THE CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

THE WORLD IN RECESSION

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MATHEWS: Good morning, all. I am Jessica Mathews, president of the Carnegie Endowment for National Peace. It is my great pleasure to welcome you to this important session this morning.

This is a great occasion for us to hear from the eye of the storm how the outlook of the international financial crisis looks both with respect to burdens on national economies and national policy making, but also with respect to the new burdens that have been added -- international collaboration to address the crisis, and to hear from the IMF itself, from it's senior economic counselor and director of research, Olivier Blanchard, based on the new published world economic outlook how the crisis looks.

As you all know, the G-20 emphatically moved the IMF to the center of international policy making on addressing the crisis with the decision to increase research to $750 billion and the issue of new special drawing rights. And so what the IMF thinks and how it sees the crisis becomes of absolutely central importance.

This is a particularly noteworthy event for us, as well, because Carnegie, as some of you know, has just launched a new program at International Economics led by Uri Dadush, and we have just published one of his first publications -- what will be a regular international economic bulletin -- that draws not only on his knowledge and contacts in Washington, but on the views from the regions from Carnegie's offices in Russia, Malaysia, China, the Middle East and in Europe. And we will be issuing the bulletin at regular intervals with a real emphasis on how the crisis is being felt and seen in the regions.

I also want to take this opportunity to particularly welcome our newest staff member, Alejandro Foxley.

A name that everybody, I think, knows the former Prime Minister of Chili and before that (inaudible), who will be dividing his time between here and home over the coming years, and we are thrilled to have him.

He tells me that he has read every page of the report and gives it an A plus.

(LAUGHTER)

He thinks it's the best (inaudible) report he's ever read. If so, it's the only thing that's been exciting around here these days, but anyway let me say how pleased we are to have all three of our panelists with us and turn the mike over to Uri.

I should say that we have a Russian delegation meeting downstairs, and I am supposed to be chairing that so I can only stay for a little bit, but I will go back and forth.

DADUSH: Well, good. Jessica, thank you very much for that introduction. I am especially pleased today to welcome my old friends from the International Monetary Fund.

We competed in a friendly way for many years when we was doing this work at the World Bank, but I'm also doubly pleased to welcome (inaudible), who we go back (inaudible).

(LAUGHTER)

And it's a pleasure to have you with us and to have this conversation with you on the World in Recession. Also joining in reviewing the presentations are two excellent economists, also from the Fund, Marco Terrones, who is the Deputy Division Chief in the Research Department, and Stephan Danninger, who is the Senior Economist in the World Economic Studies Division.

Before handing it over to Olivier, let me extend my sympathy to all who are engaged in economic forecasting at the moment.

(LAUGHTER)

(Inaudible) difficult economic forecasting, but when you are in a situation where world economic activities are plunging at record rates and the stock markets around the world are rising at record rates, can be especially challenging. And so I look forward to seeing how our (inaudible) deals with that particular problem. Go ahead, Olivier.

BLANCHARD: Thank you. Thank you. Control L, is it Control L? That's right. Very good. Good. (inaudible), it's a pleasure to be here, it's a pleasure to see you again.

What I'm going to do is give you a sense of not the forecasts themselves, you can read them in newspapers, but how we came to the conclusions we came to, and I'm going to start with a slide, which sketches the main theme of the world economic outlook (ph), and the way we think about it is that at this stage, and that's very much what Uri was referring to, the global economy subject to two cross curves, two opposing forces.

The first one comes from the financial (inaudible) and the drop in confidence and the drop in demand, which affected nearly all countries in the last quarter of 2008, which is something that we've never seen, I hope we never see again, but once you have something like this you have what we, the economists, call dynamic multipliers, which is that the decrease in demand leads to decrease in output which leads later to decrease in unemployment, which leads to further decrease in income and the balance (inaudible) and you very much see the dynamic effects of the shock just reverberating around the world.

So, that force is still very strong and is still pulling us down. Then you have forces pulling the global economy up. In a normal recession, you'd have what we call national stimulizers (ph), which is once people have not bought cars for a while or not bought houses at some point they need actually to replace their car so they need housing and so you (inaudible) forces eventually dominate, et cetera.

Not much has happened on this front and the national stimulizers (ph) will probably come, but they haven't quite played the role yet, but what has played the role is very aggressive and rightly so -- the demand policies, macroeconomic policies, financial policies from the fiscal side, from the fiscal side and so on.

So, what we're seeing today and that's, you know, the conflicting signals from the stock market (inaudible) come from is a balance between the two and at this stage in the first quarter and probably second quarter this year, there's no question that the force pulling the world economy down is still dominating.

It's getting weaker, but it's still dominating. And what we think is that by the end of the year, second semester, the national stimulizers (ph) and the demand policies will stop basically upsetting it and eliminating and, therefore, things will turn around.

So, our forecast is very much based on this, which is the idea that we have this force pulling down becoming weaker with a force pulling up becoming slowly stronger and this leads us to forecast for our advanced economies growth turning positive at the end of 2009, beginning of 2010, that you realize the degree of precision here is limited, but that's I think the number you should keep in mind.

Now, what's important is that positive growth is surely better than negative growth, but it's not enough. What you need basically to be on a steady path is growth at the normal rate. We don't quite know what the normal rate will be when we get out of the crisis, but it's really surely not it.

And so as long as growth is less than the normal rate, our economy keeps increasing this is what we call low control and that's a very strong relation, which means even if growth becomes positive at the beginning of next year, the end of this year, unemployment will increase so long as growth hasn't gone back to normal. And that's basically one more year out.

I think it's a very important message to deliver because I think when people read newspapers they may think tomorrow things are going to change. What is going to be less negative tomorrow, most likely, growth positive, that unemployment is going to increase for a long time, and we have to think about this, but (inaudible) forecast are based on some assumptions, obviously, but in particular assumptions about policy.

Fiscal policy will continue to be strong, fiscal policy will continue to be very aggressive as it has been, but more importantly we assume that financial measures to repair the financial system will slowly be put in place.

We do not assume it would be unrealistic that that will be put in place tomorrow. We understand the process. It's a slow process, but we assume it's happening and, therefore, our forecast is based on steady, if so, improvement of the financial system.

If this does not happen, then we can think of other scenarios. Mainly we can think of vicious cycles in which the activity is weaker, leading banks to be weaker, leading banks to catch (ph) even more, but we don't want to go there and then even if we pass that stage and things will turn around, I think the evidence is that while you can have a recovery without the financial system being in good health.

We've seen this in other countries. The recovery is slow. It takes much longer and, therefore, the speed of recovery is slower and unemployment keeps increasing for a longer time.

So, the passing message that we have is that it's very, very, very important to get with the financial system in this stage. The rest of the presentation is a set of graphs, which basically (inaudible) more precise, more (inaudible).

I'll basically just string along and insist on points, which I think are useful. The headlines (inaudible), which is what you see in newspapers. It's not very useful in an environment in which growth rates change quarterly, very much from quarter-to-quarter these days.

So, this is, I think, a better way of summarizing projections, which if you look at the red line, you see the dark blue has surpassed the light blue from the right is what we project, and you can see that we project negative growth (inaudible) until the end of 2009 and then it turns positive, but weakly positive.

In emerging market countries, basically their recovery depends very much on what happens in advanced countries. They're not going to get out of the woods by themselves. They cannot. They depend on exports too much and (inaudible).

