

***Crisis Transmission to Emerging Markets:
The Financing Challenge***

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- Until less than a year ago, Emerging Markets seemed to have “graduated” into a new successful asset class.
- Strong fundamentals, macro stability, differentiation, and strong terms of trade seem to have eliminated ***contagion.***

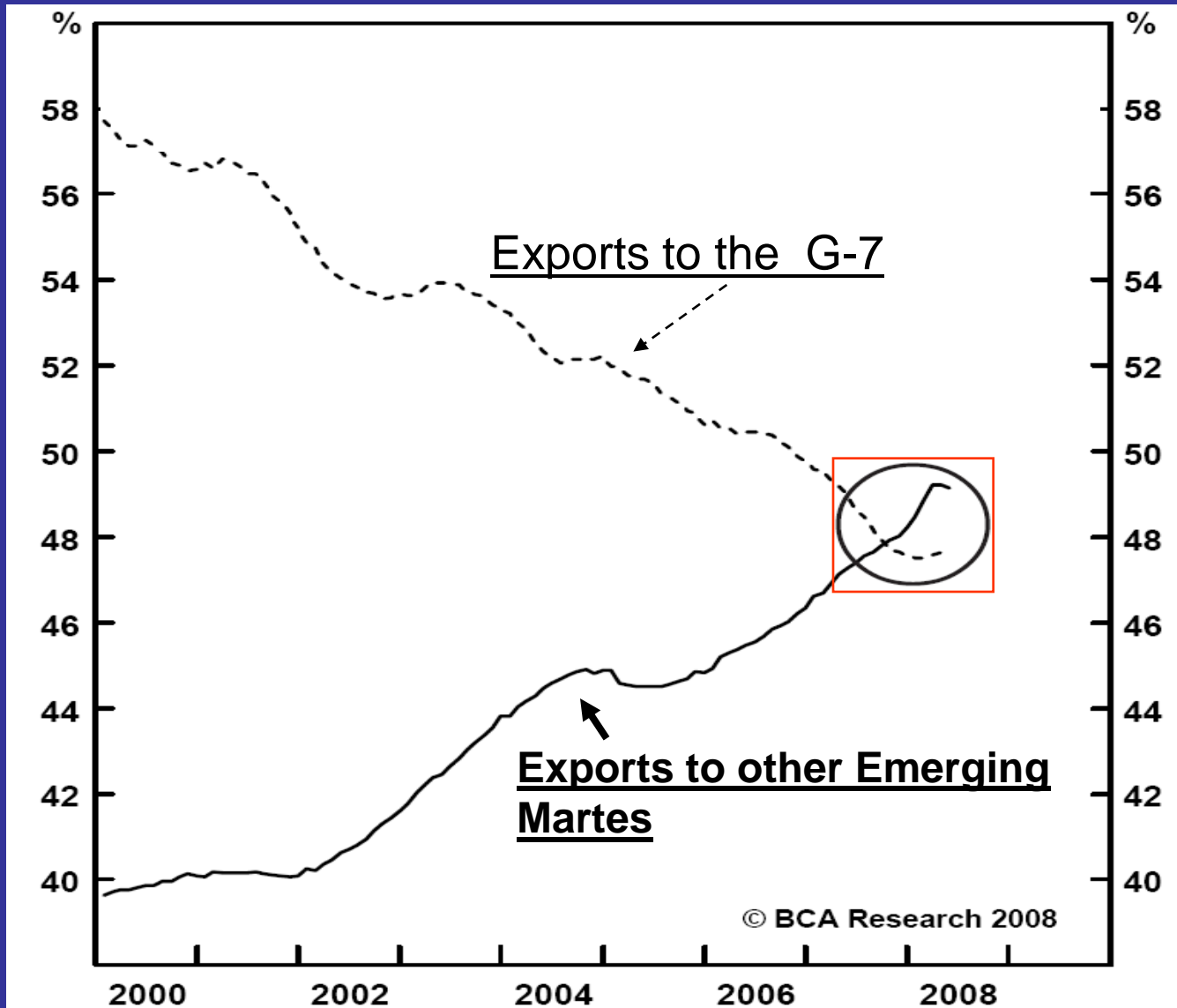
- Substantial development of financial markets supported by rapidly increasing volume of Capital Inflows
- Growing local currency markets seem to have eliminated the “original sin” problem.

- However, following the Lehman Bros. debacle, EM were strongly affected by the crisis in mature markets, demolishing the “decoupling” hypothesis.
- Contagion worked through three channels:
 - Commodity Prices
 - The Collapse of International Trade
 - Capital Market Reversals

Very rapid decline in **Trade
Financing** leading to a Real
Collapse in Trade Volumes

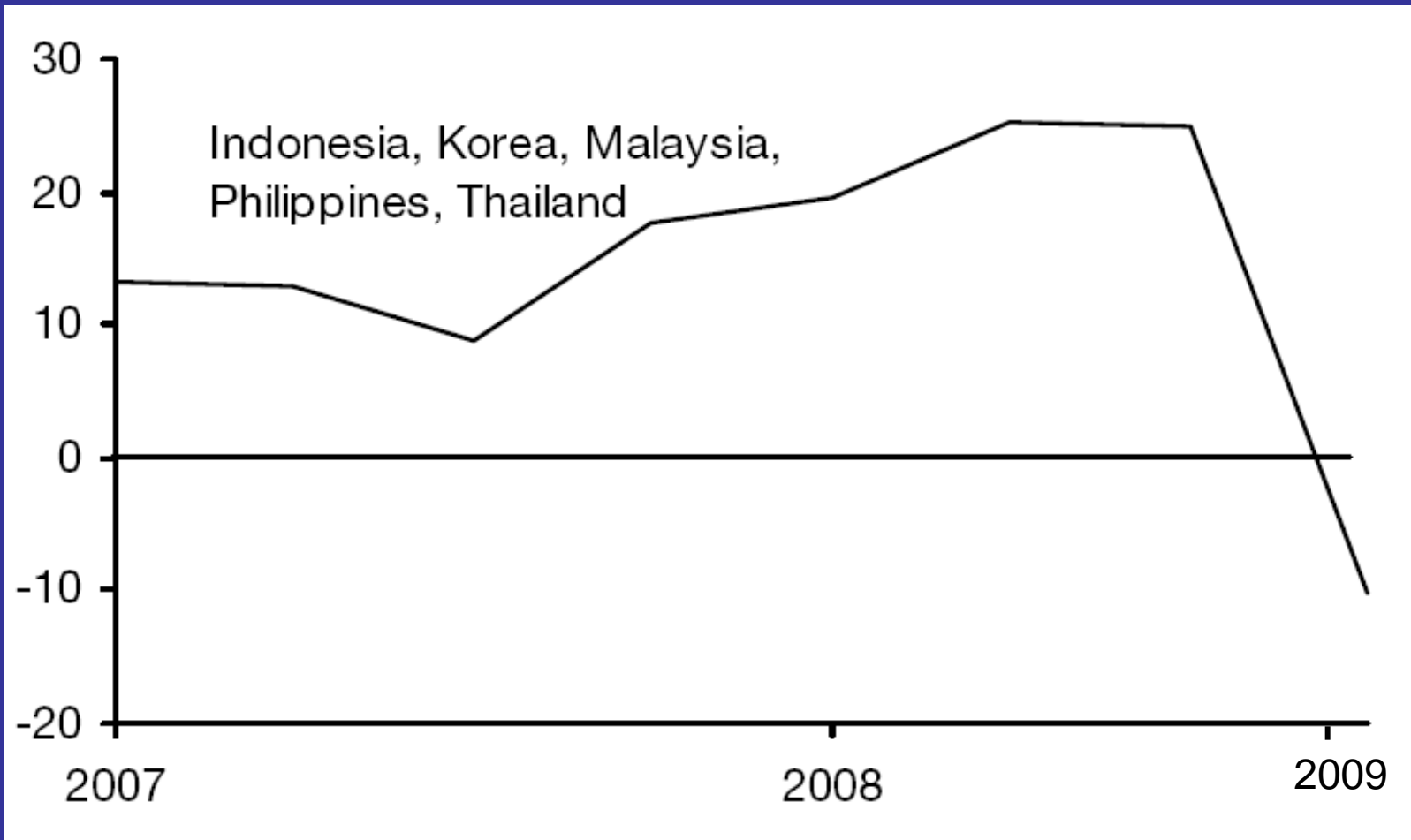
EMs: Exports to the G-7

(as % of total exports)



