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Risk mitigation strategies: Deeper role for policy as globalization amplifies impact of world cycles?"

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Tokyo
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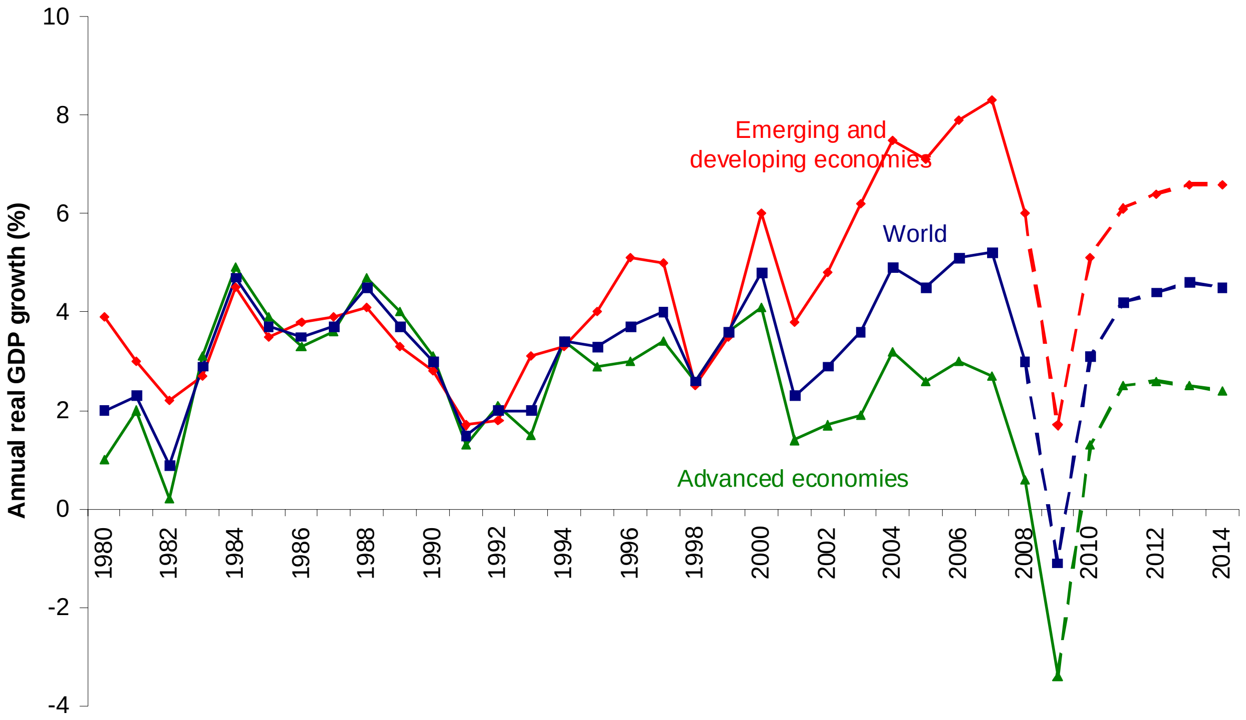
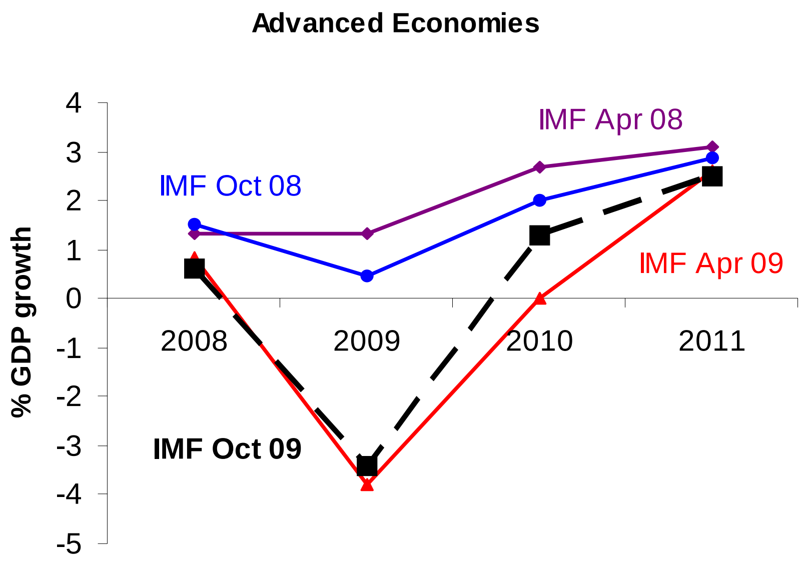
World growth rates become more divergent - and more volatile?

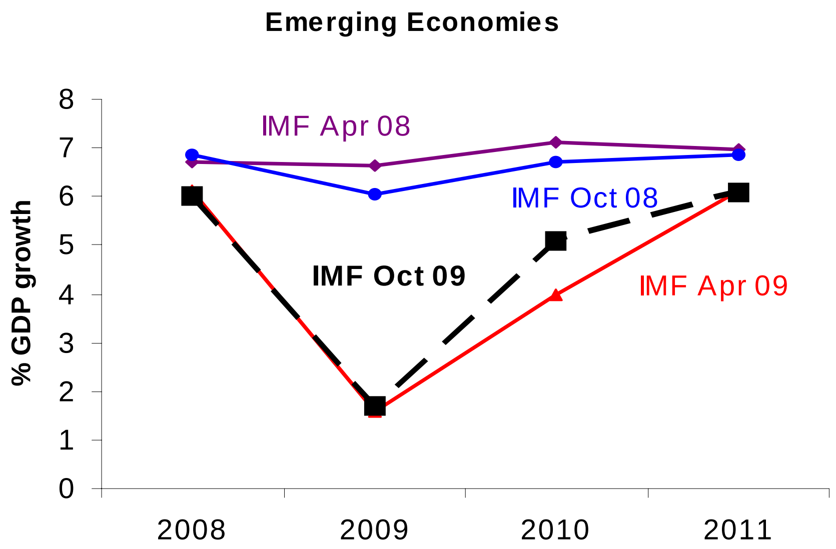


- **Great moderation ends in unexpectedly massive recession**
- **Turbulence may continue as recovery unlikely to be smooth and cycles will recur**

Source: IMF

The unexpected depth of recession - revisions in IMF forecasts





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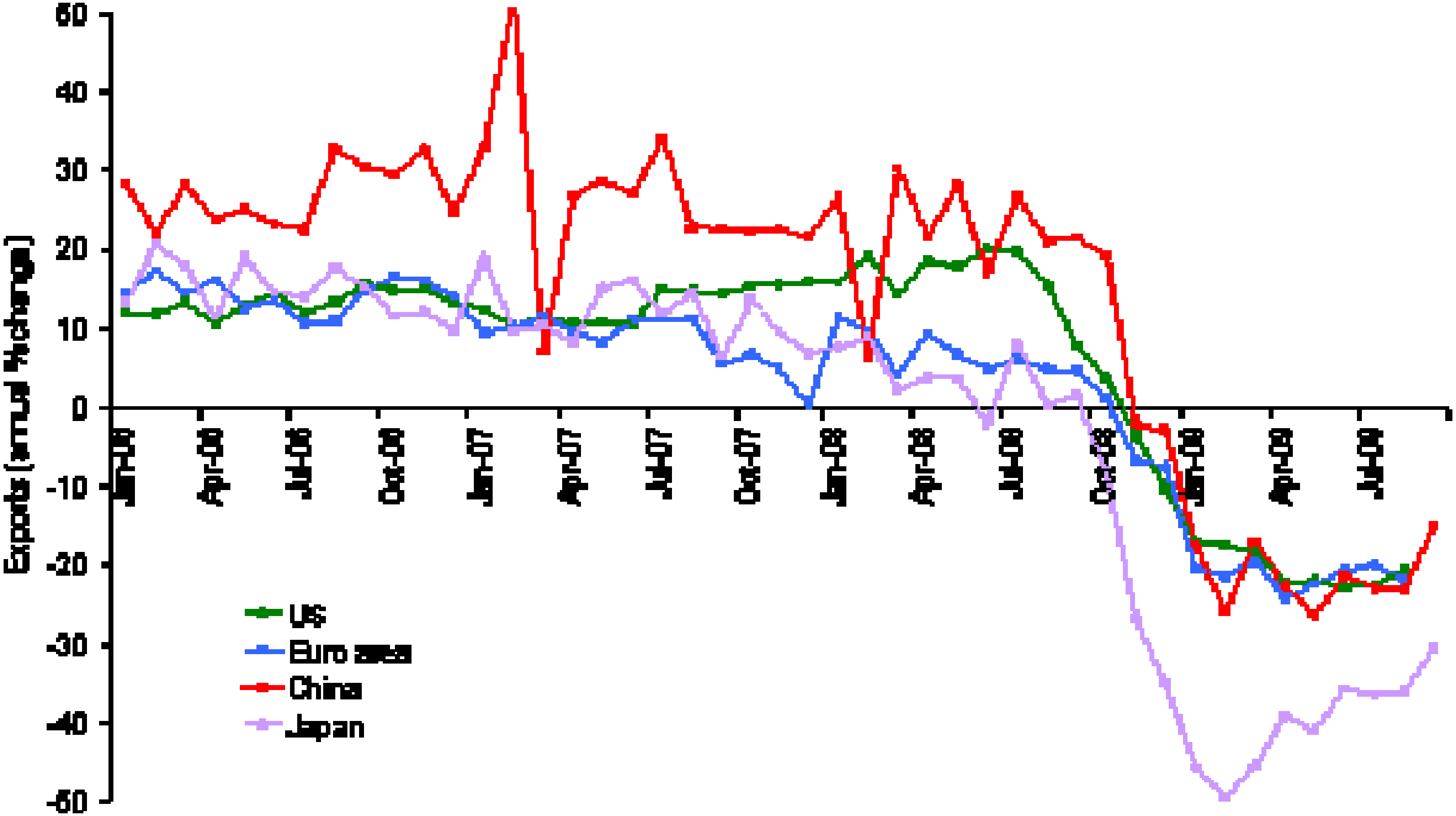
World trade still weak – upturn mainly in Asia



Recession bigger than GDP loss suggests:

- $1 trillion drop in global GDP a poor measure of crisis
- Goods trade still down by around 20%
- $3-4 trillion loss in world trade in 2009
- $10-20 trillion in lost business world wide?
- Peak to trough as much as $50 trillion n wealth lost - partially recouped as markets have rallied

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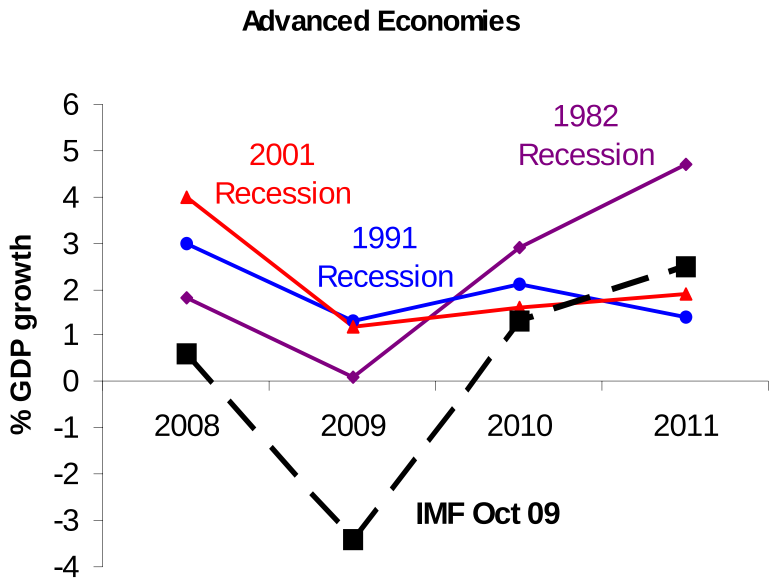
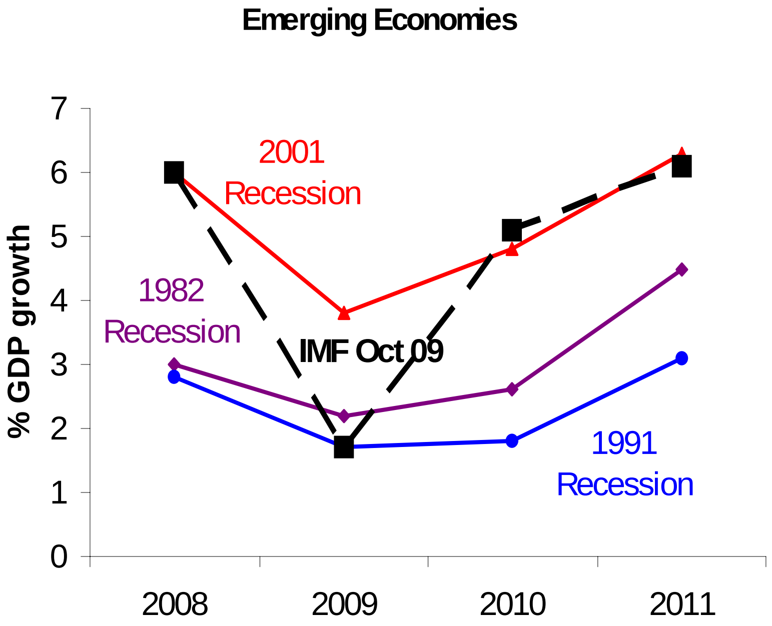
Recovery also under par for developed world