And so the (inaudible) is the same. Why is it hard? Well, it's hard because on average emerging countries have higher growth so you basically just have the movement of the same curves up and so they turn positive in terms of growth very soon. Maybe even now, but still it's a growth rate, which is much (inaudible) than usual for them.

The next graph makes a point that I've emphasized already which is (inaudible) growth turns around at the end of 2009 in terms of (inaudible), unemployment turns around much later and the implication of this picture is that we can expect unemployment to coast (ph) at more than 10 percent in a fairly large number of countries and we have to think about that.

Let me give you a sense of these two forces I spoke about in (inaudible) two forces what we see is the result of (inaudible) numbers that look for things, but this I think shows the strength of what happened in the 2008 fourth quarter.

So, what you have here, let me just focus on emerging markets on the right. What you have here, our forecast in yellow as of January 2009 and then in red you have our current forecast.

Now, what's interesting is that the forecast in January (inaudible) 2008, but the information we had then and the information that the world had at the time was that, yes, it had been a bad quarter, but nothing catastrophic as you can see based on what we knew in January we felt that the previous quarter had had a decrease in output minus 1.5 percent for the annual rates.

It turns out now that we have better numbers that the decline was actually much larger, was three times larger and that's the same thing in the advanced countries. What happened in 2008 was it collapsed, which took a while to be perceived and is still very much playing out, so it shows you the strength of the first shock of the (inaudible).

Let me now spend the rest of the time on the forces eventually putting things up. National stimulizers -- in principle, you would expect that, you know, builders would stop building houses and (inaudible) and the stock of housing would basically go up initially and then come down and then would stabilize things eventually.

On the left you see the totally (inaudible) housing and basically our world has come down to this. It's still very high, it's not doing much in terms of stimulating housing, we are still quite a way from it.

On the right you have automobile sales and, again, you would expect eventually to go up initially and then to decline and then automobile producers to start producing more so it's picking up and as you can see except for the very last points -- data points, it's still very, very weak.

So these things have not (inaudible) yet, but as things go and unless something bad happens, they should (inaudible) increasing. What has played a major role is a set of policies, which have been (inaudible) financial and are now (inaudible).

The fiscal policy that has been done. Early on I think in the crisis the (inaudible) you have to do something, you basically have to increase public spending and give tax breaks (inaudible) have an effect, we suggested a discretionary impulse measures to basically do things for about two percent of GDP.

First it turns out that it will be two percent. I don't think that countries followed us to the letter, but the results is very much what we expected. We (inaudible) especially in Europe where basically when activity falls, (inaudible) revenues fall and, therefore, people get tax breaks automatically.

When you want to think about what happens overall, you have to add the two. The picture here shows you what is happening in 2009 and what we expect to happen in 2010 -- the major point large increase in deficits, fiscal (ph) stimulus, not much difference between the U.S. and Europe.

The difference in composition in the U.S. (inaudible) are smaller, discretionary is stronger, but the end result is very, very similar. So, very strong fiscal effort and it's showing up in the data already. The big issue here is whether more should be done and here we get into a delicate point and that shows on the right hand side.

You basically have G-20 advanced countries what the baseline path is for public debt. So, in 2007 for (inaudible) countries public debt was roughly about 80 percent of GDP, which is the blue line you have on the right, and under the baseline we expected to go to 110.

(Inaudible) differences across countries, but still it's useful to look at the average. (inaudible) is a bit lower than we expect under the baseline, which is (inaudible) then that might go to 130 percent of GDP and the governments have basically (inaudible) many of the (inaudible) of the financial system, but supposed we actually have to pay, which might happen in the third scenario, then we think that could easily go to 150 percent of GDP.

This raises the issue, which is when you increase spending to (inaudible) financial markets (inaudible) worrying a whole lot about the future and (inaudible) has a direct effect, which is increase of interest rates on you and so what you gained on one hand by spending more you are losing by the adverse effect of interest rates, and I think the implication at this stage is fiscal policy should still be very aggressive, but has to be done in (inaudible) context in which you do something today you have to start reforms which improve the (inaudible) such as health care, such as retirement in many, many, many countries.

This slide just makes the point. I'm not going to go over it, but basically makes the point that financial markets have started worrying a whole lot about these financial positions, and we cannot ignore what you have is (inaudible) will not be repaid for a number of countries, and without going through the list (inaudible) countries where the financial markets are looking and say, why worry?

The U.S. is not (inaudible) it should probably be because the numbers are not great, but we hope that something will be done. (inaudible) policy, as you know, (inaudible) policy has been extremely aggressive.

Most (inaudible) banks got what we call the policy rate (inaudible) zero and then they have embarked on what we call credit and (inaudible), which is instead of intervening in the Treasury bill market they have decided to buy private assets and the idea here is that (inaudible) in which the markets are very dislocated.

So it's (inaudible) between interest rates (inaudible) the markets where the (inaudible) are very large, investors are not there, then the (inaudible) central banking (inaudible) amount of funds make a big difference to the equilibrium interest rate and without going into the details again here, what you can see from the left hand side graph is the effect of interventions in two particular markets for commercial (inaudible).

The point to be made is you have vertical lines in the middle of a graph (inaudible), and you can see that the interest rates basically on these assets have decreased very, very much. There is much more to be said here, but in the interest of time I will pause. The conclusion here is that these policies are not standard, but they have proven to be extremely useful.

The last point is financial policies and the question is, well, suppose that the plans to improve the financial system (inaudible) assuming in the baseline how bad could things get? This is based on the (inaudible) that we've been using to think about these issues.

Let me, again, give you just a feel for what is done here. What you have on the left is something called the bank lending, BLT, Bank Lending Standard, I don't know what "T" stands for, I should know, I don't. Anyway, (inaudible) it means that more than (inaudible) so any number above zero means (inaudible).

And as you can see from the yellow line, there has been steady tightening since the beginning of the crisis. What we're assuming based on forecast is that this will come down (inaudible) for a long time above zero, which means that we expect (inaudible) and then things turning around.

The output gap, the difference between actual output and where we could be or we should be, is the yellow line in the graph on the right. The point here is that the bottom of the output gap is reached (inaudible) based on scenario at the beginning of 2010 if there's less progress, then we will get red line from the left hand side so bank lending would be (inaudible) for longer and the output gap would basically be largest one year later.

So we basically would delay the recovery by one year. This is an adverse scenario. We can think of (inaudible) that, but it indicates that's very, very important to get banks to start lending again.

Last point is international dimension and especially what's happening to emerging market countries. For them it is very much two outside (inaudible) they are just affected by what happens in the world in two ways.

One is drop in the exports and this affects countries to different degrees, but it's a very, very strong shock. And the other is, what we used to go (inaudible) stops, which is stopping capital (inaudible) and what's happening here is a combination of two things.

First, international investors have become (inaudible) so they tend to take money home away from emerging markets and advanced country's banks are (inaudible).

They need (inaudible) lending and they tend to do this both domestically and to foreigners and so what has happened is shown in this graph, which is, I think, very, very striking, which shows you the net capital first and most of the sample here from 2004 to third quarter of 2008, net capital shows emerging market countries were positive. What you saw in the last quarter of 2008 is an enormous change in (inaudible), an enormous decline (inaudible) negative net capital (inaudible).

