

ADB Support to its Developing Member Countries During External Shocks

*Instruments, Past Experience and
Some Examples*

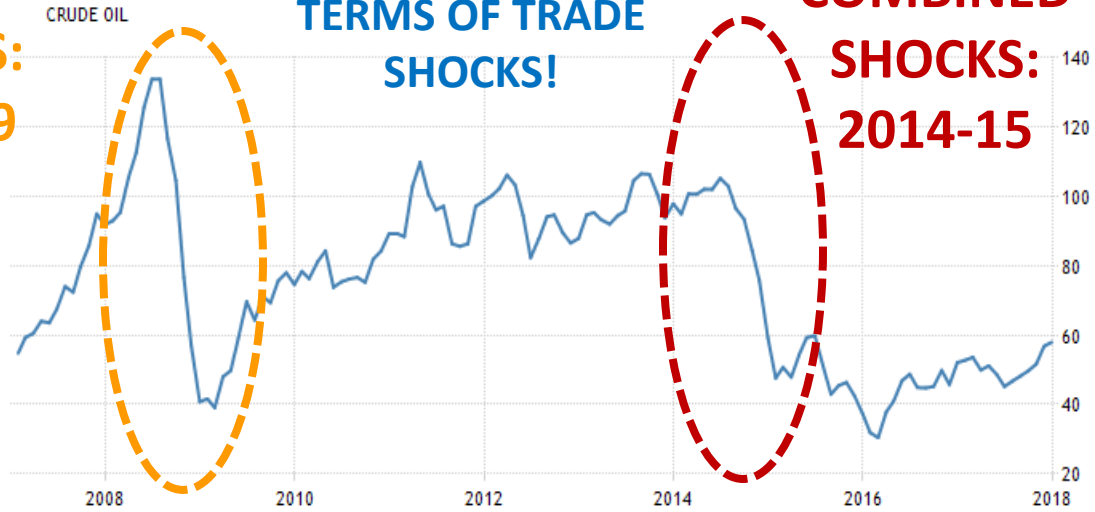
2008-2018: Decade of External Shocks in Central West

COMBINED SHOCKS: 2008-09

TERMS OF TRADE SHOCKS!

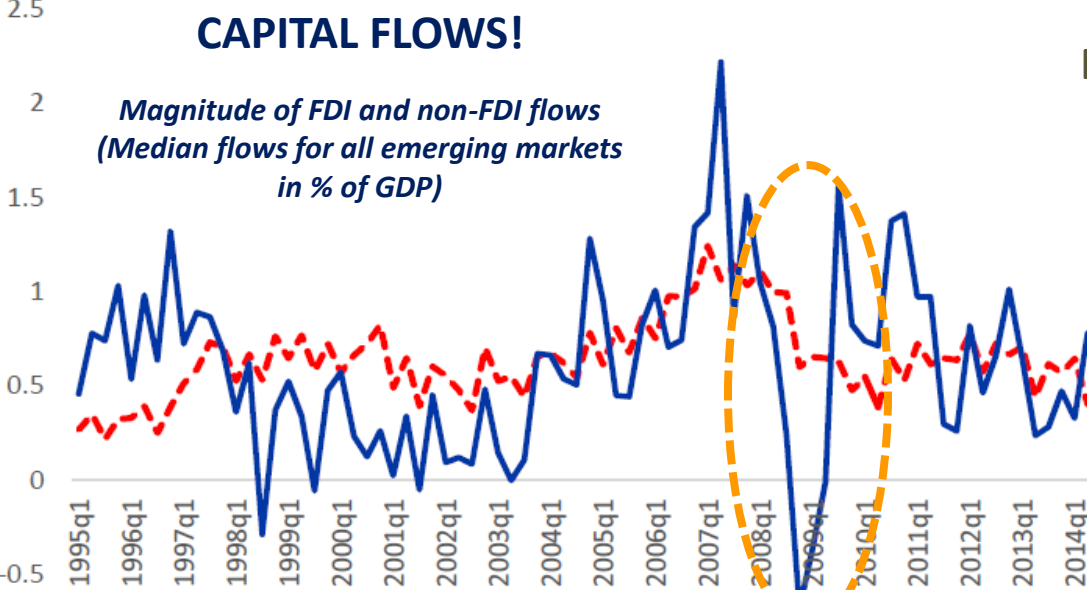
COMBINED SHOCKS: 2014-15

MACRO VULNERABILITY: Central West DMCs have highly-dollarized economies and banking systems...



