Session 3: Aftermath of Global Crisis

Trade in the Aftermath of the Global Crisis

International Monetary Fund
World Economic Outlook
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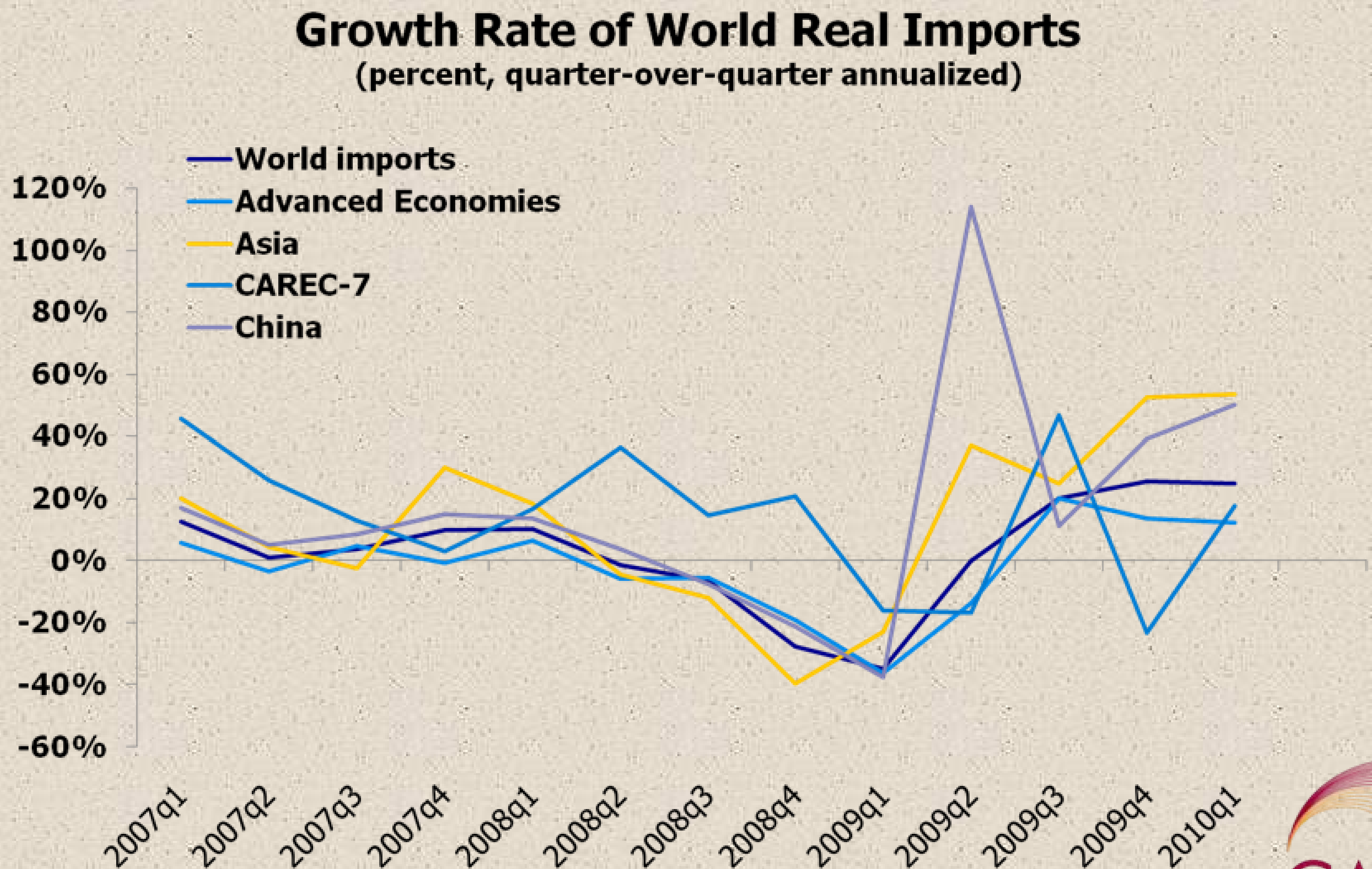
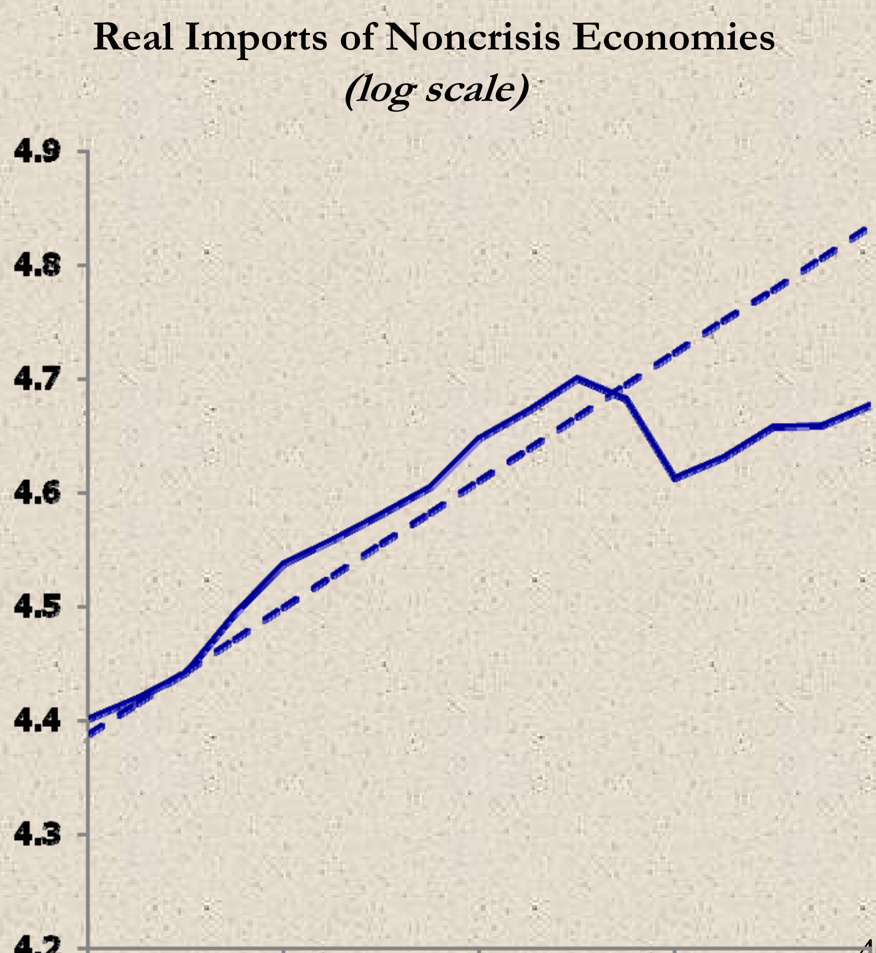
Outline

