

THE RECENT GLOBAL FINANCIAL CRISIS RECAP

Mohammed Al-Jafari
General Director
Jordan Deposit Insurance Corporation

2nd Seminar on Islamic Deposit Insurance, 5&6 Nov 2009, KL

The Presentation Will Address

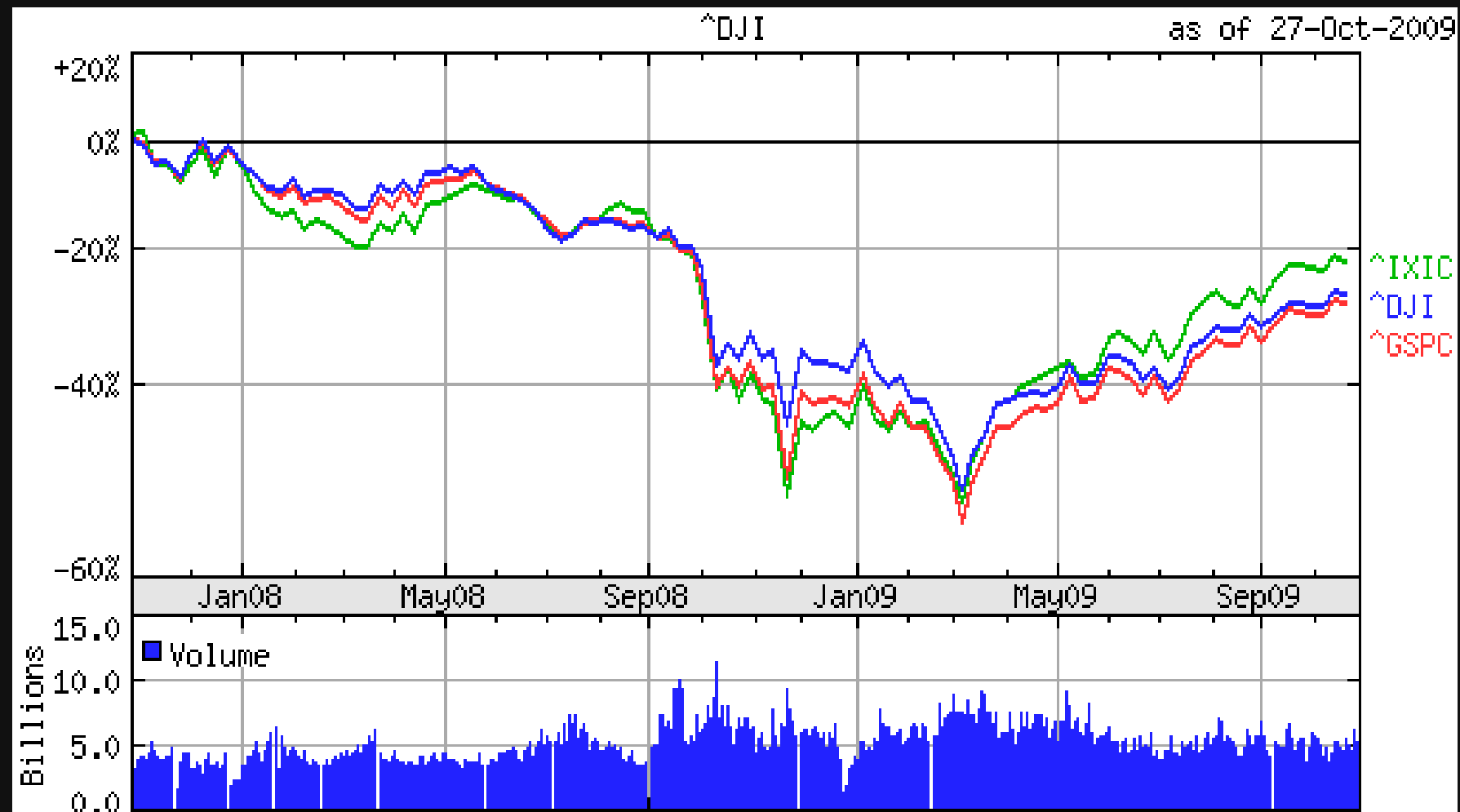
- *Latest Developments in the Financial Markets: Rebound or Recovery*
- *World Economic Outlook: Revisited*
- *The Origin of the Crisis*
- *Root Causes of Crisis*
- *The Scale of the Crisis*
- *Dealing with the Crisis*
- *Policy Measures Taken:*
 - Financial*
 - Prudential Regulations*
 - Monetary Policy*
 - Fiscal Policy*
 - Deposit Insurance*
- *Rebound or Recovery ???*
- *Challenges Ahead*
- *Conclusion*

Rebound or Recovery!

Is the Global Economy Emerging from its Deepest Postwar Recession?
Stock Markets record new levels in Oct.