SOURCE: TRADINGECONOMICS.COM | OTC

SUDDEN-STOP IN CAPITAL FLOWS!

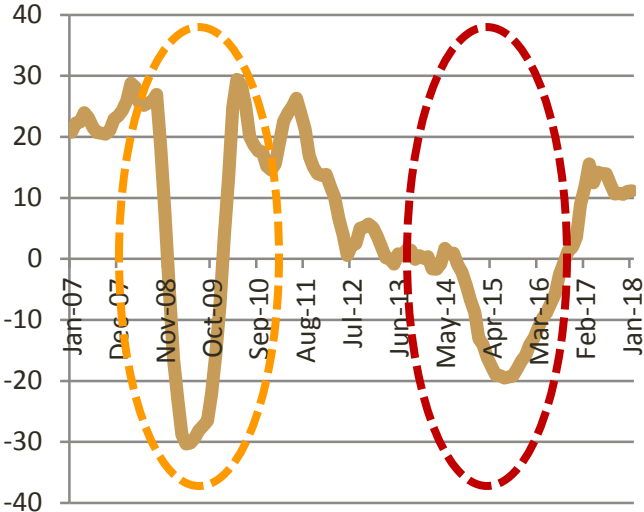


Source: Eichengreen, Barry and Gupta, Poonam, Managing Sudden Stops (2016)

--- FDI Flows — Portfolio and Other Flows

REGIONAL TRADE SHOCKS!

Russia Real Activity Index (Prasad and Foda, 2018)



ADB Support is Responsive to Two Key Realities:

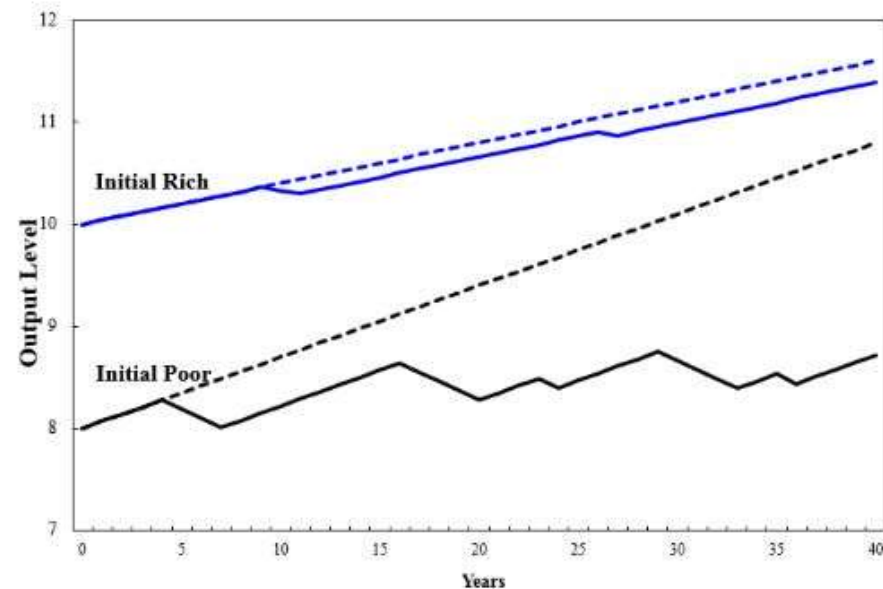
1. Crises and Recessions leave long-term scars: *“all types of recessions—including those arising from external shocks and small domestic macroeconomic policy mistakes—lead to permanent losses in output and welfare.”* (Cerra & Saxena, 2018)

- Thus, supporting DMCs in fighting or countering recessionary swings in their economies is **PRO DEVELOPMENT**

2. Fiscal Support. It is often crucial to insulate medium-term reform processes from fiscal shocks and difficulties in keeping fiscal stability.

