Impact of the US Subprime Crisis on the Global Economy and the Caribbean

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*The views expressed herein are those of the author and should not be attributed to the IMF, its Executive Board, or its management.
Outline

- Strains in financial markets →
- Weakening of global economic outlook →
- Impact on the Caribbean →
- Conclusions and policy recommendations →
The troubles started with a housing market correction—which is still underway...

U.S. and European House Price Inflation (Percent year-on-year)

Note: Europe ex-U.K.: unweighted average of Spain, Germany, Italy, Netherlands, Greece (from 1995), Ireland (from 1997).
... as mortgage delinquencies continue to rise

U.S. and U.K. Nonconforming Delinquencies by Mortgage Vintage Year
(In percent of original balance)

Note: U.K. delinquencies for 90+ days; U.S. delinquencies for 60+ days.
...and lending standards tighten.

Net Percentage of Banks Tightening Lending Standards

- Residential mortgages
- Commercial real estate

Source: Haver Analytics.
Aggregate potential losses from financial crisis estimated at US$ 945 billion

Comparison of Financial Crises

Note: U.S. subprime costs represent staff estimates of losses on banks and other financial institutions. All costs are in real 2007 dollars. Asia includes Indonesia, Malaysia, Korea, the Philippines, and Thailand.
Housing and financial market pressures are interacting to slow growth.

- Declining House Prices
  - Case-Shiller 10 cities index
  - Futures market prices

- IMF Financial Conditions Index
  - Real GDP; 12-month % change
  - Financial conditions index (Loan stds., LIBOR, HY spread, equities, ...)

- Re-pricing of Risks
  - High-yield bonds
  - High-yield CDS

Global economic outlook
Advanced economies are most affected by financial turbulence...

(Percent change)

Source: WEO
...but other countries will be affected, too...

<table>
<thead>
<tr>
<th>Recent Changes to Growth Outlook</th>
<th>Difference from</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current projections</td>
</tr>
<tr>
<td></td>
<td>2007</td>
</tr>
<tr>
<td>World</td>
<td>4.9</td>
</tr>
<tr>
<td>Advanced economies</td>
<td>2.7</td>
</tr>
<tr>
<td>Emerging and developing economies</td>
<td>7.9</td>
</tr>
</tbody>
</table>

Source: World Economic Outlook, IMF
...and the balance of risk to global growth remains *tilted* to the downside.
Caribbean stock markets saw little impact from the financial turbulence...

Stock Prices
(In percent change; local currency) 1/

July 1, 2007 - April 11, 2008

Impact on the Caribbean
...although sovereign spreads on internationally traded bonds have risen.

Emerging Market Sovereign and U.S. High Yield Spreads (Basis points)

Sources: Bloomberg; and Datastream.
The banking systems in the region are well capitalized and profitable...

**Financial Soundness Indicators, end-2006**

<table>
<thead>
<tr>
<th></th>
<th>Capital Adequacy</th>
<th>NPLs/Total Loans</th>
<th>Return on Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECCU 1/</td>
<td>19.2</td>
<td>6.1</td>
<td>2.6</td>
</tr>
<tr>
<td>Bahamas</td>
<td>33.9</td>
<td>4.2</td>
<td>4.0</td>
</tr>
<tr>
<td>Barbados 2/</td>
<td>10.8</td>
<td>2.9</td>
<td>2.3</td>
</tr>
<tr>
<td>Jamaica</td>
<td>16.1</td>
<td>2.2</td>
<td>3.5</td>
</tr>
<tr>
<td>Trinidad and Tobago</td>
<td>18.0</td>
<td>1.1</td>
<td>2.2</td>
</tr>
</tbody>
</table>

1/ Based on end-2007 data.
2/ Preliminary data as of September 2007.
...and the recent credit expansions have been funded largely through domestic deposits.

### Contributions to Private Sector Credit Growth (in Percent), 2005-07 1/

<table>
<thead>
<tr>
<th>Private sector credit growth, total</th>
<th>of which: contributions from</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Private deposits</td>
</tr>
<tr>
<td>ECCU</td>
<td>16.5</td>
</tr>
<tr>
<td>Bahamas, The</td>
<td>13.8</td>
</tr>
<tr>
<td>Barbados</td>
<td>13.2</td>
</tr>
<tr>
<td>Jamaica</td>
<td>24.2</td>
</tr>
<tr>
<td>Trinidad and Tobago</td>
<td>22.1</td>
</tr>
</tbody>
</table>


1/ Computed as simple average over the period. Data for Jamaica and Barbados for 2007 are for end-November.
Canadian banks with representation across the region dominate the system...

*The Royal Bank of Trinidad and Tobago is in the process of being acquired by the Royal Bank of Canada.*
...but have been relatively protected from losses thus far.

### Global Bank Losses, as of March 2008

(In billions of U.S. dollars)

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Total Reported Losses</th>
<th>Remaining Subprime-Related Losses Expected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>80</td>
<td>43</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>19</td>
<td>22</td>
</tr>
<tr>
<td>United States</td>
<td>95</td>
<td>49</td>
</tr>
<tr>
<td>Canada</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Asia</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>GCC</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>193</strong></td>
<td><strong>95</strong></td>
</tr>
</tbody>
</table>

Sources: Goldman Sachs; UBS; and IMF staff estimates.
But financial risks remain...

- Challenges of consolidated and cross-border supervision
- Regulatory weaknesses in non-bank financial sector
- Inadequate reporting and disclosure standards, including for off-balance sheet entities (as in many advanced economies)
- Exposure to sectors affected by the slowdown (real estate)
... and there are other channels for the financial crisis to affect the region.

- Tourism dependence →

- Reliance on FDI inflows →

- High levels of public debt in many countries →
Tourism will be adversely affected by slowing growth in advanced economies.
FDI inflows are sizable and could also be adversely affected.

Foreign Direct Investment in Percent of GDP, 2000-06

Source: World Economic Outlook, IMF.
1/ Computed as a simple average of six IMF member countries.
High public debt exposes countries to liquidity pressures and constrains fiscal space.

Public Debt in Percent of GDP, end-2006

Source: World Economic Outlook; and Fund staff calculations.
Policy Recommendations for Financial Supervisors Around the Globe

- Review financial institutions’ public disclosure standards
- Improve access to information to assess health of individual institutions
- Provide clearer guidance on risk transfer and capital requirements for off-balance sheet entities
- Improve cross-border information sharing and coordination among regulators
- Establish contingency plans and conduct “fire drills” to prepare for liquidity crises
Conclusions and Policy Recommendations for the Caribbean

Notwithstanding resilience thus far, challenges lie ahead

Strong coordination between fiscal, monetary, and incomes policy will be crucial to:

- preserve debt sustainability
- support the most vulnerable groups
- contain second-round effects on inflation
Issues for Discussion

- Do participants agree with the identified risks and channels of transmission?
- Are there additional channels?
- How should policy makers balance the risk to stability (financial and social), growth, and inflation?
Thank you!