



World Economic Outlook

Presentation by Subir Lall

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Chapter IV

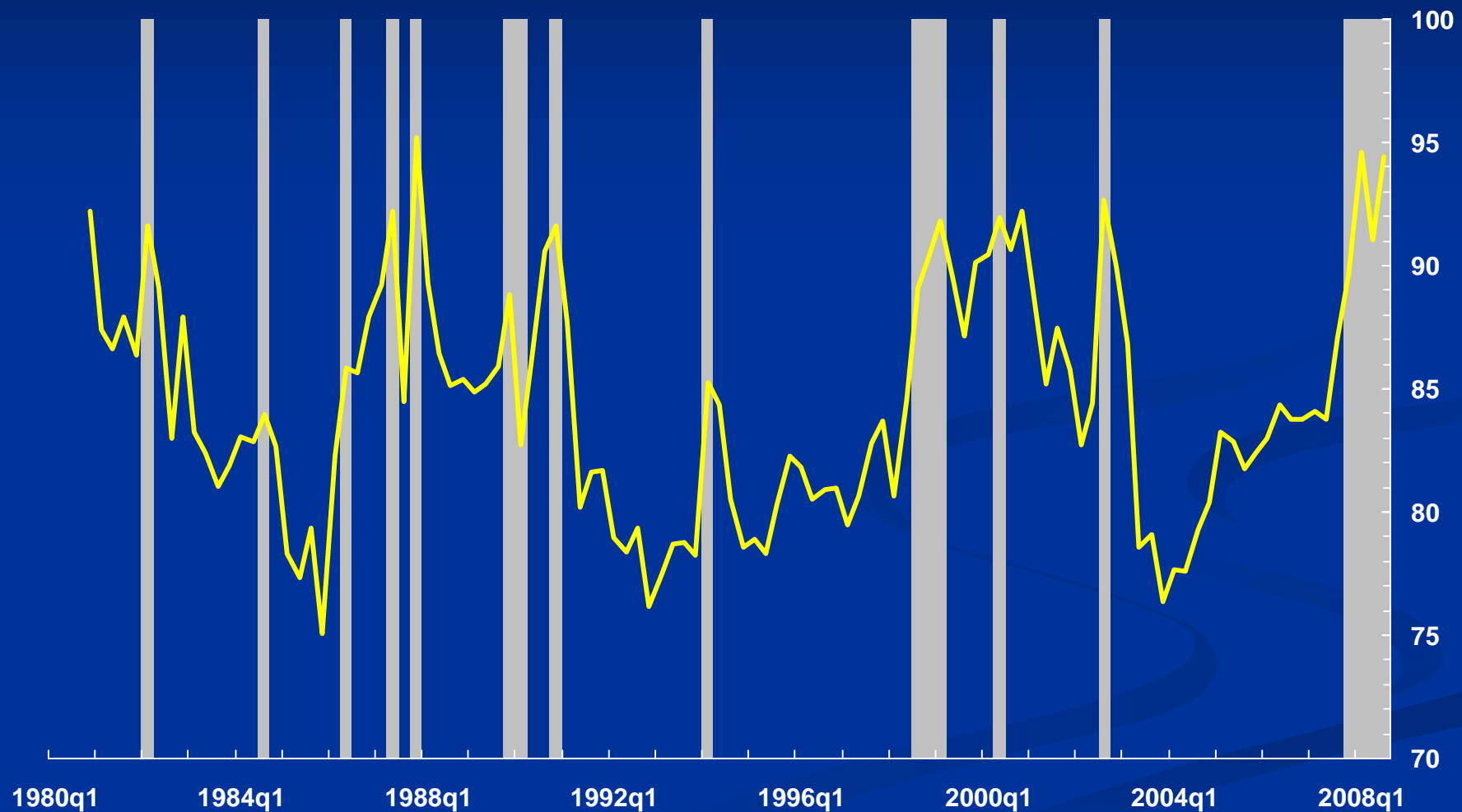
Financial Stress and Economic Downturns

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Key Findings

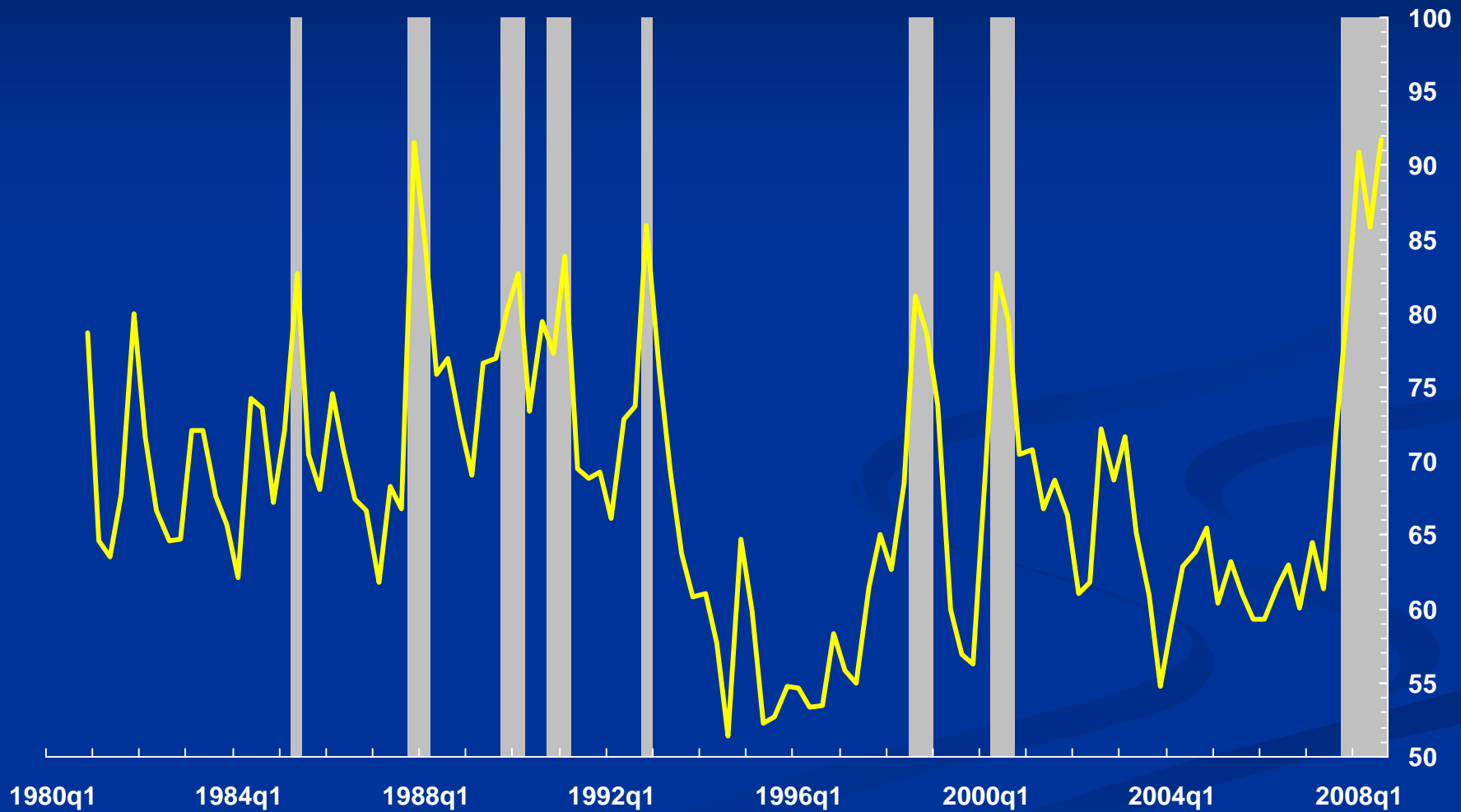
- Financial turmoil more likely to be followed by severe and protracted downturns when
 - characterized by banking sector distress
 - preceded by rapid increases in credit, a run-up in house prices, and heavy borrowing by households and non-financial corporates
- Banks still key in transmitting financial shocks, especially in arm's length financial systems
- Current conjuncture bears some resemblance to previous episodes of banking-related financial stress episodes that were followed by recessions