- Cerra & Saxena, 2018: *“Economic policies should be geared toward avoiding crises and severe recessions, and responding with appropriate stimulus and safety nets.”*

New model of economic development
Crises and recessions prevent poor countries from catching up to rich countries.



Options for ADB support (1/2)

- **OPTION 1: Policy-Based-Lending (PBL)**, with two versions:
 - **Stand-alone policy-based lending.** Budget support that is typically packaged as a multi-tranche loan to support structural reforms in a particular sector.
 - **Programmatic Approach.** Provided in conjunction with structural reforms over a medium-term time frame. Programmatic budget support finances a series of subprograms, each as a fully front-loaded single-tranche intervention.
- **Proceeds of the Policy-Based Loan** are (i) disbursed in a minimum number of installments (e.g. 2 or 3), as either tranches or subprograms, upon Govt achievement of reform objectives and ADB internal review and processing; (ii) generally non-earmarked (earmarking solutions can also be devised to represent financing flows to a particular reform-related use).

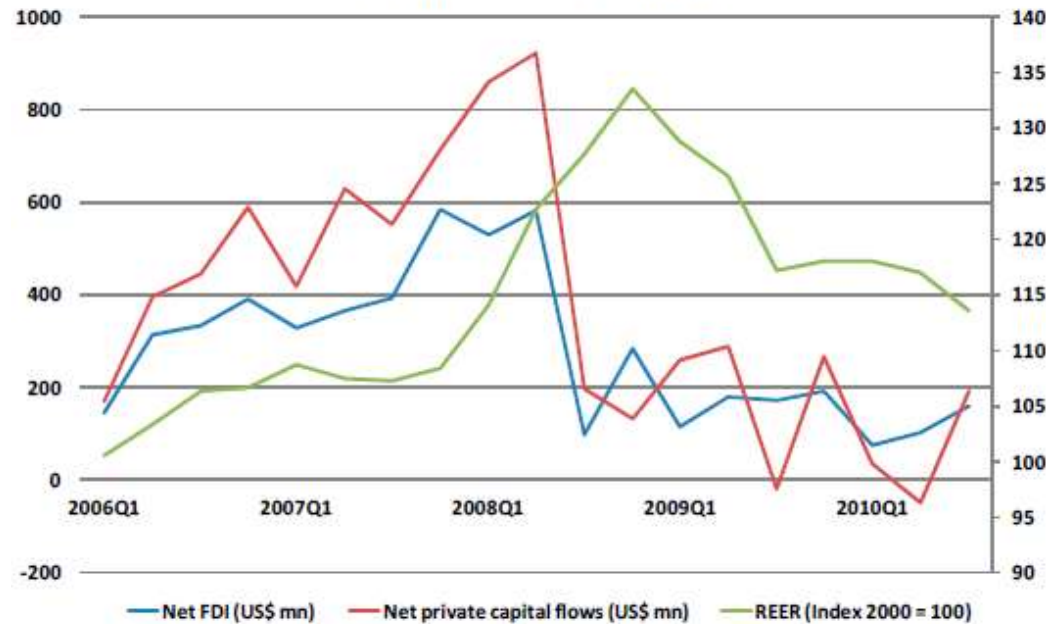
Options for ADB support (2/2)

- **OPTION 2:** Countercyclical Support Facility (CSF) on fulfilling the following Access Criteria.
 1. *Adverse impact of Exogenous Shock*
 2. *Countercyclical Development Expenditures/Policy for Poverty Reduction*
 3. *Sound Pre shock Macroeconomic Management*
 4. *Structural Reforms*
 5. *Debt Sustainability*
 6. *Coordination with IMF*