Source: IMF

Average growth rates in BRICs

- Emergers' growth largely on the back of China
- Brazil growth steady (above 80s and 90s rates) but not spectacular
- Russia hardest hit country among BRICs

Source: IMF

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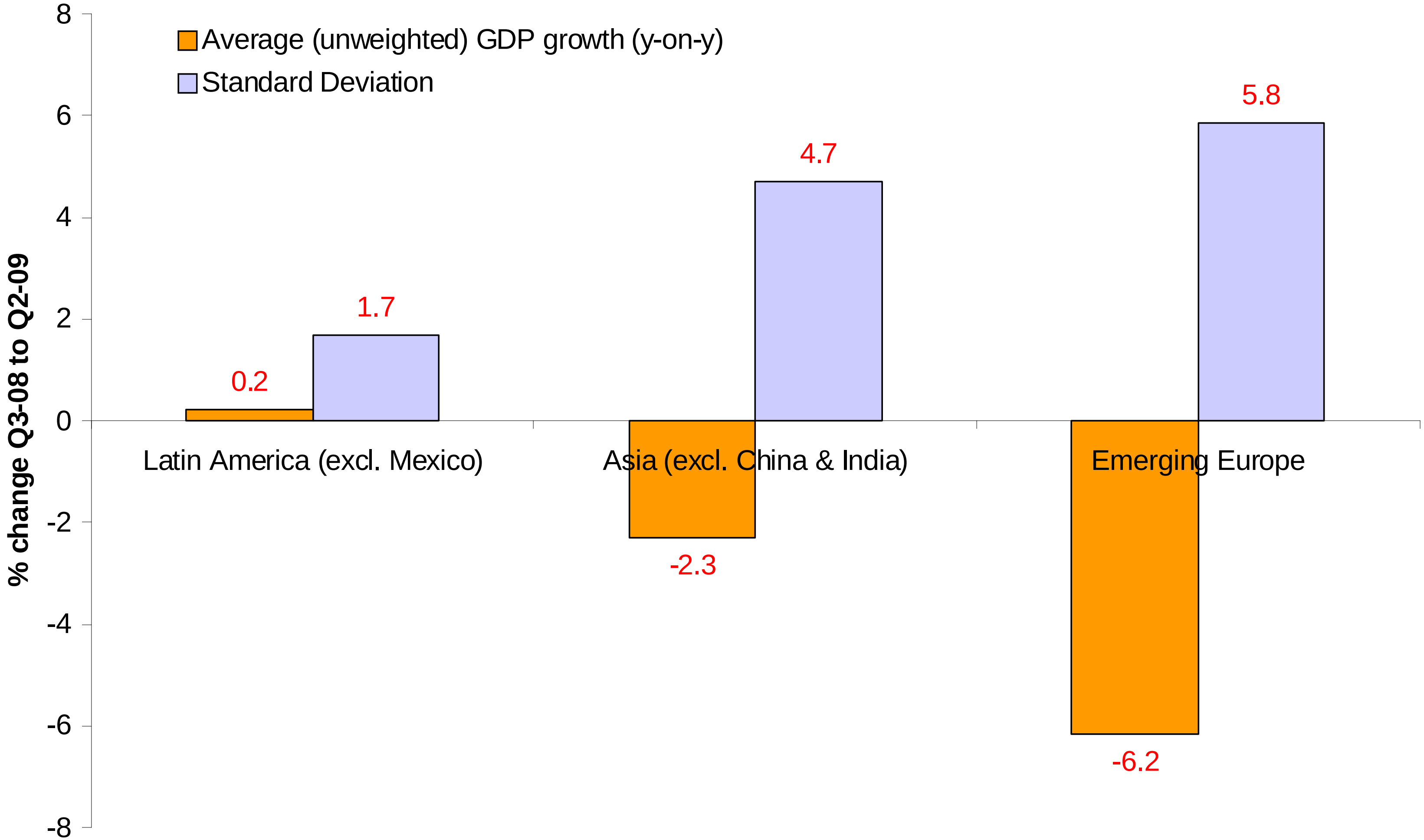
Performance since Q3-2008



Source:

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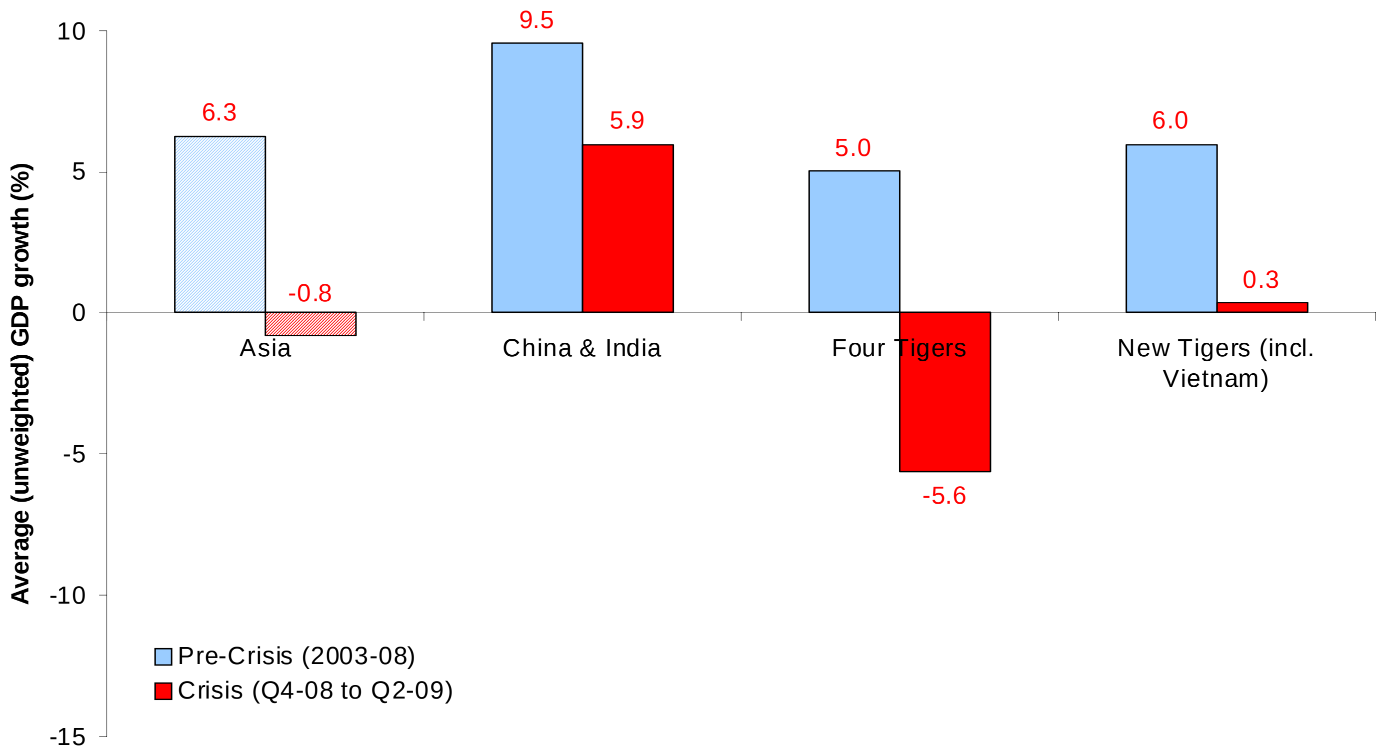
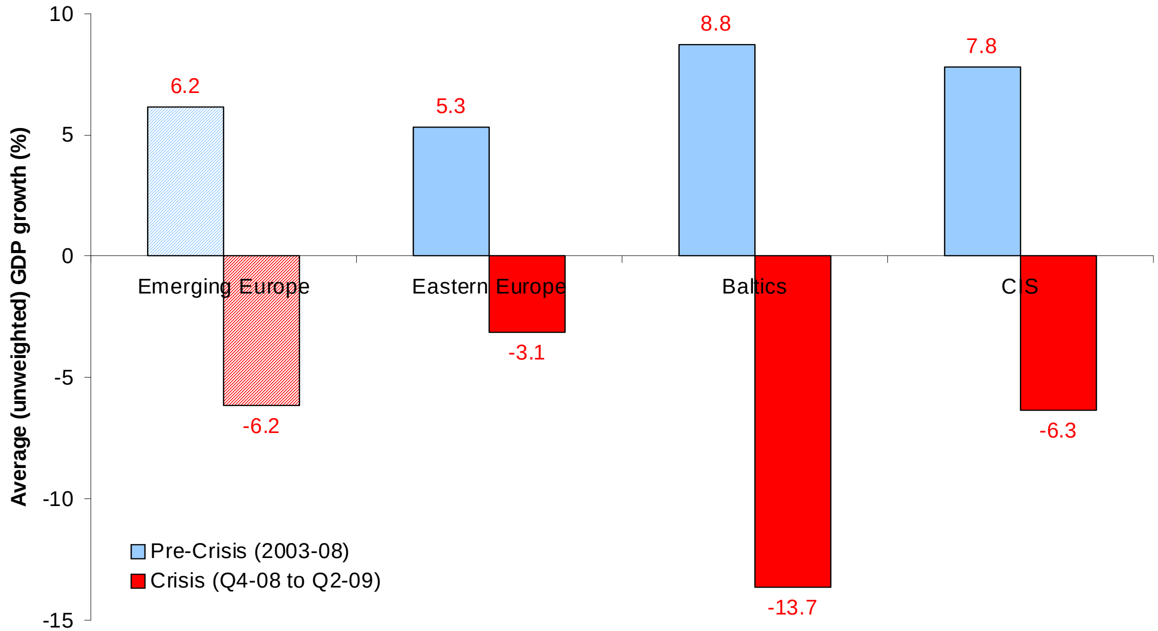
Asia crisis vs. pre-crisis



- “Old” Tigers hit hard by slump in cyclical manufactures trade
- New Tigers doing relatively well particularly Indonesia and Vietnam (both over 4% growth on average during last 3 quarters)

Source:

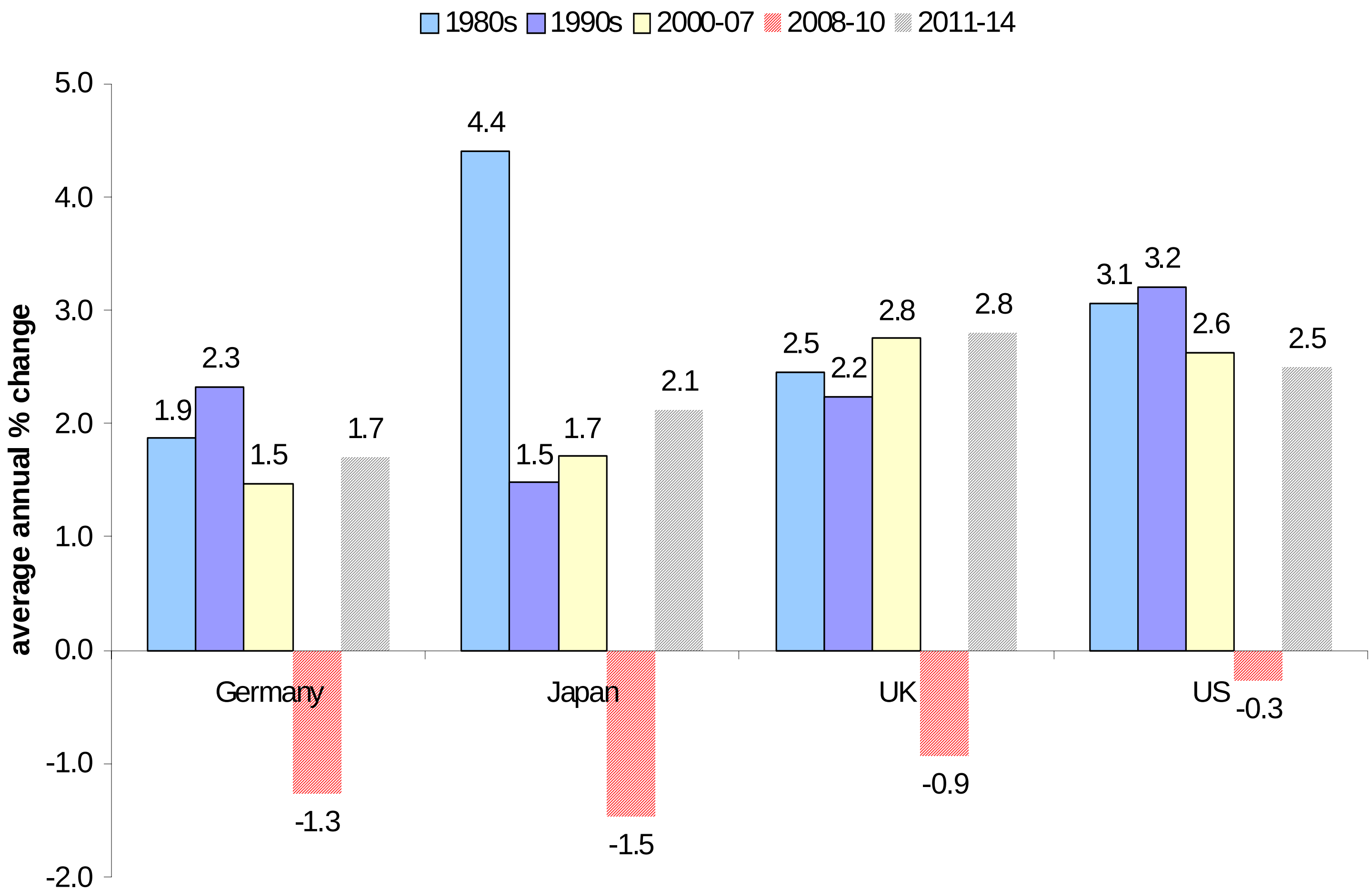
Emerging Europe crisis vs. pre-crisis



- Worst performing region in the world: only Poland growing (1.5)
- Baltics suffering from double-digit contraction
- CIS: Ukraine collapsed, Russia doing poorly, Belarus only mild recession