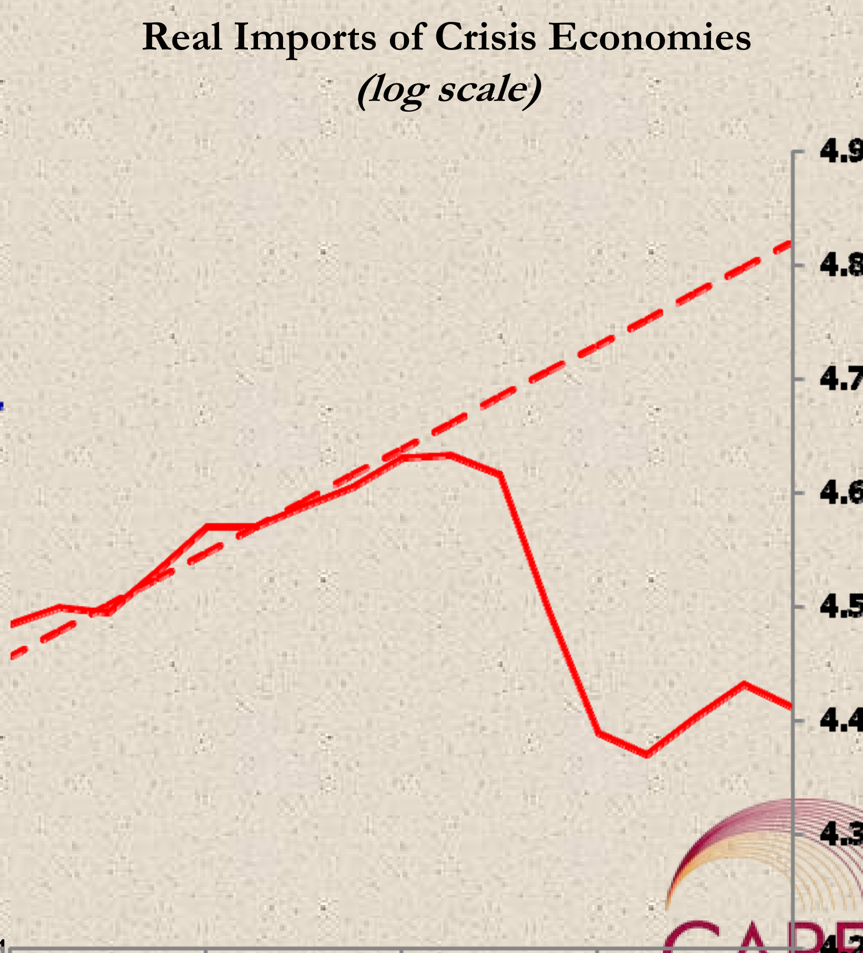
- The recent collapse and recovery in trade
- What happens to trade following a financial crisis? Evidence from historical banking/debt crises
- The role of output and other factors in post crisis trade dynamics
- Conclusions and policy implications

