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Fathoming the depeening global crisis

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THE world economy has changed spectacularly since September 2008. What began as a slump in the US housing sector is now a global crisis, spreading to both rich and poor economies. Many believe that this may go down in history as the worst crisis since the Great Depression of the 1930s wiping out almost 10 trillion US dollar worth of value from stock markets over the past months. The triggers for the present global financial crisis were in the US subprime mortgage market the crumbling of which engulfed the global financial markets leading to a painful recession of the world economy.

Bangladesh, though not so much globalised financially, depends a lot on foreign trade. More significantly, its exports including readymade garments, shrimps, leather, etc are solely dependent on the western consumer demand. So the employment decline and hence that of the income of the ordinary consumers in the USA and Europe are bound to have serious impact on our export potentials. This has started impacting since January with the buying spree during Christmas sales coming to an end. Similarly, there can be negative impact on the export of Bangladeshi low-skilled manpower following the ever declining oil price and a likely depression in infrastructural development activities in the Middle-East.

The new government will have to face these economic crises head on. One positive thing is of course the falling prices of oil and commodities in the international market. This will surely dampen inflationary pressures.

Let us now try and understand the nature of the global financial crisis.

The extent to which the crisis will hurt the economy of Bangladesh is still unclear. At present, some indicators such as exports and remittance are actually encouraging. However, that does not mean that the government can be complacent. A prolonged global recession now seems likely, and therefore, negative impacts may be inevitable. So, Bangladesh must be prepared to face this crisis, both at the macro and micro level. Policy adjustments may have to be made at any time as demanded by the depth of the crisis. Appropriate policy taskforce, in addition to the routine monitoring by technical groups will have to be functioning continuously to provide necessary guidelines to the implementers, so that no sense of complacency, and hence, inaction creeps in.

Subprime crisis

Subprime lending is the practice of making loans against mortgaged property to borrowers who do not qualify for market interest rates owing to various risk factors, such as income level, size of down payment, credit history, employment status and so on. Banks transferred credit risks to third-party investors through a process called securitisation -- Mortgage Backed Securities (MDS) and Collateralised Debt Obligations (CDO). Four primary categories of risks are involved in subprime lending -- credit risk, asset price risk, liquidity risk and counterparty risk.

The value of US subprime mortgages was estimated at $1.3-2 trillion as of March 2007, while total mortgage market was estimated at $12 trillion. Between 1997 and 2006, American home prices increased by 124 per cent. Thus second mortgage of properties increased and the added funds were used for consumer spending. As a result, household debt grew from $680 billion in 1974 to $14 trillion in 2008. However, records of nearly 4 million unsold existing homes were for sale which placed significant downward pressure on prices. As a result, more homeowners were at risk of default. Factors that contributed to the global financial crisis include: poor judgment by borrowers and/or lenders, speculation and overbuilding during the boom period due to lower price and interest rates, risky mortgage products and high personal and corporate debt levels, weak financial regulation and lack of oversight of financial institutions, aggressive activities by the insurance companies and vague ratings of assets and securities, overexposure of banks to risky lending and easy credit money, greed of Wall Street financiers, unsupervised cross border integration of financial markets, market fundamentalist philosophy and so on.

Governments across the world have taken multiple efforts to mitigate impact of financial crisis. The US, UK, Ireland and others have virtually 'nationalised' giant financial institutions including banks, insurance companies, and mortgage houses. In the US, Congress adopted a massive bailout plan with taxpayers' money. It initially approved a law to buy $1.5 trillion worth of bad mortgages and other assets from the troubled banks, which would wipe debts from their books with the hope that they will be able to start lending more freely again.

Overall, a $2.4 trillion dollar rescue package has been put into motion in the US, the EU and Asia. India cut its key interest rates (20, October) by one percentage point -- from 9 per cent to 8 per cent. China also cut interest rates and announced a $586 billion stimulus package focusing mainly on infrastructure and social programmes. This was followed by a similar $11 billion fiscal stimulus package announced by S Korea. The International Monetary Fund (IMF) has urged the major central banks to provide direct support to the banking system, saying some $657 billion would be needed in the next few years. Several meetings have already taken place regarding the restructuring of the global financial system and more are scheduled in the near future.