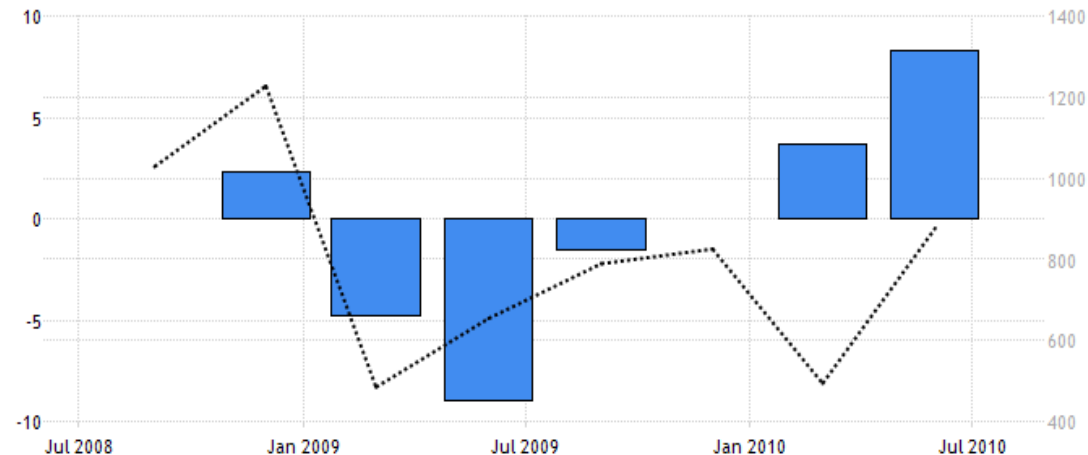
GEO: Growth Recovery Support Program (2009)

- The loss of investor confidence, caused initially by the August 2008 conflict and then by the international financial crisis => sharp slowdown in capital inflows (both foreign direct investment and debt inflows) to Georgia => recessionary conditions in the largely dominating non-tradables sector.
- Stand-Alone Policy Loan (single tranche), approved in Q2-2009 for \$80 million-equivalent (fast-tracked processing):
 - Joint-Needs Assessment (with IFIs) and IMF Stand-By Arrangement as anchors.
 - Immediate Objectives:
 - Meet incremental expenditure needs arising from the worse than-expected economic conditions in 2009 without complete drawn down of cash balances at NBG.
 - Core Government expenditure program for 2009 delivered in accordance with approved budget, irrespective of subsequent shortfalls in revenue.
- Focus on key Financial Reforms as conditionals, to establish banking sector stability tools and strengthen monetary management**