- MSCI's all-country world stock index reached 294.41 last week , a level last seen in early October a year ago. The index was up 29 percent this year, with a more than 71 percent gain since hitting a six-year low in March the 9th.
- The Dow Jones industrials closed above 10,000 last week for the first time in a year
- Europe's Dow Jones Stoxx 600 index jumped 56 percent since March 9
- MSCI's emerging market equities index also rose, reaching its highest since late August 2008 above 965.
- The global equity rally has added about \$20 trillion to the value of stocks since this year's low on March 9

US Stock Market Performance (Dow Jones, NASDAQ and S & P 500)

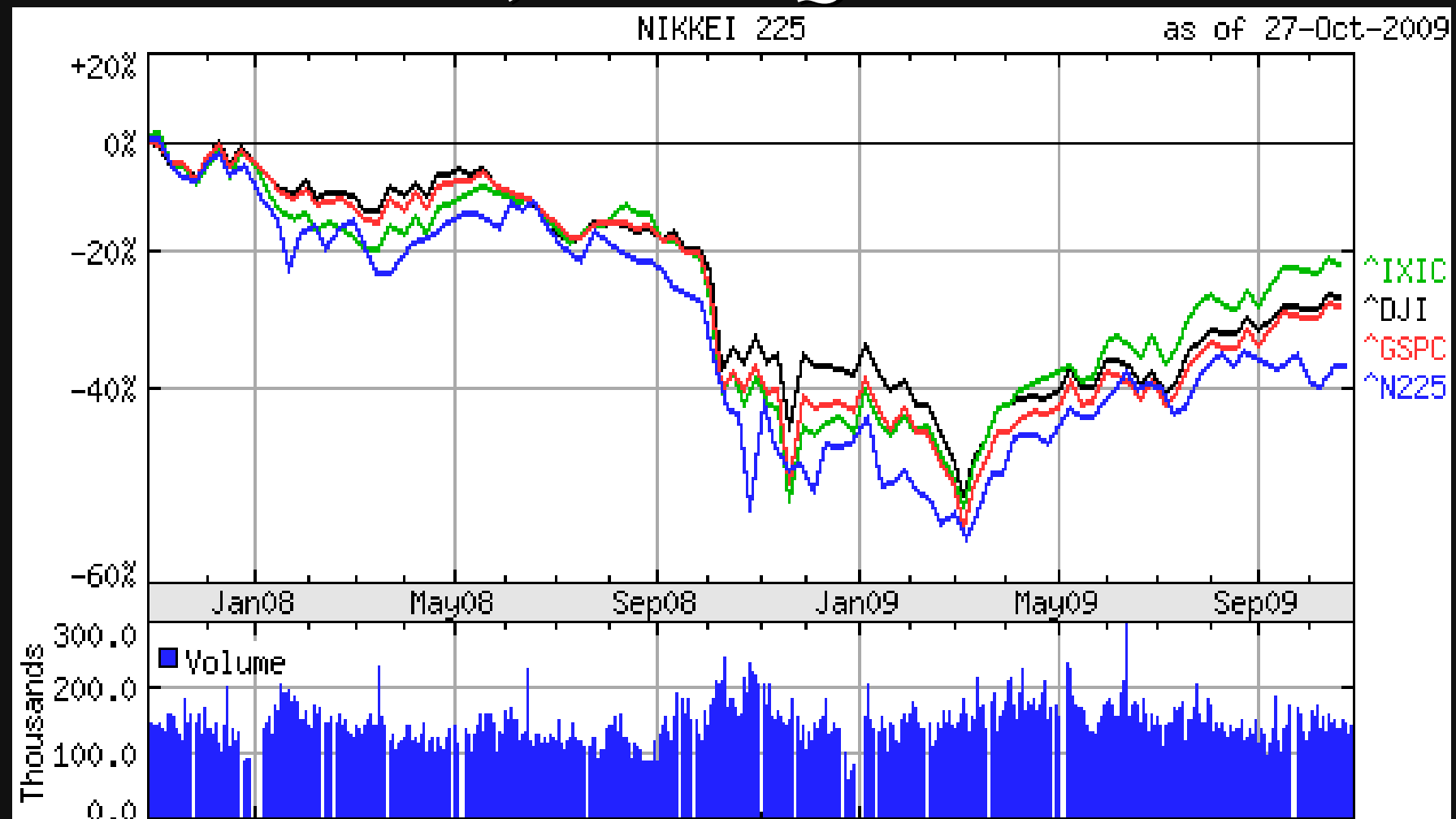


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NIKKEI 225, Dow Jones, NASDAQ and S&P 500