The Great Trade Collapse…



…and the partial and uneven recovery



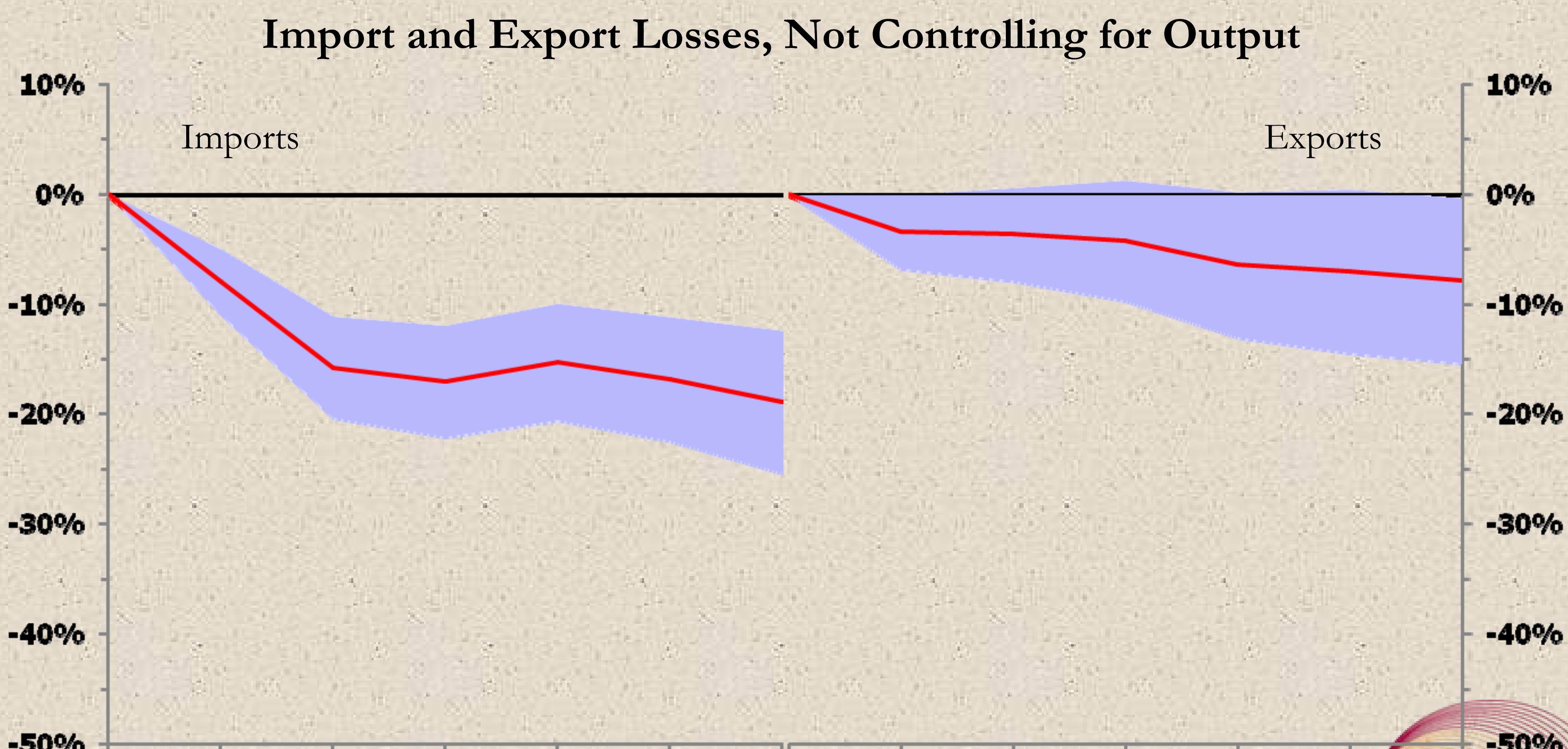


Fall in imports was larger than the fall in output

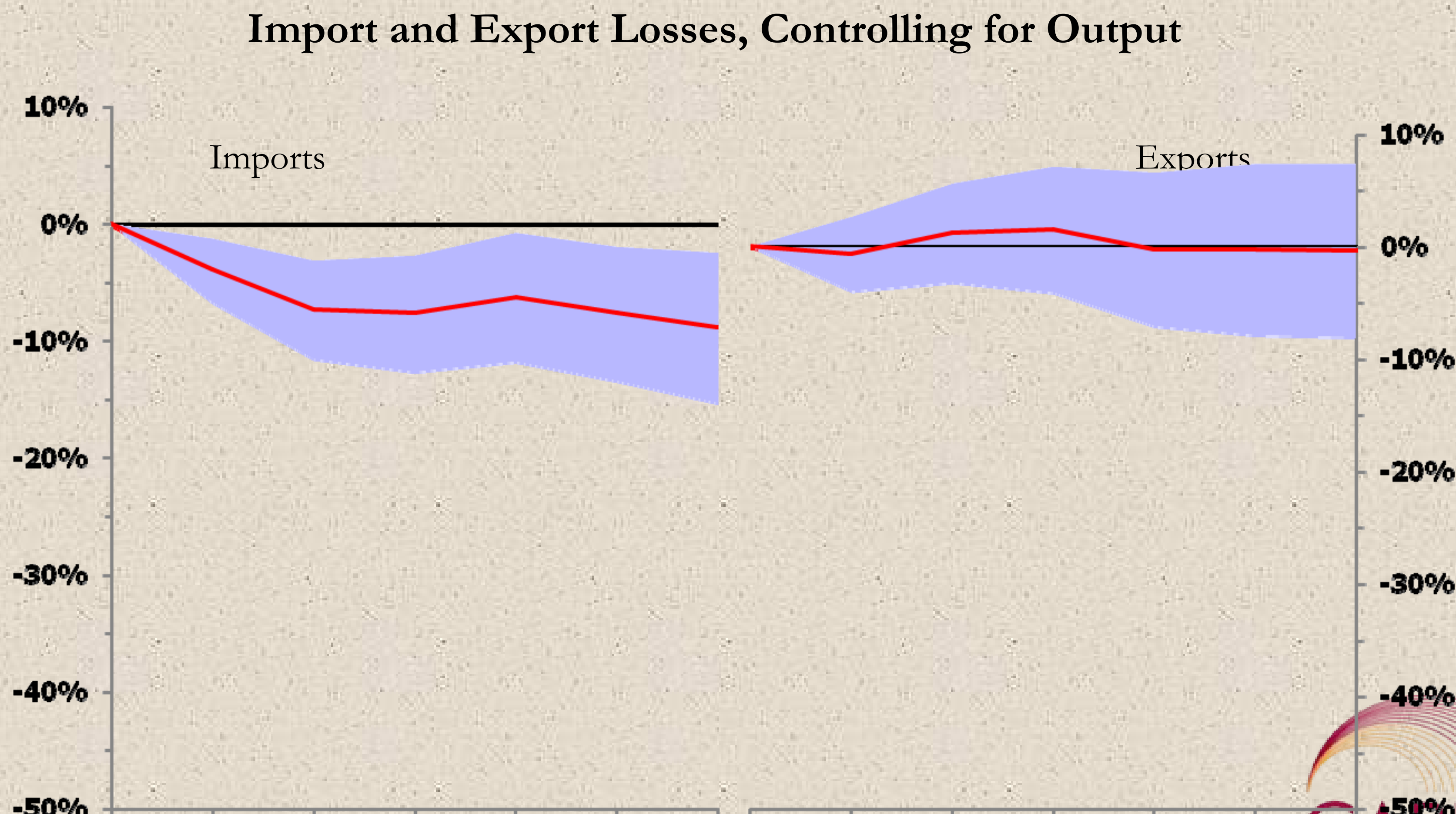
Evidence from Past Financial Crises

- Financial crises (banking and debt) from 1970-2009 as identified by Laeven and Valencia
- Descriptive exercise, to identify patterns and correlations, not causality
- Regression framework derived from gravity model of trade, but aggregated and in changes