What this means in practice is that it is becoming increasingly difficult for countries to actually finance their balance of payments needs. (inaudible) deficit to start with and if their (inaudible) are not willing to roll over the debt then it can be very bad.

That's something we identified very early on in the crisis this is why we went (inaudible) lending window (inaudible), which was put in place, this is what led us to try to convince governments that the fund needed more money and we basically got it or at least we got pledges and some of the money already at the G-20 meeting.

We think now that with the amount of money, which has been pledged to us, this will be sufficient to basically facilitate the adjustment in those countries. We'll be able to basically lend them the funds that they need. They still have to do an adjustment to the world, the world will not be the same in the future as it was in the past, but will facilitate the adjustment very much.

Let me just conclude. I think that we should (inaudible) things are turning around as I've explained, but I'm worried that the message is things are fine, and I think the first message from us is really that the need for strong policies is still extremely strong (inaudible).

(Inaudible) policies that I've said I think we'll basically see positive growth starting next year with some (inaudible) at the end of next year. For emerging and developing countries what's going to happen to them is going to depend on what happens in advanced countries. They'll turn around with us and then recover with us.

Last point, which is going to be what (inaudible) has to think about when things improve if they do is (inaudible) policies. There's a long list of things we have to think about. I think the fiscal implications are at the top of my list, but there are many others. Thank you very much.

DADUSH: Would you like us to...

(CROSSTALK)

BLANCHARD: ... presentation.

DADUSH: Just go to the next presentation. Thank you very much, Olivier, it was terrific. And so Marco Terrones I think is going to speak next.

TERRONES: Well, thank you for inviting us to present our work. In the next few minutes, I'm going to present the main findings of chapter three of World Economic Outlook.

The chapter was entitled, From Recession to Recovery: How Soon and How Strong? This is joint work with (inaudible), and we had the support from (inaudible) and (inaudible).
Let me briefly introduce the chapter. As all of you know, the world economy is facing a severe recession. Employment losses, (inaudible) losses are amounting everyday and also we have seen a decline in trade and capital (inaudible) around the world.

There are two aspects of this recession. The first topic is that these recessions are associated with financial crisis and the second aspect is that the recessions are global and synchronized around the world.

So, basically what we are trying to do in the chapter is to answer three basic questions. Our (inaudible) financial crisis different from others? That is the first question we are going to address.

The second question (inaudible) raises is what are the main features of global synchronized (inaudible) and how do their recoveries look like? And the final, last question we will be addressing in this chapter is (inaudible) policies help shorter recessions and (inaudible).

In order to address these three questions, we are examining the (inaudible) cycles in 21 advanced economies since 1960. So, what we do first is as we find the turning points, (inaudible) turning points initially bringing advanced economies.

Once we have identified the significant turning points, we identify the periods of recessions and the periods of expansions and then we find their properties, like, for instance, (inaudible). (Inaudible) is how much it takes to go from picked to truck, pick to truck (inaudible) recession.

Also the (inaudible). How much it takes to (inaudible) from pick to truck. So those are the two (inaudible) we are going to be estimating in (inaudible). When we have identified (inaudible), we get 122 (ph) recessions in this economies since 1960.

(Inaudible) these 122 recessions (inaudible) financial crisis and 37 of these 122 recessions were globally synchronized. These recessions were a factor of three main (inaudible); the 1975, 1980, and 1992.

So, those are the two (inaudible) where the recessions were globally synchronized in the past. Finally, there were (inaudible) recessions that were developed (inaudible) crisis and at the same time were globally synchronized.

As you can see, the (inaudible) of this kind of recession you have the (inaudible) are very rare. So, we have the recessions and then as I mentioned to you the next step is to find features of the recessions and what are the main features of the (inaudible) of the recessions and also what we do is to find how much time it takes to recover to (inaudible) speak.

Remember recession is a (inaudible) peak and (inaudible) and then the recovery (inaudible) to (inaudible) peak. So, that's how we're going to (inaudible) some of the features.

In the next slide, what we show you is the (inaudible) of recessions and recoveries. Recessions are on the left hand side of the slide and recoveries are on the right hand side. We (inaudible) different types of recessions the very first bar on the charts (inaudible) the recessions and the corresponding recoveries.

Usually it's about two years duration. Now it's about one year, less than one year. Usually (inaudible) lasts less than one year. So, that's what the first chart is showing to you.

You see that the recovery from these recessions in the right hand side, the recoveries tend to be fast and the time it takes to go from the peak where you started to recovery (inaudible) takes about six quarters so that's one year and a half.

So usually in the typical case you have for this kind of (inaudible) recession. You have a quick recovery. Now, we move to the recessions as we've seen in financial crisis.

We see that recessions tend to last longer than the typical recessions and they usually last almost one year and a half (inaudible) in the left hand side in the second bar, you have the (inaudible) the time it takes the average recessions and the (inaudible) show the (inaudible) of time associated with these kind of recessions with financial crisis.

So, the purpose of doing this is to show how these recessions take longer and also the recoveries are longer as you can see on the right hand side the recoveries of the recessions as a (inaudible) financial crisis into almost ten quarters as you can see in the right hand chart.

Finally, (inaudible) the recessions are (inaudible) financial crisis and they are (inaudible) synchronized, you find that they are much longer. So they last almost two years as you can see in the left hand side the last bar. (Inaudible) the recoveries also tend to be weak and you can see that the recoveries almost last around 14 quarters.

So, the message coming out from these charts are very powerful. What these charts are telling us is that situations like the ones that we are now facing are really (inaudible) because of the recession that we could be facing could be very long and they can be very severe.

Now, (inaudible) tend to be (inaudible) than other recessions and (inaudible) in the next slide what we have done is to present how the recessions (inaudible) financial crisis compare with all of the recessions.

On the left hand side you have the recessions (inaudible) financial crisis with a red line and all other recessions are portrayed with a yellow line. Also we are representing the (inaudible) synchronized recessions compared with the other recessions and what we are finding is (inaudible).
The question I postulated was, why is it that recessions (inaudible)? And (inaudible) examines what happened (inaudible) face the (inaudible)? With (inaudible) decline sharply and also (inaudible) very sharply.

(Inaudible) what happens is that (inaudible) tend to adjust the consumption pattern. As you can see, the consumption in the case of financial crisis (inaudible) are very flat for many quarters.

That (inaudible) because consumers want to (inaudible) and also they need one to deliver us so they start (inaudible) facing the financial situation. So, the main reason why financial crisis tend to be costly is this one. The effects that it has on consumers.

Also, it has a similar effect on the (inaudible). Now, notice that highly synchronized recessions also has an effect on consumption, but after the second quarter consumption starts picking up so in the two places consumption plays a big role.

(Inaudible) in their consumption (inaudible) is also very fast.
So, (inaudible). Now, (inaudible) and consumption is a reflection of what's happening with other prices. In particular, with house prices.

As I mentioned to you in the (inaudible) through the recession, (inaudible) were facing (inaudible) and as the prices were increasing by (inaudible). And (inaudible) the housing prices tend to fall. (Inaudible) house prices (inaudible) financial crisis. It's a sharp drop and it's a long-lasting drop.

You can have a situation where the process of a (inaudible) recovery is fast and house prices continue falling. That's what the first chart on the right hand side is showing to you.