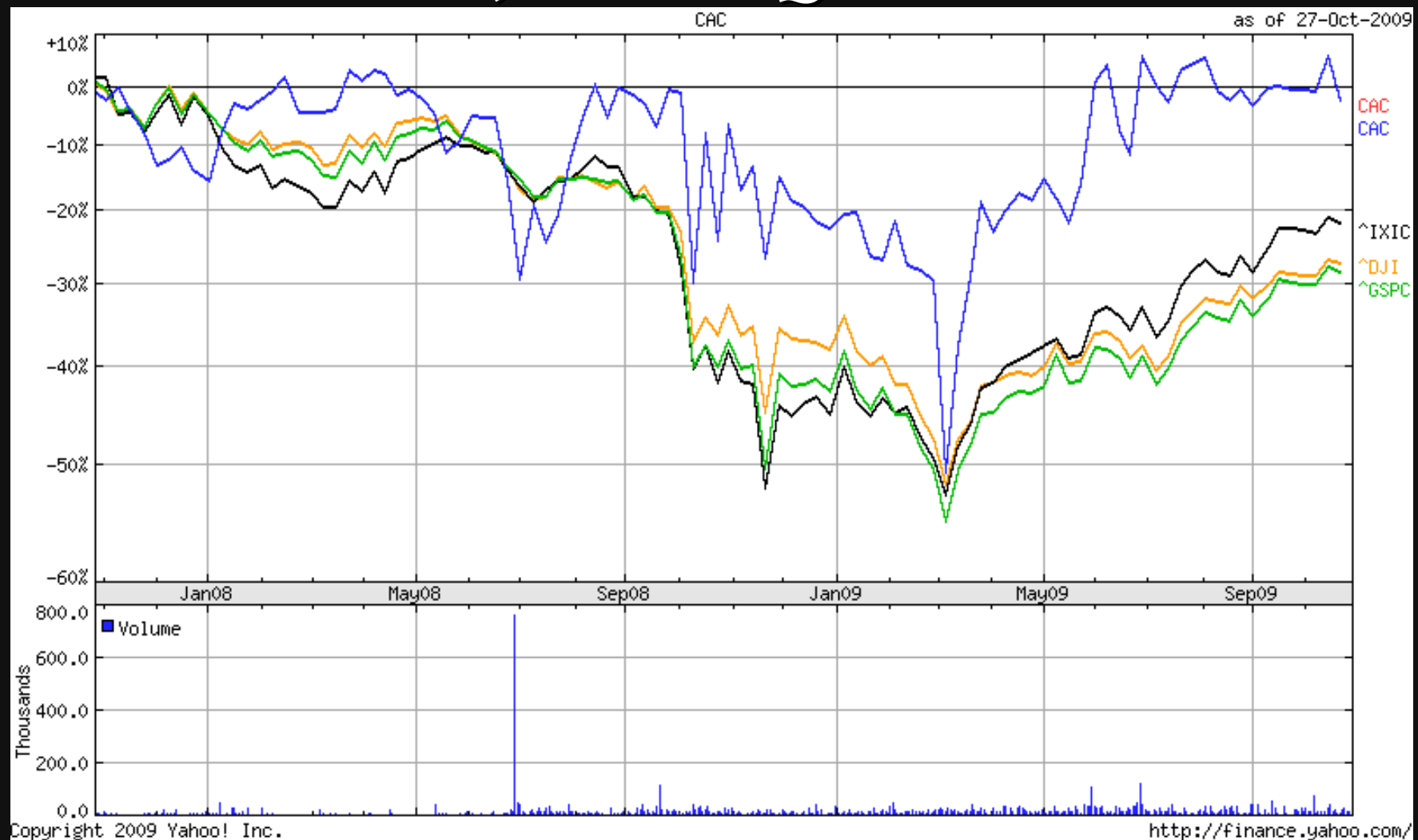


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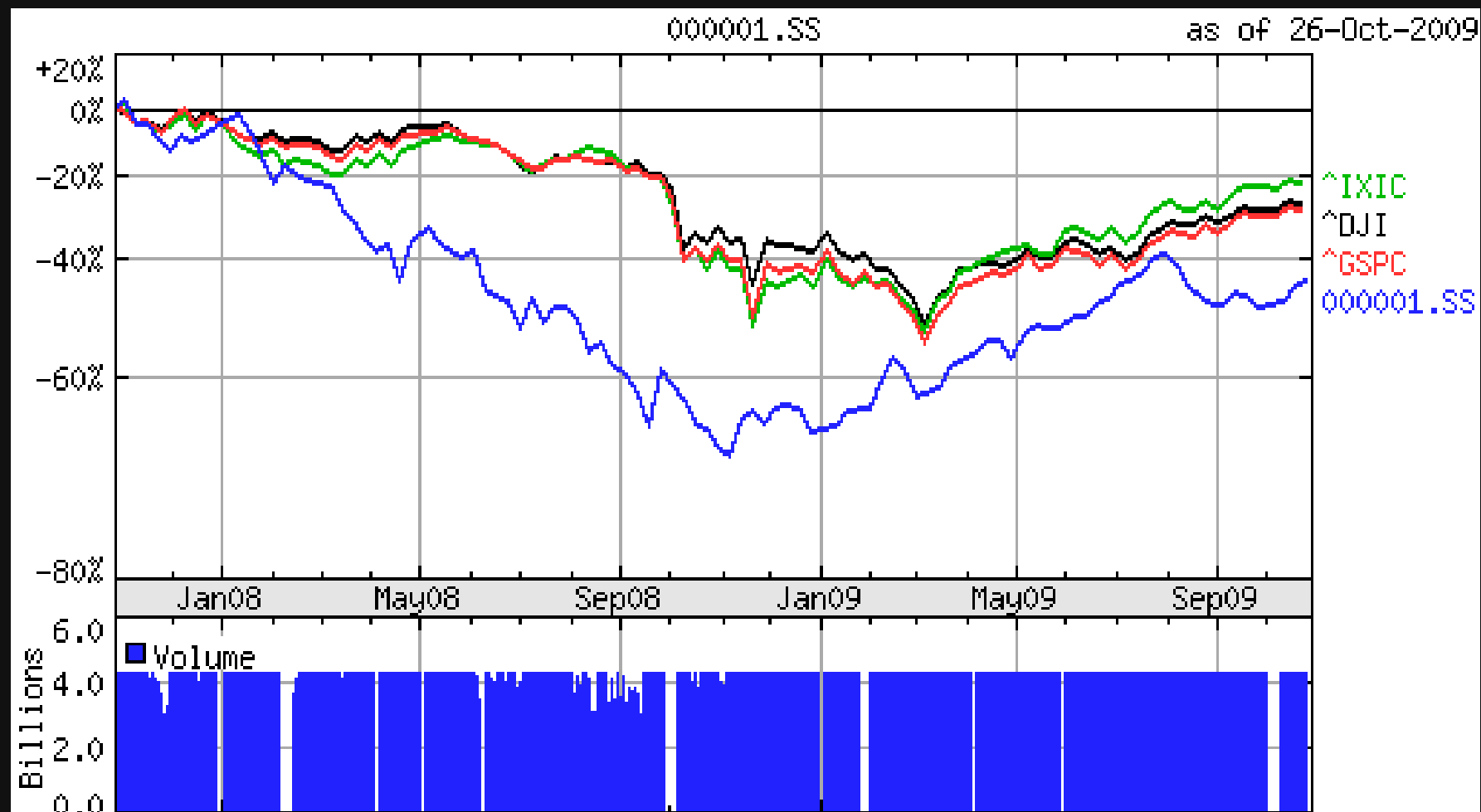
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CAC