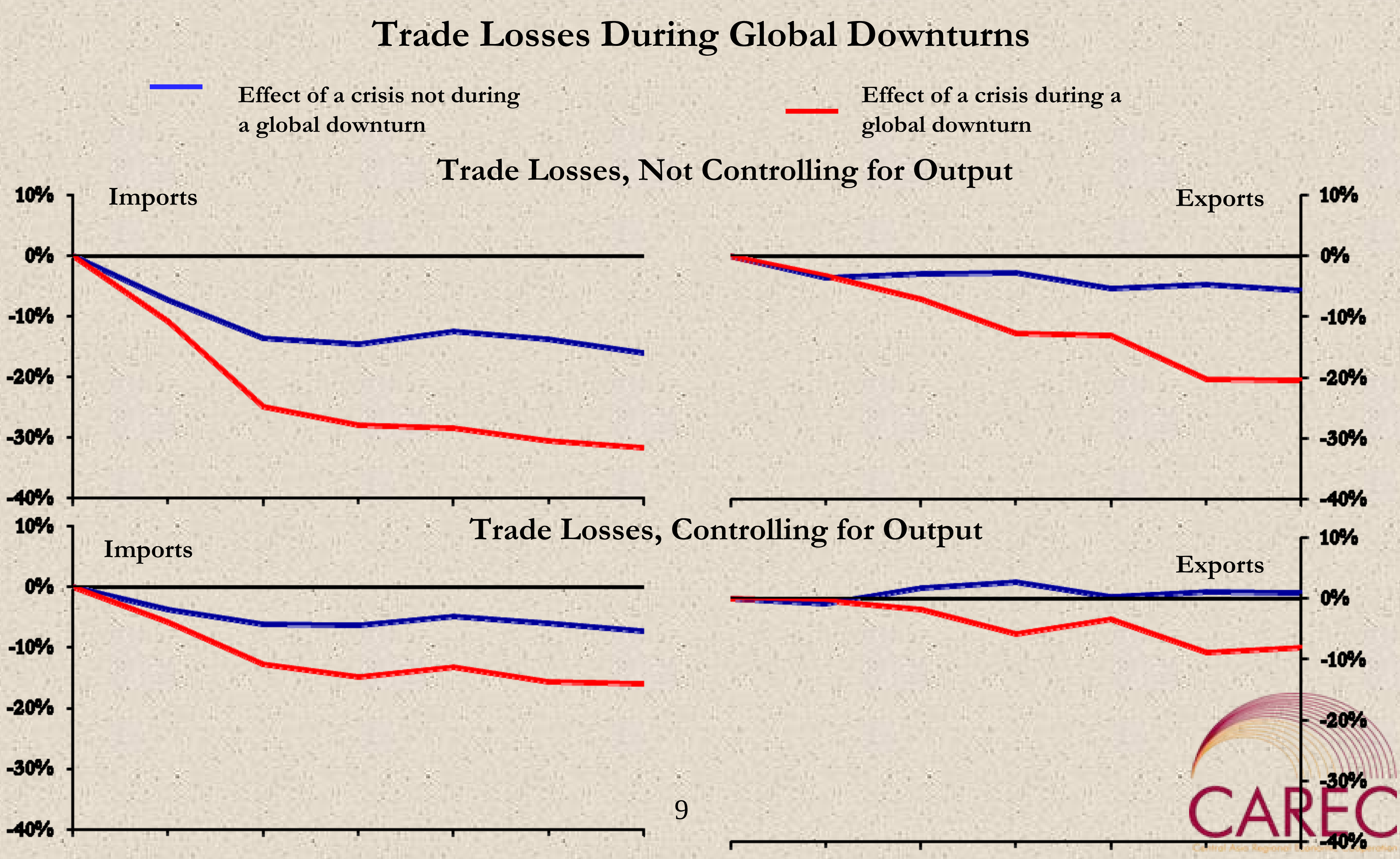
Imports fall sharply and star depressed (exports are not as affected)…



…and it's not just because of lower output



Trade losses are larger during global downturns



Why the slow recovery?

- Impaired credit
- Exchange rate dynamics
  - Depreciation
  - Higher volatility
- Increased protectionism
- Composition effects

Impaired Credit

- Banking crises associated with tightening of credit conditions
- "Creditless recovery" becomes likely
- Creditless recovery is even likelier when downturn is preceded by a credit boom
- Difficulty in obtaining credit may have a detrimental effect on imports (above and beyond any effects on aggregate demand)

Exchange rate dynamics

- Banking crises often associated with sharp depreciations of the currency and increased volatility
- The swing in relative prices hurts imports but boosts exports
- Increased volatility has been shown to adversely affect trade

Increased Protectionism

- After crisis, interest groups that favor protecting domestic production may be strengthened
  - Increased tariffs
  - Increased use of antidumping measures
  - Clauses in stimulus packages restricting spending to domestic producers