Not the (inaudible) in the red line, red dotted line that you have there, and you see that as the prices continue falling. Now, one weak (inaudible) in the process of recovery (inaudible) when you have this depression, when you have (inaudible) financial crisis and when you compare it with the other recessions (inaudible).

(Inaudible) much when you have financial crisis. (Inaudible) with what's happened in the case of highly synchronized recessions on the right hand side, (inaudible) highly synchronized recessions (inaudible) follow and then recover fairly late and (inaudible) other recessions because the (inaudible) economy side of the recession.

So, that means in the difficult (inaudible) where you have recession (inaudible) financial crisis, (inaudible) tend to help recovery, but when you have (inaudible) cases, when you have (inaudible) crisis and (inaudible) synchronized, there is no (inaudible).

So, that's the main research coming out from this light. Now, (inaudible) in this kind of situation. (Inaudible) this question we have ways to examine what happens with (inaudible). (Inaudible) we are going to look at (inaudible) policies.
(Inaudible) certain numbers you (inaudible) the blue line represents what happens in the typical recession and the red line is (inaudible) recessions in the case where you have recessions as a sort of financial crisis.

(Inaudible) recession tend to be lower (inaudible) in the case of the typical case and the case where you have financial crisis. The red line shows you that (inaudible) in the case where you have financial crisis and the blue case or the blue line shows (inaudible) case.

What we have (inaudible) next is try to see what the impact of (inaudible). So, when we (inaudible) relations (inaudible) what we've found is that (inaudible) tend to help reduce the (inaudible) recession. So, (inaudible) the blue line to the left, but (inaudible) significant.

So, (inaudible) from this case while (inaudible) significant. Another (inaudible) screen in the case where we have (inaudible) financial crisis what we find is the opposite. The fiscal policies tend to be very powerful in the (inaudible) of reducing the problem (inaudible) the recession and (inaudible) is not.

And now these are some of the (inaudible). And also the (inaudible) crisis is (inaudible) when you have a (inaudible) crisis. So, the results are fairly (inaudible). The (inaudible) fiscal and monetary policies and to (inaudible) recovery.

(Inaudible) the longer the recovery is (inaudible) to reach (inaudible) to see what happens with (inaudible) one year after the (inaudible). So, what we have (inaudible) we have found is that both monetary and fiscal policy tend to help the (inaudible). Now, the next question was whether (inaudible) in this case or for their (inaudible).

So what we did was to introduce (inaudible) policy, which (inaudible) we have (inaudible) in (inaudible) and other ones with (inaudible) and we (inaudible). What we have seen is that if it continues to fiscal policy, it has to be kind (inaudible). (Inaudible) the issues (inaudible) of fiscal policy are key when one is (inaudible) in these situations.

So, this chart here shows you the (inaudible) with (inaudible) negative effects. The higher the level of (inaudible) tend to be negative. Now, next what we did is the (inaudible) recessions look like and (inaudible) lead us to (inaudible) that this recessions are going to be more severe than the typical recessions.

So, in the next chart (inaudible) we show behavior of the behavior (inaudible) United States and we compare it with typical cases, which is (inaudible) countries. (inaudible) recessions represent what typically happens (inaudible) in (inaudible) United States.

(Inaudible) in most of the charts the lines for United States are away from the typical behaviors. So, (inaudible) perhaps we are headed to very severe recession and also (inaudible) house prices and equity prices (inaudible) are also (inaudible) meaning that these recessions seems to be very peculiar.

I (inaudible) where the (inaudible), you know, extreme efforts (inaudible) and also the fiscal (inaudible) has been stimulating the economy. So, (inaudible) of this chapter? The (inaudible) is that recovery recessions are likely to be going up and severe and the recoveries are going to be very weak and (inaudible) economic recovery. So, it's very important that (inaudible) keep helping the economy in the process of recovery. Thank you.

DADUSH: Thank you very much again for a very solid review of this episode against the background of a long experience with different types of crisis.

And so next I'm going to ask Stephan to present and then we're going to open it up for questions, comments.

DANNINGER: So, this is complementary chapter, a course chapter that deals with mostly the impacts on emerging economies. And to set the stage let me just motivate this presentation with this chart.

This is the level of stress in advanced economies and what you see here is the scale of the crisis currently but it's (inaudible) a number of countries that are under high financial stress currently.

Number one is 100 percent currently and you can (inaudible) look back in history in (inaudible) economies through different crisis and you see that the scale in terms of the number of countries and regions involved in the advanced worlds and also the duration is unprecedented.

What matters and what we care about for emerging economies especially since we are talking about the financial sector in the past economies is implications on capital (inaudible).

Sharp and rapid drop offs are what we call sudden stops can have very strong negative effects on emerging economies that have been associated with crisis, and I think we've seen the chart earlier there has been a sharp drop off, and in fact, if you read the Financial Times this morning, (inaudible) just released a (inaudible) numbers of bank lending with a very shocking decline in bank lending liabilities of advanced economies, banks, (inaudible) and European banks. What we have here is a look maybe ahead in the first quarter, which we don't know yet and there seems to be a little bit of an uptake.

These are specific part of capital flow, syndicated loans, corporate international bonds, and so it's not that quite clear where we stand and this is sort of the background of the (inaudible) asking the question how really, how severe is the crisis on the financial sector in emerging economies?

And in general (inaudible) taking it another step further how strongly (inaudible) in general (inaudible) in the current crisis emerging economies affected by advanced economies with international markets (inaudible) for which these capital flows are being channeled.

And given that we know that in the current crisis banking sector is so strongly affected (inaudible) advanced economies (inaudible) make it more severe for emerging economies. And finally, (inaudible) remedies that emerging economies can look at.

So, how do we go about this? Well, we first develop a measure, which is our emerging market economy financial stress index. It captures different aspects of the financial sector. It's not only the banks. The banks are an important component. We look at the exchange market. The exchange market pressure is countries depreciating their surpluses. What about (inaudible)? That's on the capital market. And also look at stock markets and stock market returns.

And we look at this on a monthly level for a set of about 25, 27 economies, and we simply try to gauge how far the (inaudible) normal state with (inaudible) being having a positive number meaning your (inaudible) in terms of significantly lower exchange rate, depreciating exchange rate or a lower performing bank or stock market returns being lower. So, higher number means more stress.

This is what we (inaudible) is the aggregate average index for emerging economies and the one thing to point out is that if you compare to the last large regional crisis, the Asian crisis, then it spread to Russia as well as and Brazil, if you remember, then currently levels of stress or at least at the end of the last year we're already exceeding these levels, and we plotted next to it the index that's the thin line for advanced economies, and you can see there's a strong (inaudible) movement and also that for advanced economies the peak is much higher than anything advanced economy has happened in the past.

Looking at the aggregate, it does not reveal, obviously, where stress is located and one might think, well, possibly it's really driven by emerging euro, but when you look at the regional aggregates, you see there's actually been quite some synchronized movement after financial stress index, and it's not just one or the other region was affected. Markets in Asia as well as Latin America as well as in Europe have seen a strong increase in stress.

The next step we will try to understand, how does transmission work from advanced to emerging economies? And what we're particularly interested in is the long vertical arrow going from the bottom up, how large, how intensively is stress responding, financial markets responding in emerging economies and other stuff like factors that influence this (inaudible) this rate of transition?

We also want to control for, well, usually when there's stress in advanced economies other things are going on, like growth is declining. So, to control for that and disentangle these effects.