Example: FSI for United States



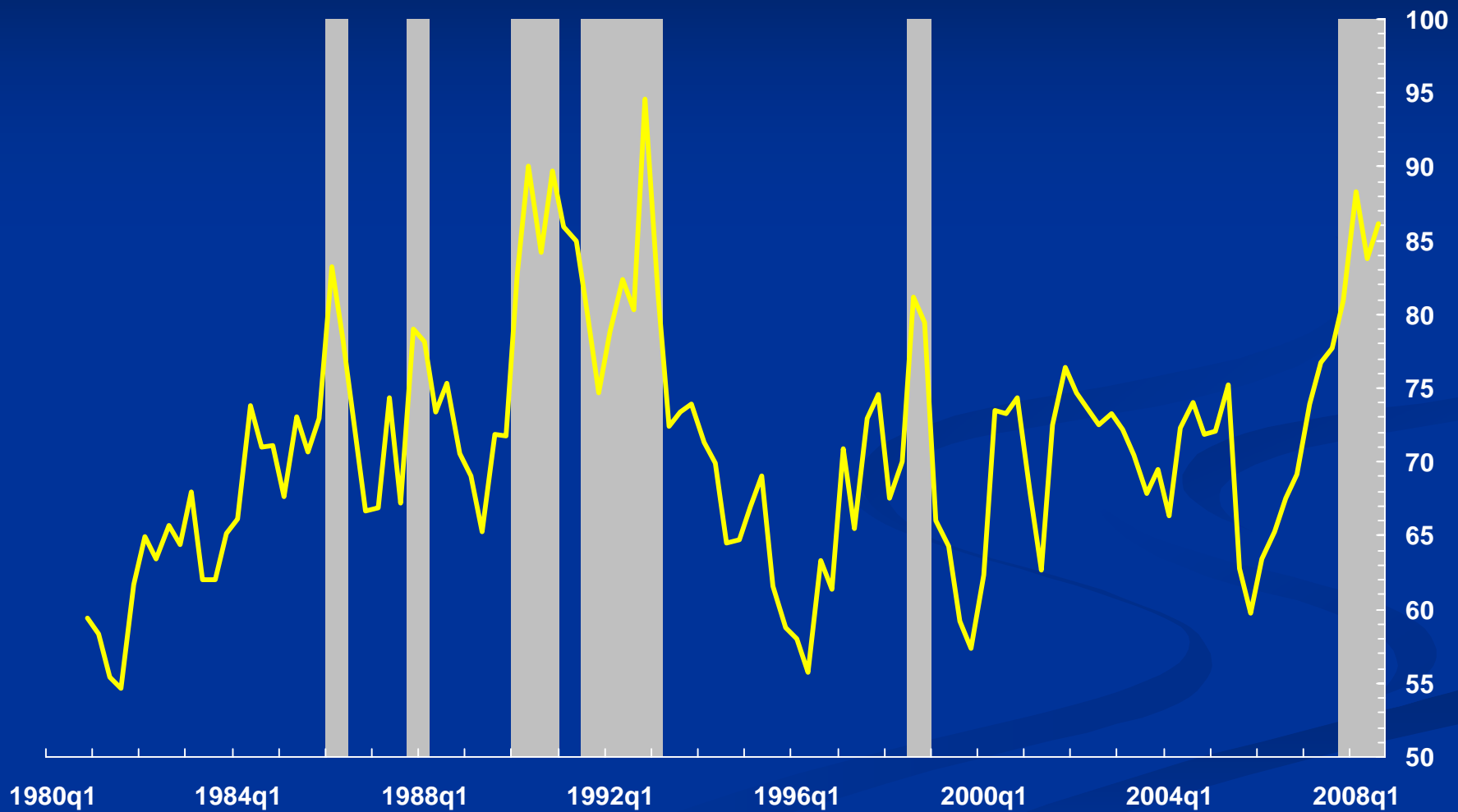
Note: Shaded areas indicate periods of financial stress.

Example: FSI for United Kingdom



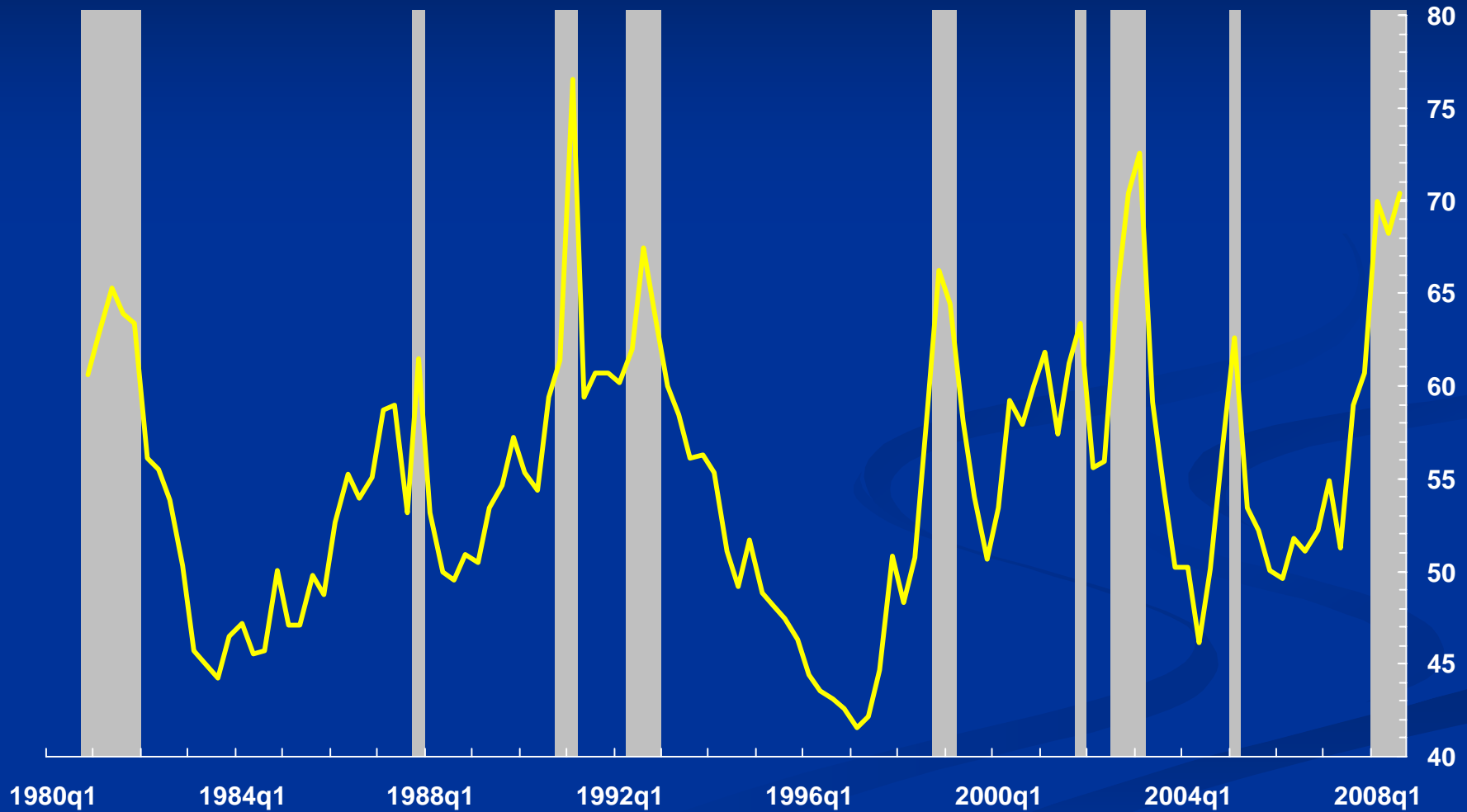
Note: Shaded areas indicate periods of financial stress.

