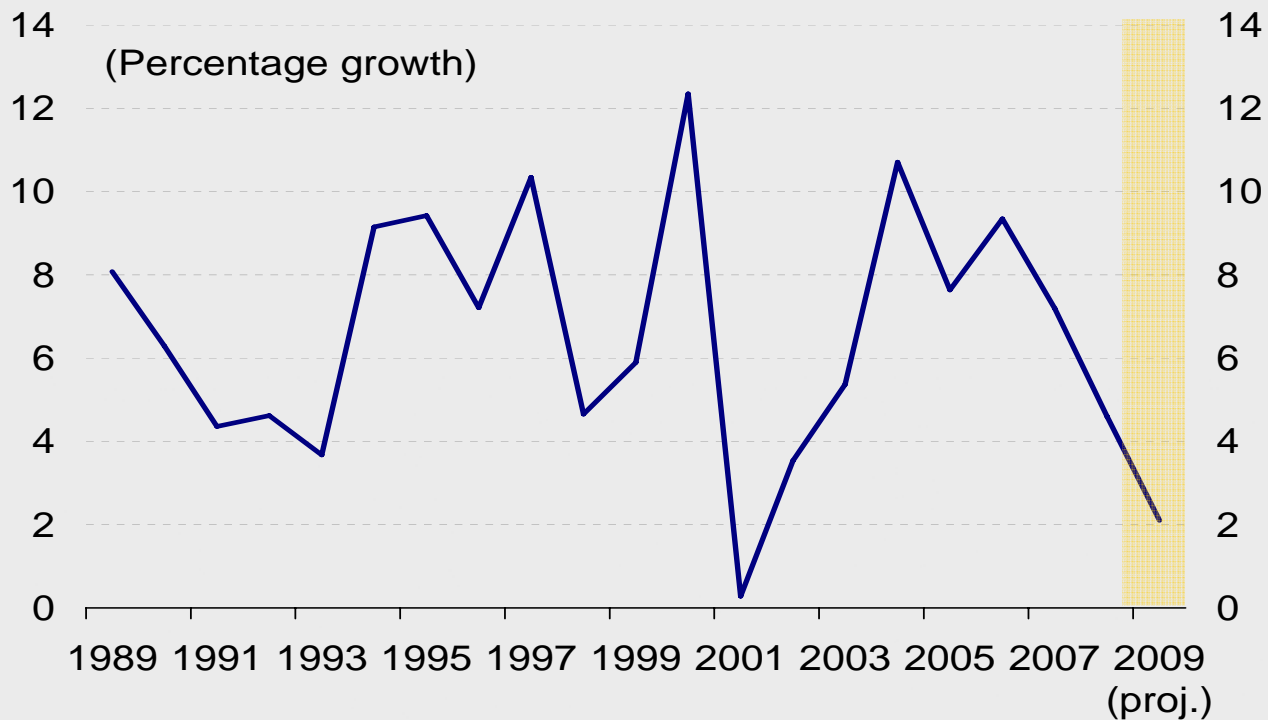
- Remittances from Russia have surged in recent years