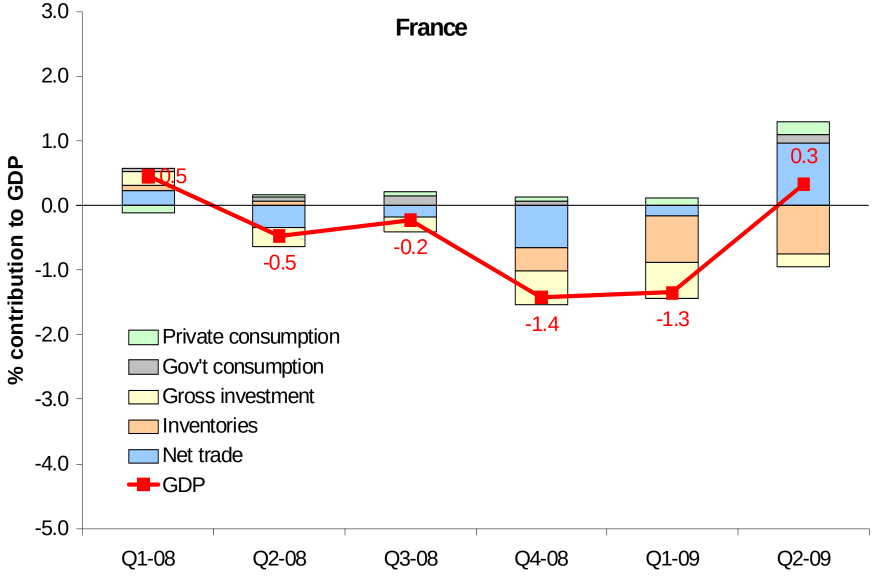
Source:

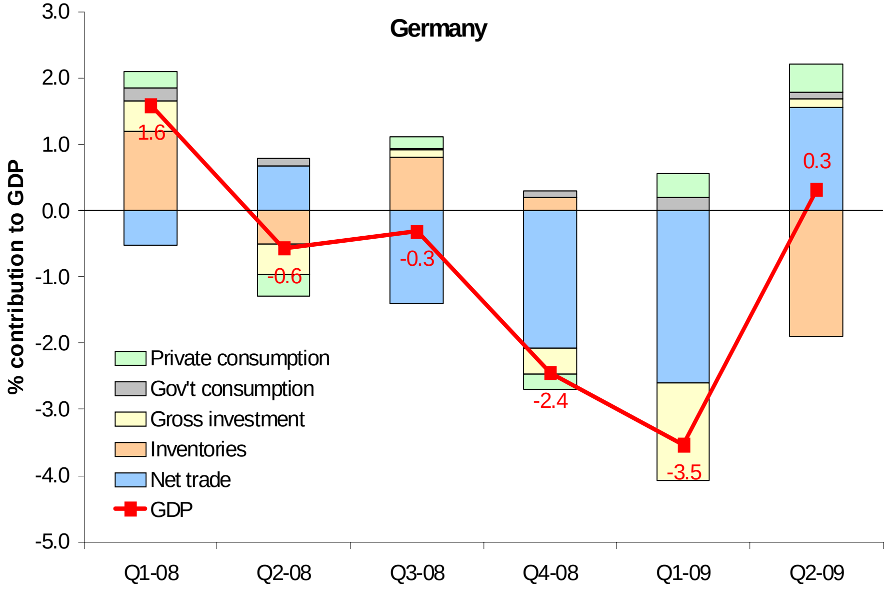
Why bigger losses in some countries than others?



Source: IMF

France and Germany show varying impacts of crisis





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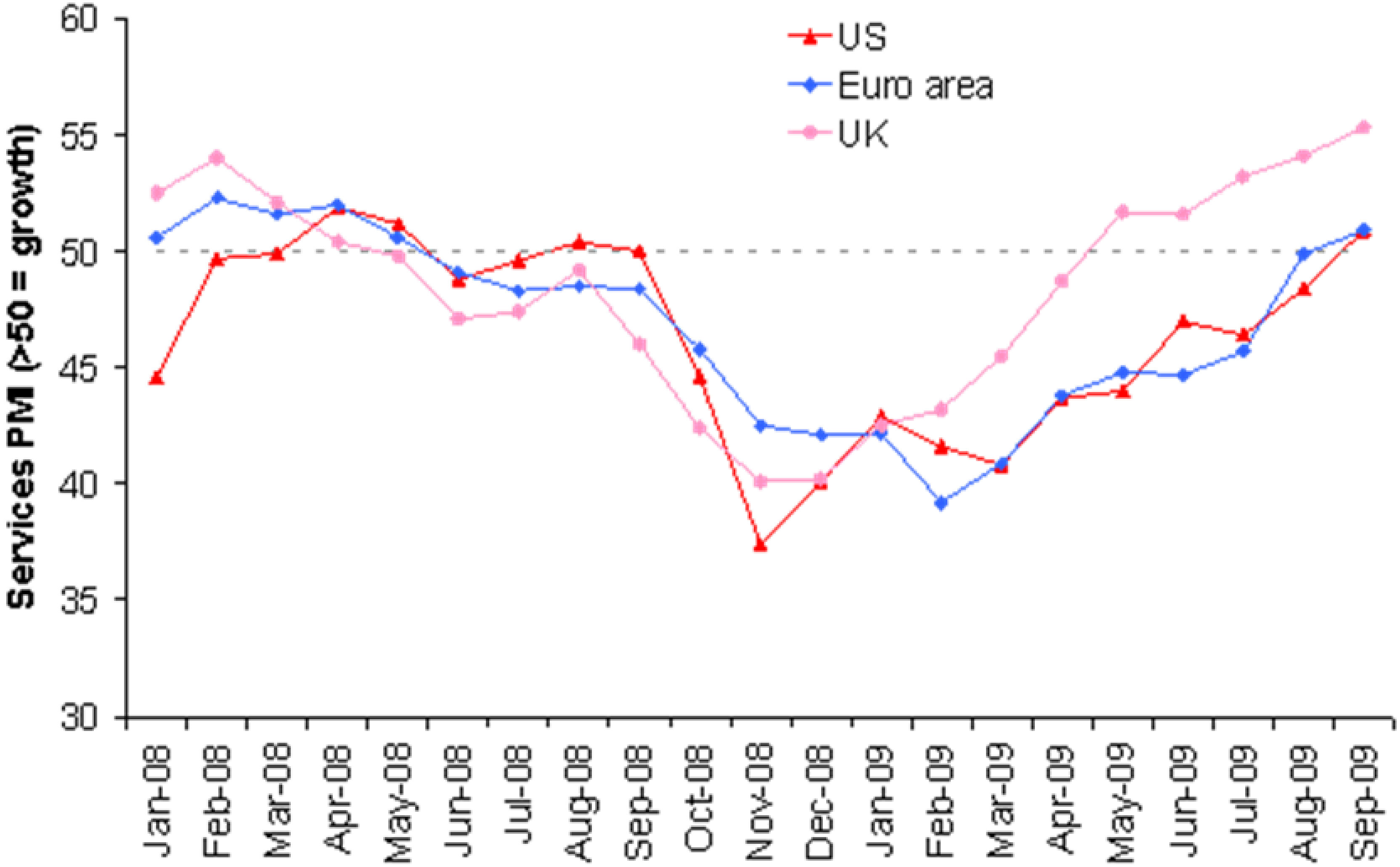
Services quickly recover - even expand



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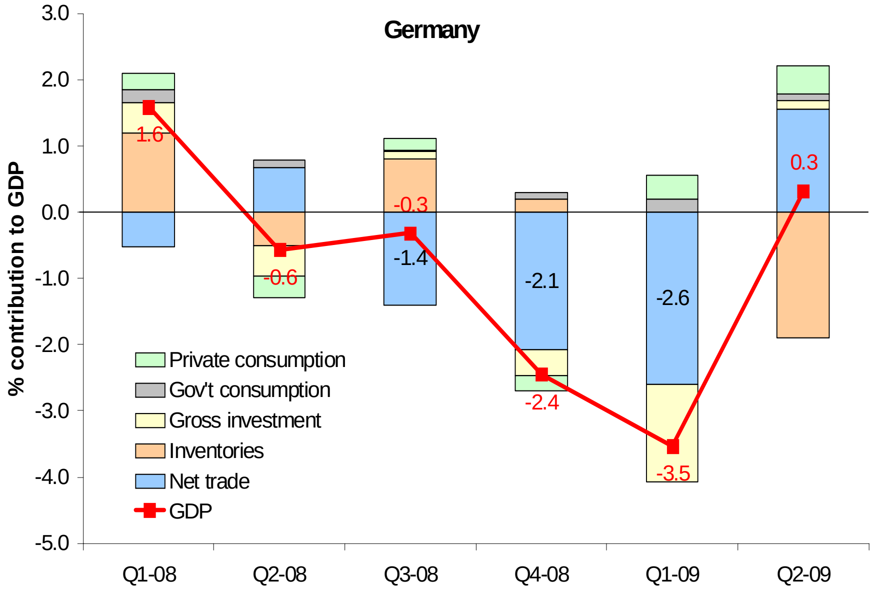
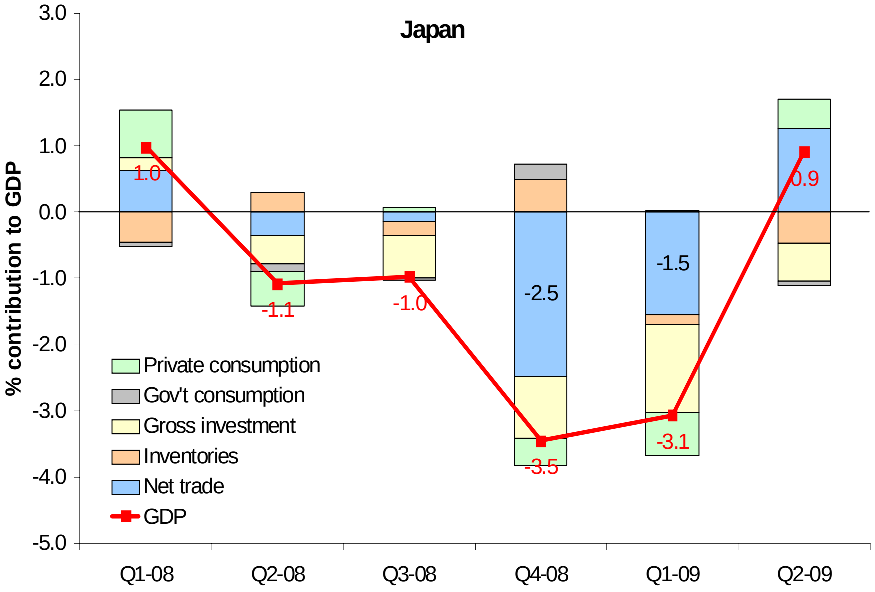
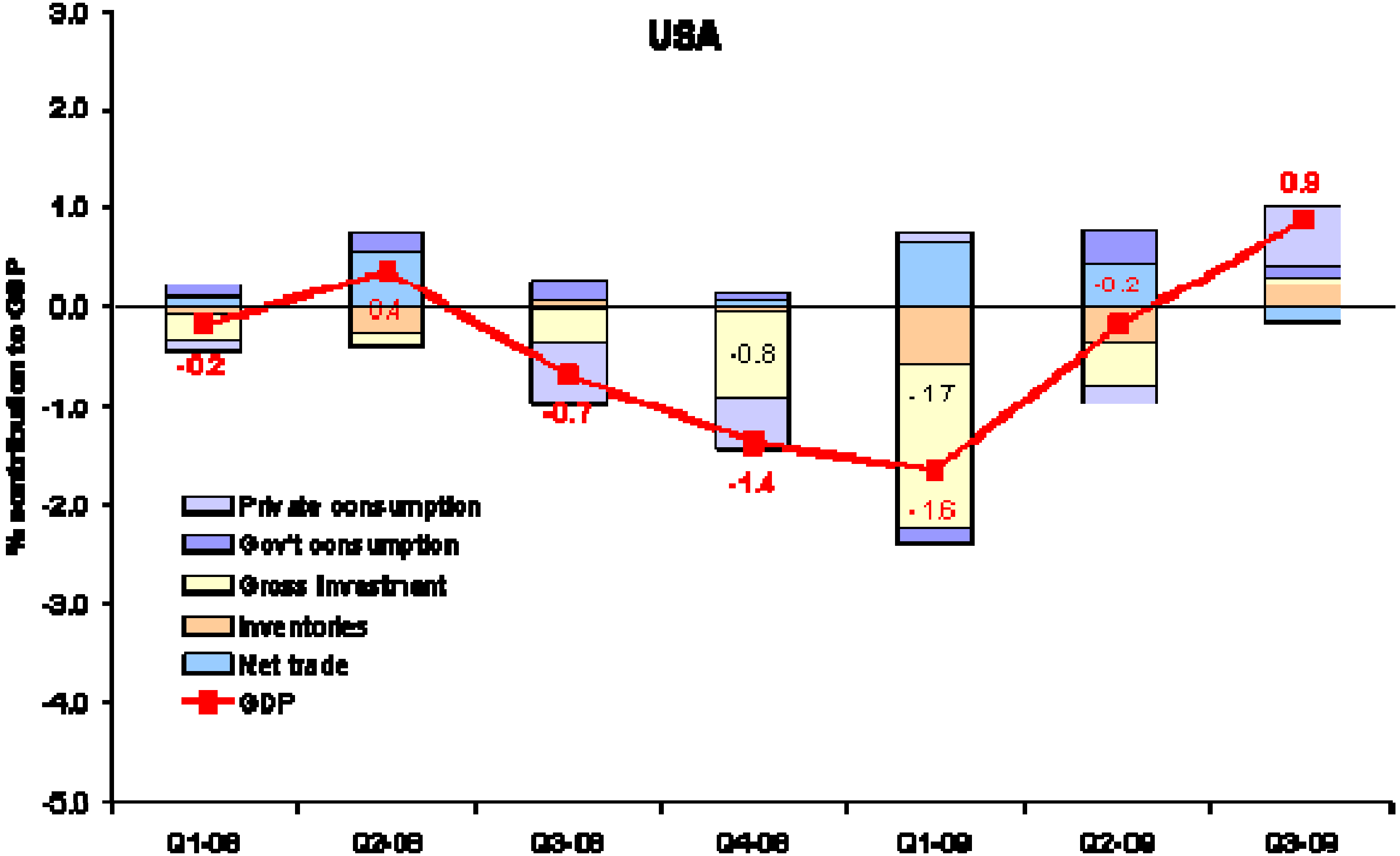
Effect of cyclical trade in Germany and Japan





