MEMU Supplement No.10-2008

International financial crisis: black September

In August 2008 global financial markets were relatively stable after a year in calamity. However, financial crisis went into the new phase in September. Two giant mortgage guarantee and financing companies – Fannie Mae and Freddie Mac – were taken into conservatorship by the U.S. government, while it became an ultimate guarantor for trillions worth of mortgages. Big Five investment banks ceased to exist as such through either mergers or transformation to commercial banks. After collapse of important players market confidence was shaken and obtaining financing became very difficult even for traditionally rock-solid corporations. Under tight credit U.S. economic prospects became increasingly bleak.

To alleviate the crisis, the U.S government made available up to USD 2 trillion in financing including USD 700 bn for buying bad securities from financial sector, USD 300 bn in guarantees for sub-prime mortgages, USD 85 bn for AIG insurance and finance company, USD 200 bn for Fannie Mae and Freddie Mac, and about USD 1 trillion from Federal Reserve to primary dealers, U.S. banks and foreign central banks. These funds may be sufficient to resolve liquidity crunch and soften the hard landing for the economy. But this may also become the next step in U.S. decline as financial superpower.

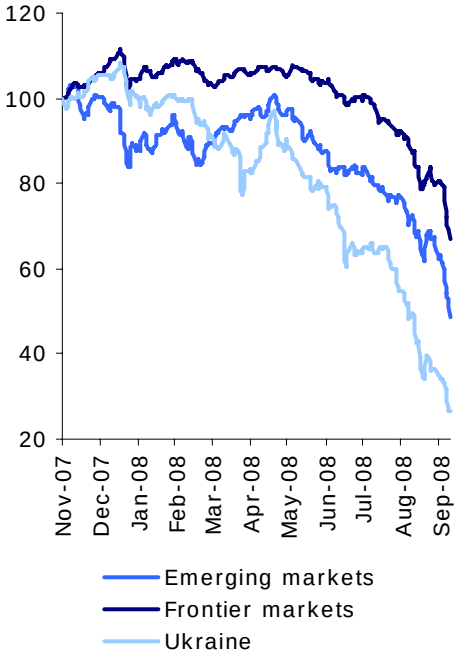
Globalization of financial markets caused U.S. troubles to spill over on the other side of Atlantics. Liquidity problems caused European central banks to inject large amounts of funds into the market. Several large bank failures in the EU prompted a number of EU governments to increase depositor protection. This had an unintended consequence of the flight to safety with deposits moving to banks with larger government protection, exacerbating the problems in the EU banking sector. Thus, the EU economy may also expect hard time under liquidity crunch.

Flight to safety, liquidity problems in developed markets and increased likelihood of economic problems caused capital outflows from emerging markets. According to EPFR Global in the three quarters of 2008 emerging markets funds lost USD 32.5 bn in outflows as compared to USD 20.6 bn inflow in the same period a year ago. MSCI emerging markets stock index lost 27.6% in its worst quarter ever wiping out USD 1.3 trillion in capitalisation. However companies and major investors in emerging markets remain cautiously optimistic about their outlook in the next two to five years.

The Ukrainian stock market suffered one of the worst declines in the world along with Chinese and Russian markets. But as even in its heyday in 2007 it remained very thin, the crash had no major impact on the economy. Banking system so far continues business as usual, but limited external financing has already constrained loan issuance. Continued liquidity constraints will contribute to slowdown in consumer and investment demand as credits will be expensive and limited. Economic slowdown of Ukraine's main trade partners and dropping world commodity prices may also adversely affect the Ukrainian economic growth. This may add to banks' problems as credit non-returns are likely to increase. In the extreme case several large banks may turn to state support to stay afloat denting the confidence in banking system and hindering sector's future development. Yet other important question for Ukraine is how the large current account deficit will be financed. Flight to safety is likely to dry out the foreign capital inflow in the country, exerting the devaluation pressure on hryvnia.