Example: FSI for Japan



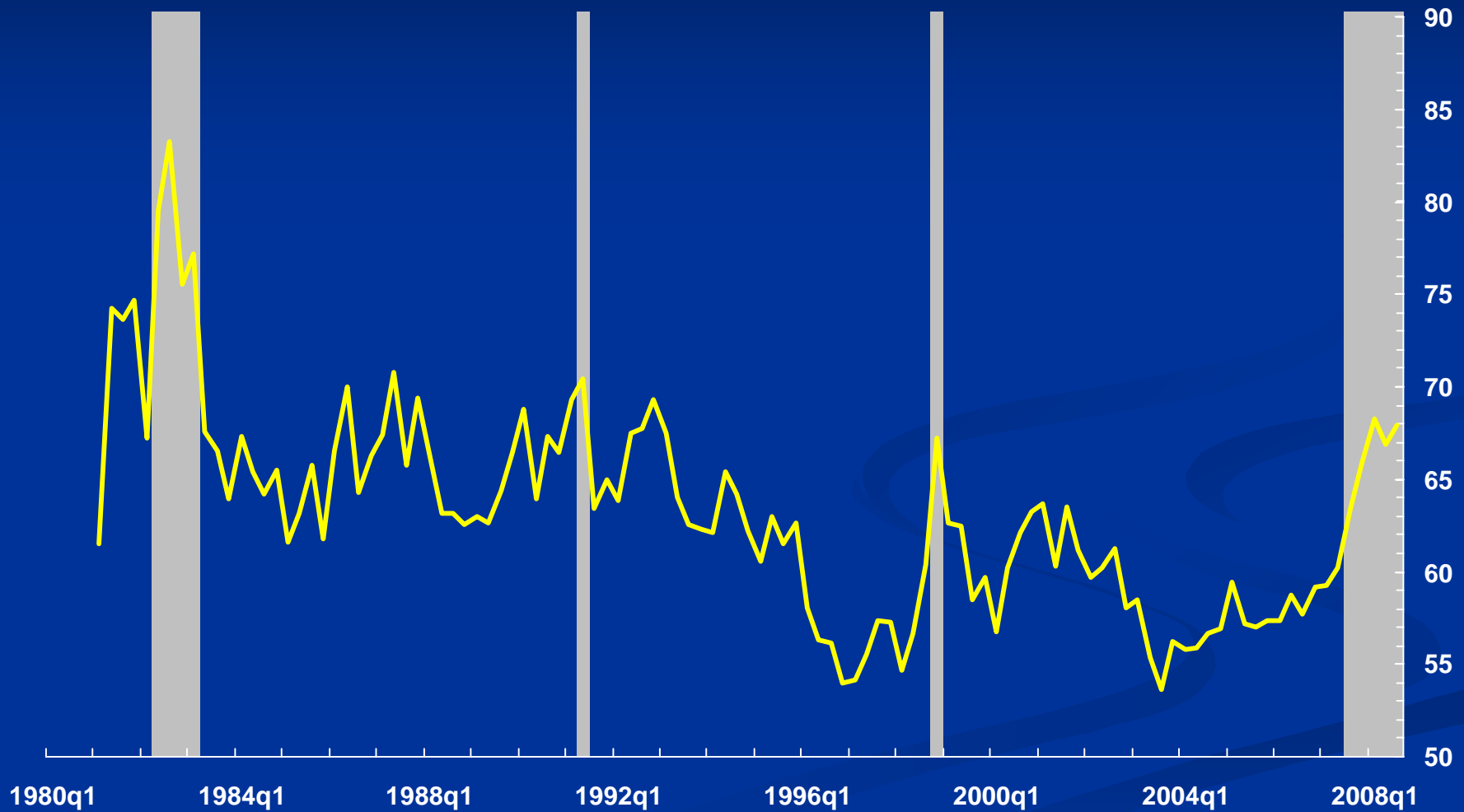
Note: Shaded areas indicate periods of financial stress.