US exits recession in Q3 – more convincingly than Germany and France in Q2



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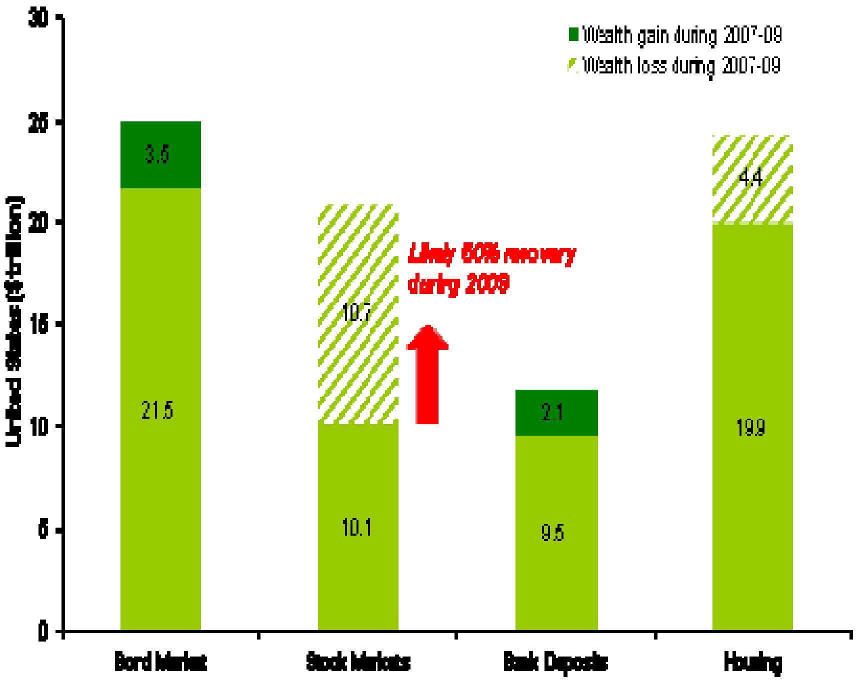
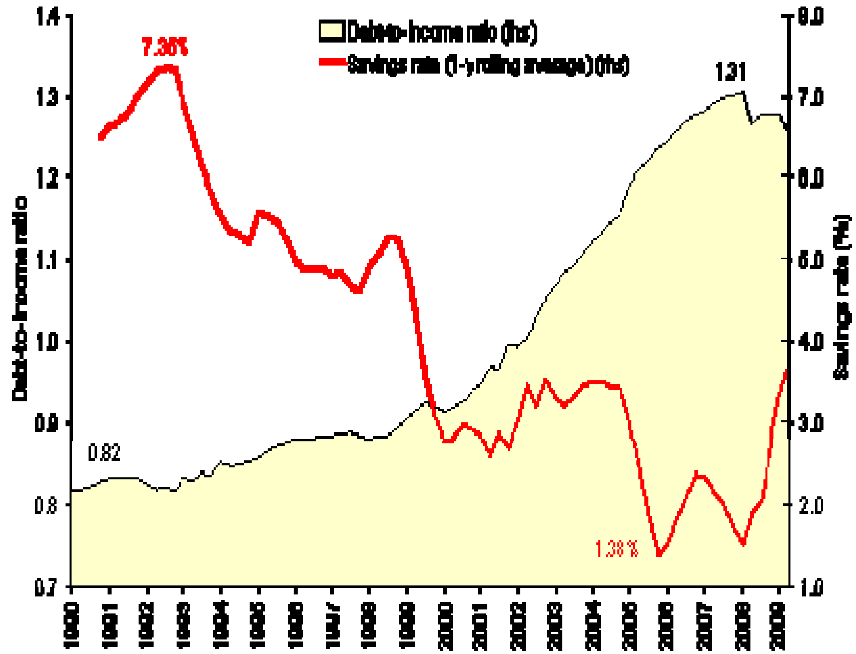
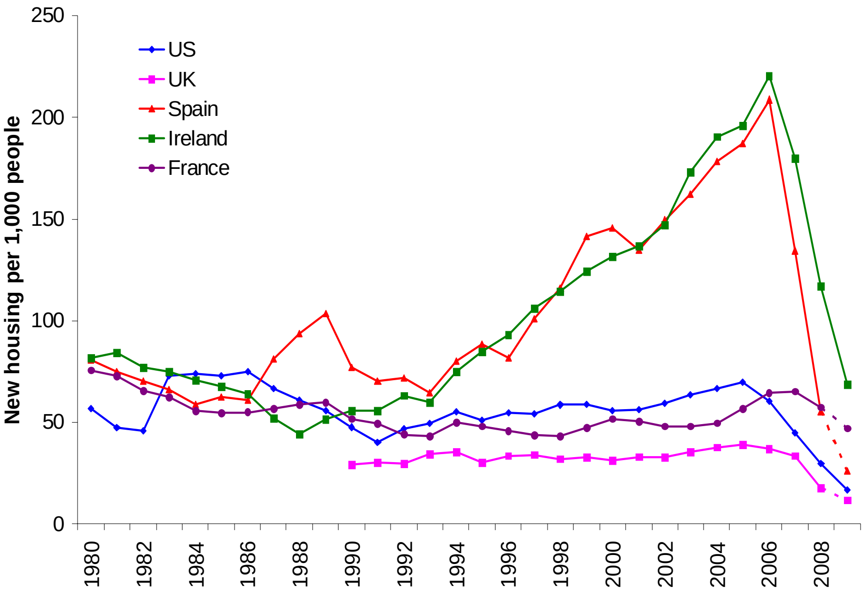
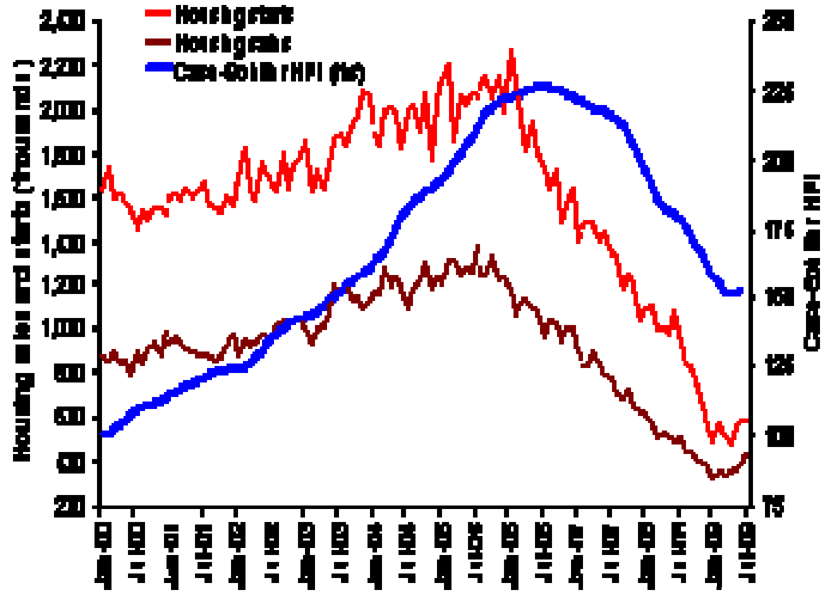
US wealth effects large, savings up, debt decreasing