Dow Jones, NASDAQ and S&P 500



Shanghai Composite Index Dow Jones, NASDAQ and S&P 500

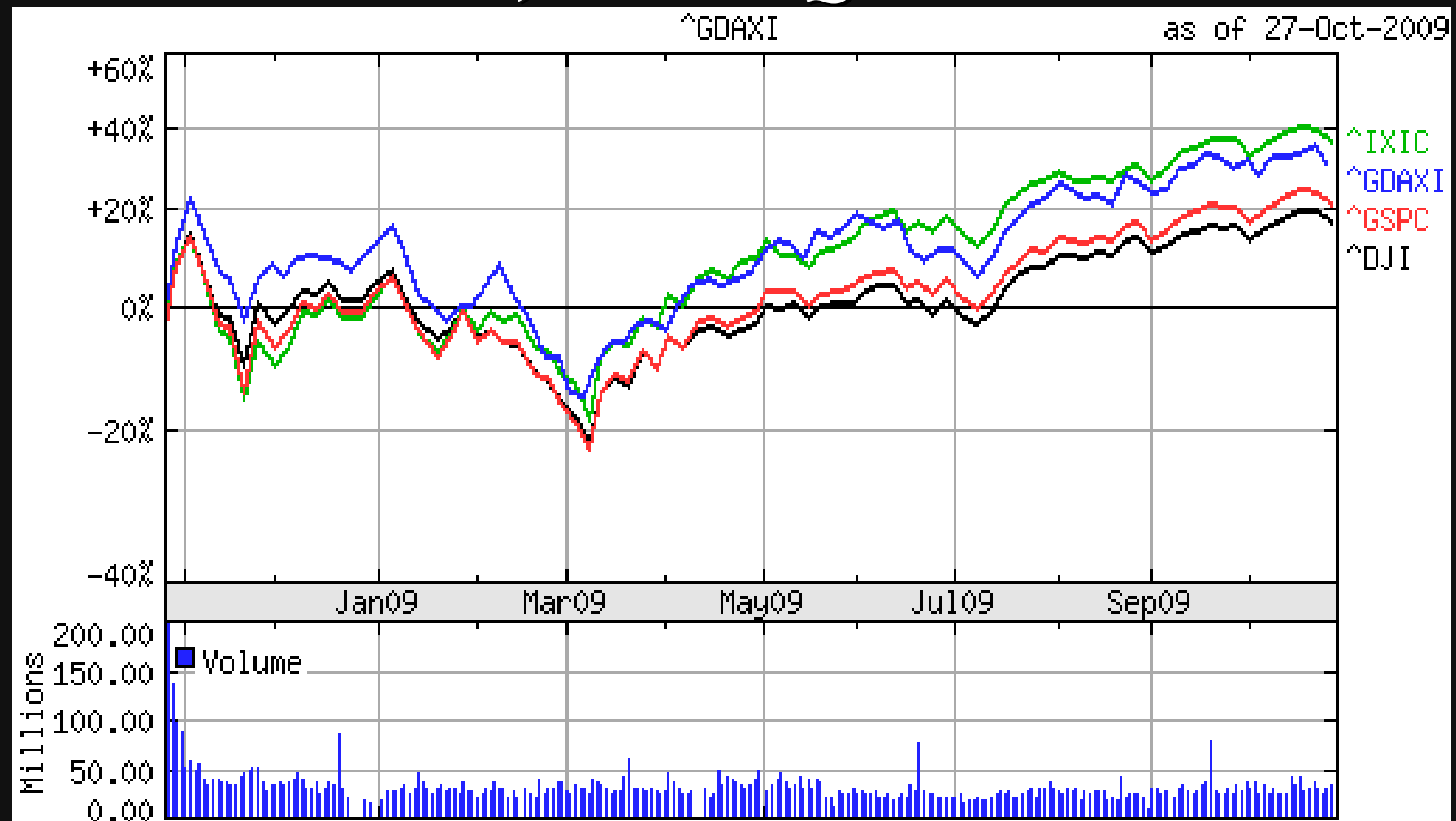


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DAX

Dow Jones, NASDAQ and S&P 500



Rebound or Recovery!