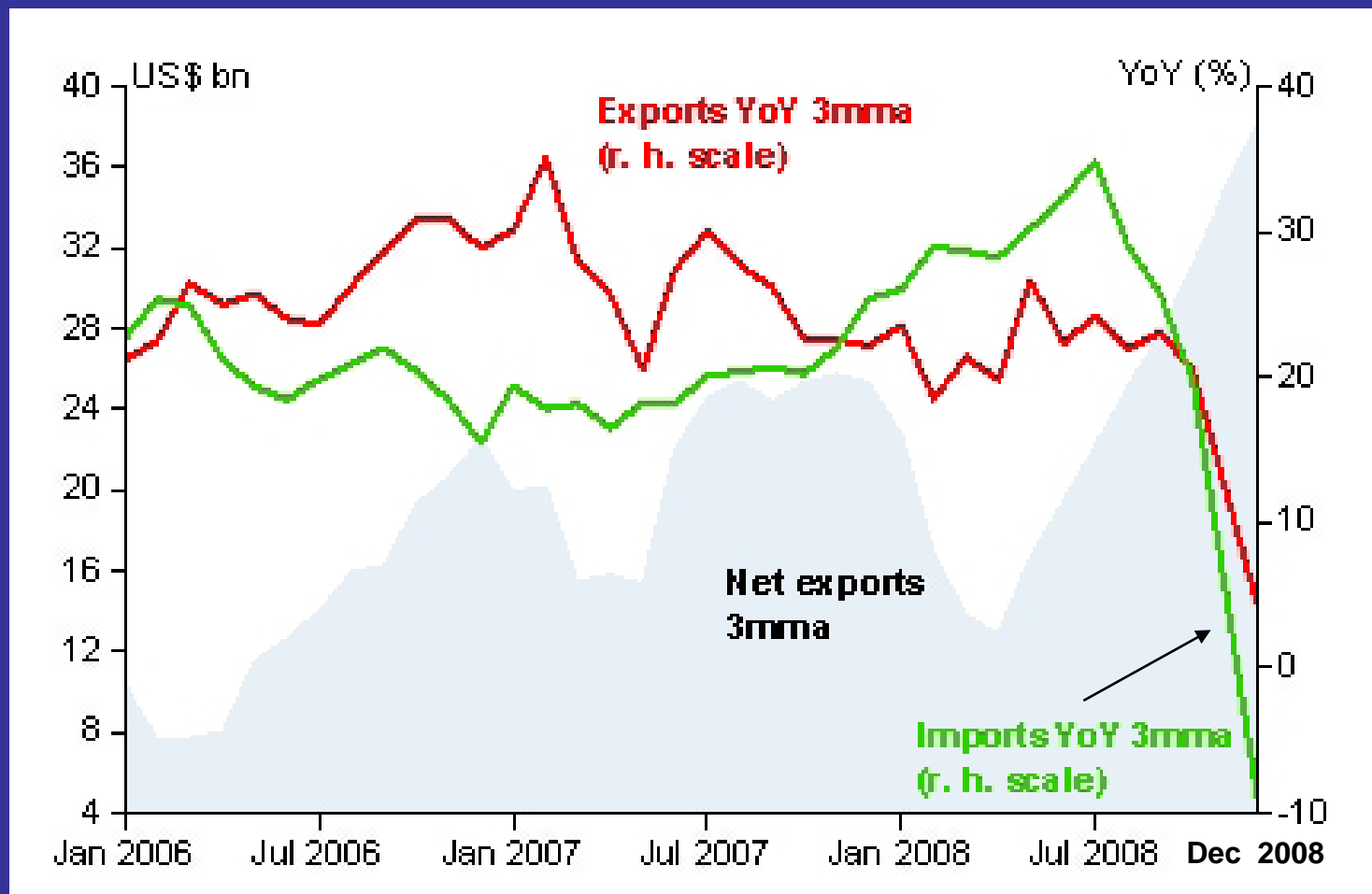
Asia: Exports

(annual % change)



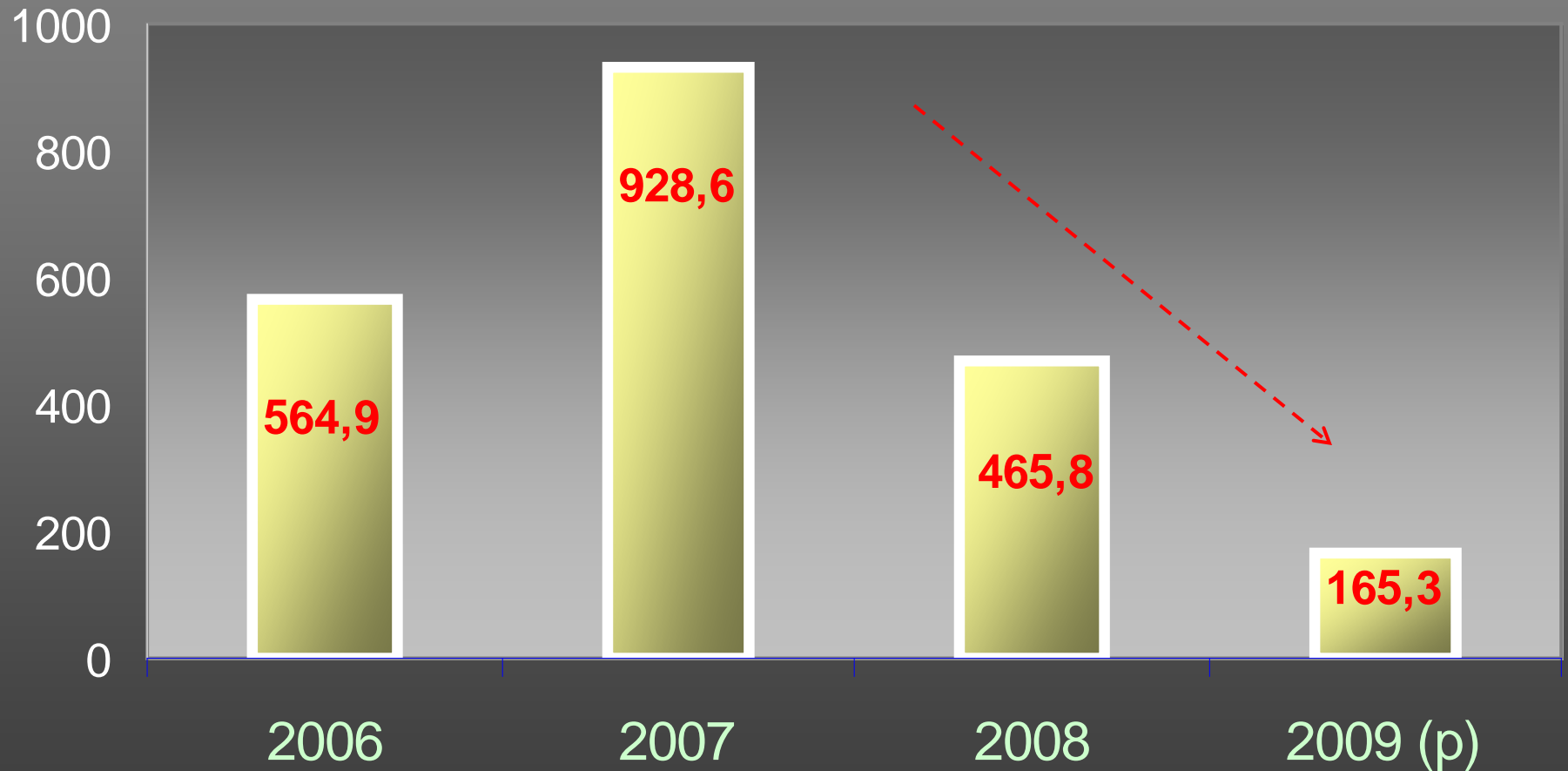
China: Imports and Exports

(% annual, US\$ bn)