Remittances to selected CAREC countries



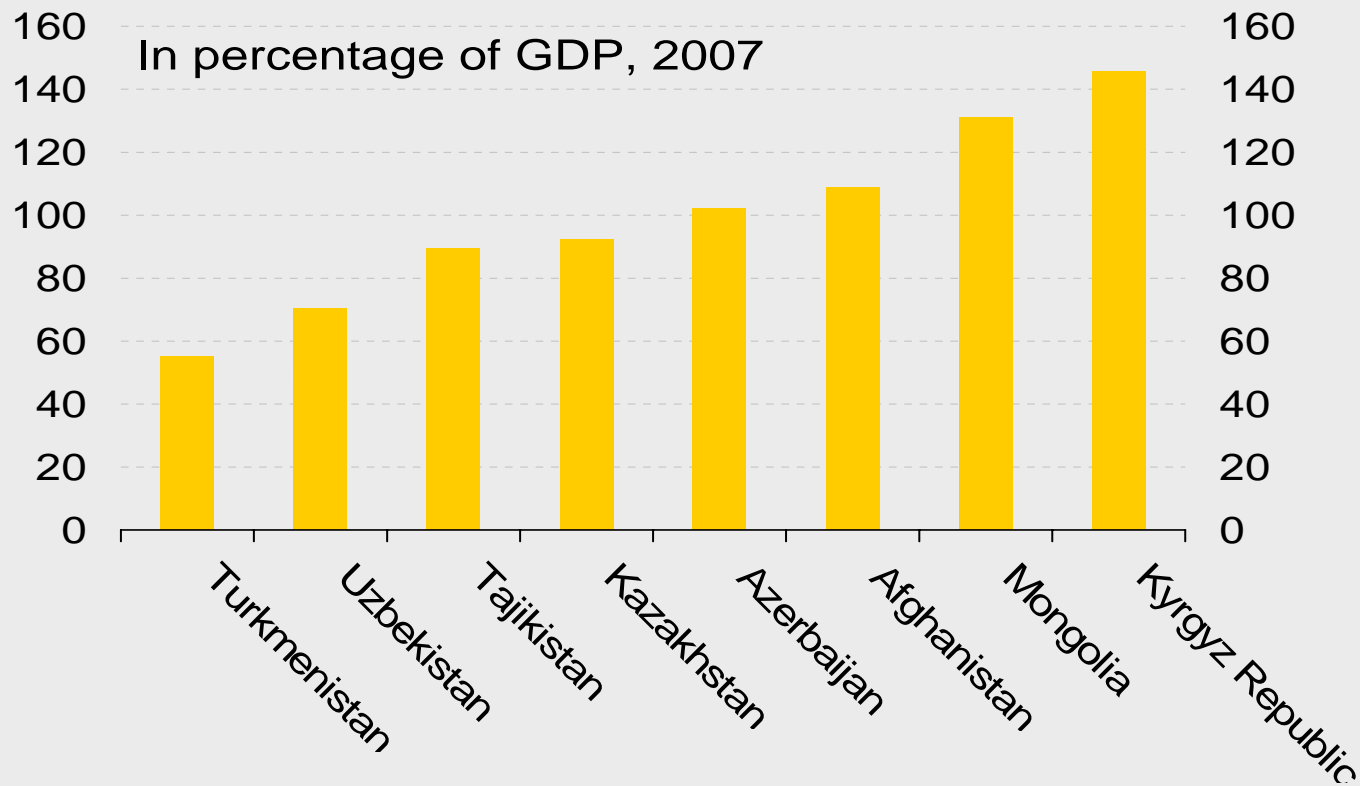
- Tajikistan and Kyrgyz Republic especially vulnerable to a downturn in remittances from Russia

World trade growth slowing sharply



- Trade being hit by problems in obtaining trade financing
- Affecting China's export performance