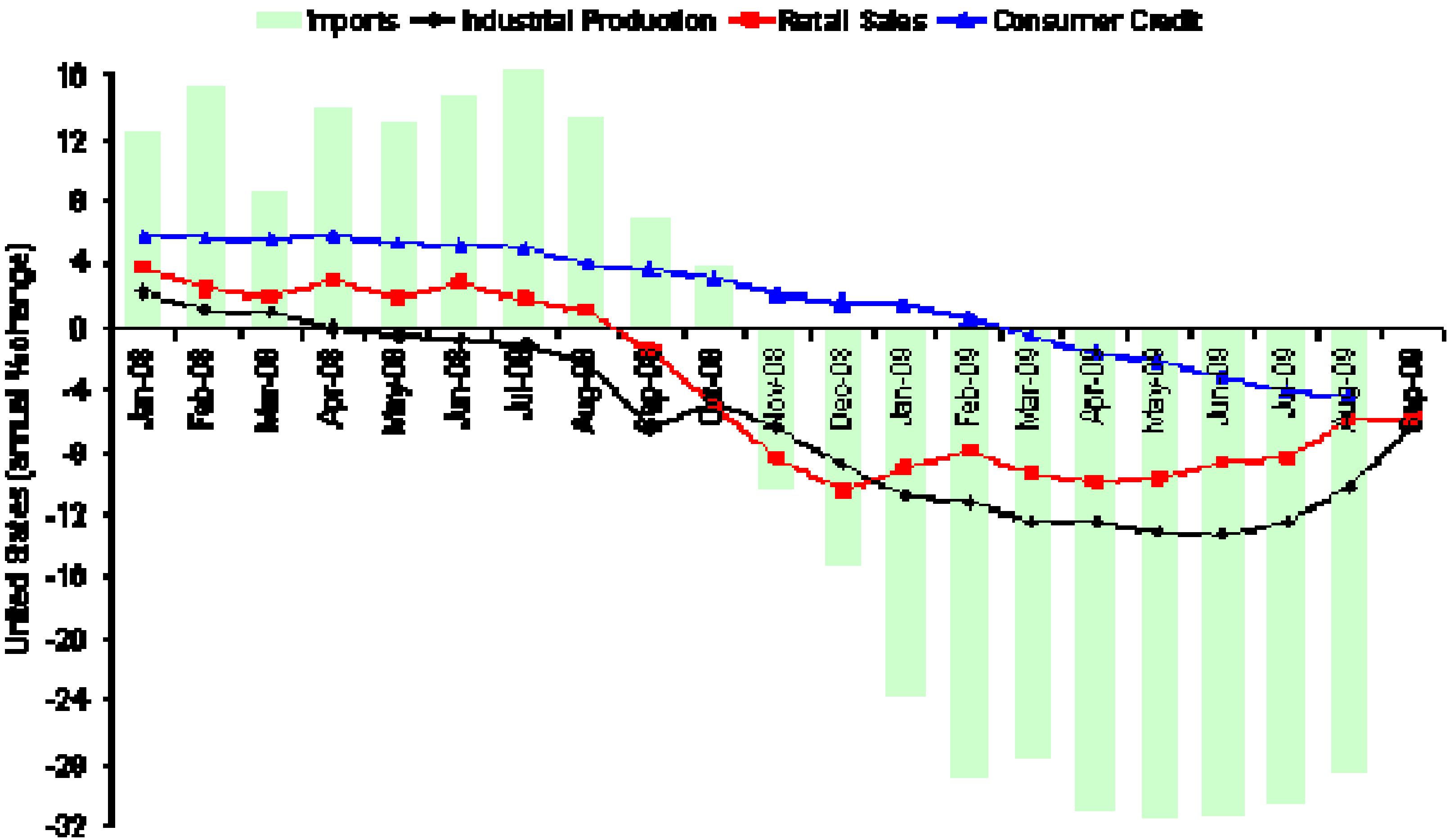


Property losses: housing markets level off

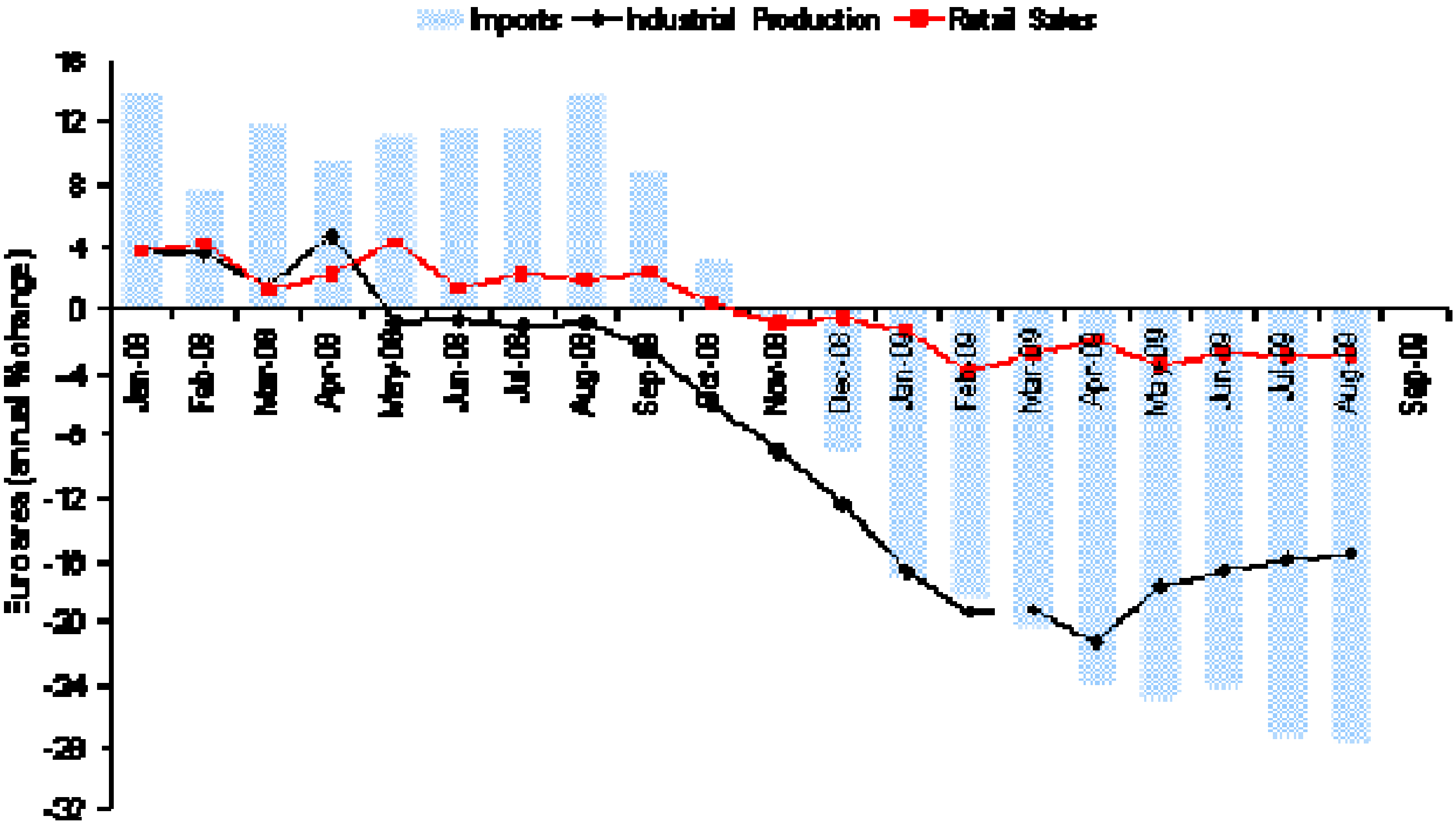




US signs of improvement



Euro area indicators also remain weak



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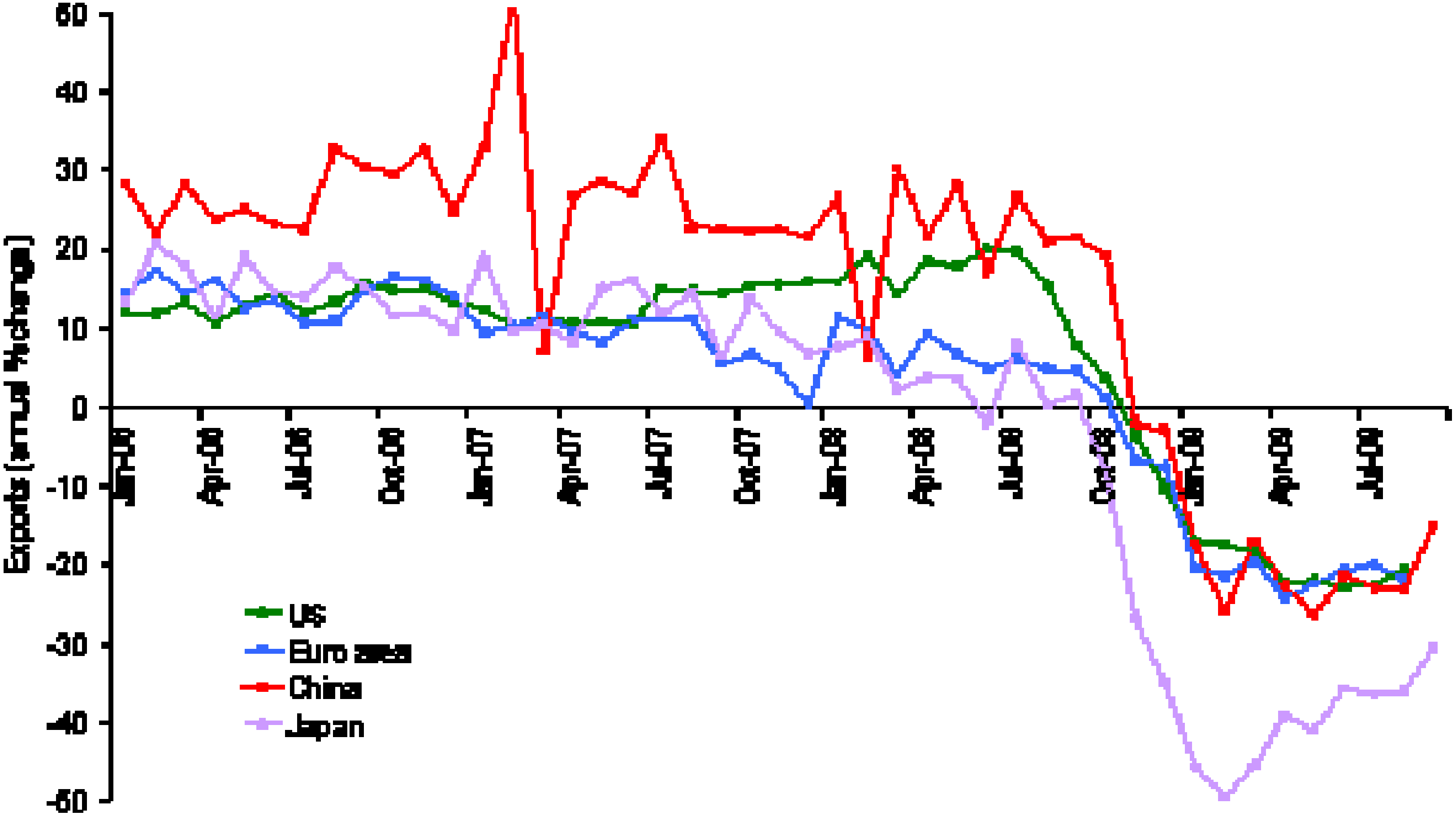
World trade loss worth $3-4 trillion in 2009



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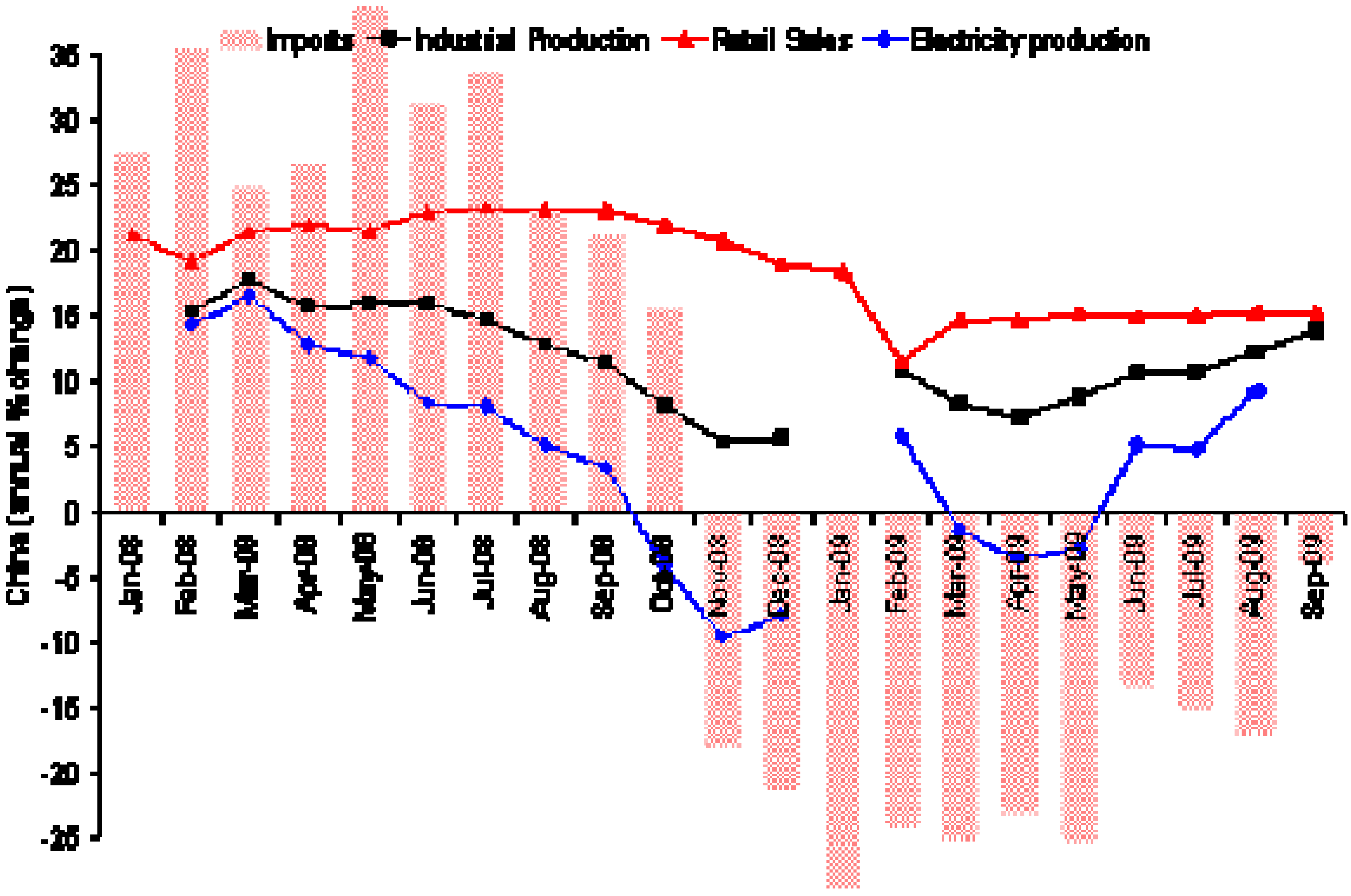
China grows robustly – imports picking up