REER and Private Capital Flows



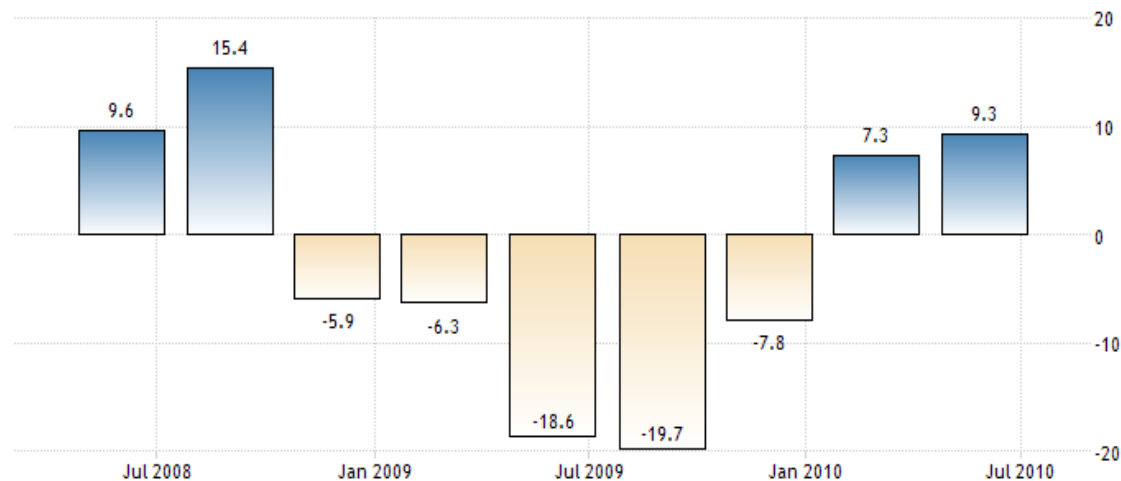
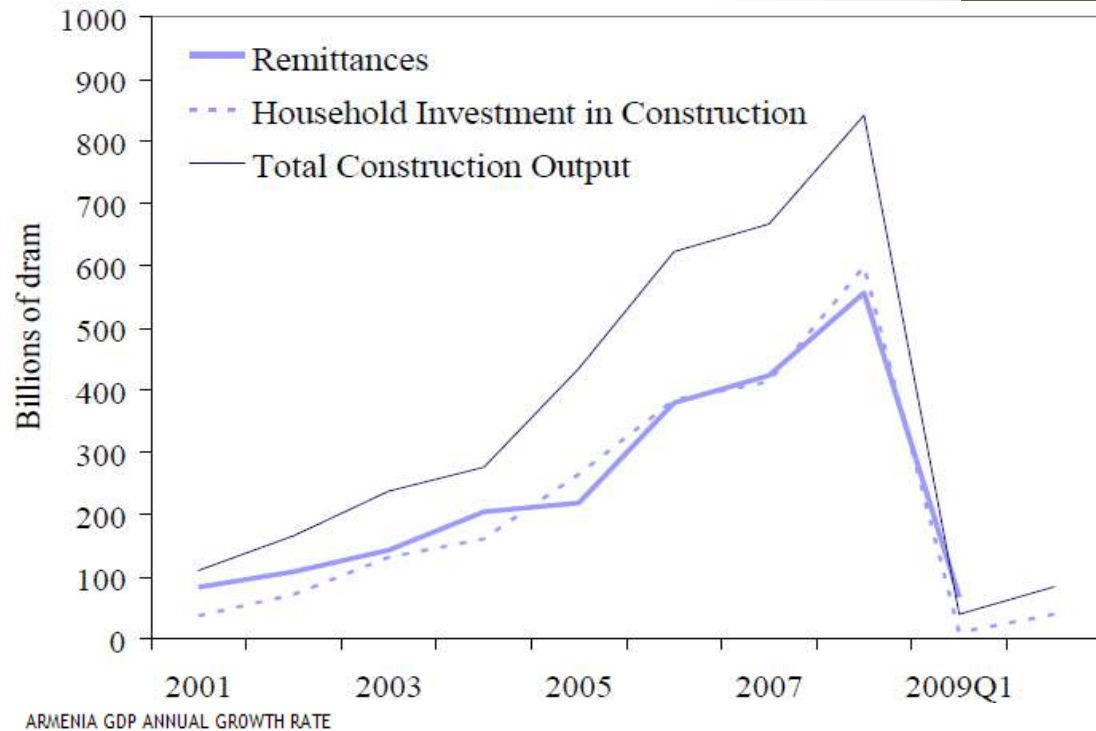
GEORGIA GDP ANNUAL GROWT... GEORGIA GROSS FIXED CAPITA..



ARM: Crisis Recovery Support Program (2009)