So, what you see in the next chart is representation on a country-by-country basis of responsiveness of the (inaudible) movement of individual countries with stress in advanced economies. And what you see the two points to take home is that on average the red line response is close to one so there's a stress impulse in advanced economies many, most emerging economies respond very strongly. The second one to take home is, well, it's not that all countries vary at the same rate. There's clearly some differentiation that takes place. Just to sum up what the findings what we came up with. If you look at what determines the variation of this responsiveness of stress, then what really (inaudible) in the last crisis that transmission was countries bank linkage to advanced economies banks.

So, if you've been borrowing a lot from advanced economy's banks, your financial markets have been affected more and the chart on the left (inaudible) may be the case. It shows you what the bank lending liabilities of different emerging regions are.

At the bottom you have emerging Asia, emerging Europe and so on and the one that stands out is the second one, which is emerging Europe, which is (inaudible) quite massively to the average tune of 50 percent of emerging Europe's GDP in terms of the stocks.

And the biggest country with the Western European banks, and we know that there's a lot of stress on the European banks. So, it's in a way not surprised that we've seen a lot of stress in emerging Europe relative to other regions because there was the strongest link in the last period.

Now, about policies. Can economies insulate themselves from this transmission? And basically (inaudible) insulation does not work. What we've tried to do is we analyzed what happens to emerging economies when the global economy, advanced economies, are being stressed. And what you see is that the red (inaudible) this is what happens in these periods of direct and advanced economy.

There's a big increase in financial stress index. And then the question is, so how does it vary across countries? What are the contributing factors? And the one that dominates throughout. The economies is advanced economies stress. It's just driving what happens in emerging economies. We can have good policies in place, but the marginal effect in terms of reducing the stress that you experience or that the economies experience is small in times of when the global economy is in crisis.

It's different if there's a global (inaudible) there's much more differentiation possible having improved (inaudible) balances, fiscal balances and high reserves helps, but it does not help you to advert transmission.

That leaves the question, how come that in Latin America or in emerging Asia we haven't seen as much of the (inaudible) yet? Well, you have (inaudible) markets responded you could (inaudible) some of it off through aggressive policy moves so it came from a position of strength (inaudible) Latin America the same with (inaudible) in place, but there's only so much one can do.

So looking forward the question is, what is the outlook for these emerging economies of a resumption of capital flows through the normal channels? And the last point to make is we looked at case studies. What happened to emerging economies when advanced economies they were (inaudible) economies when they had a systematic banking crisis or financial sector crisis?

And there were two cases that we look at that's the United States in the 1980s and that was because of a response after the Latin American debt crisis -- a lot of U.S. banks got hit very strongly and what happened to them afterwards? And a second example is the Japanese banking crisis in the 1990s and their involvement in emerging Asia.

And I just want to highlight the first one. Basically, U.S. banks pulled out quite a bit stronger than other advanced economies from Latin America in the 1980s. The reason (inaudible) quite interesting parallels to Western Europe right now where you have (inaudible) banks being quite strongly engulfed in emerging Europe and the blue line in those charts show you decline of capital flows or liabilities and from banks into the Latin American region and that the decline was quite long lasting over 10 years in that example.

Just to wrap up. So, basically financial markets (inaudible) emerging economies get affected quite substantially by crisis in advanced economies. What seems to matters most for transmission is how tightly you're linked through your financial markets. Straight linkages matter, too, but in that case, financial market is (inaudible) special bank linkages (inaudible) crisis.

The option to defend itself through having good policies in place doesn't (inaudible) that the crisis comes to your country, but it may give you some room to smooth the impact in the first period.

And finally, over the long run, given that the banking crisis of advanced economies the outlook for resumption of capital flows is not a very good one. In terms of what does it mean for emerging economies and what can they do? Well, I think on an individual basis there's little to be gained. What has to be done is, or what can be done should be done in a coordinated basis.

I think what's at the forefront or the foremost importance is to avoid (inaudible) second round of leveraging so that western banks do not (inaudible) or considering withdrawing out of deterioration in emerging economies (inaudible) have, are under pressure to improve their balance sheets.

And this has more different angles to it. One is providing sufficient supports to emerging economies, but at the same time it is in the interest of emerging economies, that advanced economies clean up the financial sectors quite rapidly, and I think it's probably a case for more corporation between the home and host supervisors.

(Inaudible) looking through a period of normalization, I think if you want to keep the level of financial integration that has been generating a lot of growth, the path for emerging economies you have two systems in place that economies can draw on, and I think the financial support systems like our (inaudible) I think that the flexible credit line with the IMF has put on the table I think is one of these mechanisms that could help remain -- keep emerging economies engaged in a global integration (inaudible).

Thank you.

DADUSH: Thank you very much (inaudible). Let me open it, but before doing that, we've had lots, I just wanted to bring out a couple of points. One is the central point that (inaudible) continue to (inaudible) press down as well as forces that are pulling us up and it's possible to get (inaudible) circles or it's possible to get vicious circles and, therefore, the role of policies at this juncture is absolutely critical so that we can move to a higher equilibrium rather than to a lower equilibrium.

And one way to think about it is (inaudible) and hence the contradiction between what you see in the financial market (inaudible) at the moment and the real numbers, which are continuing to look very bad with some weak exceptions, some scattered exceptions.

And the other presentations also were very pertinent. The presentation about the (inaudible) and depth of financial crisis in (inaudible) recessions. Again, I'm (inaudible) the importance of policies (inaudible).

And finally, the presentation about financial stress, which illustrated, I think, remarkably well just how powerless in a sense the emerging markets are in the face of financial turmoil in the industrial countries that everybody gets affected and that policies only give you so much shelter from financial stress, at least in the short term.

And, again, so these are some of the points, the fact that this is likely to be a (inaudible) episode, continue to be (inaudible) at least in the United States, but (inaudible) is likely to be (inaudible) emerging markets and the capital flow (inaudible) is likely to be protected. Very, very important set of messages coming out of these presentations, but a lot of imminent (inaudible) in the room. I look forward to their comments, I look forward to their questions. You, sir. Please introduce yourselves.

QUESTION: I'm (inaudible). First off, thank you very much (inaudible) very interesting presentations. I wonder (inaudible) comments (inaudible) mention some of them and just (inaudible) comment.

(Inaudible) global crisis (inaudible). In (inaudible) countries actually do have negative economic growth rate and (inaudible) rates (inaudible). So, that is why to call it global in the sense that every country (inaudible) fact the global rate of (inaudible) true. Not each country has been affected. (Inaudible) to the question, why not all countries have been affected? And what makes these countries that happen to be like, exception, why are these countries exception?

Another issue that would be closely related to (inaudible) that even (inaudible) potential has been (inaudible) economists and (inaudible) looks like slightly better than advanced economies and examples of (inaudible) Middle East, Africa, (inaudible) and they are on (inaudible) better than advanced economies.

It's also (inaudible) issue because there was talk about (inaudible) between advanced economies (inaudible) market economies (inaudible) the opposite (inaudible) because (inaudible) we can see (inaudible) market economies are doing (inaudible) advanced economies (inaudible) this year why (inaudible) crisis.

So, (inaudible) different. Now (inaudible) I'm sorry, because (inaudible) here (inaudible) your comments on the (inaudible) because it looks like the (inaudible) factor for these economies and (inaudible) as well as (inaudible) recommended to other countries (inaudible) what is not right? (inaudible)

DADUSH: Yes. Thank you very much. It's very interesting. Please keep your questions in one or two questions.