Real sector developments support the stock markets rebound:

- A rebound in manufacturing
- Turn in the inventory cycle
- Gradually stabilizing retail sales
- Returning consumer confidence
- Firmer housing markets.
- Several U.S. gauges of production are showing clear acceleration in activity
- Europe's manufacturing and services industries expanded more than initially estimated
- China's output gains were the fastest in almost a year
- India's industrial production rose the most in 22 months
- Pace of Chinese exports and imports slowed in September, boding well for China's recovery

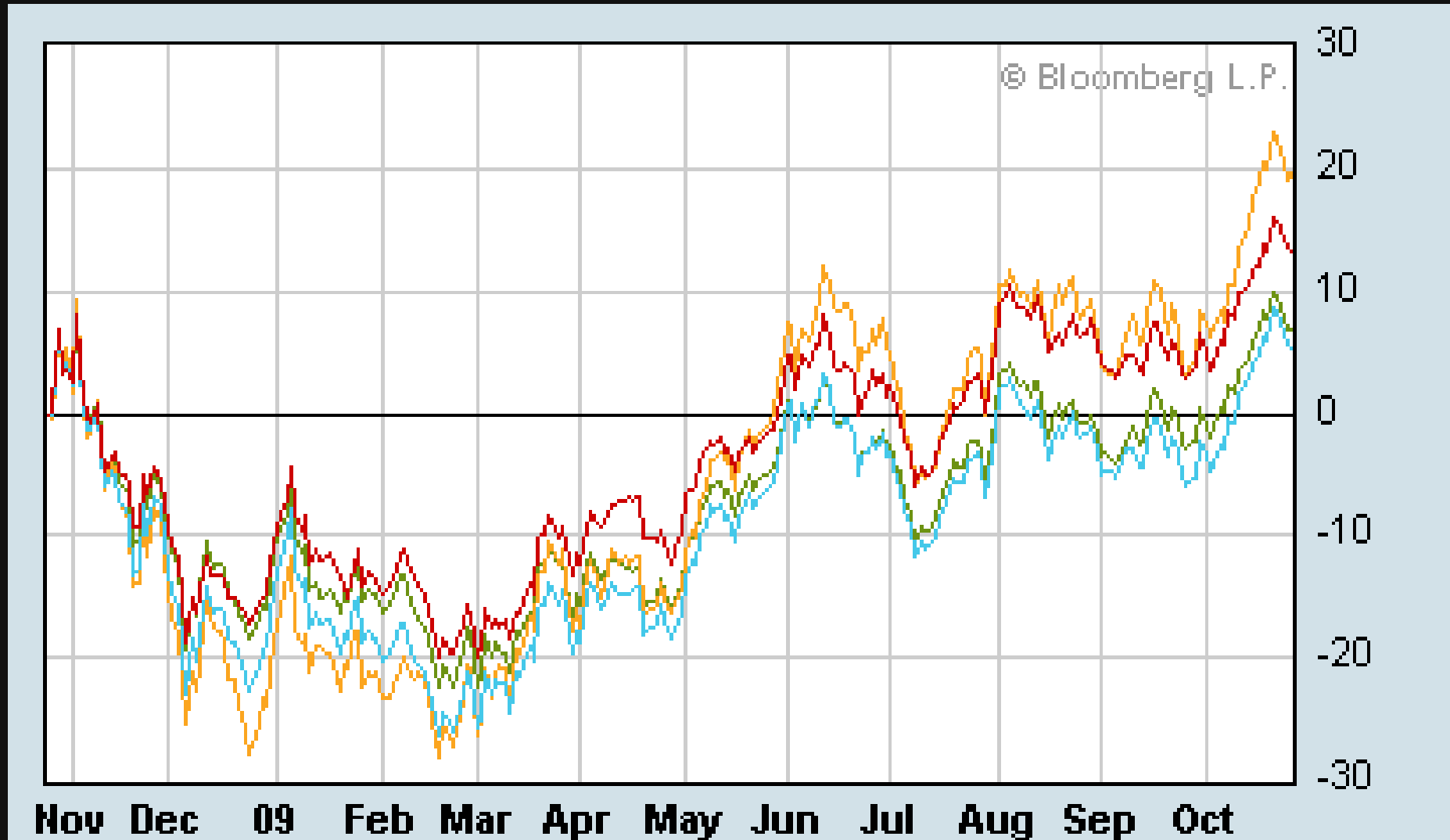
Rebound or Recovery!