Example: FSI for Germany



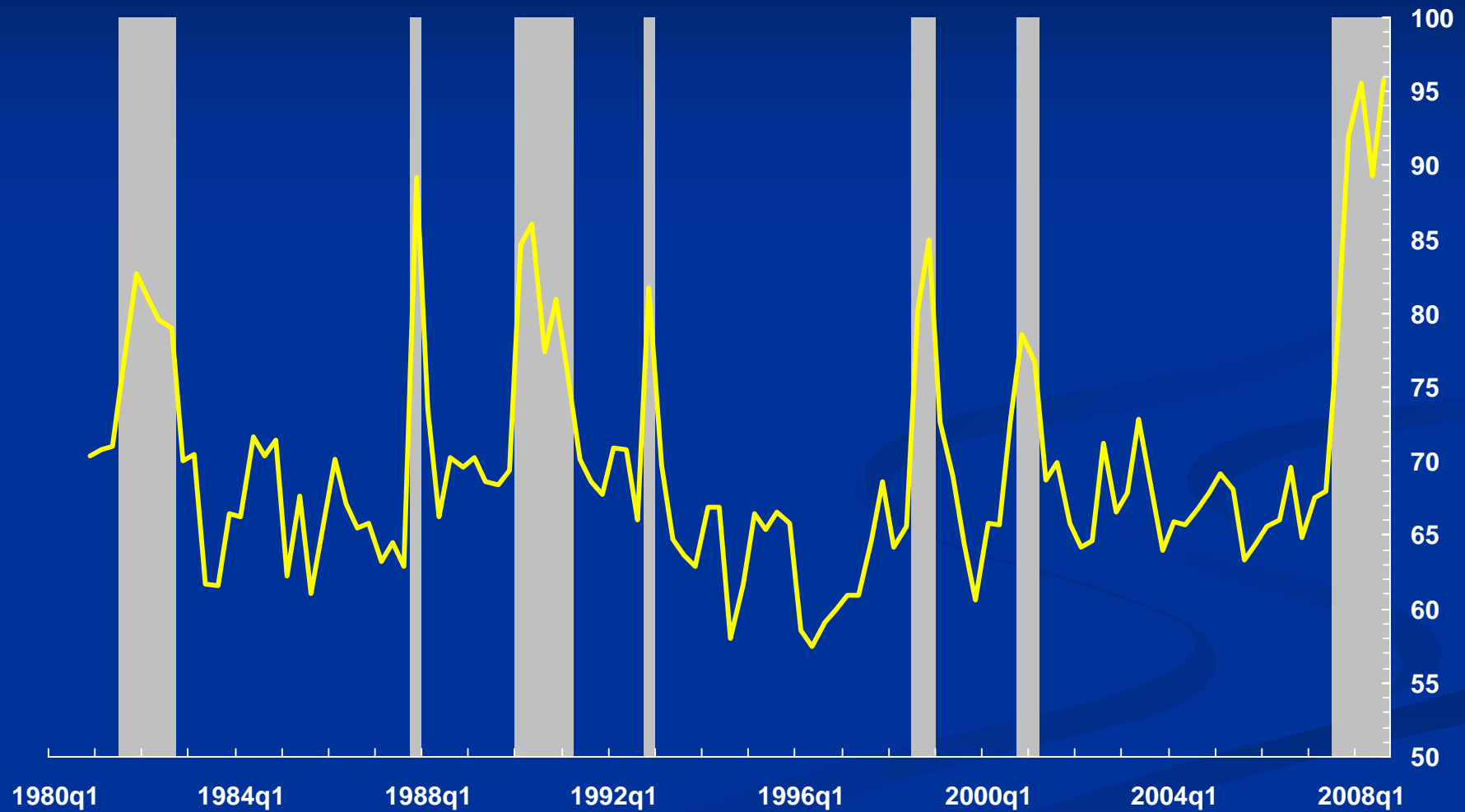
Note: Shaded areas indicate periods of financial stress.

Example: FSI for France



Note: Shaded areas indicate periods of financial stress.