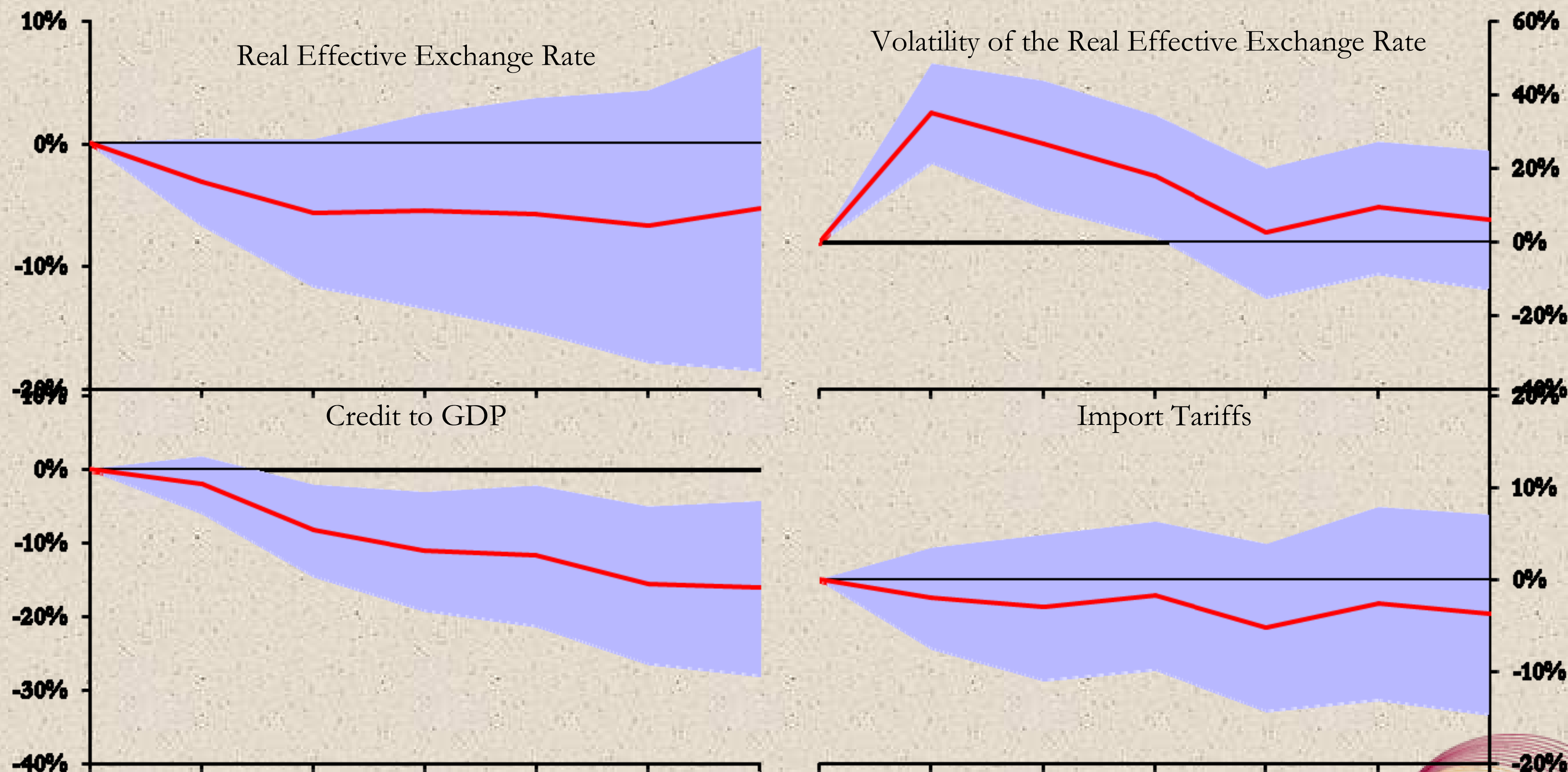
Composition Effect

- Arises when demand falls for products that represent a larger share of trade than of output
- Crises may lead to a greater fall in demand for goods than for services