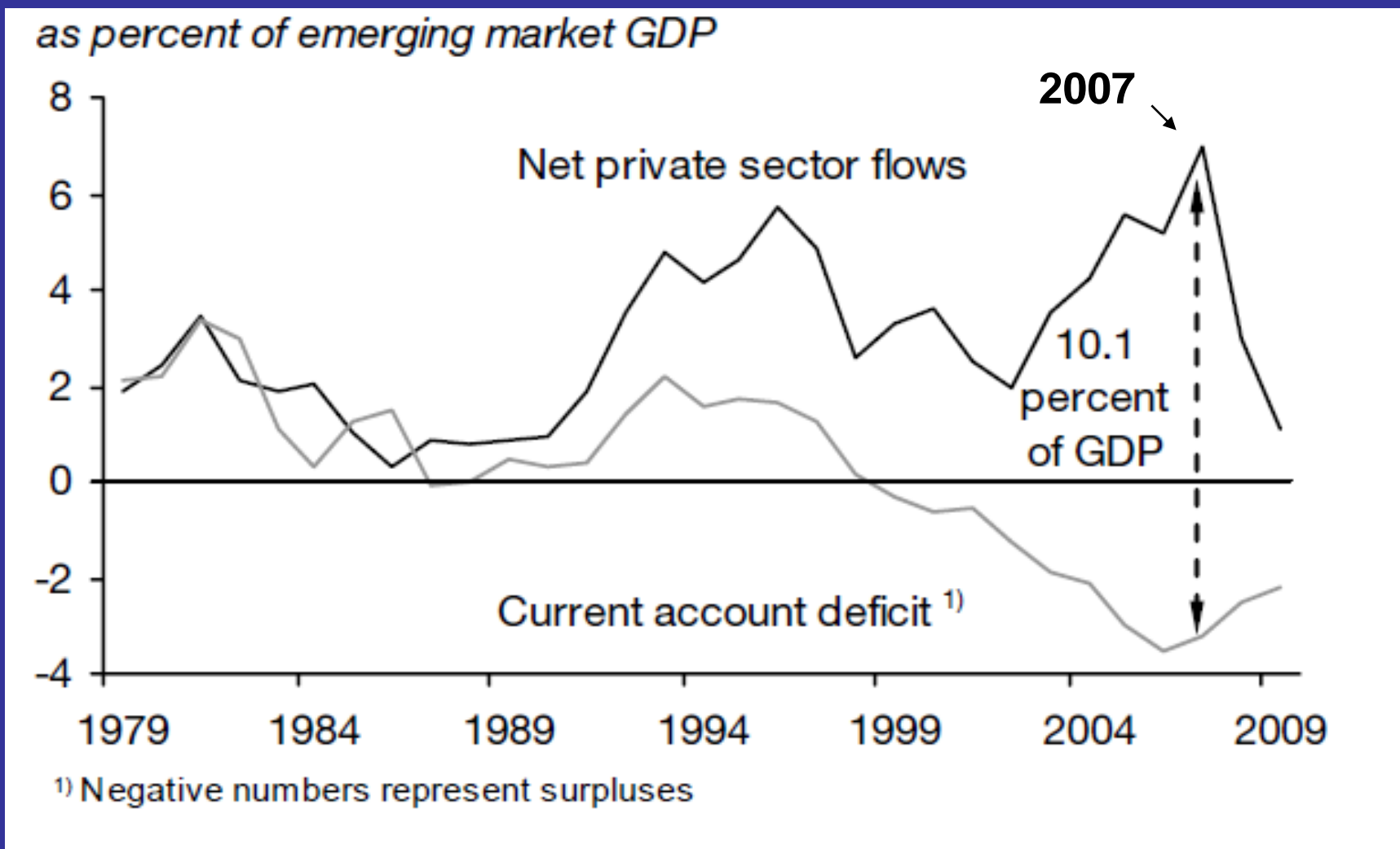
The Capital Flows Reversal and the Financing Problem

Private Capital Flows to Emerging Markets (in U\$S bn)