BLANCHARD: (Inaudible) go along or I'd rather do that.

DADUSH: You would rather do that, all right. Let me (inaudible) audience has been sitting quiet for a while. Let me give them a chance to ask two or three things and let me turn next to the person responsible for this whole mess, (inaudible).

(LAUGHTER)

QUESTION: Yes. (inaudible). I want to say that I think the presentations are excellent as regards to short term. I think we are all indebted to the IMF for the latest (inaudible) in analyzing this crisis, and I have no criticism with short term, but I do want to (inaudible) medium term.

That means two things that really (inaudible) presentation or the world economic outlook. One is the idea that you define a return to normalcy as simply returns to previous (inaudible) on the world economy.

That's really not right. I mean when, you know, there's been (inaudible) like 10 percent (inaudible) as a result of this crisis and that needs to be made up before one does return to normal growth rate before one gets back to equilibrium.

The second problem I have is with the (inaudible) apparently you make no attempt to extrapolate (inaudible) impact of exchange rate changes. I mean, if you look at (inaudible) Saudi Arabia, I think it's true that the greater (inaudible) projections of (inaudible) are essentially the same as if you extrapolate 2009 predications.

I mean, the differences of 2012 versus 2009 are peanuts for most countries and that includes the United States in which there was a big (inaudible) in the second half of last year and surely one expects that to lead to a (inaudible) in the (inaudible) picture you have (inaudible) of it continuing to fluctuate (inaudible) deficit.

DADUSH: Thank you, John. We're going to take two more and then turn back to the panel. Let me ask Desmond and then Alejandro to comment. I'll come back to you, Peter. I have you on my list.

QUESTION: I'd like to say that I really enjoyed those presentations were quite excellent. Following up on John Williamson's (ph) point, I was just wondering if you could comment on the risk of deflation looking at your charts what you've got is you've got enormous output gaps developing in 2009, and I noticed that those outputs don't disappear until around 2012.

My question is, do we really have a deflation risk that we have got to be worried about? My second question relates to -- which countries in the (inaudible) and I think of Ireland, Greece, Spain, Portugal, Italy and so on, my question there is, what is the IMF's advice to those countries facing deep recessions with public finances going out, you know, are you suggesting that those countries (inaudible) fiscal policy in those kind of circumstances (inaudible) to be (inaudible)?

QUESTION: I'm concerned about the (inaudible) crisis and what it would look like particularly for (inaudible). (Inaudible) relatively good job in terms the basic (inaudible) and (inaudible) and (inaudible) conclusions and (inaudible) conclusions in the (inaudible) experts.

Secondly, (inaudible) experts (inaudible) experts (inaudible) better. And (inaudible) we used to think (inaudible) and (inaudible). (Inaudible), which is something that has been highly recommended (inaudible) countries. So, (inaudible) questions (inaudible). So, how do you (inaudible) when you (inaudible) experts (inaudible) countries go into recession within the (inaudible). Secondly, you look at (inaudible). So, this (inaudible) questions, which seem to (inaudible) countries.

DADUSH: Well, excellent. So, we have a set of very easy questions (inaudible).

BLANCHARD: (Inaudible) questions. I'll take them in order and probably won't do justice. First, is it a global recession? Yes, it is a global recession. (Inaudible) have higher growth in 2009 than 2007.

Some countries are doing better than others in terms of growth rates in (inaudible) China and India, but we know that for China it's an enormous decrease in the growth rate. And (inaudible) comes from the fact that the (inaudible) that you have depends very much on your exposure in terms of your (inaudible) ratio, your openness, and your openness in capital markets on both fronts.

India is an economy where (inaudible) plays a major role in where there has been (inaudible) controls so they are less exposed to the crisis, but even India has a very substantial decrease in its growth rate. Now, we say emerging market countries are going to positive growth before advanced countries is completely (inaudible).

I assure you just comes from the fact that (inaudible) has much higher growth. So, (inaudible) exactly the same pattern (inaudible) percent (inaudible) for advanced countries, but they are doing (inaudible) just as (inaudible) in many cases much worse.

On the (inaudible) consensus, (inaudible) answer questions, but I'll make the following point, which was made very clear by one of the charts presented in the third presentation, which is (inaudible) fiscal and (inaudible) policy in this crisis. I think the answer is typically when you go into a country in trouble, you (inaudible) about the (inaudible) and in general (inaudible) very much to a fiscal position of the country in the (inaudible) interest rate.

So, if you think that increasing the domestic interest rate of (inaudible) is going to be a major impact on capital (inaudible), (inaudible) you have to say that's what needs to be done. This crisis is very different. (Inaudible) to domestic measures such as fiscal policy and (inaudible) policy of the (inaudible) in a country it (inaudible) domestic interest (inaudible).

And so (inaudible) this means that (inaudible) traditional crisis (inaudible) some countries have the more relaxed fiscal position than (inaudible). I think that conditions are different and, therefore, that's why the advice is different, but I do think that the general way of thinking has changed quite dramatically.

On (inaudible) I thought it was clear, but maybe not enough, that unemployment was (inaudible) at the end of 2010 (inaudible) doesn't mean go back to normal. (Inaudible) basically recovery, which is you (inaudible) normal (inaudible), and I think the message come from the presentations with recovery maybe very slow because it's (inaudible) financial crisis and, again, when you think about (inaudible) to be (inaudible) consumers are probably going to save more and it's not creating (inaudible).

So, (inaudible) should be a fairly stable recovery and (inaudible) 2012, which will be good news, but 2013, 2014 before we actually get back to (inaudible) rate we hope we get back to. So, I think (inaudible). On the (inaudible), you know, the forecast for the (inaudible), but I think the issue of what happens to (inaudible) deficits and (inaudible) is a fascinating one.

In the U.S., too, we'll have to increase saving rate and that's likely to lead to a reduction to (inaudible) deficit (inaudible) present direction how this is all going to be played out with very substantial adjustments and exchange rates, the (inaudible) focus of (inaudible) something that we're thinking about fairly hard (inaudible) return to a decision and complete answer to your question.

(Inaudible) inflation, (inaudible), which is a very long one, it's not number one, but it is (inaudible) on the list, why (inaudible) less because the output gap is going to be very large for a long time. The relation between the output gap and inflation seems to bring down (inaudible) of inflation.

(Inaudible) gaps were predicted for the number of years predicting it would mean that inflation would become minus two, minus four, minus ten, minus fifteen, and inflation rates of minus fifteen percent are an absolute catastrophe in the (inaudible) interest rate (inaudible) inflation very, very high (inaudible).

(Inaudible) is there is one, right, Japan from the '90s is they (inaudible) we have long (inaudible) for a long time and (inaudible) inflation but somehow inflation stayed at minus one, minus two percent. Why? I think that's something we have to understand better.

It could be an (inaudible) expectations, it could be (inaudible), which would make it very hard to go below, but if this is what we get (inaudible) inflation of minus one, minus two percent for number of years, which is (inaudible) could clearly happen (inaudible) minus one, minus two percent makes interest rates a bit higher and changes the position of (inaudible), you know, (inaudible), you know, (inaudible) this is not the worst in which can happen.