Commodity prices have staged a comeback from lows reached earlier this year

- Oil rose to a 2009 peak close to \$82 a barrel
- Natural gas rose significantly
- Chinese copper imports in particular were a surprise, jumping 23 percent against an expected fall, pushing London copper futures to surge
- Basic food items reflects a clear increase in prices over the same month
- Gold hit a record above \$1,070 an ounce and the dollar hits 14-month lows against the euro

Commodity Future Indexes:

■ **UBS BLOOMBERG CMCI**, ■ **S&P GSCI**, ■ **RJ/CRB**
COMMODITY and ■ **ROGERS INTL**



World Economic Outlook: Revisited

- **The IMF World Economic Outlook (WEO) of September 22, 2009 indicates that: there is a recovery, but it will be weak by historical standards.**

According to the Report forecasts:

- Global growth is projected to reach about 3 percent in 2010, following a contraction in activity of about 1 (up from 1.3) percent in 2009
- During 2010–14, global growth is forecast to average just above 4 percent, appreciably less than the 5 percent growth rates in the years just ahead of the crisis

World Economic Outlook: Revisited

| | Difference from | | | | | | | | |
|--|-----------------|------------|-------------|------------|-----------------|------------|-------------|------------|------------|
| | Projections | | | | July 2009 | | Q4 over Q4 | | |
| | 2007 | 2008 | 2009 | 2010 | WEO Projections | Estimates | 2008 | 2009 | 2010 |
| World output | 5.2 | 3.0 | -1.1 | 3.1 | 0.3 | 0.6 | -0.1 | 0.8 | 3.2 |
| Advanced economies | 2.7 | 0.6 | -3.4 | 1.3 | 0.4 | 0.7 | -2.2 | -1.3 | 1.7 |
| United States | 2.1 | 0.4 | -2.7 | 1.5 | -0.1 | 0.7 | -1.9 | -1.1 | 1.9 |
| Euro area | 2.7 | 0.7 | -4.2 | 0.3 | 0.6 | 0.6 | -1.7 | -2.5 | 0.9 |
| Germany | 2.5 | 1.2 | -5.3 | 0.3 | 0.9 | 0.9 | -1.8 | -2.9 | 0.8 |
| France | 2.3 | 0.3 | -2.4 | 0.9 | 0.6 | 0.5 | -1.6 | -0.9 | 1.4 |
| Italy | 1.6 | -1.0 | -5.1 | 0.2 | 0.0 | 0.3 | -2.9 | -3.2 | 0.8 |
| Spain | 3.6 | 0.9 | -3.8 | -0.7 | 0.2 | 0.1 | -1.2 | -3.5 | 0.5 |
| Japan | 2.3 | -0.7 | -5.4 | 1.7 | 0.6 | 0.0 | -4.5 | -1.3 | 1.4 |
| United Kingdom | 2.6 | 0.7 | -4.4 | 0.9 | -0.2 | 0.7 | -1.8 | -2.5 | 1.3 |
| Canada | 2.5 | 0.4 | -2.5 | 2.1 | -0.2 | 0.5 | -1.0 | -1.5 | 3.0 |
| Emerging and developing economies ² | 8.3 | 6.0 | 1.7 | 5.1 | 0.2 | 0.4 | 3.3 | 3.8 | 5.5 |
| Developing Asia | 10.6 | 7.6 | 6.2 | 7.3 | 0.7 | 0.3 | 5.5 | 7.7 | 7.8 |
| China | 13.0 | 9.0 | 8.5 | 9.0 | 1.0 | 0.5 | 6.9 | 10.1 | 9.2 |
| India | 9.4 | 7.3 | 5.4 | 6.4 | 0.0 | -0.1 | 4.8 | 5.1 | 7.0 |
| ASEAN-5 ³ | 6.3 | 4.8 | 0.7 | 4.0 | 1.0 | 0.3 | 1.9 | 2.8 | 3.8 |
| Middle East | 6.2 | 5.4 | 2.0 | 4.2 | 0.0 | 0.5 | ... | ... | ... |
| Western Hemisphere | 5.7 | 4.2 | -2.5 | 2.9 | 0.1 | 0.6 | ... | ... | ... |
| Brazil | 5.7 | 5.1 | -0.7 | 3.5 | 0.6 | 1.0 | 1.2 | 2.2 | 3.5 |
| Mexico | 3.3 | 1.3 | -7.3 | 3.3 | 0.0 | 0.3 | -1.7 | -4.1 | 3.4 |

The Origin of the Crisis

- The collapse of the US sub-prime mortgage market
- The reversal of the housing boom in other industrialized economies
- Other weaknesses in the global financial architecture have surfaced: Banks borrowed more money to lend out so they could create more securitization
- Some investment banks like Lehman Brothers got into mortgages, buying them in order to securitize them and then sell them on.