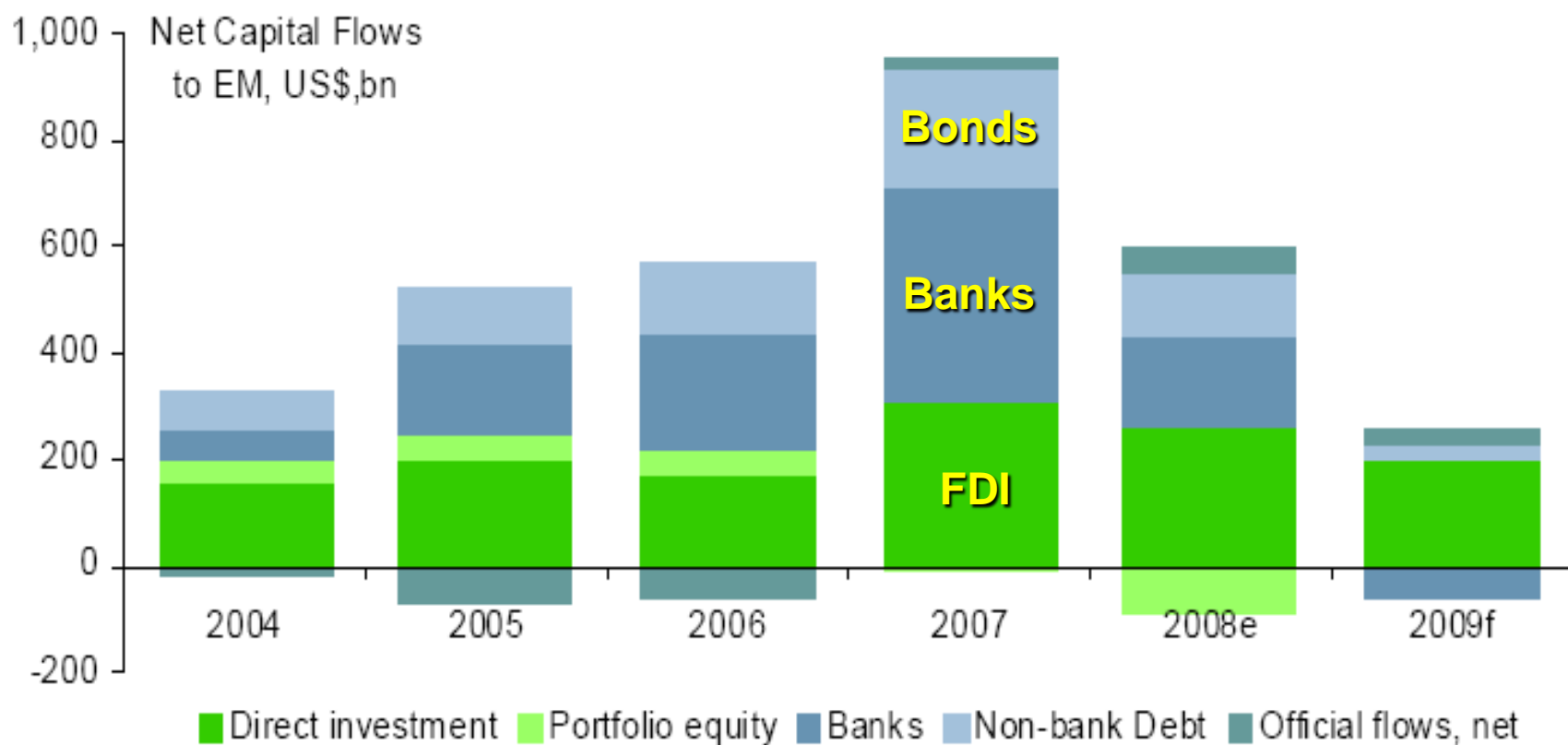


Source: IIF

Net External Financing of Emerging Economies



Emerging Markets: Capital Flows

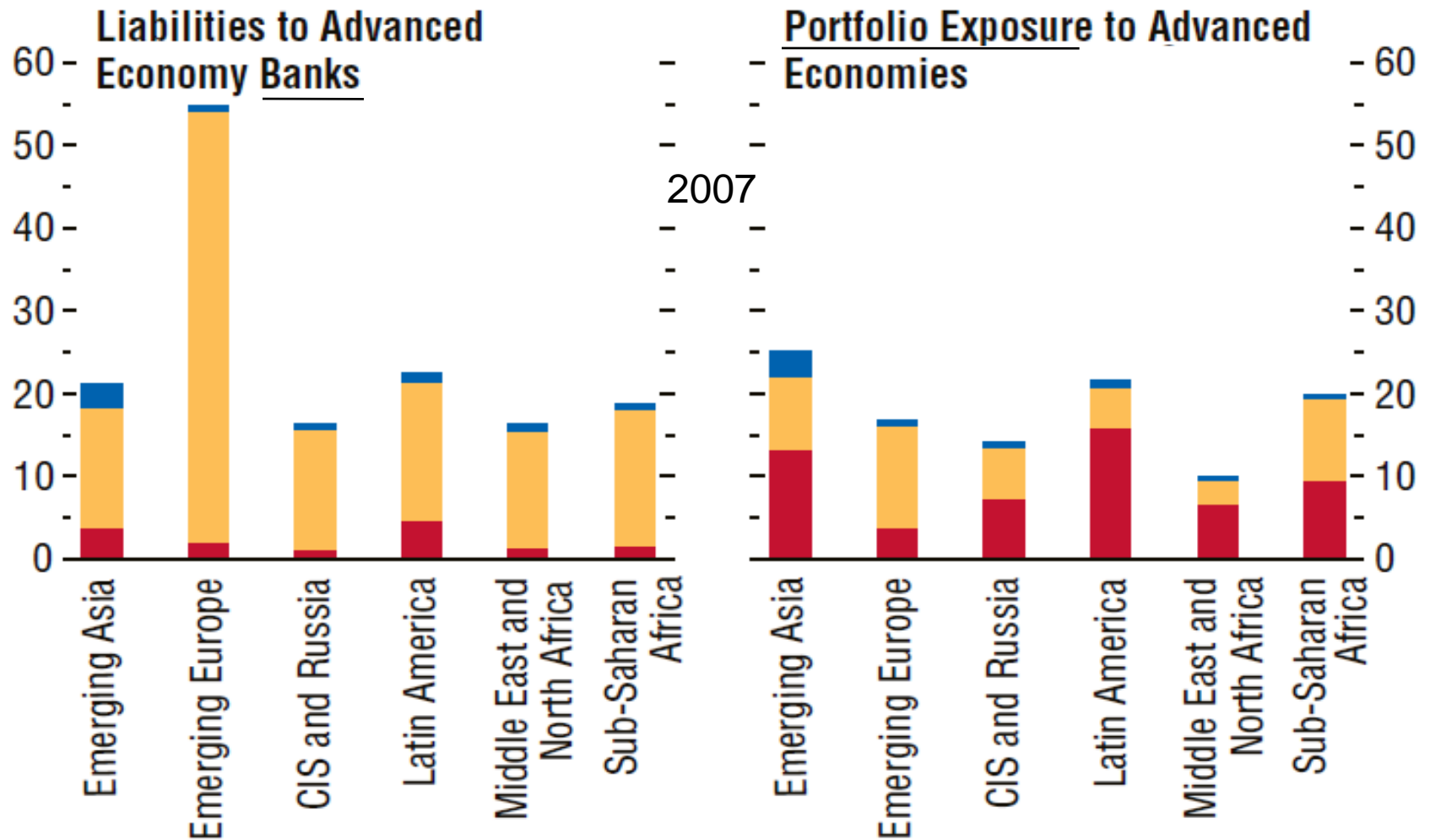


Source: IIF

Two Distinctive Characteristics

- I. Bank lending ties, directly or through home-host relationships, have emerged as one of the main channels of contagion. Banking flows to EM have taken a severe hit.
- II. The drying up of capital flows is becoming a private sector, corporate problem, rather than the more traditional sovereign problem