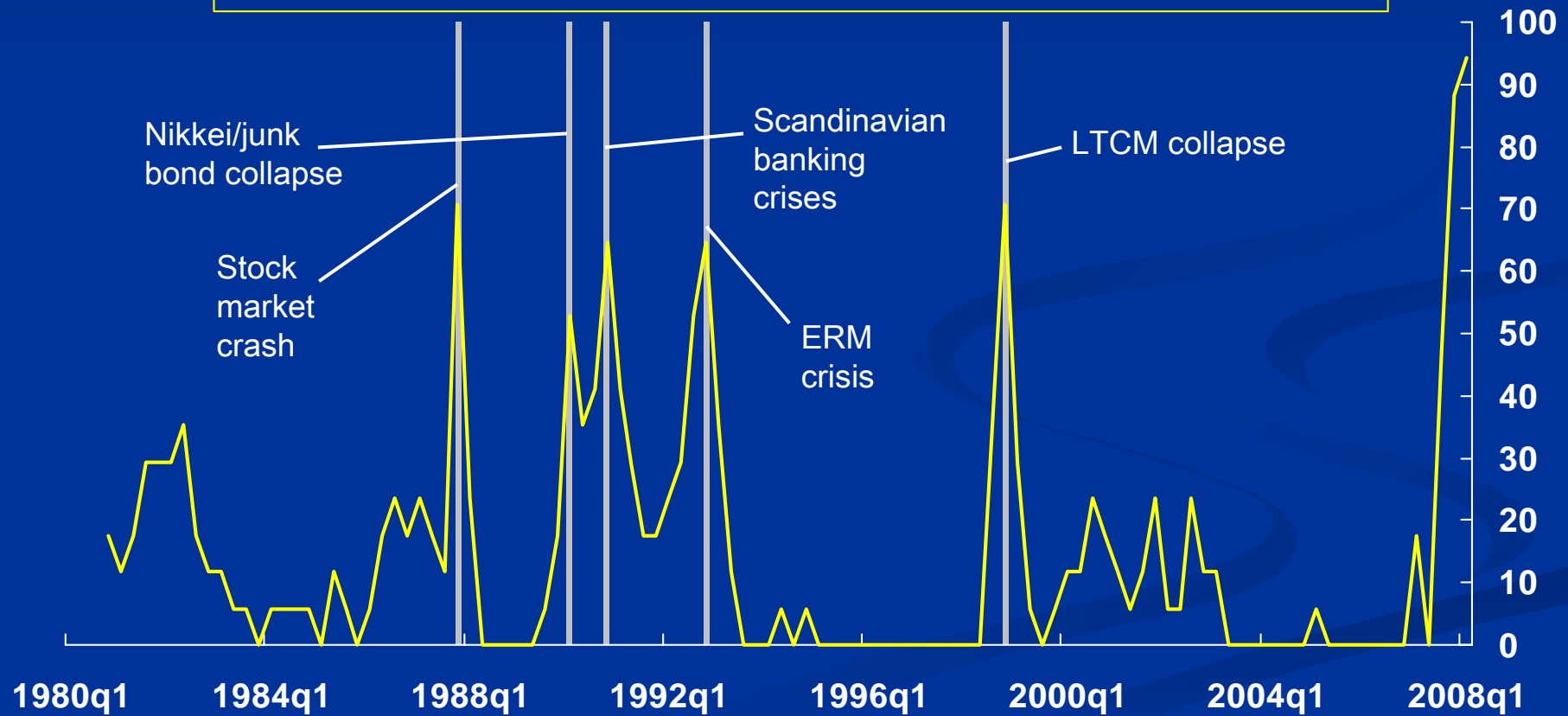
Example: FSI for Canada



Note: Shaded areas indicate periods of financial stress.