What happens in the weaker European countries, in particular, those in the (inaudible), you look at a country like Ireland and it clearly has (inaudible), which is (inaudible), you know, I didn't talk about. Not only do they have the fiscal (inaudible), the regular fiscal (inaudible), but they have the (inaudible) and that (inaudible) if something went wrong and something may, then they would find themselves with just a very, very large amount of debt.

I think the answer here is that they do any fiscal extension at this stage and they have (inaudible) they have to take measures for (inaudible) and even that, this is the general advice, that we (inaudible) I think one has to (inaudible) scenario (inaudible) countries would have to come and help. I think that just is, again, under the (inaudible) scenario problem (inaudible) Ireland can handle on its own, you can think of other European countries where this would be the same.

(Inaudible) in some countries is such that they have to get help. We can help, you can help. (Inaudible) issues, of course, crisis implications. (Inaudible) one question is (inaudible) probably going to see a rise in (inaudible) as a result of this crisis. Is there any (inaudible) consider an openness in (inaudible) markets

(Inaudible) openness comes with great advantages and great benefits, but it (inaudible) you to (inaudible) and you (inaudible).

(Inaudible) economy, (inaudible) would have to sit down (inaudible) benefits are very large. We just have to think about ways of (inaudible).

Now, (inaudible) in terms of exports (inaudible) much more in the direction (inaudible). I don't have to tell you about how a country, which is (inaudible) might want to (inaudible) itself against (inaudible) in the (inaudible), but it seems to me that's much more the dimension in which to go and think about insurance (inaudible) in that (inaudible) are (inaudible) instruments on the financial markets more can be done here.

Again, (inaudible) in the direction. I don't think it's (inaudible) to deal with the (inaudible) and then it (inaudible), but my sense is (inaudible) pluses and minuses, but I think in the end (inaudible) have to get ready for it. Your questions are more on the capital account. (Inaudible) capital controls. I think it needs to be revisited, it is being revisited (inaudible) because many countries are considered (inaudible) what should we do?

My sense we have to revisit the issue and, again, you come from the country that shows (inaudible) points. One of the things which strikes me that maybe you want to actually (inaudible) is (inaudible) exposure. If you think about what's happened in emerging Europe, it's clear that given the size of (inaudible) it would be very nice if we could (inaudible) quickly by the (inaudible) because (inaudible) exposure the (inaudible) unless we can restructure (inaudible) things is not available.

It's something essential you had that instrument and that it works. And so, probably have to (inaudible) to limit potential (inaudible) exposure and then (inaudible) to go to (inaudible) think about things again. I can stop here.

DADUSH: Thank you so much. That was very, very clear. Let me just say that just as a comment, passing comment, that this issue of open, short-term foreign currency exposures combined with a fixed exchange rate is, of course, one that we saw in (inaudible) back in 1998 -- 1999.

In 2000, it was perhaps the headline lesson to be learned from the Asian crisis, and we see that yet repeated again right at the (inaudible) sophisticated economic management. And so one question may be for the IMF and others for future discussions is, what is it about the situation that prevents us from learning even the most basic lessons from previous mistakes?

And we just (inaudible) discussions (inaudible) actually changing these lessons. Let me (inaudible) I also will ask you at the closing if others don't ask you that if you were managing the world, which I say, you know, is close to what you are doing, what would you do differently today? What would you like to see done differently?

BLANCHARD: (Inaudible).

(LAUGHTER)

DADUSH: Other questions? Peter, you had a question here?

QUESTION: Thank you. Peter (inaudible). My first question has been discussed to some extent and is related to the first question. I was very struck by the fact that (inaudible) unequal stress, financial stress on (inaudible) charts that you showed (inaudible).

On the high end you had, I believe it was (inaudible) if I remember correctly Chili and Turkey (inaudible) China. Could you explain a bit more what is behind that and what policy lessons we might have (inaudible)? And if you'll allow me a second question that's more of an inquiry than a question, has the (inaudible) done any (inaudible) on the linkages between household wealth and changes in household wealth and business cycles?

(Inaudible) and (inaudible) drew attention to the (inaudible) crisis, housing crisis in particular, the housing crisis might serve as a (inaudible) for household wealth, but what is really important and we can measure that is equity in houses and, of course, (inaudible) financial assets.

Household wealth in the United States is a multiple (inaudible). It's five or six times as high. The (inaudible) in household wealth must have an enormous impact on business cycles. What do we know about it and why don't we never explicitly talk about that in these analyses?

DADUSH: Good questions. (Inaudible) I think it is, yes, and then the lady at the back.

QUESTION: How are you doing? My name is Al Winsenscott (ph). I was just wondering with (inaudible) on record saying that it was monetary policy that was at fault with the Great Depression, I was wondering if (inaudible) interest rates weren't (inaudible) current financial crisis?

I also was wondering if any of you could set the (inaudible) prospect of global currency? What the implications of that would be, how it would be implemented, and how control over the world's currency would be (inaudible) abused? Thank you.

DADUSH: OK. Yes, (inaudible)?

QUESTION: (Inaudible) issue the question is about the impact of the (inaudible) and global recession (inaudible) and what the impact should be and if you could (inaudible) affect the outlook?

DADUSH: Anybody else? No. Yes, the gentleman?

QUESTION: Thank you. (inaudible) I just wanted to ask (inaudible) saying that the (inaudible) policies were not insulating (inaudible). I would like to know what you consider good policies and why you consider (inaudible) should insulate the financial (inaudible) from (inaudible) country.

DADUSH: OK. Olivier?

BLANCHARD: I'll start with (inaudible) it is two questions (inaudible). What have we learned from the crisis about foreign currency exposure? I think because it was just attractive for people to actually do (inaudible) and this is related to (inaudible).

One has (inaudible) so we can do that. And so the question then is, is it practical one, which is what (inaudible) do you basically put in place in order to prevent households to (inaudible) in foreign currency? And do you allow them under some conditions and do the same thing for corporations?

I think there has (inaudible) and maybe the second time around we will learn the lesson. (Inaudible) and we have to think about both. Household wealth, I don't know why you said what you said. It is absolutely essential to the way economies think and the way the IMF thinks, and you know, I took (inaudible) and what we learned is consumption is in the absence of credit constraints a function of wealth and when wealth goes down, consumption goes down.

So there's absolutely no question that decline in asset prices and the declining wealth in 2008 is affecting consumers very much, and we can think of it in different (inaudible) less wealthy, well, (inaudible) retirement income in mind (inaudible) need to save more, but it always comes to the same result.

Where I think there is some question is whether the effect of housing wealth is the same as the effect of the stock market wealth. And there's some arguments for thinking that the effects of housing wealth may be weaker because if the value of your house goes down, then (inaudible) that you pay on your house also goes down.

But in the (inaudible) question (inaudible) there was actually a (inaudible) question decrease in wealth, which is a (inaudible) of I think $26 trillion (inaudible) for financial of the world. Yes?

QUESTION: (Inaudible)?

BLANCHARD: No, I don't think so.

QUESTION: The United States (inaudible).

BLANCHARD: Yes.

QUESTION: (Inaudible)?

BLANCHARD: There has been an improvement in the stock market.

QUESTION: (Inaudible) the latest (inaudible).

BLANCHARD: Well, that's how we do things in the IMF.

(LAUGHTER)

BLANCHARD: (inaudible) and there is no question that this is affecting consumption, investment and that's how much (inaudible).