EM: Bank External Liabilities and Portfolio Exposures



Japan and Australia

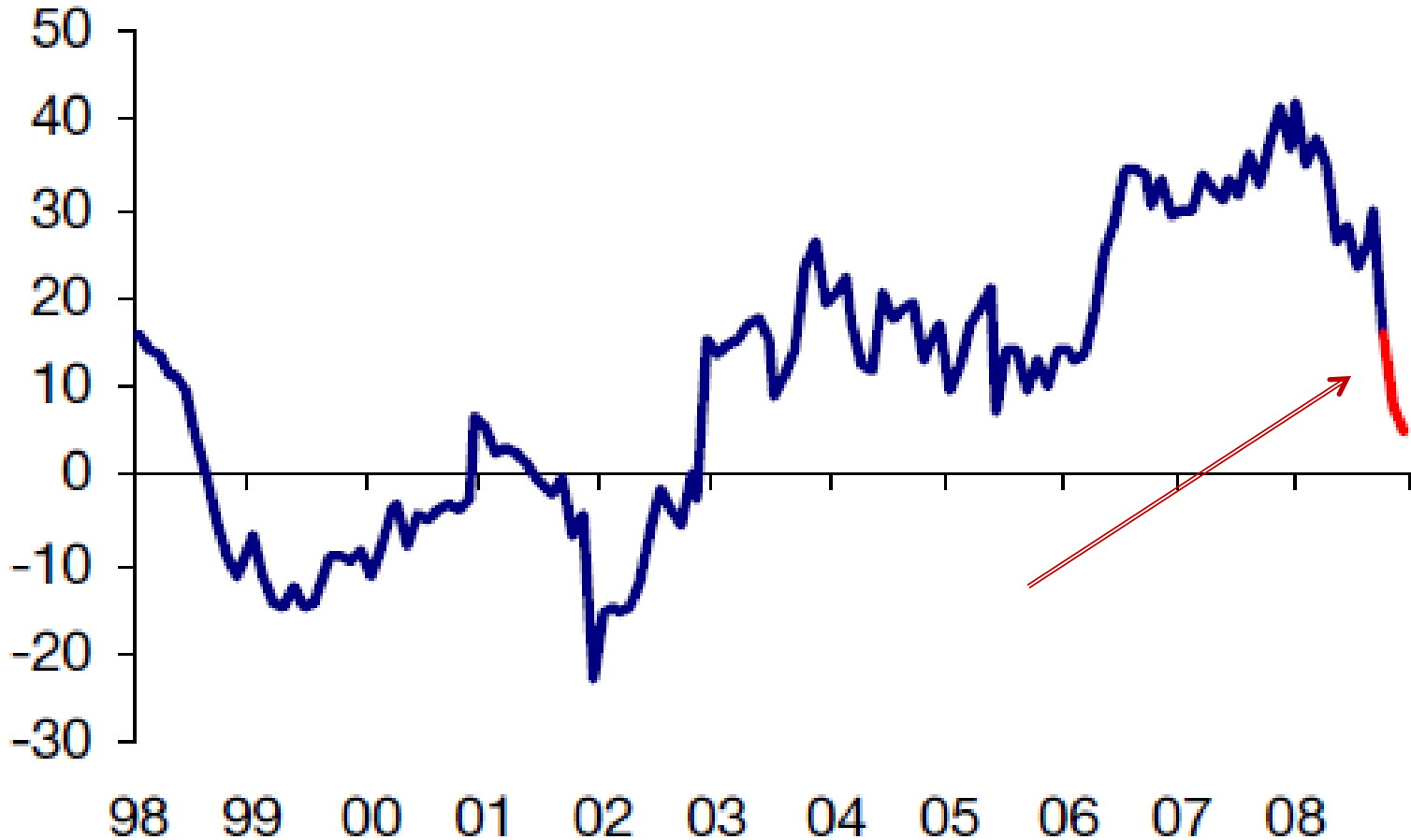
United States and Canada

Western Europe

Source: WEO

EM: Banking Sector Foreign Liabilities

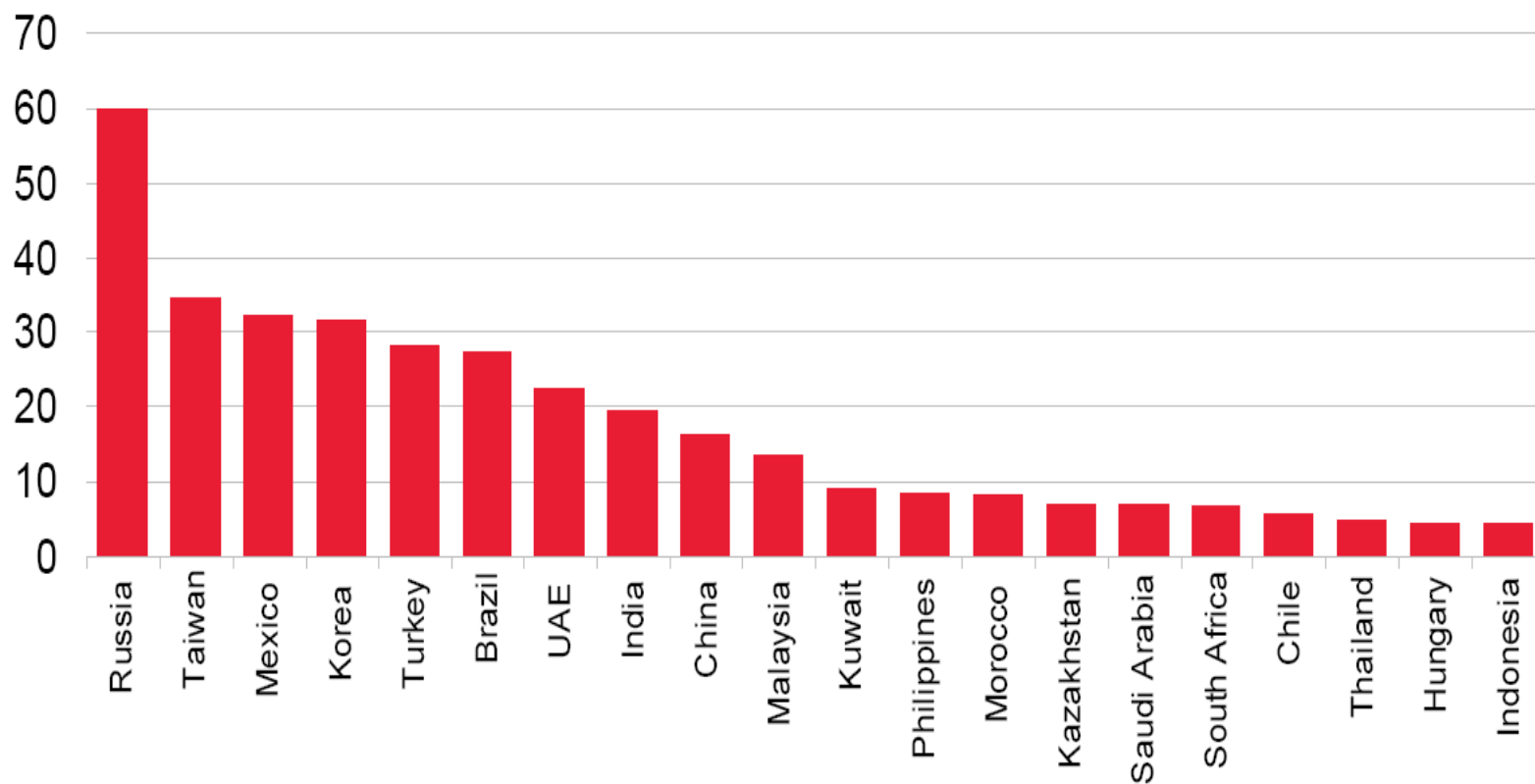
%YoY, USD terms, external borrowing by domestic banks



The Corporate Rollover Problem

Corporate and Bank External Debt Maturing in 2009

(USDbn)



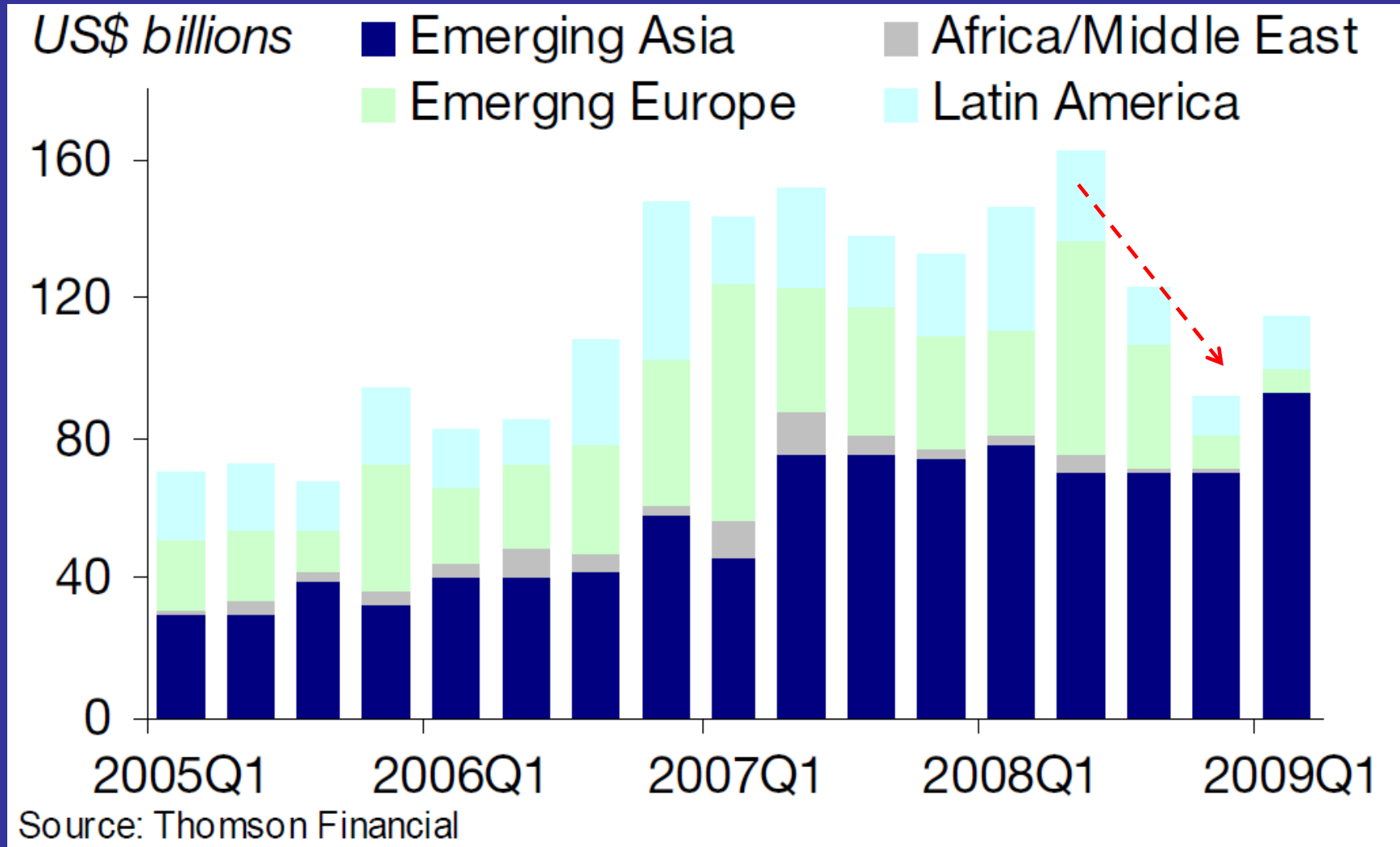
Source: Dealogic, Bloomberg, Fitch Ratings