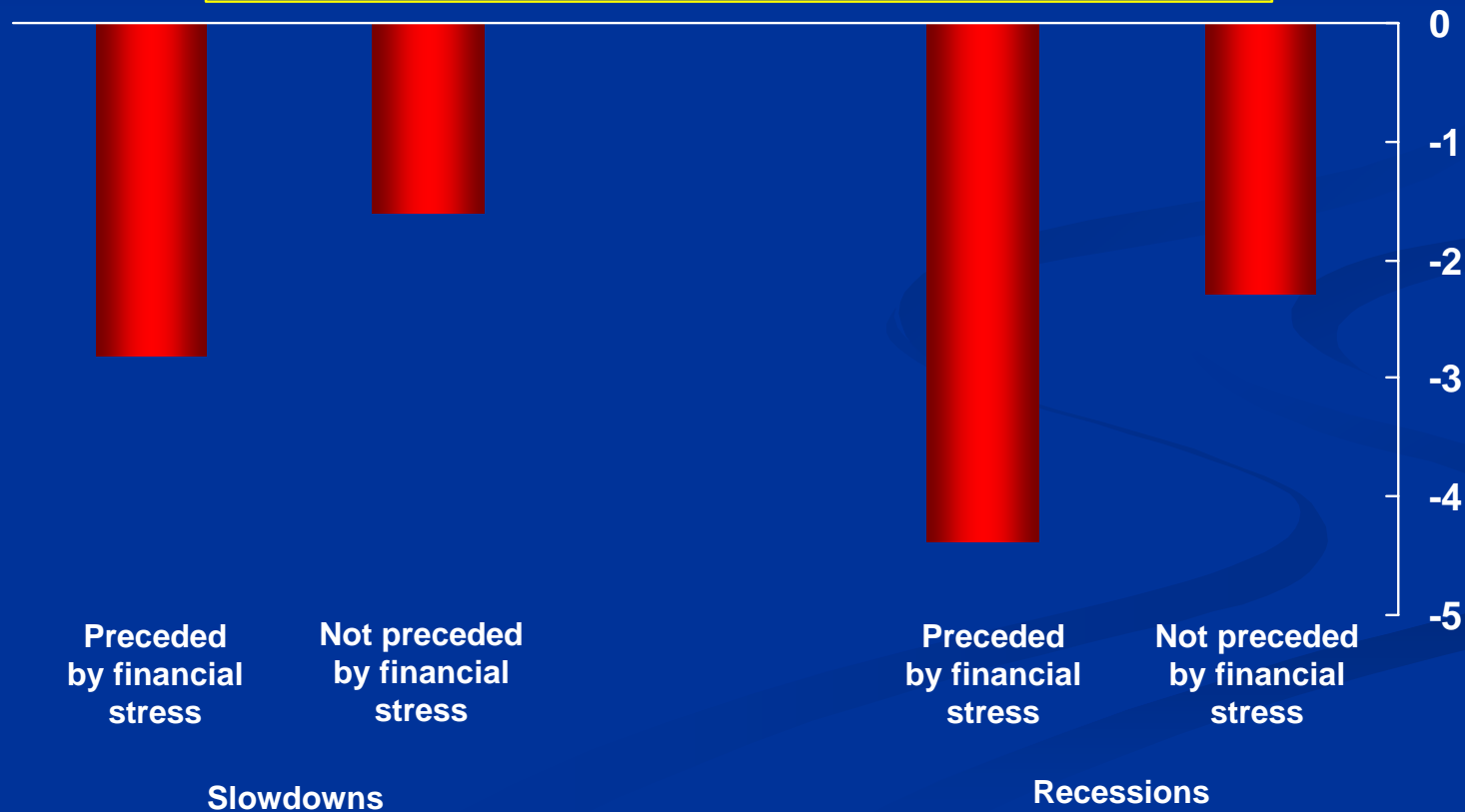
Main global financial stress episodes are captured by FSI

Share of Countries Experiencing Financial Stress



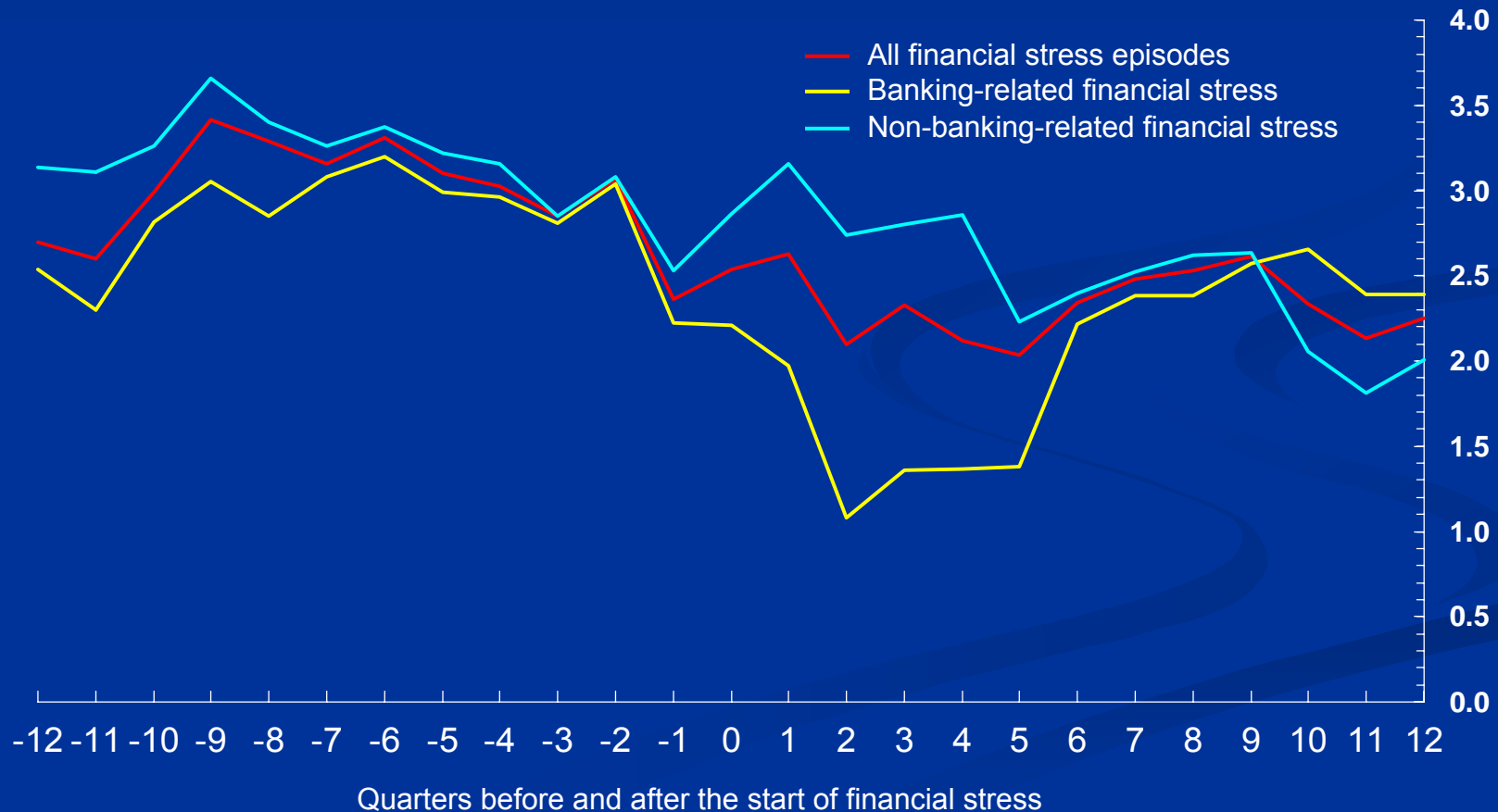
Economic downturns tend to be more severe when preceded by financial stress...