Global consequences of the financial crisis include sharp fall in exchange rates of most of the currencies against the US dollar, despite ongoing recession in the US territory, sharp decline in global stock markets, fall in property prices in many western countries and sharp rise in unemployment in the US -- over 65,400 jobs cut as of September 2008. Currently, unemployment rate is estimated to be around 6.5 per cent and fall in consumer confidence has been observed in developed economies and so on. Some projections made by IMF in its World Economic Outlook, October 2008 indicate that world economic growth would slow down to 3.9 per cent in 2008 and 3.0 per cent in 2009 from the relatively robust growth of 5.0 per cent in 2007.

Impact of meltdown on developing countries

Developing countries -- at first sheltered from the worst elements of the turmoil -- are now much more vulnerable, with dwindling capital flows, huge withdrawals of capital leading to losses in equity markets, and skyrocketing interest rates. It is no longer a question of 'whether' but 'when' and 'how' the ongoing financial crisis will affect developing and least developed countries. The effects will vary substantially across the globe depending on size and structure of the national economy, as well as level and nature of global integration. The full effects of financial crisis on developing countries have not yet been registered. Lack of real time data is a problem. The risks for low-income countries vary, but all are potentially severe.

Large external demand shocks will immediately have real economy impact as they can not be cushioned by internal demand. Unfavourable effects in Official Development Assistance (ODA) may accelerate economic slow-down in LDCs. World Bank projects the real GDP growth to slowdown across all developing regions in 2009. GDP growth in developing countries -- only recently expected to increase by 6.4per cent in 2009 -- is now likely to be only 4.5 per cent, according to economists at the World Bank. Moreover, rich countries are now expected to contract by 0.1 per cent next year. Thus LDCs are to be affected more, given the trade relationship. Progress towards MDGs faced setbacks over the last 2 years due to soaring food and fuel prices. Now the challenge for many LDCs who rely on exports is how to cope with falling demand for these exports and prevent mass unemployment. But unfortunately, the challenge of high inflation has yet to fade away in some regions.

Impact on South Asia

If we compare the economic integration of Bangladesh, India and Pakistan with the rest of the world, we will find that in 2006 trade as percentage of GDP is highest in India (48.78 per cent) followed by Bangladesh (44.22 per cent) and Pakistan (38.61 per cent). Pakistan receives the highest FDI inflow as percentage of GDP (3.37 per cent) followed by India (1.19 per cent) and Bangladesh (1.13). From the exchange rate side it is noticed that Pakistan rupee has depreciated the most against the US dollar, followed by the Indian rupee while Bangladeshi Taka has remained relatively stable.

The IMF data and projections indicate that all the three countries are expected to experience some slowdown in GDP growth rates from the previous years. Bangladesh government expects over 6 per cent growth in FY 2008-09. The Indian PM forecast growth at 7.5 per cent. Pakistan's economy has grown by 7-8 per cent over the past few years but most of this growth has taken place in sectors such as consumer financing. Real economy (agriculture, industry, mining, etc.) has not had much growth and impact on poverty reduction has been minimal at best. IMF projects high inflation of 23 per cent and growth rate of only 3.5 per cent for 2009. The depreciation of Pak rupee has adversely affected the country's ability to repay foreign debts. As a result, the foreign exchange reserves of the country have fallen so low that they hardly cover 9 weeks of imports. To avoid default, Pakistan has sought help from the IMF. A US $7.6 billion has been approved and the country is expecting about $500 million loan from China. Pakistan will immediately access US $3.1 billion of the loan under a 23-month facility, with the rest phased in.

The slowdown of economic growth in India has been less rapid than in more export-dependent East Asian economies like Hong Kong, Singapore and Taiwan. GDP growth in the second quarter of the current fiscal year declined to about 8 per cent on the back of weakening investment. According to the Commerce Minister of India, the global meltdown in financial markets will impact demand in developed countries for Indian exports and the export target of $200 billion for the current financial year may be missed. Real estate and textile sectors are already facing a slump. Unrelated to the crisis, tourism and some related sectors may face short-term setbacks as a consequence of the tensions following the Mumbai terrorist attacks. Export growth in India slowed in the third quarter of FY08 from 33.7 per cent year-on-year in July to 12.6 per cent in September as demand from developed countries dropped dramatically. Trade and commercial services, manufacturing and agricultural sectors have all

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