Creating More Risk by Trying to Manage Risk

- Securitization was an attempt at managing risk
- Legitimate insurance against risk and problems
- Derivatives “financial innovations” market, make buying and selling of risk on the open market possible in ways never seen before
- The market for credit default swaps exceeded the entire world economic output of \$50 trillion by summer 2008
- Hedge fund managers and bankers fool themselves into thinking they are safe despite being on high ground

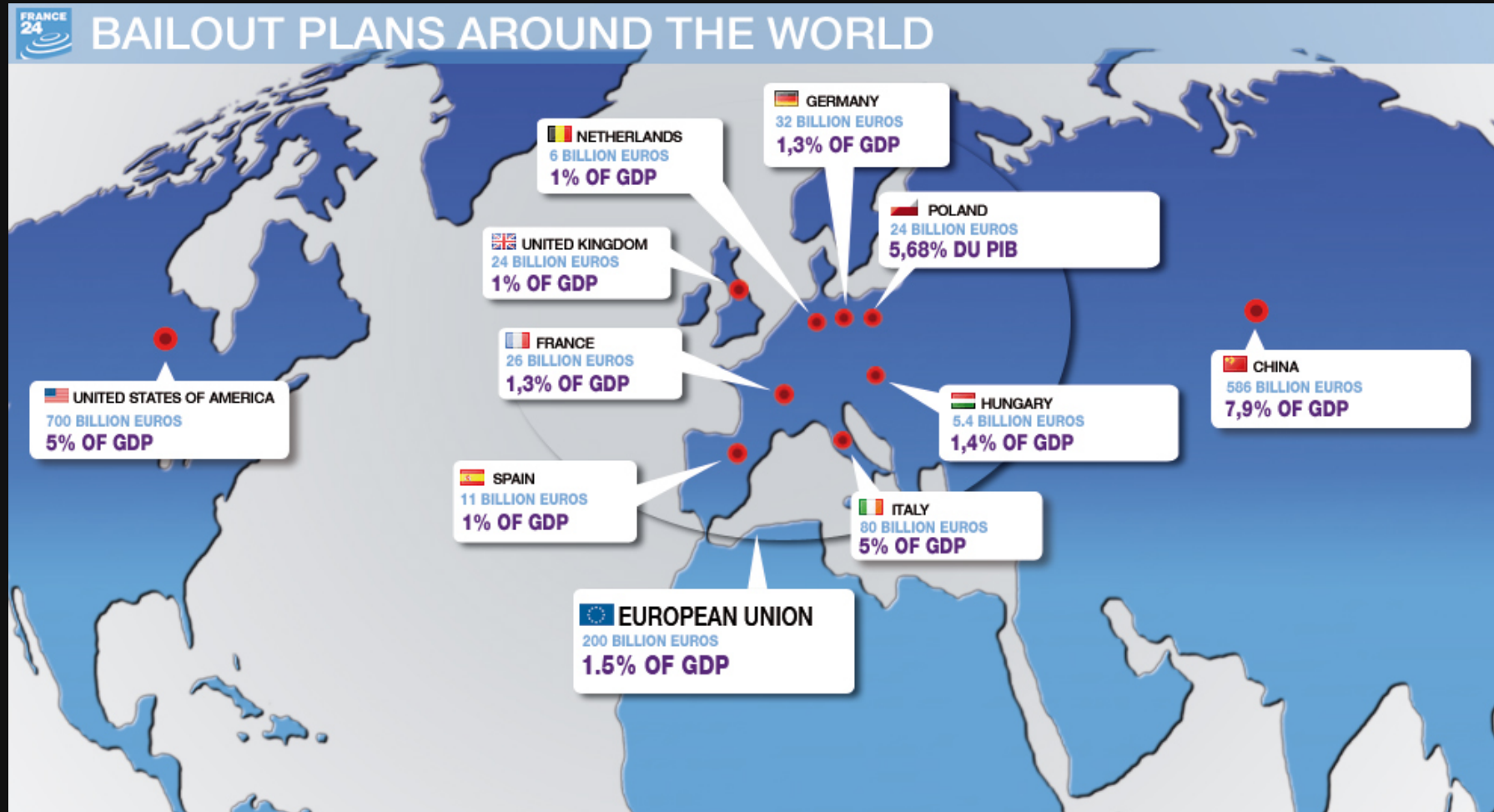
Root Causes of Crisis:
***Declaration of the G20 Summit on Financial
Markets and the World Economy (November 15, 2008)***

- Market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence.
- Weak underwriting standards
- Unsound risk management practices
- Increasingly complex and opaque financial products
- Consequent excessive leverage
- Inconsistent and insufficiently coordinated macroeconomic policies
- Inadequate structural reforms

The Scale of the Crisis

- Largest financial institutions have collapsed
- Others have been bought out by their competitors at low prices
- Governments of the wealthiest nations in the world have resorted to extensive bail-out and rescue packages for the remaining large banks and financial institutions
- \$14.5 trillion, or 33%, of the value of the world's companies has been wiped out
- US alone planned to spend more than \$ 9.7 trillion in bailout packages and plans
- The UK and other European countries have also spent some \$2 trillion on rescues and bailout packages

Dealing with recession



Dealing with Crisis:
Declaration of the G20 Summit on Financial
Markets and the World Economy (November 15, 2008)

- Continue our vigorous efforts and take whatever further actions are necessary to stabilize the financial system.
- Recognize the importance of monetary policy support, as deemed appropriate to domestic conditions
- Use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability
- Help emerging and developing economies gain access to finance in current difficult financial conditions, including through liquidity facilities and program support.
- Strengthening Transparency and Accountability
- Enhancing Sound Regulation
- Promoting Integrity in Financial Markets
- Reinforcing International Cooperation
- Reforming International Financial Institutions

Communiqué from the G20 London Summit (April 2nd, 09)

We have (the leaders) today therefore pledged to do whatever is necessary to:

- restore confidence, growth, and jobs;
- repair the financial system to restore lending;
- strengthen financial regulation to rebuild trust;
- fund and reform our international financial institutions to overcome this crisis and prevent future ones;
- promote global trade and investment and reject protectionism, to underpin prosperity; and
- build an inclusive, green, and sustainable recovery.
- By acting together to fulfill these pledges we will bring the world economy out of recession and prevent a crisis like this from recurring in the future.