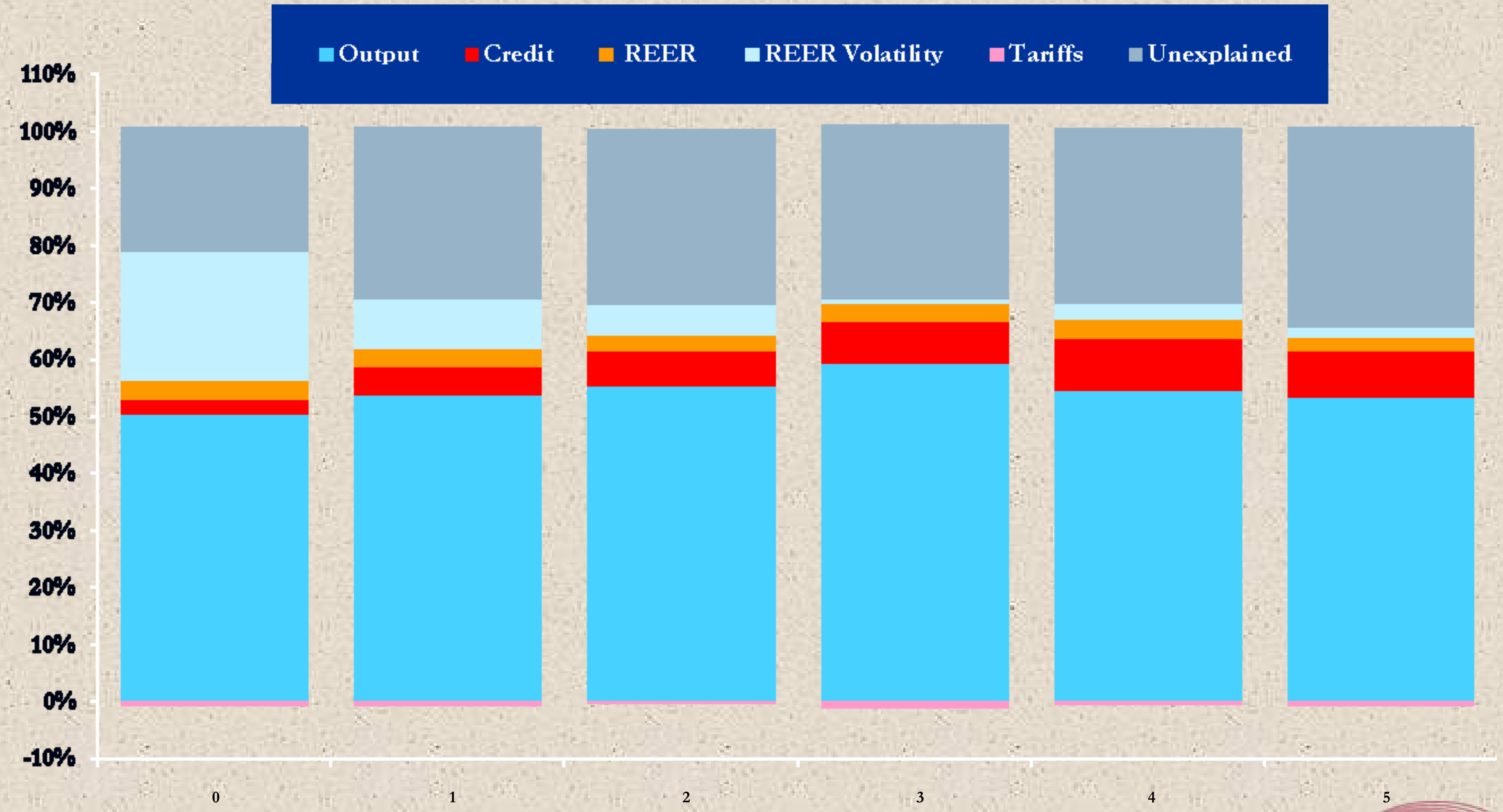
Postcrisis evolution of various mechanisms

Effect of a crisis

90 percent confidence interval around the estimated impulse response function



Decomposition of Import Losses



Summary and Policy Implications

- Following a financial crisis, imports fall sharply in the first two years, then stay depressed
- Not just because of lower output; exchange rate dynamics, credit conditions also matter
- Exports are not as badly affected
- Implications for outlook:
  - Import recovery in advanced economies likely to be anemic; narrowing of deficits in crisis countries may be quite durable
  - Export-led countries need other engines of growth

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Central Asia Regional Economic Cooperation