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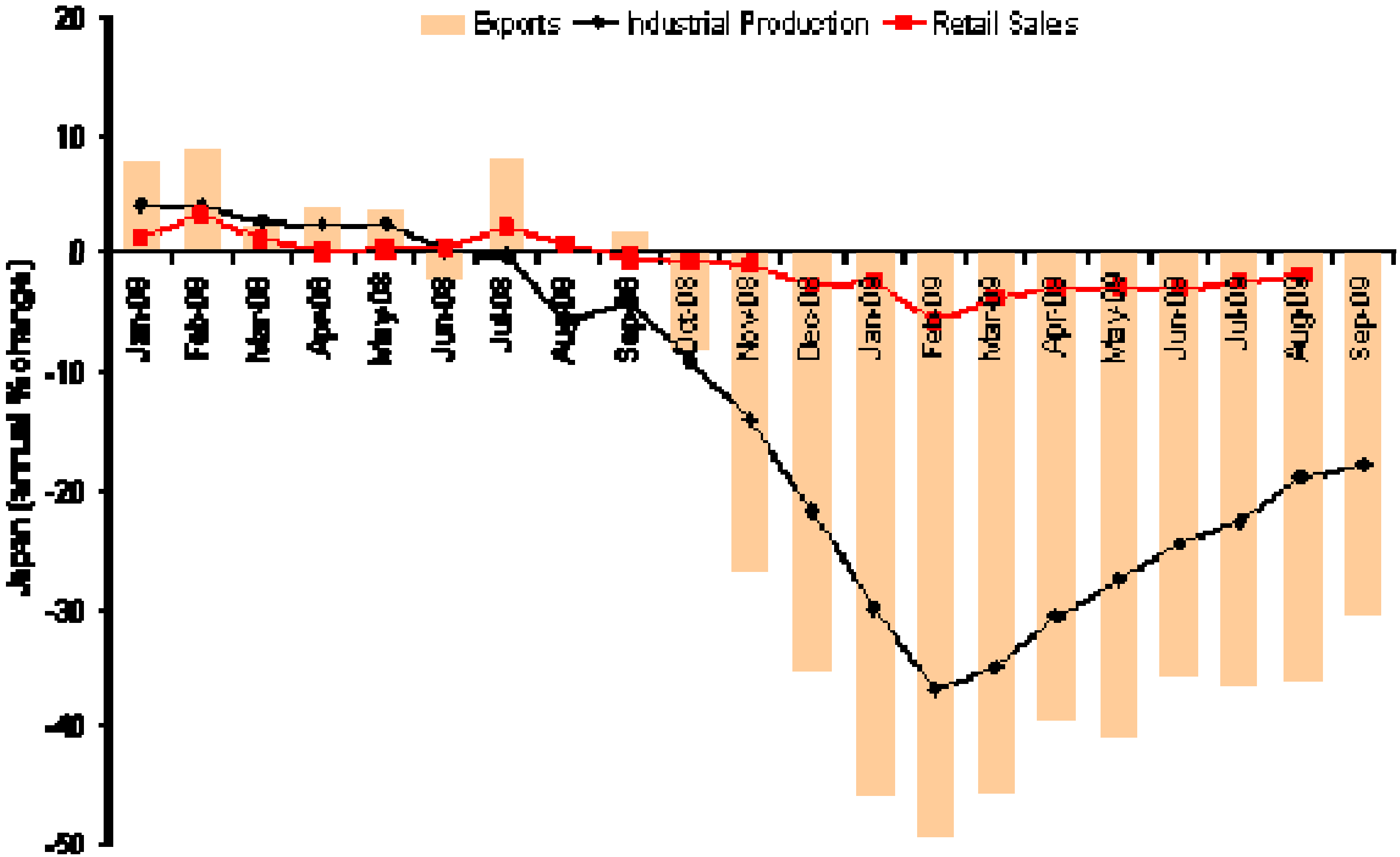
Japan benefits from Asian growth



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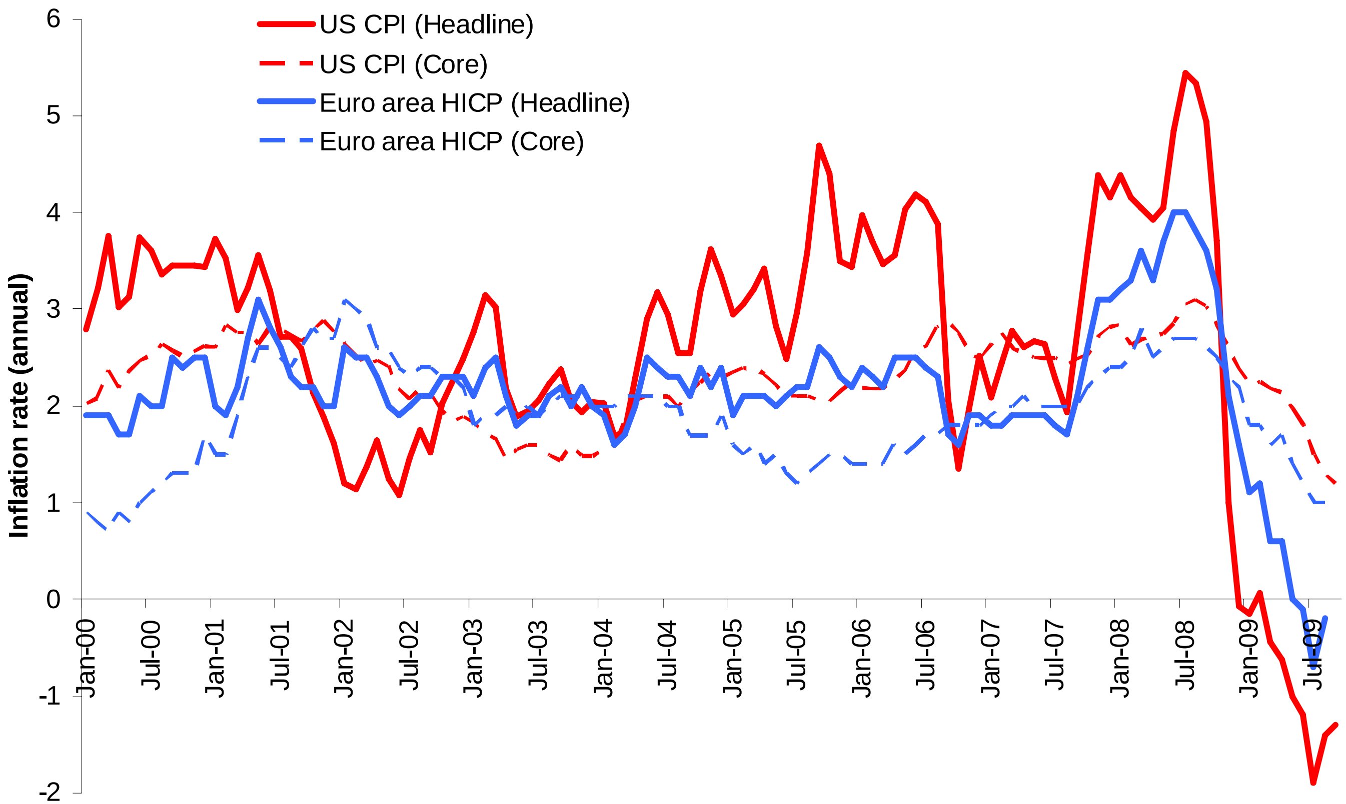
LONG-TERM FORECASTS AND RISKS FROM PREMATURE EXIT STRATEGIES

Deflation in US, EU will end



Source: St. Louis Fed, ECB

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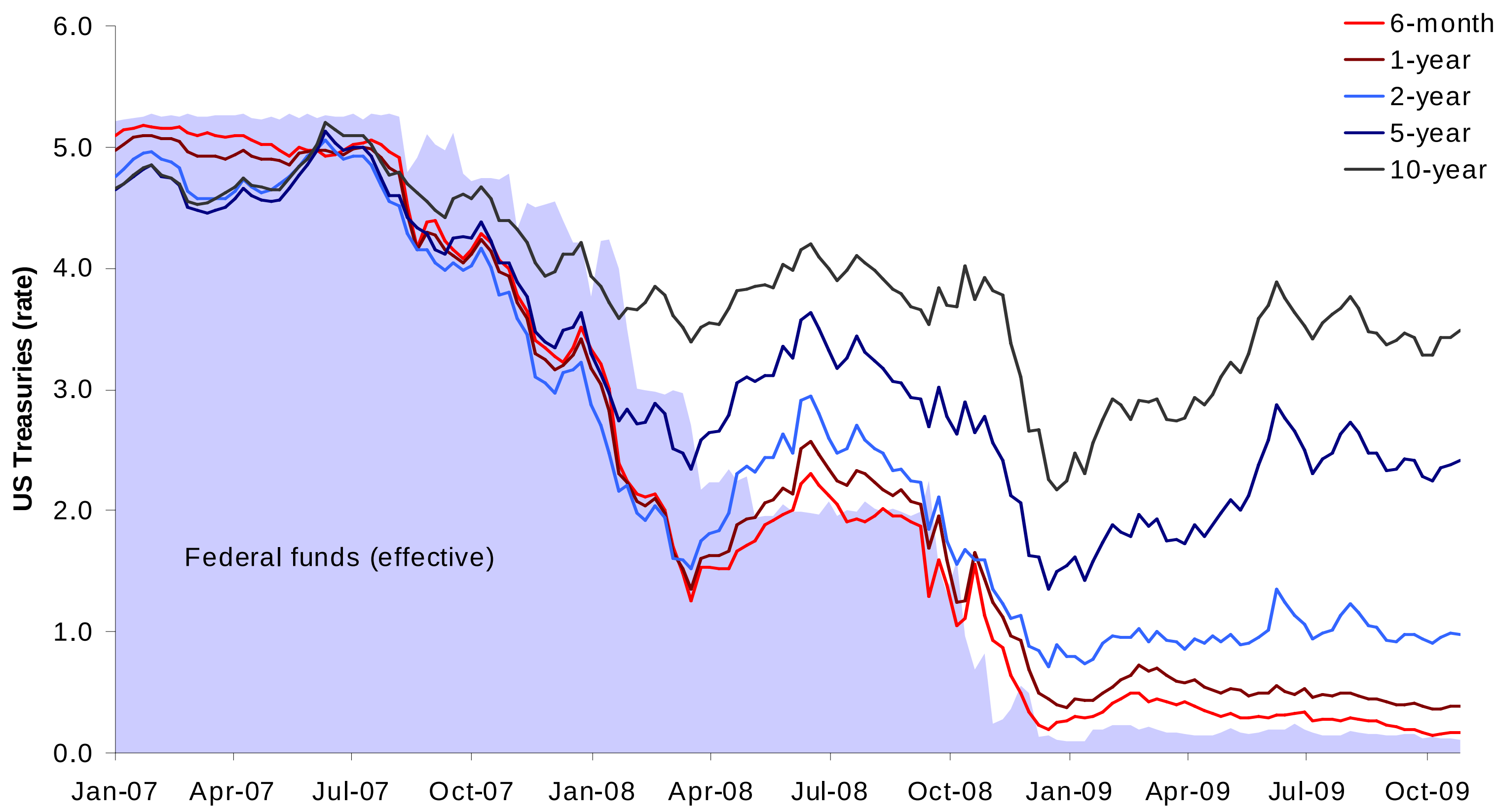
US yield curve



Source: US Federal Reserve

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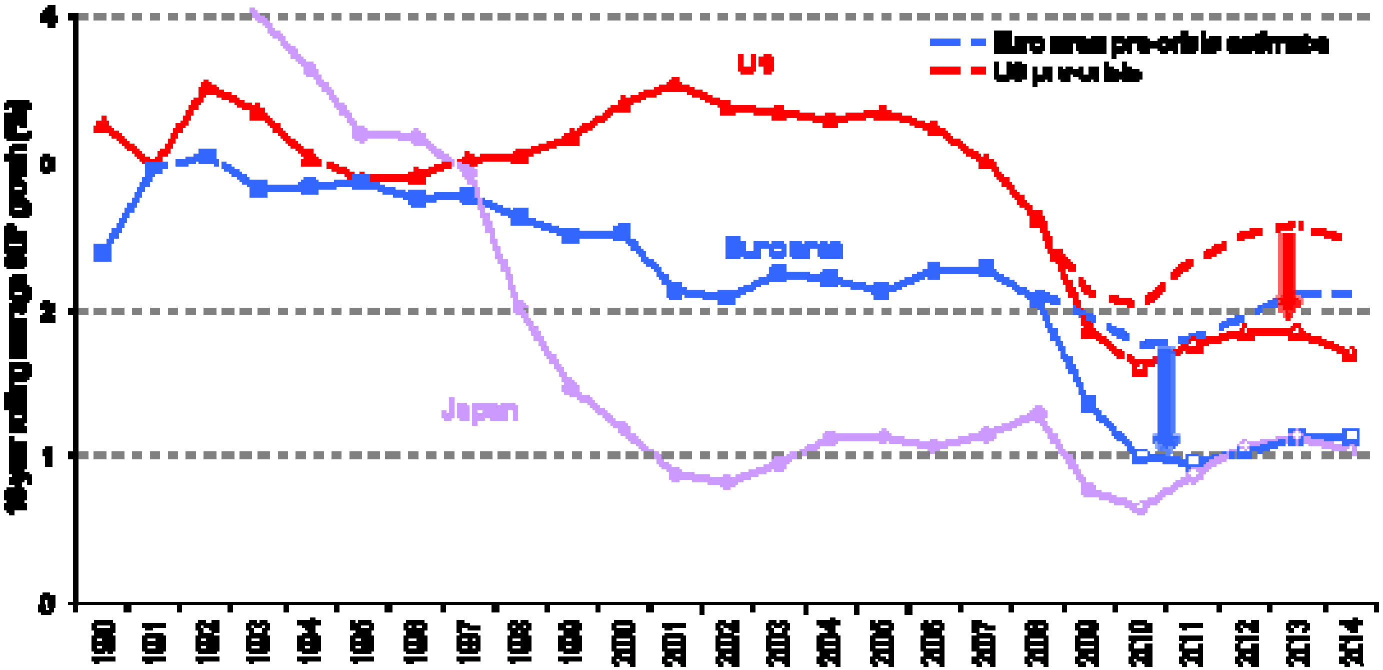
Impacts on long run growth potential?