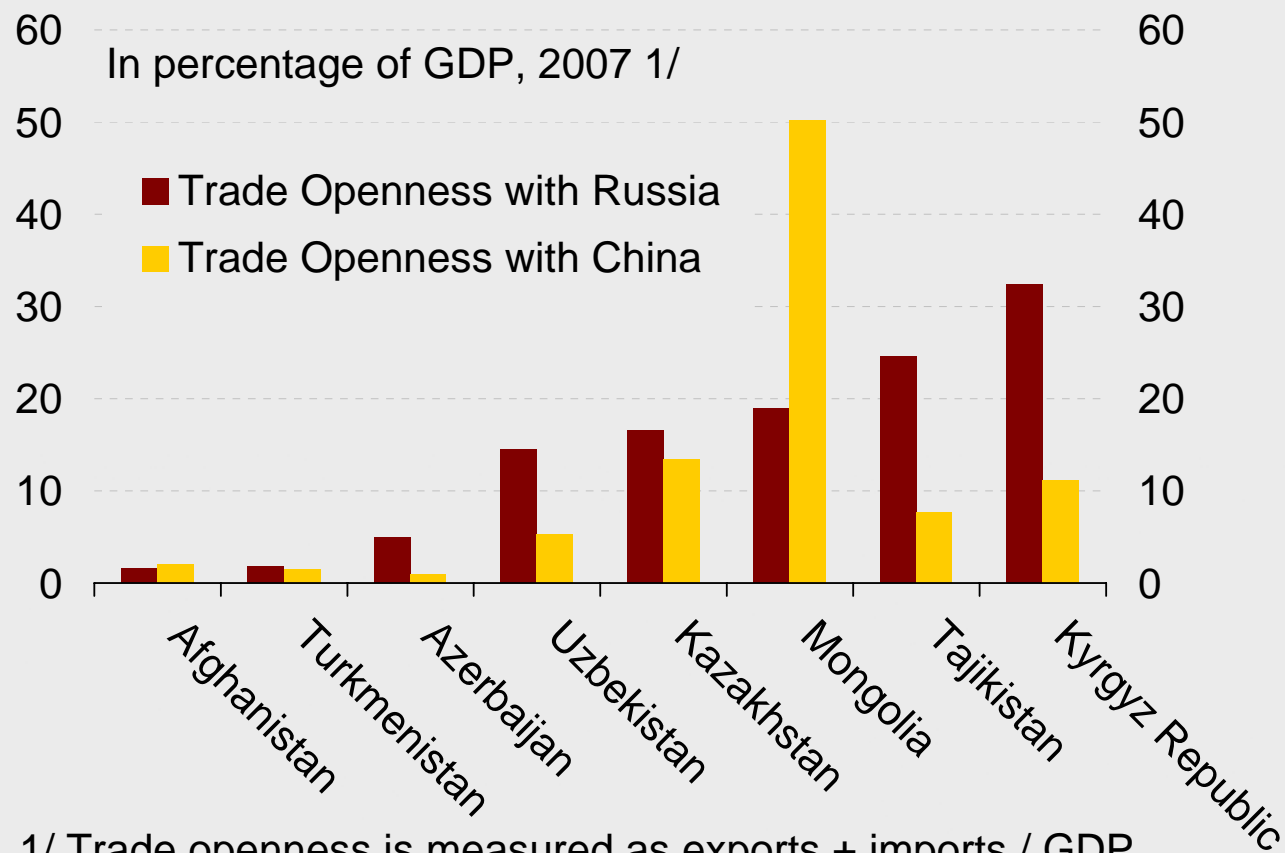
Trade openness



1/ Trade Openness is measured as exports + imports / GDP

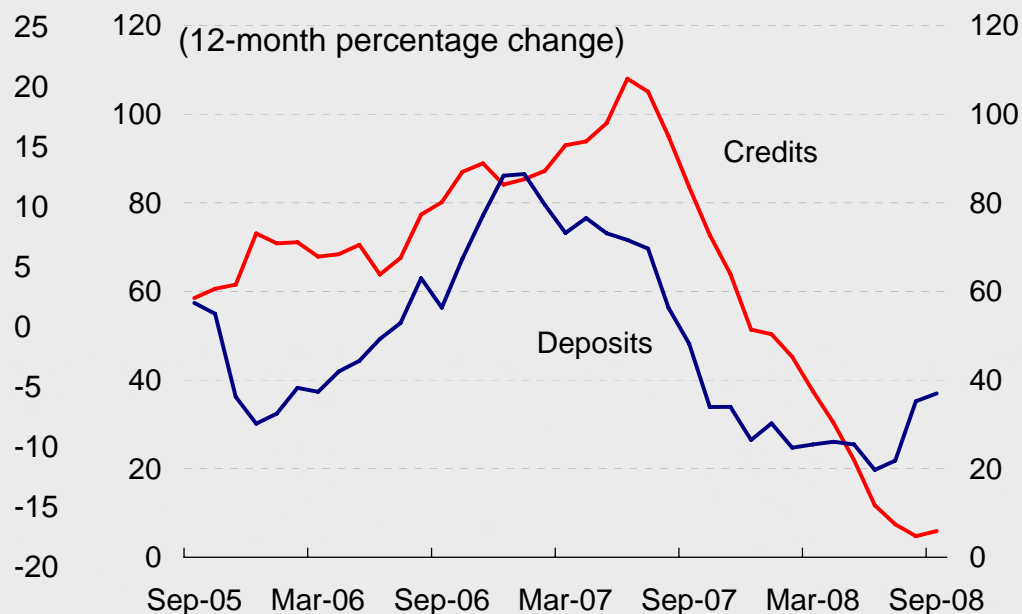
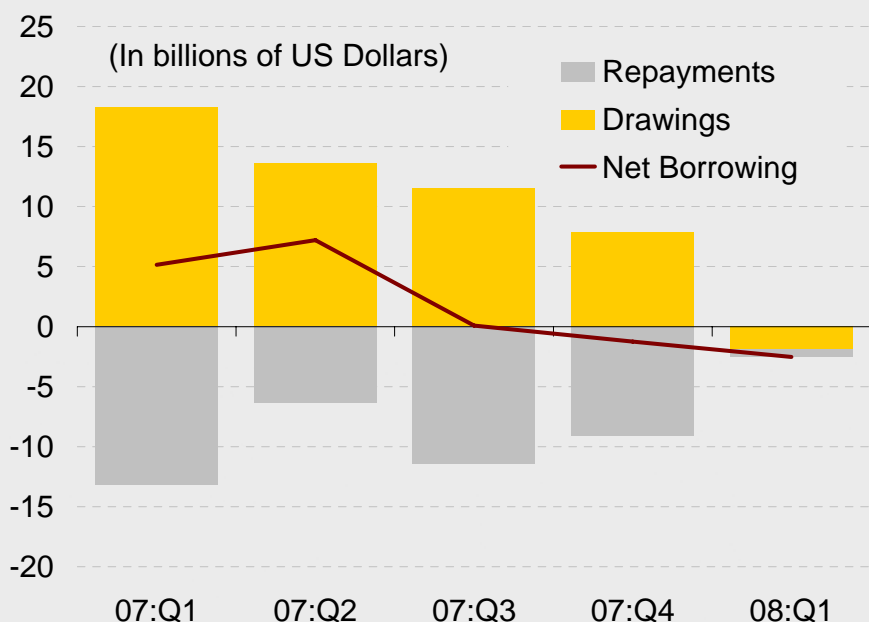
- More open economies are more vulnerable to slowdown in world trade