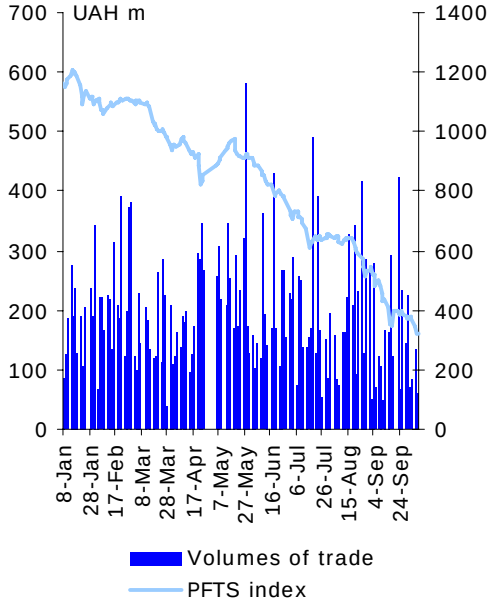
Financial crisis also may have some positive consequences for Ukraine's economy. Economic problems in the EU may force some emigrant workers to return increasing labour supply, limiting wage growth and somewhat expanding output. Weak demand may result in lower inflation. Thus, while economic growth is likely be slower and financial sector faces liquidity problems after global financial crisis, labour market may become less tight and inflation slower. Decrease in emigration and low inflation may last even after the financial crisis has long passed.

MSCI emerging markets indices



Source: MSCI Barra

Volumes of trade and PFTS index in 2008



Source: PFTS

Authors:
Alla Kobylyanska
Vitaliy Kravchuk
Institute for Economic
Research and Policy Consulting