Policy Measures Taken: Financial

- Supporting Inter-bank Lending
- New Lending Programs
- Capital Injection Programs
- Blanket Coverage for Customers Deposits
- Top-up of Existing Deposit Guarantee Scheme
- Loan Guarantees
- Guarantees of Bank Bond Issuance
- Troubled Asset Relief
- Nationalization and Recapitalization Using Public Funds

Policy Measures Taken: Prudential Regulations

- Revisions to Supervisory Guidelines
- Improving Transparency
- Enhancing Risk Management and Disclosure by Financial Institutions
- Improving the Regulatory Framework for Credit-Rating Agencies
- Early Warning System
- Prompt Corrective Action (PCA)
- Stress Testing

Policy Measures Taken: Monetary Policy

- Exceptionally Large Interest Rate Cuts
- Unconventional Measures to Inject Liquidity and Sustain Credit
- Expanding Central Banks Balance Sheet by Adopting Unconventional Policy Actions to Support the Extension of Credit

Policy Measures Taken: Fiscal Policy

- Major Fiscal Stimulus Programs,
- Tax Cuts (VAT, General Sales, Income Tax)
- Initiating New Infrastructure Investments
- Unprecedented levels of budget deficits worldwide

Policy Measures Taken: Deposit Insurance

- 46 Jurisdictions adopted some form of enhanced depositors protection
- Full depositor guarantee or blanket coverage were provided in 18 jurisdictions
- 7 jurisdictions increased deposit insurance level on a temporary basis.
- 21 jurisdictions (18 from Europe) increased permanently their deposit insurance coverage limit.

Policy Measures Taken: Deposit Insurance

Amendments to EU Directives Related to Deposit Insurance

- To maintain depositor confidence and to attain greater financial stability on the financial markets, the minimum coverage limit should therefore be increased to EUR 50,000. (By 30 June 2009)
- By Dec. 2010, coverage limit should be set at EUR 100,000.

Rebound or Recovery???

- Policy measures taken have reduced uncertainty and increased confidence, fostering an improvement in financial conditions
- The Bloomberg Professional Global Confidence Index increased to a record 61.7 from 58.54 in September.
- The index exceeded 50 for a third month, which means there were more optimists than pessimists.
- Financial and asset markets are rising and that's having positive wealth effects and helping confidence come back a bit stronger worldwide but the real sector has long way to go
- Conditions have not reached the stability yet because the world has to deal with a lots of challenges.

Challenges Ahead

- The key question is: how far will this initial rebound go?
- Is it an indicator of a strong recovery?
- Is a renewed recession coming over the next year as expansionary monetary and fiscal policies lose impetus and private demand fails to gain momentum in the face of limited credit?
- Firms are still going bankrupt at a high rate, unemployment continues to rise
- Private consumption and investment remain weak as households still struggle with income and wealth losses
- Firms operate with large excess capacity
- Lending conditions remain tight
- Financial and corporate restructuring will continue to exert considerable downward pressure on activity, and wide output gaps will help keep inflation at low levels; deflationary environment is not healthy
- Demand is likely to be dampened by the need in many advanced economies to rebuild savings.

Downside risks to growth are receding gradually but remain a concern

Economic Policy Challenges

- Timing: its not over yet
- Implication of Policy Measures Taken
- Balance sheets of the Central Banks
- Budget Deficits and Unemployment
- Instability in FX Markets
- Priorities
- Phasing

Regulatory Challenges

- **Balancing the act:**
 - Protectionism vs. Moral Hazard
 - Regulation vs. Deregulation
 - Protectionism vs. Free Market Economy
 - Nationalization vs. Privatization

Transitioning Challenges

- **Unwinding Current Arrangements**
- Transition should be as rapid as a country's circumstances permit
- Plans are needed to orderly transition
- Preconditions should be met to minimize the risk of instability during the transition
 - Economic and financial stability
 - Sound banking system
 - Strong prudential regulations and supervision
 - Detailed communicated timeline
 - Public awareness
 - Cross-boarder regional and international coordination

Conclusion

- There are several positive signs in the real sector
- Stock markets react positively
- Commodity prices reflect clear rebound
- It might be a recovery but it will be a weak and slow recovery
- Policy measures taken were effective but costly
- Unemployment and deflation are major concern
- Unwinding policy measures is a challenge by itself

THANK YOU FOR YOUR KIND ATTENTION

mjafari@dic.gov.jo

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