Corporate External Refinancing Needs

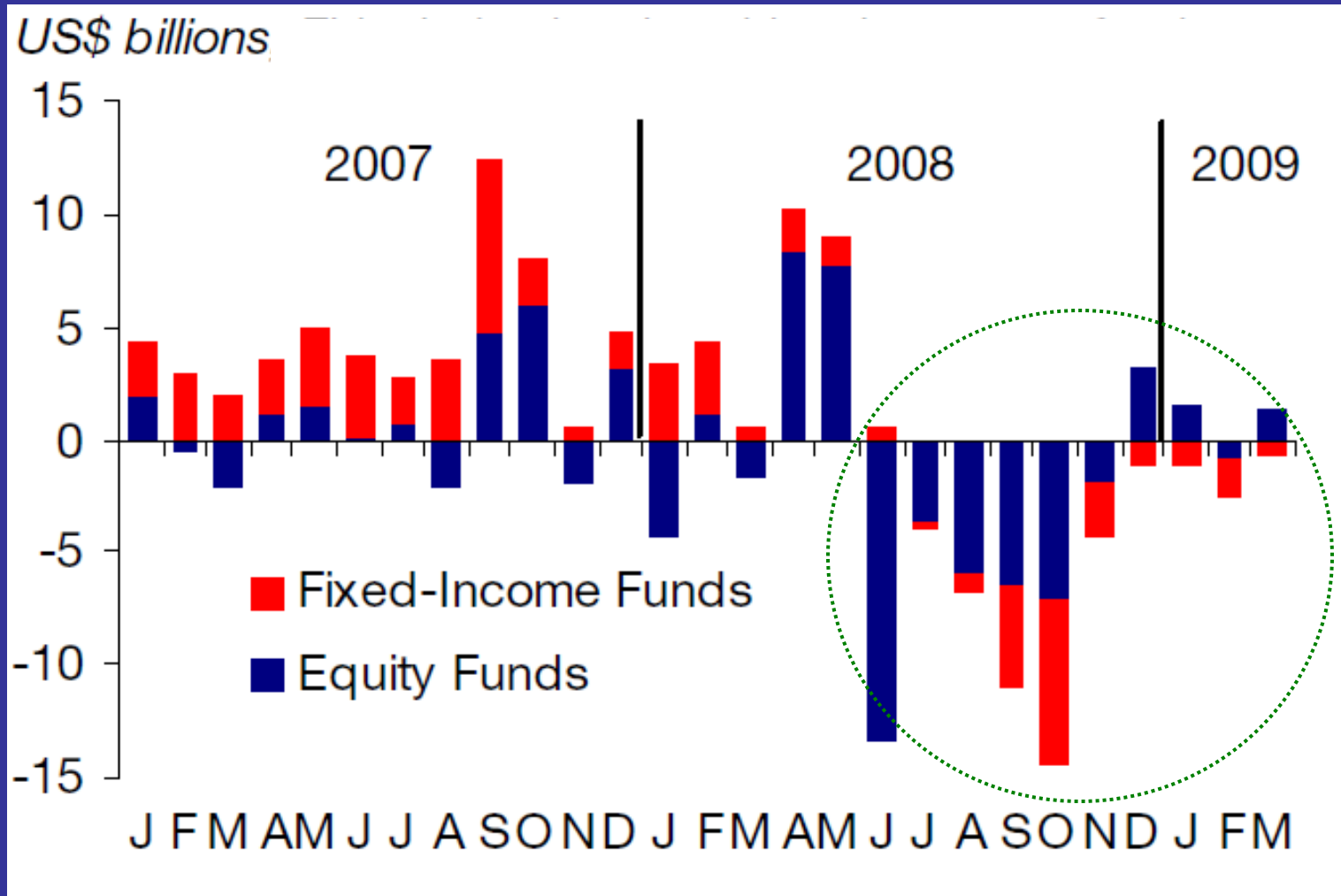
(in U\$S bn – First Semester)

Country	2009
Argentina	1,648
Brazil	8,132
Chile	5,640
Mexico	13,675
Kazakhstan	4,107
Russia	39,874
Ukraine	2,385
China (& HK)	31,961
India	13,943
Indonesia	3,613
Korea	14,712
Philippines	3,512
Singapore	11,976
Thailand	2,327
Taiwan	17,739
Kuwait	4,158
Saudi Arabia	2,940
UAE	13,940
Other	41,165