Questions outside of the concerns of this conference about global currency, (inaudible) here, but we have a paper, which is (inaudible) from the crisis, which basically discusses whether (inaudible) policy is one of the causes of the (inaudible).

The (inaudible) says no. (Inaudible) expert, but the IMF has been thinking about these issues in the context of the previous (inaudible) and there's a chapter in appendix in the (inaudible) of 2005, which discusses potential economic effects of the (inaudible), and (inaudible) conceptual it's true they have an effect on the (inaudible) so some countries are going to be affected.

It is part of the (inaudible) people who don't go to Mexico City will go to Disney World, but some of them will just not take a vacation, but it is clear that for some (inaudible) the effect will be quite drastic and for the (inaudible) industry the effect is clearly visible and these companies are not typically in very good shape and, therefore, (inaudible) this leads to (inaudible) for some of them is clearly present.

Is it something which is (inaudible) of the scare of the economy crisis we had (inaudible) information that we have at this stage is

(inaudible) minor that one has to be careful. I might have said the same thing about (inaudible) mortgages in the U.S.
(LAUGHTER)

BLANCHARD: I still believe that this is not going to be a major issue in economic terms. I'll stop here.

DADUSH: Very good. We have time for one or two more questions before we (inaudible).

BLANCHARD: (Inaudible).

DADUSH: Yes. Any other (inaudible)?

BLANCHARD: I have one question about the transition. (Inaudible) I think the (inaudible) is quite intuitive. Having said that, this is (inaudible) average transition rate or transmission rate from 1997 to 2008, and if you will look at it carefully, Hungary is all the way in the (inaudible), which looks surprising anybody who knows what happened to Hungary, but if you split it time by time periods, you do see that Hungry really shoots up in terms of the transmission rate (inaudible) Europe there is no (inaudible) in the past, but I think that has been a change.

(Inaudible) which you haven't quite understood and it's probably something we have to look into more carefully is how do we justify (inaudible) discussion about (inaudible)? There seems to have been some (inaudible), some period of time before the crisis really sort of explode, and I think that's something we try to (inaudible) explore a little bit further what happened there.

The (inaudible) lies pretty well with how countries are linked to the (inaudible) regions in terms of their exposure. Mostly financial, also (inaudible) related and banking (inaudible) most recent period.

And the other question about (inaudible) good policies, the good policies (inaudible) and many other ones you can look at is external balances between account balances, fiscal balances and reserve to GDP ratios. And all of them sort of break into mitigating (ph) financial stress; however, having (inaudible) as you enter the global crisis (inaudible) does not (inaudible) the financial sectors.

It's not the (inaudible) stock market is going to be fine (inaudible) exchange market is not going to come under pressure. If, or that seems to be the experience with banks (inaudible) on a global scale and that (inaudible), but it still is going to be a significant impact for economies.

DADUSH: Good. Let me then, unless there are other questions ask Olivier for closing comments. I have one (inaudible) question, which relates to Marco (inaudible) presentation.

You mentioned that when you have financial crisis coming to (inaudible) policy is less effective because the transmission mechanisms break down. How does this (inaudible) with the emphasis...

(UNKNOWN): ... sorry, yes.
DADUSH: I'm sorry. Did you hear me at the back? How does this (inaudible) with the emphasis (inaudible) current U.S. policy has with the Federal Reserve engaging massive (inaudible) using also (inaudible) findings (inaudible) out of the Great Depression largely because of (inaudible) monetary stimulus.

(Inaudible) Chair of the Council of Economic Advisors. So, if we could relate to that point and elaborate on it that would be very helpful and then Olivier if you could close, thank you.

BLANCHARD: OK. (Inaudible) two questions. So, what would I do if I were in charge of the world?

I think I would engage in very specific (inaudible) about the path to recovery. I think there's a bunch of (inaudible) too much on (inaudible) on one hand (inaudible) improving and there's (inaudible), which is to say this is the end of the world and we'll never get out of it.

I think that indicating that the (inaudible) quarters, which I (inaudible) to be difficult and then we can basically see positive growth and eventually a decrease in unemployment can be explicit about the timing is actually very important.

In that respect, I think actually most policy makers especially in the U.S. are doing a very good job. It's a very (inaudible) crisis and you could just (inaudible) in the last quarter of 2008 was uncertainty. Just complete confusion as to what may happen, you know, what economists call (inaudible) uncertainty. Just the notion that we didn't know what we were against so we stopped spending whether you are a consumer or (inaudible).

It's very, very important to indicate to people that (inaudible) it's not for sure (inaudible). In terms of policies, (inaudible) again, (inaudible) policy I think in all of what most central banks have done in terms of fiscally being needed to go beyond the normal use of the, of financial policy to (inaudible) in more and more markets and accepting more and more assets as collateral, central banks are thought to be conservative I think (inaudible) crisis have shown they could be extremely aggressive and for the right reasons in the right way, which I (inaudible) has been remarkable.

I think (inaudible) policy, which is using (inaudible) understand there's a (inaudible), but (inaudible), which is (inaudible) in specific markets has proven very useful.

(Inaudible), which is (inaudible), which I think (inaudible) in the (inaudible) I think (inaudible) or not, but you know, why not try it and see if it works. On (inaudible), again, I think that (inaudible) surprisingly (inaudible) should they (inaudible) many countries about being (inaudible) in the (inaudible) really have to do both.

I think that's an important message. The other thing is that (inaudible) projects in terms of (inaudible) projects at this point because (inaudible) move forward in time we can get more spending now, but at the same time you may have less spending later.

The problem is inflation recession is that the (inaudible) involved are just (inaudible) so when it becomes (inaudible) the recession is (inaudible). While we had the unfortunate luck of (inaudible) the longer session so that some of these projects can (inaudible) in time.

I think it's important to think of (inaudible) in their direction, which is if 2011 or 2010, 2011, turned out to be worse than we thought, we should have (inaudible) ready. If we start thinking about it in early 2010, it's too late and (inaudible) now think about what is it that we can start if we need to in 2010, in 2011, in 2012, and then ready, not (inaudible) ready, but (inaudible) ready and ready in all possible dimensions. I think it's an important message.

(Inaudible) financial, the IMF review has (inaudible) basically need to remove (inaudible) assets and (inaudible) what people call the legacy assets. There are more and more (inaudible), which are now doubtful. You should not remove everything from the (inaudible), but the (inaudible) ones. That needs to be done. It's not happening fast enough in most countries and then we need to look at the (inaudible) banks and, again, we understand the difficulties of it, but that's (inaudible) very much to be done.

I don't know how much (inaudible) do I have to deal with Parliament? Do I have to deal with Congress? Do I have to deal with (inaudible)? That's basically what's stopping in many cases or slowing down the efforts, but it is essential that it happens.

DADUSH: Well, you are being very statesman like. You actually didn't mention, as far as I can remember, a single country. Sorry about this. You actually didn't mention a single country or continent in your response.

So, I deduce from this that you are very happy with European policies, with Japanese policies and with U.S. policies across the board. Is that correct?

(LAUGHTER)

BLANCHARD: You are absolutely right. I did not mention any country in my (inaudible).

DADUSH: I would like to extend a lot of thanks. I think he was a wonderful (inaudible).

(APPLAUSE)

BLANCHARD: (Inaudible).

DADUSH: Well done.

BLANCHARD: Thank you very much.

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