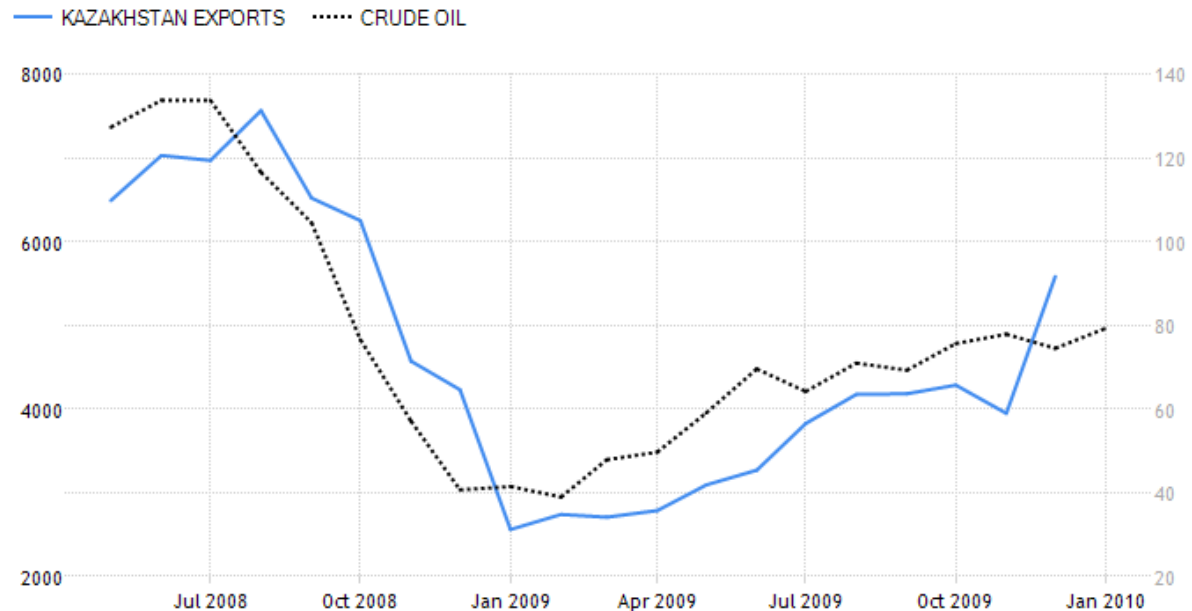
Sharp Negative Shock in FDI and Remittance Flows => Sharp Contraction in Household Investments in Construction and Construction Output => Collapse in Credit Quality and Real Estate Prices => Banking Instability

- Stand-Alone Policy Loan (single tranche), approved in Q2-2009 for \$80 million-equivalent (fast-tracked processing):
 - Anti-Crisis Action Plan and IMF Stand-By Arrangement as anchors.
 - Immediate Objectives:
 1. Increase in social protection expenditures
 2. Job creation through public investment implementation
 3. Eliminate salary and pension arrears
- **Conditionalities linked to:**
 - (1) **IMF SBA (exchange-rate flexibility and the strengthening of deposit guarantee fund),**
 - (2) **Countercyclical Fiscal Stimulus measures (e.g. acceleration of existir and planned new investments, direct support to SME)**
 - (3) **Maintenance of Social Safety nets**