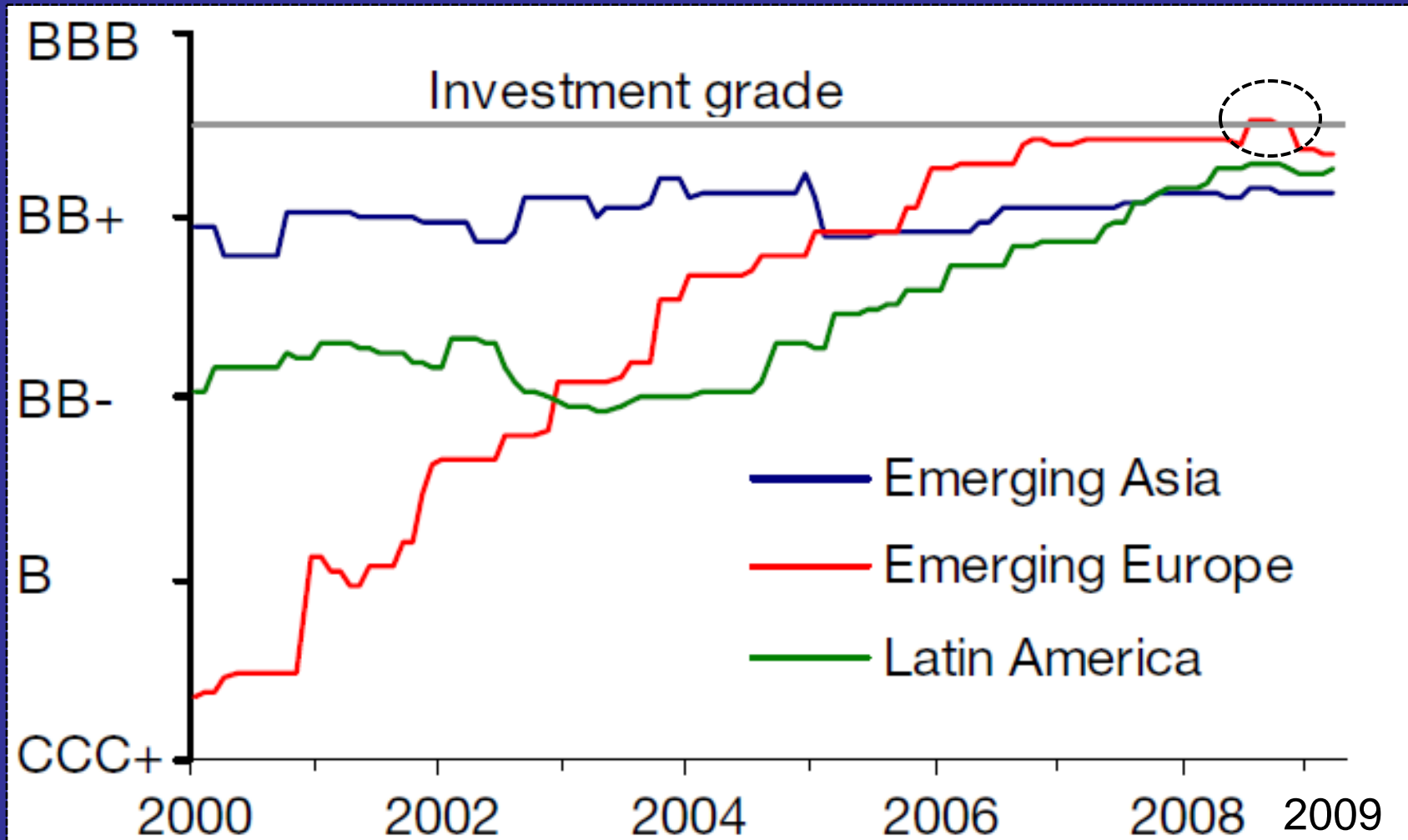
EM: Bond and Synd. Loan Issuance



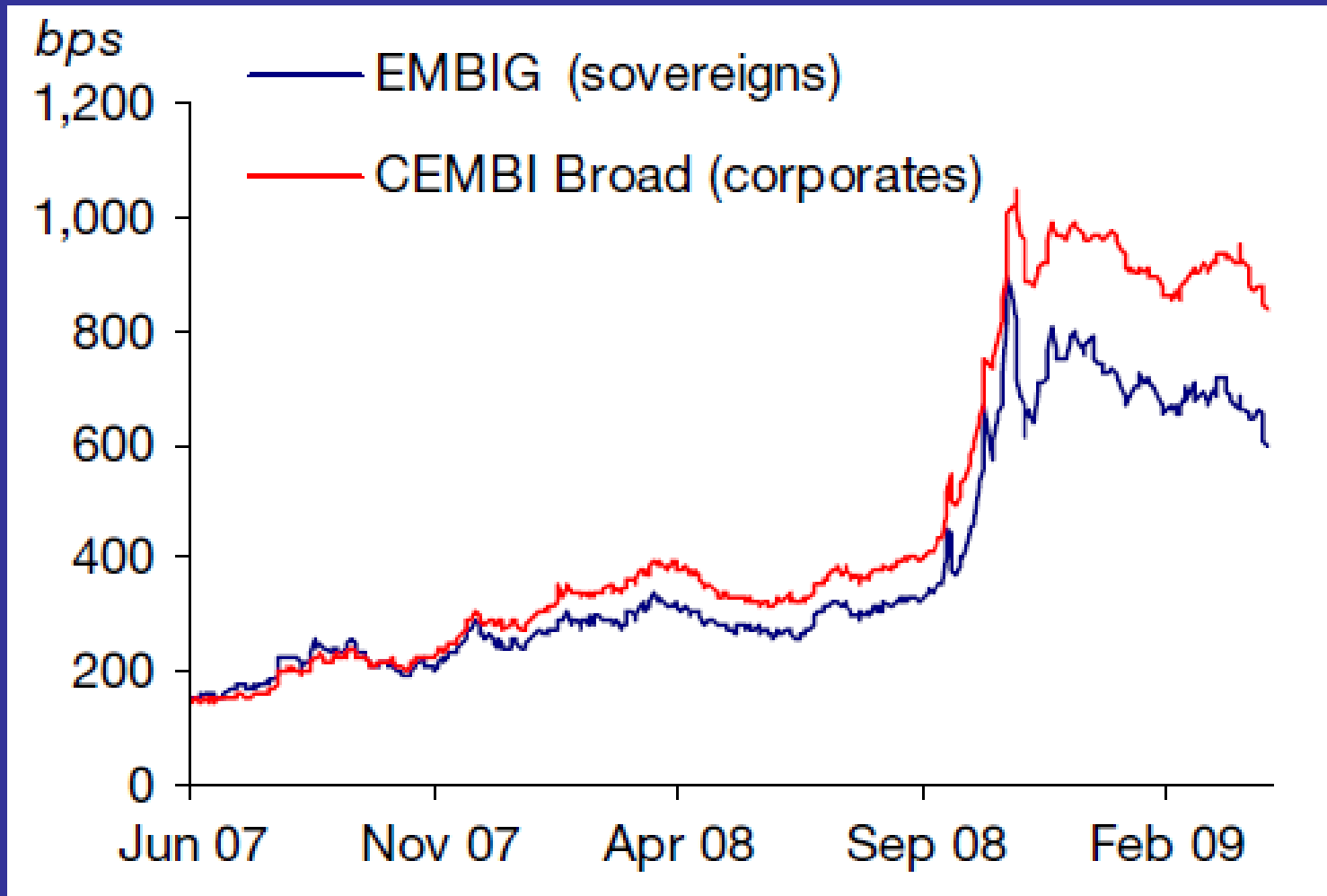
Emerging Market Funds: Debt and Equity Net Flows