Trade flows with Russia and China



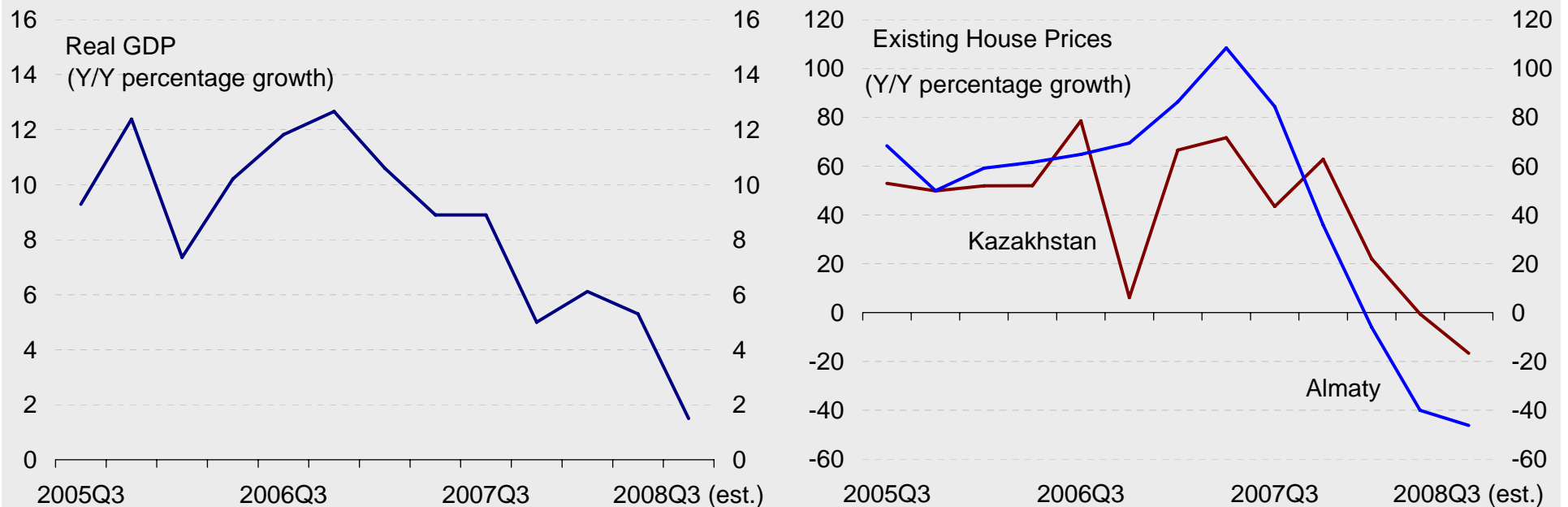
- Strong trade links with Russia add to the risks, as Russian economy is set to slow sharply
- Strong trade links with China may help, if its economy holds up better than other trading partners

Kazakhstan: external borrowing and credit



- External financing of banks has dried up
- Together with slower deposit growth, this has led to a sharp decline in credit growth

Kazakhstan: real GDP and house prices



- GDP growth has slowed to less than 2 percent
- House prices are declining sharply

Policy issues

- Key challenge for the region has switched from lowering inflation to protecting the financial system and sustaining growth
- But inflation remains high in many countries, posing a difficult policy dilemma
- Protecting the financial sector
 - Provision of liquidity
 - Strong financial sector supervision
 - Contingency planning (possible need for bank recapitalization using public money, bolstering of deposit guarantees)
 - Regional coordination—measures may have unintended spillovers
- Sustaining growth
 - Exchange rate flexibility to help absorb shocks
 - Use of fiscal space to cushion impact on growth and poverty
 - Monetary policy should focus on inflation but be forward looking: slowing growth and lower commodity prices will reduce the need for tight monetary policies in some countries

Risks

- Global slowdown may be longer and deeper than currently projected
 - Forecasters are still revising down projections
 - IMF forecasts for Central Asia subject to significant downside risks
- Financial sectors could suffer further if global financial conditions continue to deteriorate
 - Declining real estate prices would add to the risks in some CAREC countries
 - Banks with heavy lending in foreign currency may be vulnerable to exchange rate depreciation
- Excessive policy loosening and high wage increases could entrench high inflation, despite the easing of global inflationary pressures