Quarterly trends

National accounts		Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08
GDP	UAH bn	97.5	119.4	123.6	105.4	124.1	150.4	157.7	137.6	165.1	197.4	212.8	186.6	239.7
GDP (real)	% yoy	3.4	1.4	1.7	4.1	6.8	6.9	9.5	8.9	8.6	6.2	7.4	6.5	...
Households consumption (real)	% yoy	17.7	17.0	17.1	20.2	18.2	11.8	9.9	14.7	15.5	15.2	19.0	22.0	...
State consumption (real)	% yoy	0.0	1.0	4.0	9.6	5.8	5.8	1.0	0.8	6.2	4.4	2.4	1.0	...
Gross fixed capital formation (real)	% yoy	-0.5	0.2	0.3	19.9	19.3	17.9	18.3	24.4	23.5	18.9	23.8	14.7	...
Exports of goods and services (real)	% yoy	-14.0	-12.7	-15.5	-14.9	-9.6	3.2	1.0	4.9	5.2	0.1	5.6	0.9	...
Imports of goods and services (real)	% yoy	3.2	3.9	-0.9	10.7	0.9	8.3	6.4	12.9	19.6	13.7	27.2	20.2	...
Agriculture, hunting, forestry (real)*	% yoy	8.3	2.6	-7.2	3.8	2.8	-5.6	8.1	4.8	6.8	-9.3	7.1	0.4	...
Manufacturing industry (real)*	% yoy	1.8	-1.1	2.0	-1.5	6.1	7.3	7.2	15.0	13.2	13.1	4.4	8.7	...
Construction (real)*	% yoy	-11.3	-8.5	-7.5	0.1	0.8	1.4	4.2	13.3	8.2	12.7	5.8	-1.5	...
Trade, repair services (real)*	% yoy	-10.7	-11.7	-11.9	6.2	16.4	20.0	21.9	14.3	17.5	25.3	15.0	15.7	...
Transport (real)*	% yoy	5.7	2.8	7.8	4.9	7.7	9.4	5.3	7.0	5.6	8.0	10.2	10.1	...
Balance of payments														
Current account balance	USD bn	0.6	0.4	-0.1	-0.8	0.0	0.5	-1.4	1.2	-0.8	-0.5	-3.5	-3.6	-2.8
Current account balance	% of GDP	3.2	1.7	-0.4	-3.7	0.0	1.7	-4.3	4.4	-2.4	-1.2	-8.1	-9.6	-7.9
Trade balance in goods	USD m	-236	-1131	-788	-1353	-935	-884	-2022	-1735	-1701	-2684	-4452	-4321	-3562
Trade balance in services	USD m	392	1035	191	219	506	1054	347	103	512	1689	392	261	526
Current transfers	USD m	694	745	780	622	790	851	910	825	968	1099	1183	966	957
Direct investment (FDI)	USD m	365	477	6474	1053	1389	1636	1258	1709	1934	3927	1648	2387	3083
Portfolio investments	USD m	923	90	1347	4	-141	370	3350	1816	1477	517	1844	225	129
Gross international reserves	USD bn	13.1	14.3	19.4	17.3	17.6	19.1	22.3	23.5	25.6	30.6	32.5	33.2	35.5
Exchange rate(market), UAH/USD	aop	5.08	5.00	5.02	5.06	5.02	5.02	5.03	5.04	5.02	5.01	5.04	5.03	4.79
Exchange rate(official), UAH/USD	aop	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	4.96
Fiscal indicators														
Consolidated fiscal revenues	% of GDP	35.1	31.5	31.0	31.2	31.7	31.9	32.8	33.3	32.8	30.8	31.1	32.5	41.5
Personal income tax	% of GDP	4.4	3.9	4.2	4.4	4.6	4.1	4.1	5.1	5.3	4.9	4.8	5.1	6.7
Enterprise profits tax	% of GDP	5.9	5.3	6.3	3.4	4.6	4.3	6.7	3.8	4.1	4.1	6.4	4.1	5.1
Value-added tax	% of GDP	9.2	7.9	7.3	9.2	9.2	9.7	9.3	10.4	9.8	8.7	7.6	10.5	14.4
Excise tax	% of GDP	2.0	2.0	1.7	1.8	1.7	1.5	1.5	1.8	1.7	1.6	1.3	1.5	1.7
Consolidated fiscal expenditures	% of GDP	36.4	28.1	41.7	30.9	32.8	29.4	36.6	28.4	31.0	29.6	36.7	29.5	41.0
Current expenditures	% of GDP	33.6	24.0	34.2	28.9	29.7	24.9	29.2	26.9	28.4	25.9	27.3	28.6	36.2
Capital expenditures	% of GDP	2.7	4.1	7.5	1.9	3.2	4.5	7.4	1.6	2.6	3.7	9.4	0.9	4.8
Consolidated fiscal balance	% of GDP	1.0	-5.0	6.2	-0.4	1.1	-2.4	4.0	4.7	1.7	1.2	-6.2	3.0	0.5
Privatisation receipts	% of GDP	0.6	0.6	16.0	0.1	0.1	0.1	0.1	0.5	0.5	0.3	0.4	0.1	0.1
Labour market														
Average wage (real)	% yoy	19.0	19.6	26.4	23.8	22.6	18.8	11.3	14.7	13.9	14.9	15.7	13.8	7.1
Household income (real)	% yoy	28.0	19.4	18.9	22.1	18.6	20.3	16.3	17.5	17.4	14.9	16.4	19.0	10.1
Unemployment rate (ILO methodology)	% cum	7.1	5.2	7.8	7.9	6.8	6.4	6.8	7.4	6.6	6.2	6.4	7.1	6.2
Banking system														
Monetary aggregate M0	% yoy cum	39.1	31.1	42.2	36.2	25.3	23.7	24.5	22.9	30.4	36.4	48.2	48.4	48.8
Monetary aggregate M2	% yoy cum	37.4	31.3	53.9	39.2	36.6	36.7	34.3	38.6	40.7	47.8	50.8	52.7	48.8
Household deposits in national currency	% yoy cum	31.6	30.4	90.8	54.6	41.1	39.7	37.3	50.7	56.3	64.8	71.9	68.8	68.2
Household deposits in foreign currency	% yoy cum	45.4	46.4	59.1	54.5	66.2	64.3	57.5	52.3	43.8	38.4	32.5	35.2	32.9
Com. bank credits in national currency	% yoy cum	32.6	43.4	58.7	59.8	53.7	49.0	52.3	52.4	57.2	60.7	72.7	81.2	70.7
Com. bank credits in foreign currency	% yoy cum	36.8	47.1	66.3	72.0	82.1	90.4	95.4	98.9	97.4	91.0	75.4	71.3	57.9
Long-term com. bank credits	% yoy cum	53.0	70.1	84.6	87.6	86.7	76.6	79.5	84.1	86.5	87.9	85.7	84.8	67.2
Long-term com. bank credits	% of total	56.1	59.7	61.8	63.1	63.4	63.5	64.9	65.8	67.3	68.2	69.2	69.1	68.6
Average lending rate on national cur. credits	% p.a.	15.4	15.4	16.4	15.8	15.5	14.6	15.1	14.0	13.9	13.7	14.0	14.6	17.3
Average lending rate on foreign cur. credits	% p.a.	11.0	11.3	11.7	11.5	11.3	11.3	11.5	11.5	11.4	11.3	11.1	10.8	11.4

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters IER estimates

* change in value added

Notes:

yoy year on year change **p.a.** per annum