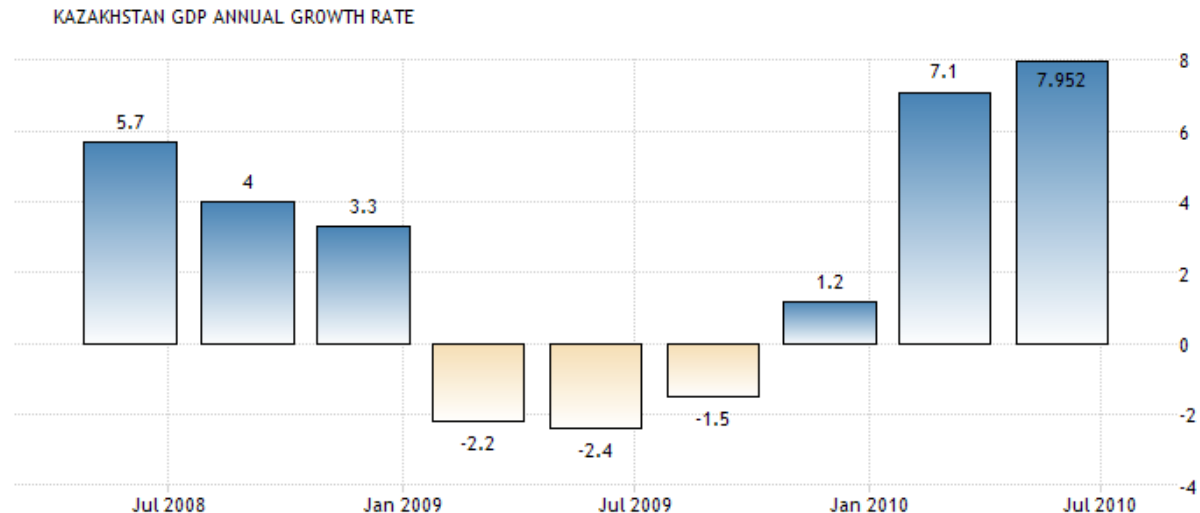


KAZ: Countercyclical Support Loan (2009)

- Collapse in Oil Prices and other commodities => Sharp Contraction in Export Revenue, Stopping Capital Expenditures in the economy => Collapse in Credit Quality and Real Estate Prices => Banking Instability



- ADB's 2nd CSF Loan: September 2009 (fast-tracked processing). \$0.5billion, anchored in:
 - Anti-Crisis Plan (e.g. countercyclical expenditures)
 - Banking Sector Stability Plan



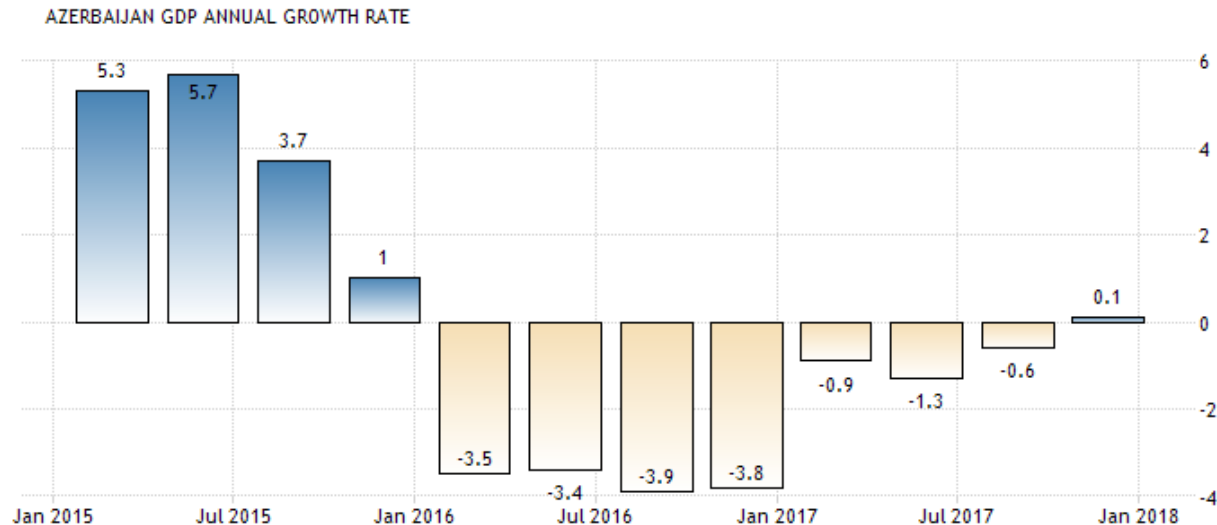
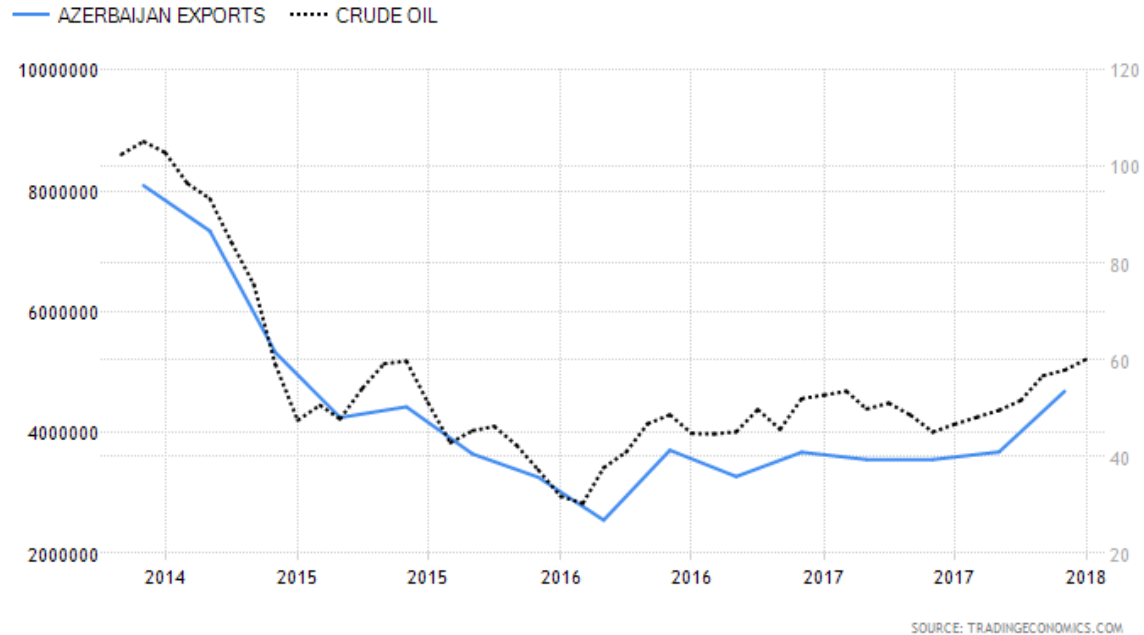
AZE: Countercyclical Support Loan (2016)