- Effect of deep recessions on investment and productivity – short and medium-term damage to growth

- Long-tailed costs from governments bailing out the economy in the short term – a “spend now and let tax payers to pay later” approach to curbing recession

- More costly environment for business and finance – “ the age of the regulator” - more restrictions ahead to “insure” against instability

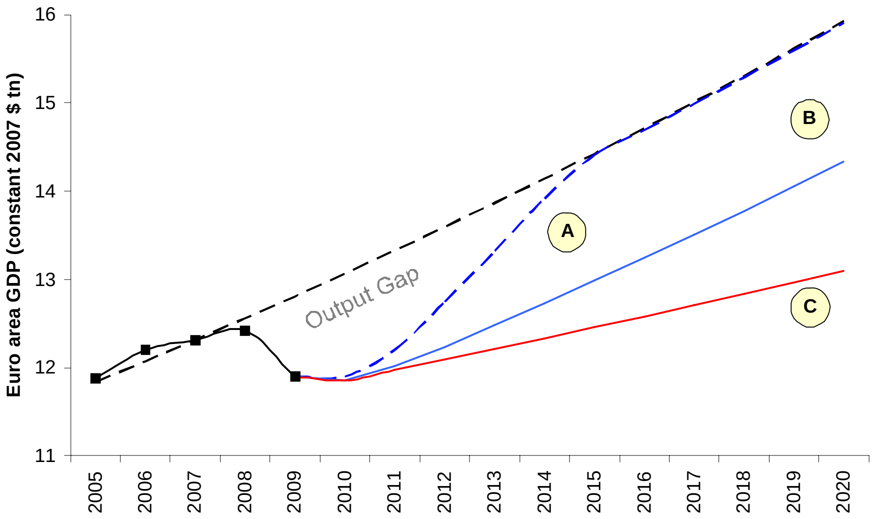
GDP 10-year rolling averages: US, Euro area, Japan

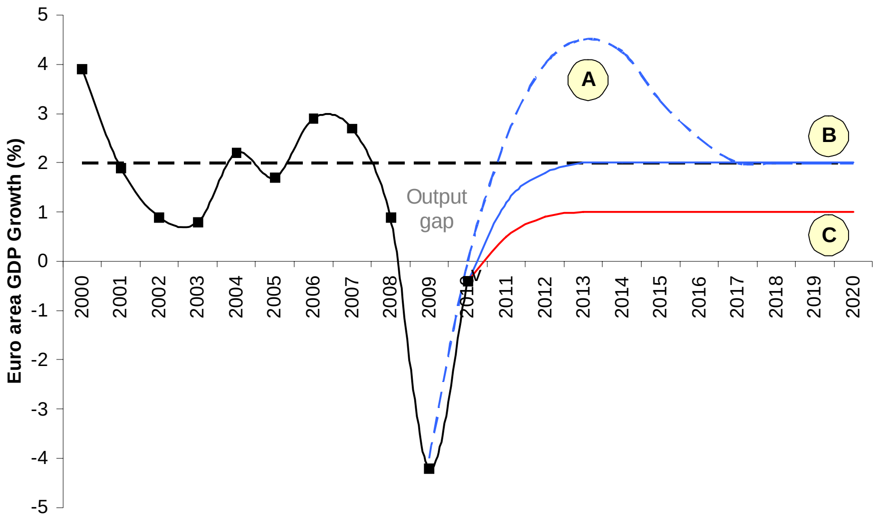


- Rolling averages roughly corresponding with long-run potential output growth: pre-crisis roughly 3% for US, 2% for Europe
- Post-crisis drop to around 1% in Europe, Japanese level, and 2% for US

Source: IMF

3 Scenarios for potential output





a) Crisis losses recovered

b) Crisis losses not recovered, potential output growth maintained

c) Crisis losses not recovered, potential output growth permanently downgraded

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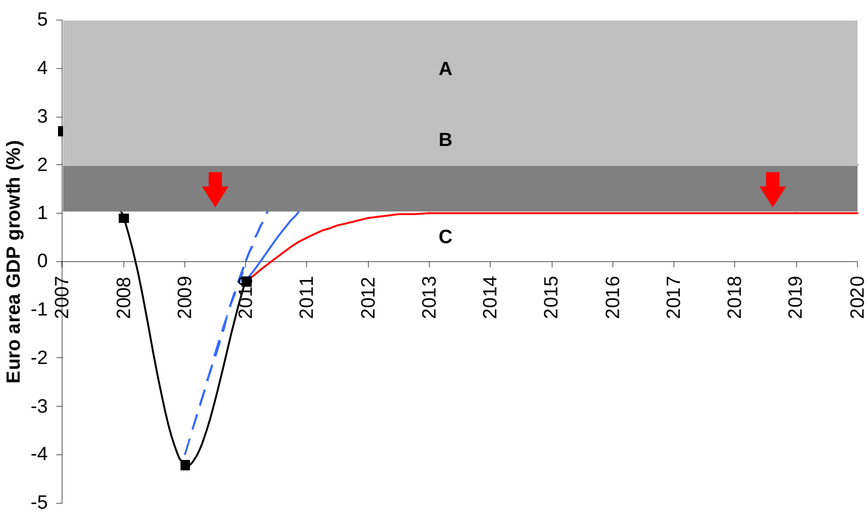
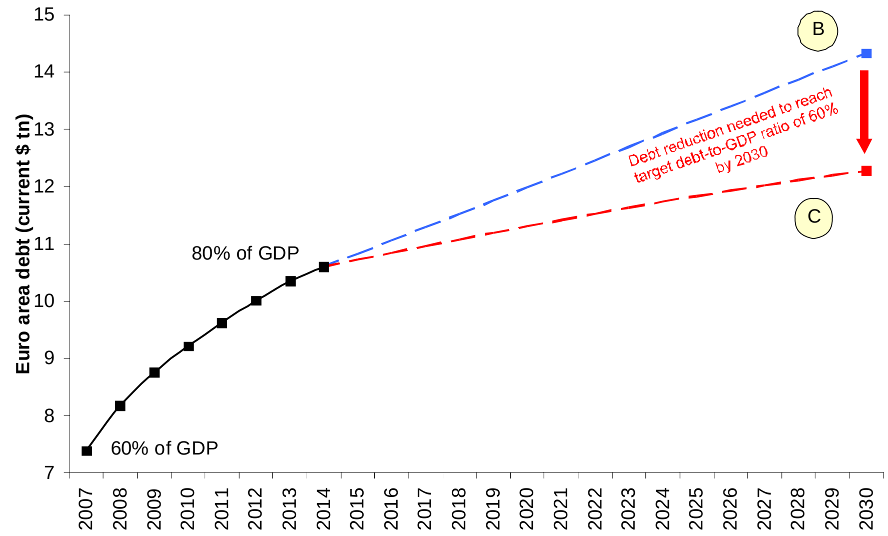
Effect on policy tightening





- **a) Crisis losses recovered**
- **b) Crisis losses not recovered, potential output growth maintained**
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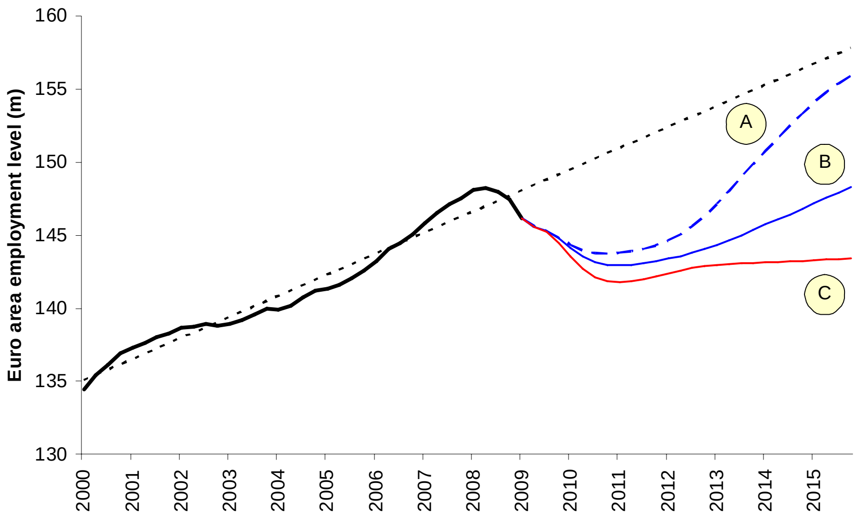
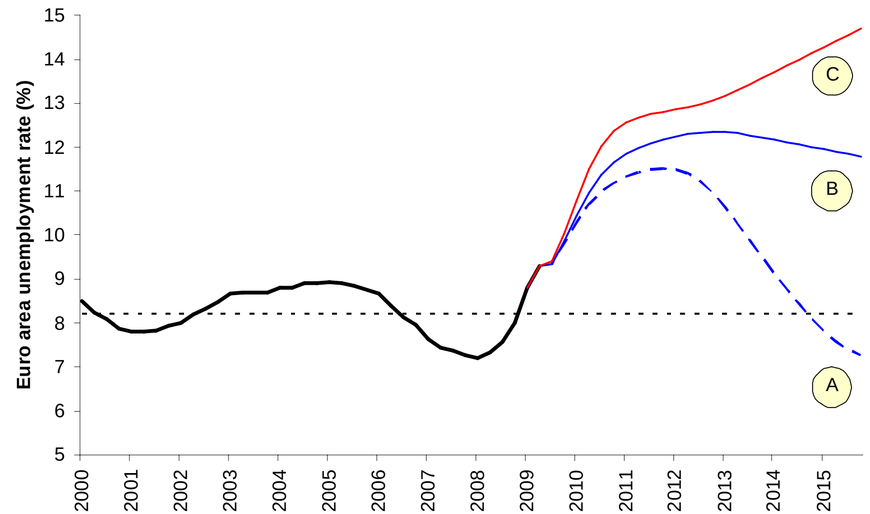
Effect on unemployment





a) High growth, high productivity
b) Normal growth, normal productivity
c) Low growth, normal productivity

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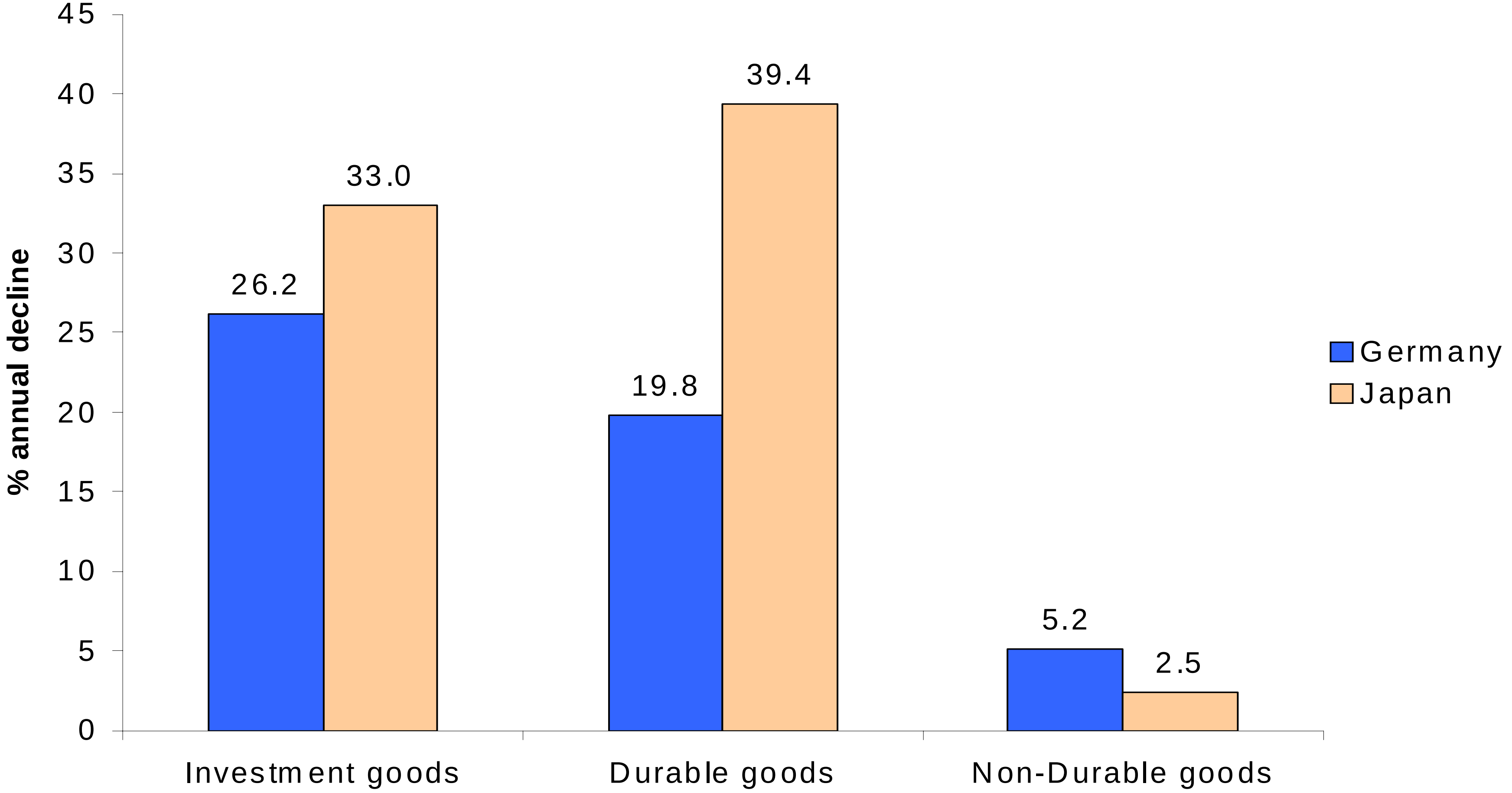
GLOBALIZATION AMPLIFIES IMPACT OF WORLD CYCLES