EM: Average Sovereign Credit Ratings

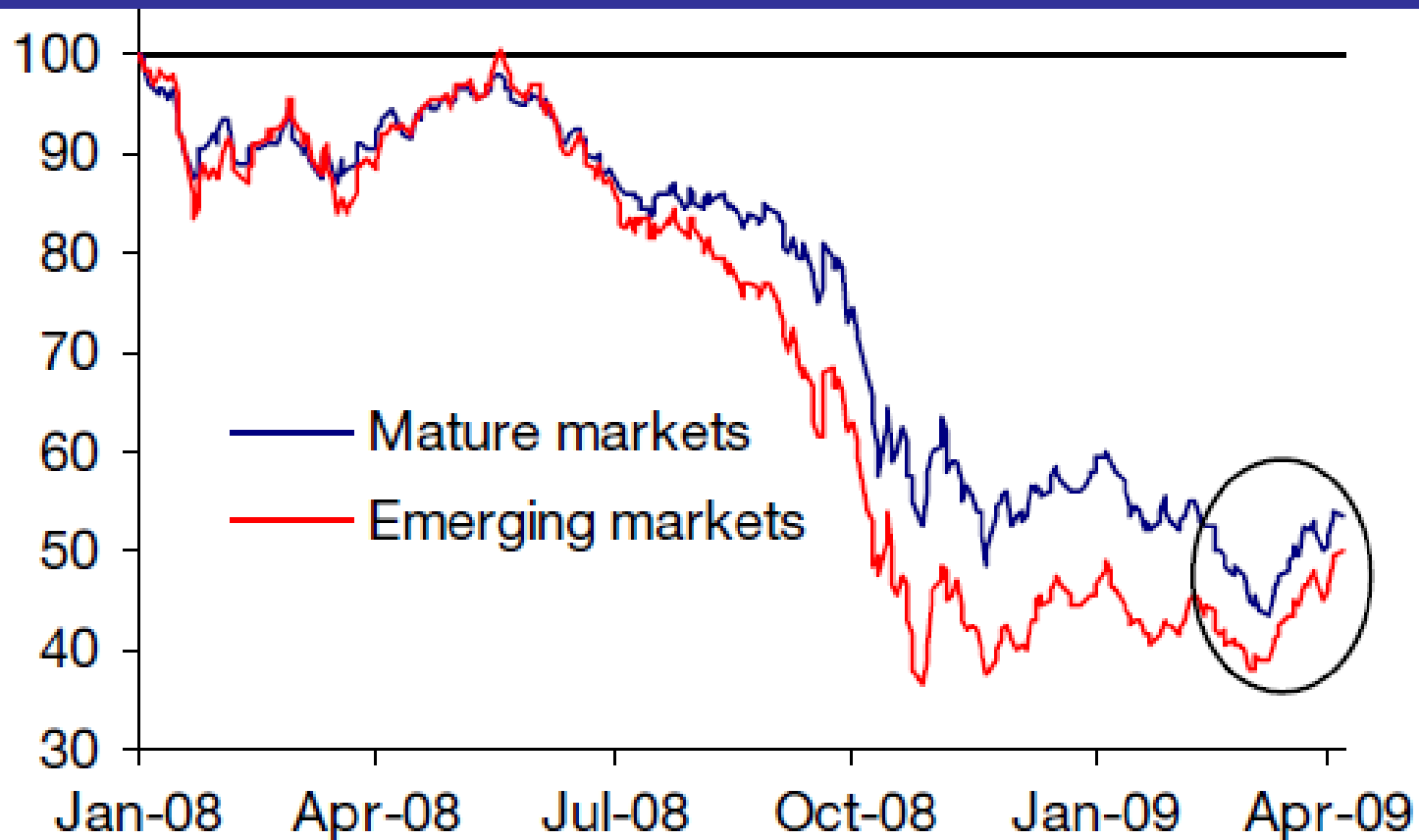


EM: Sovereign and Corporate Bonds Spreads

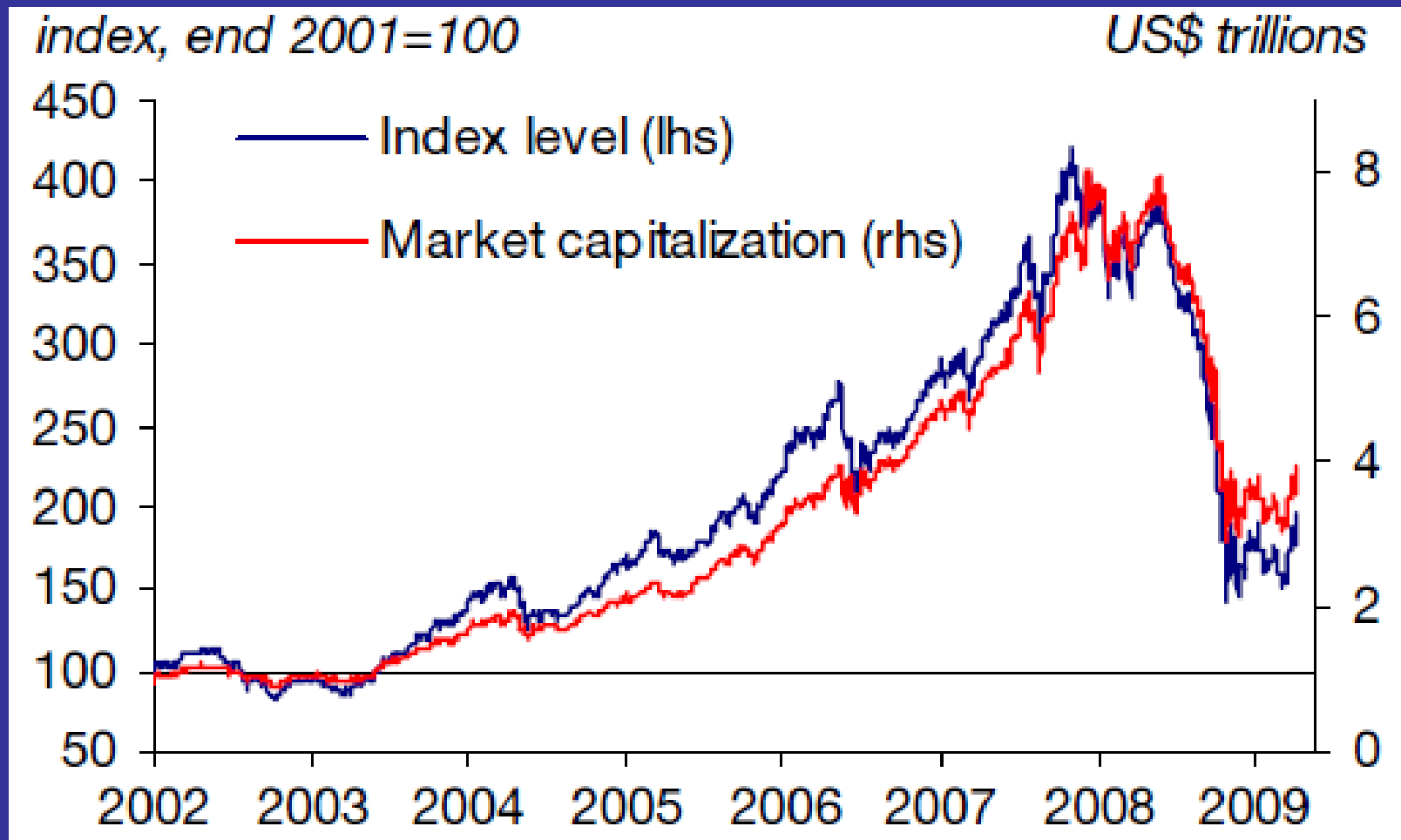


Equity Indices

MSCI indices (US\$ returns), end-2007=100



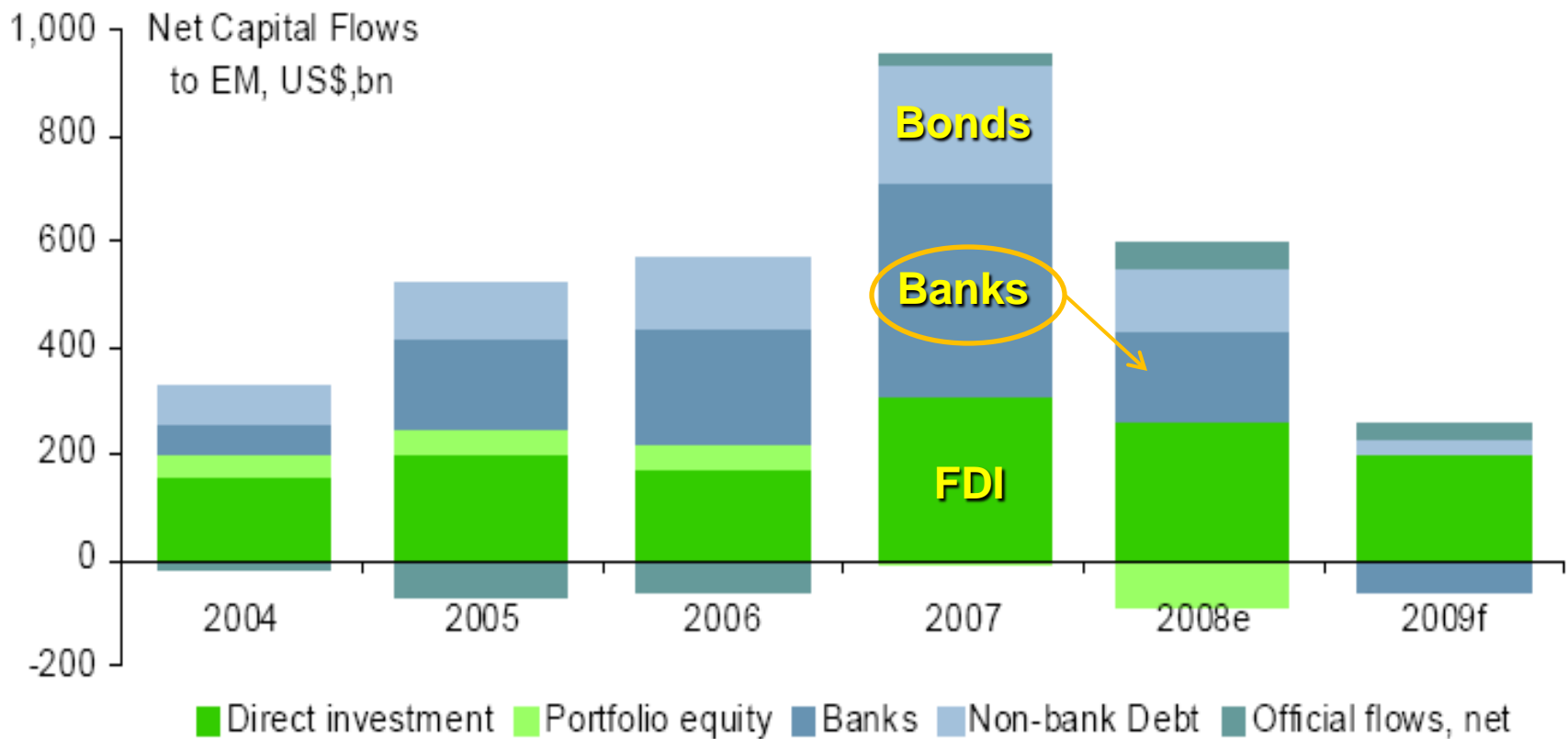
Performance of Emerging Equity Markets



What are the main reasons for the credit contraction?

- Banking claims on emerging market economies initially held up quite well.

Emerging Markets: Capital Flows



Source: IIF

What are the main reasons for the credit contraction?

- Banking claims on emerging market economies initially held up quite well.
- The initial contraction in credit followed the shrinkage in the balance sheets of major international banks who are seeking to liquidate assets, in order to improve liquidity and reduce leverage ratios. It was caused by home country stress

But a major reason is the
increase in global risk aversion
and the perception that
Emerging Markets continue to
be a higher risk class in the
midst of the global crisis

Why this perception of higher risk has returned regarding emerging market assets?

- Traditional Macro and Structural Factors
- Inability of emerging countries to implement strong countercyclical policies
- Lack of fiscal space, given the inability to finance large and credible fiscal stimulus

The return of the original sin?

Most of the major emerging market economies have experienced substantial currency depreciation against the US dollar, (albeit with the major exception of China) and local debt markets have suffered an important setback.

Need to Reduce Risk and Risk Perception about Emerging Markets

- Need for Standing FX Liquidity Facilities. Require mechanisms to provide broad FX liquidity insurance
- Could be done domestically if there are sufficient international reserves or some type of contingent instrument linked to a relevant price.

But Arrangements should be mostly international or regional

- **Support Internationally Active Banks but Avoid Financial Protectionism in Bank's Home Countries.**
- **Currency Swap Arrangements**
Currency swaps with Ems have been mainly with countries that have already high levels of reserves. The main function of the swap is to reduce the foreign-currency liquidity risk.

Role of the IFIs

- Enhanced IFIs resources and the new lending facilities (IMF's FCL) are very important risk mitigation instruments.
- IFIs (and particularly the Fund) should leverage their resources to reduce the private sector risk in maintaining their exposure to EMs **through the provision of Guaranties and facilitation of swaps.**

THANK YOU