Collapse in Oil and Gas Prices => Sharp Contraction in Export Revenue, Stopping Capital Expenditures in the economy (private and public) => Collapse in Credit Quality and Real Estate Prices => Banking Instability and Sharp Contraction of Construction Activity

- CSF Loan, approved in 2016 (fast-tracked processing), for \$0.5billion
 - Countercyclical expenditures:** Social Assistance Programs, Economic Diversification Investments, Employment Generation.
 - TA project approved for preparation of structural reforms for 2017-2019:** PFM, Medium-Term Fiscal and Budget Management, SOE Management, Financial Sector Development.

FOLLOW-UP ASSISTANCE ON STRUCTURAL REFORMS (Programmatic Approach: 2 subprograms):

- AZE: Improving Governance and Public Sector Efficiency Program (\$250m + \$250m)



We believe ADB assistance helped CWRD countries mitigate and manage the impacts the global financial crisis of 2008-2009 and the oil price shocks of 2014-2015...

... BUT WHAT ARE THE LESSONS?

1. ***ADB assistance was generally swift in providing one-time (single tranche) financial support and technical advice on crisis mitigation measures:***
 - The effectiveness of crisis mitigation efforts was crucially contingent on (i) effective macro-economic management and (ii) Govts' ability to quickly design and implement its own anti-crisis plans;
 - In some instances, follow-up dialog towards programmatic assistance to design and help implement structural reforms was successful in establishing a medium-term, structural reform engagement
2. LESSONS ABOUT THE TYPE OF STRUCTURAL REFORMS THAT MAY BE A PRIORITY AFTER THE CRISES: Crisis moments are no time for effective medium-term reform decisions. But it is crucial to initiate plans for structural reforms and long term engagement ***geared towards avoiding future crises and severe recessions (by reducing macroeconomic vulnerability and establishing appropriate and credible fiscal rules and safety nets).***

Important to note that recent CW DMC episodes are stories of...

- *"bonanzas" gone wrong:* Macro imbalances and lack of export diversification were at the root of pre-crisis macroeconomic vulnerability: a competitive REER must remain a key target for monetary management in good times.
- *Pre-crisis failure to establish institutional underpinnings of fiscal and crisis management:* e.g. local currency debt markets development, and financial de-dollarization strategies are crucial.