– raises question mark over scale and form of risk mitigation strategies

Losses in cyclical goods hurt Germany and Japan



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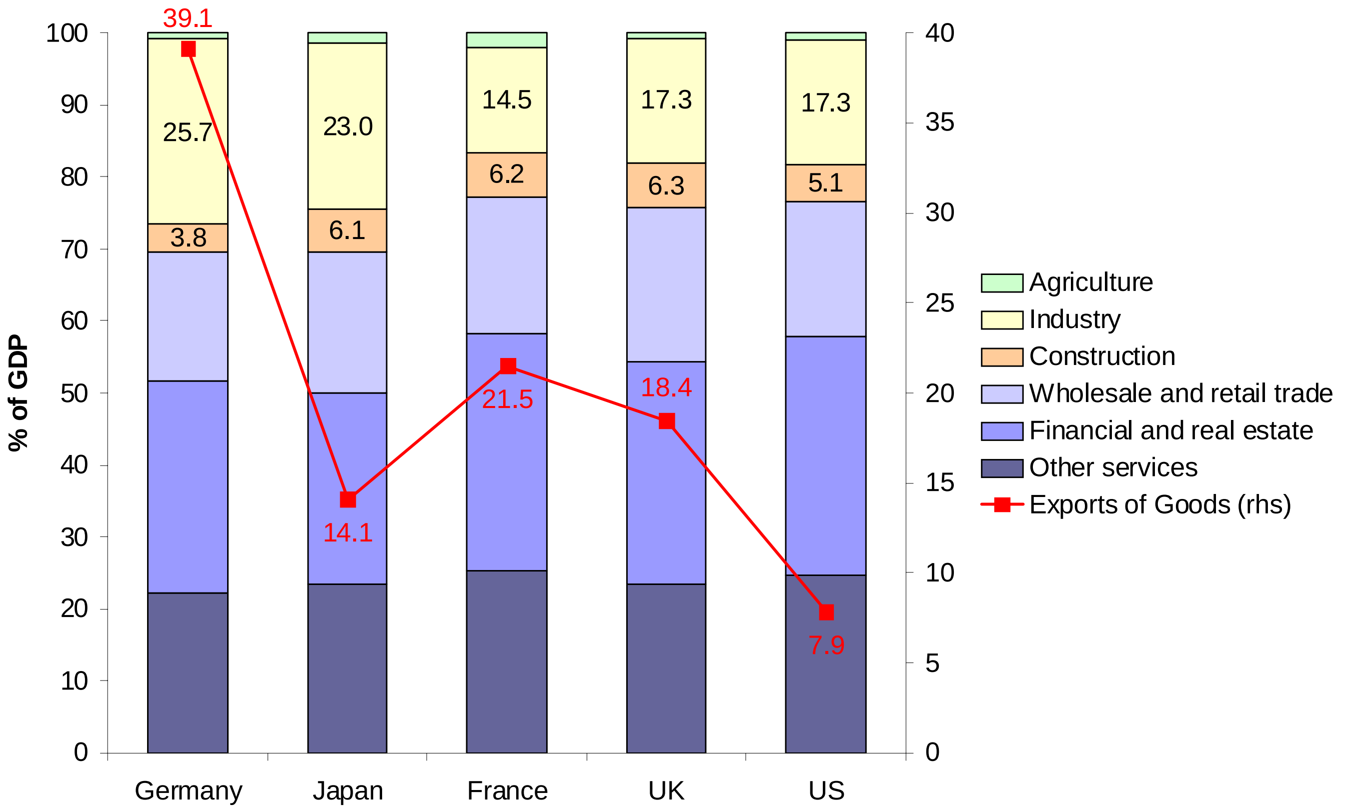
Domestic dependence on cyclical industry



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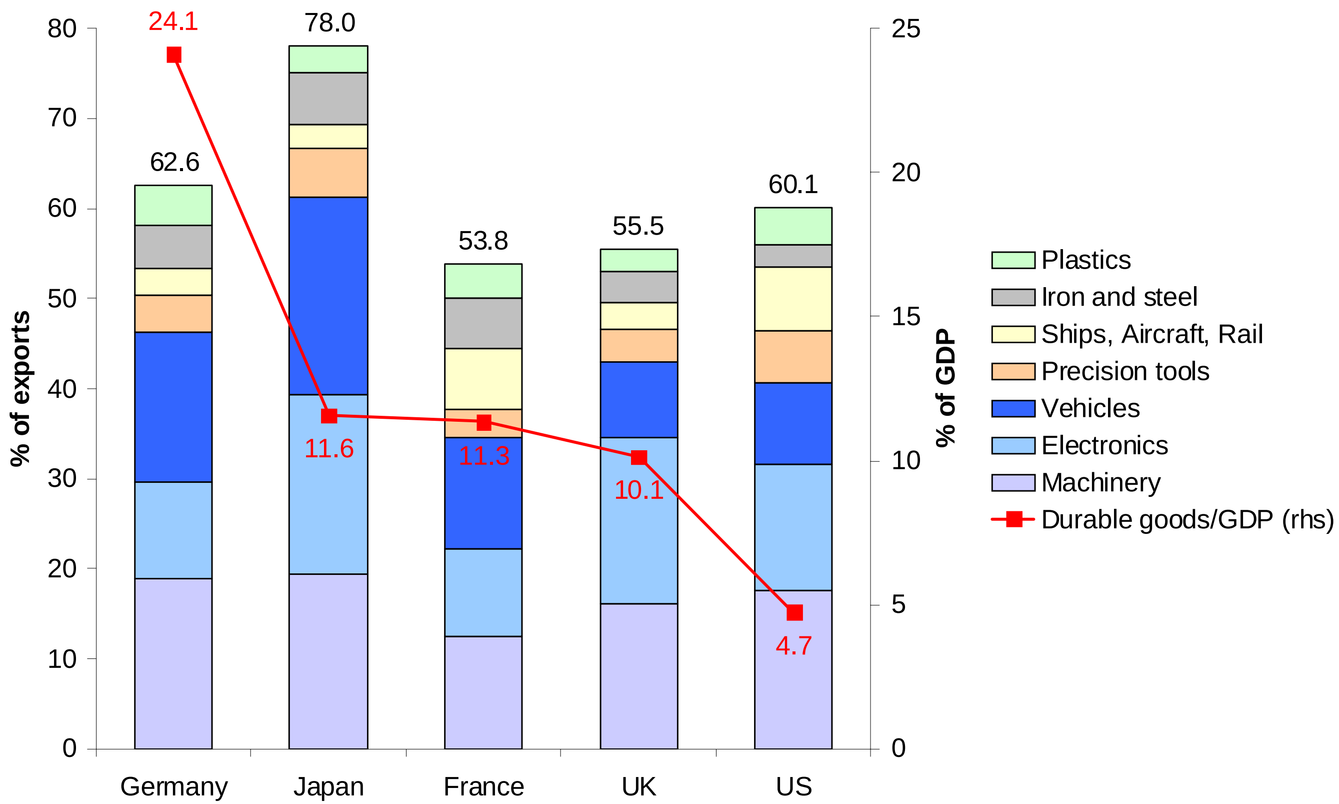
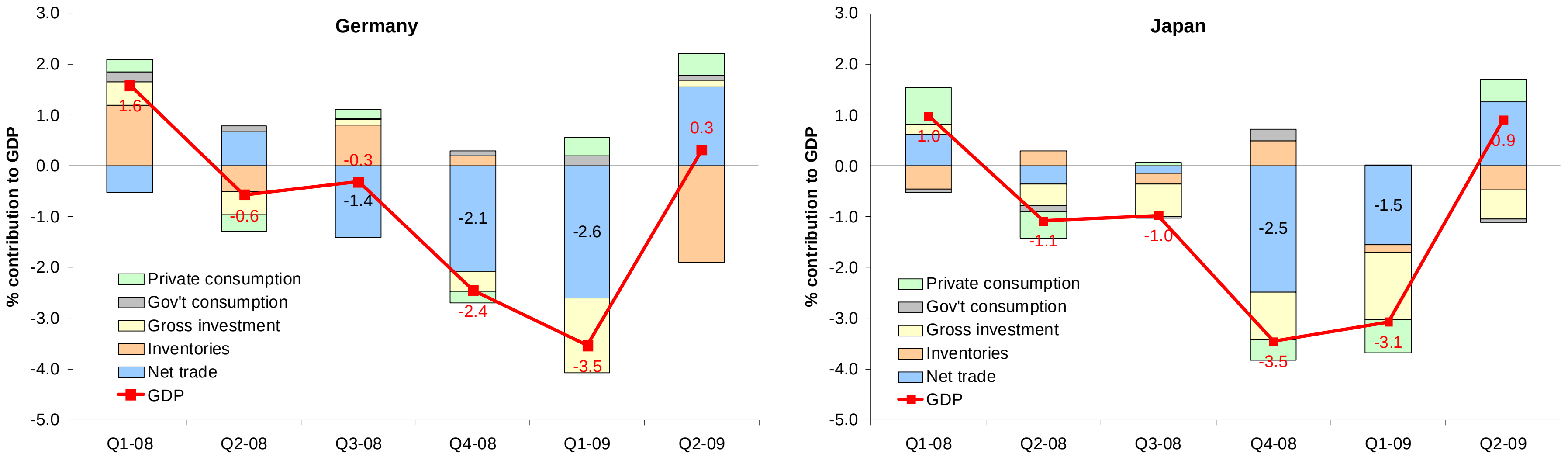
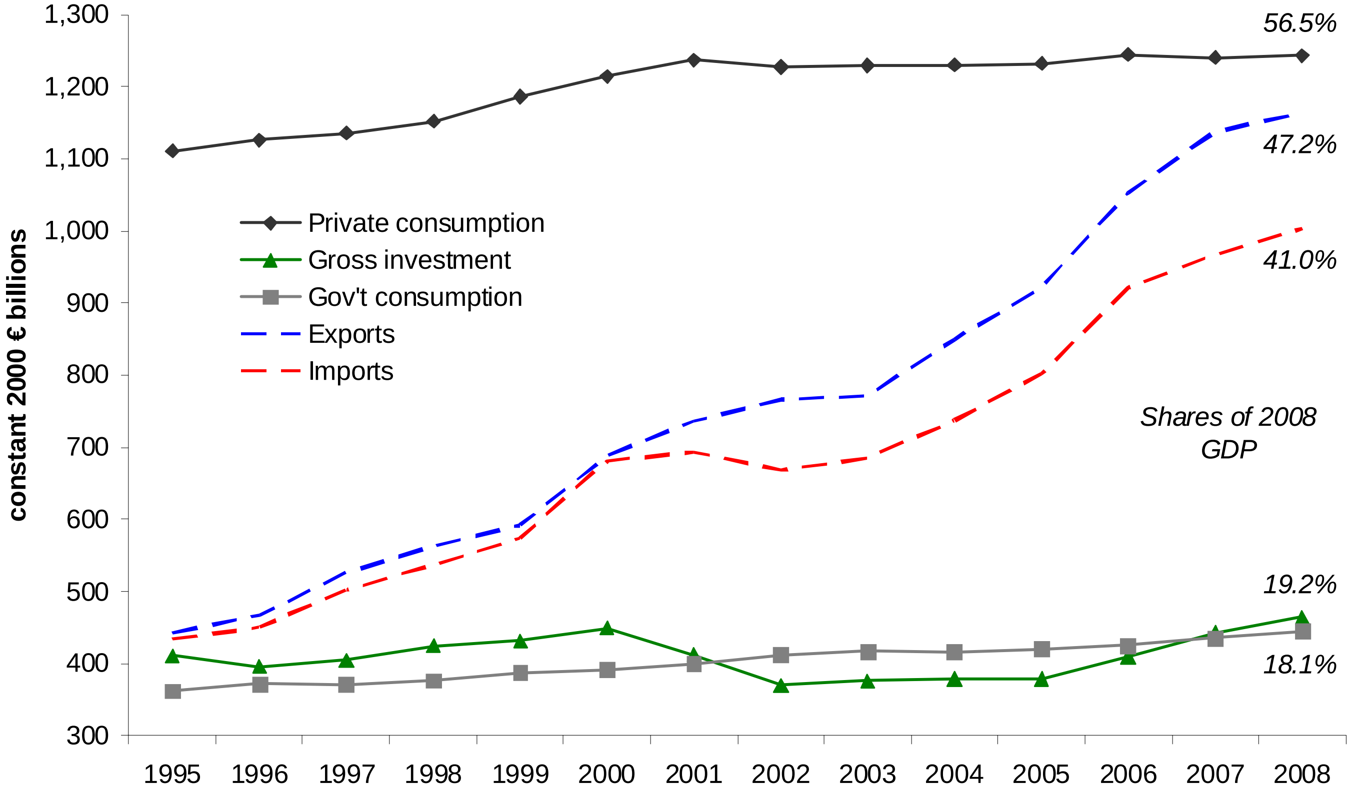
Foreign dependence on cyclical industry



Effect of cyclical trade in Germany and Japan



German trade dependency



Risk mitigation strategies?

- More financial provisioning to allow for cost of failures and cyclical disasters
- More fiscal and monetary policy flexibility?
- Avoid high risk growth strategies - such as heavy external debt financing
- New industrial policies: cannot afford banks too big to fail ...
- ... and cannot afford global scale industries too big to bail?