**Cumulative Output Loss during Slowdowns and Recessions
(median; percent of GDP)**



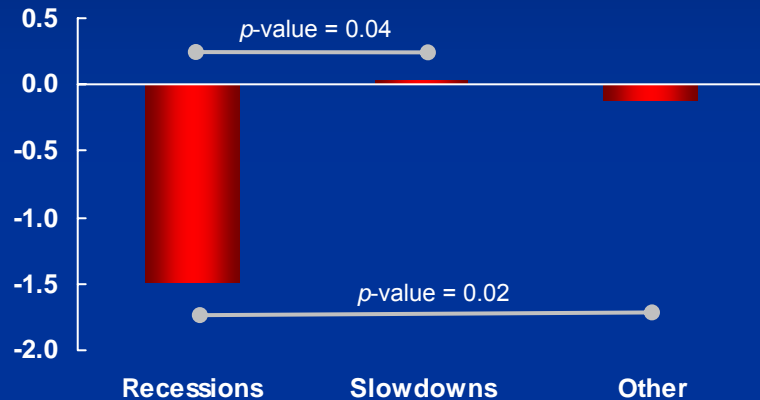
Banking system stress is associated with larger output consequences

Real GDP
(percent change from one year earlier)

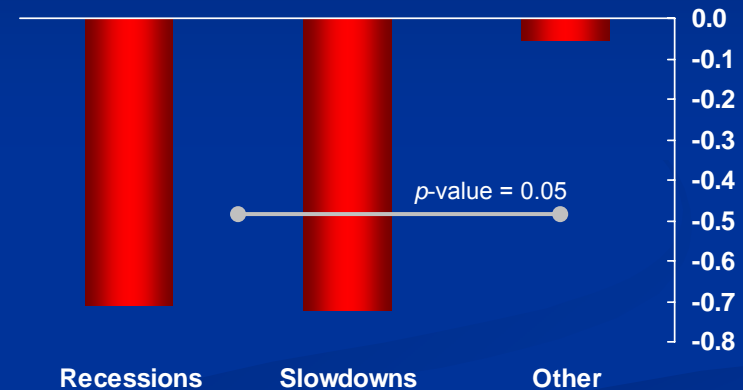


Downturns more likely with financial imbalances and large corporate borrowing

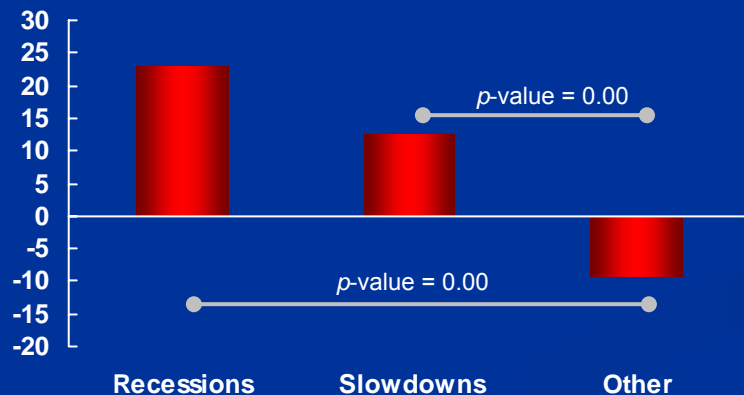
Household Net Lending/Borrowing (percent of gross disposable income; deviation from trend one year before start of financial stress)



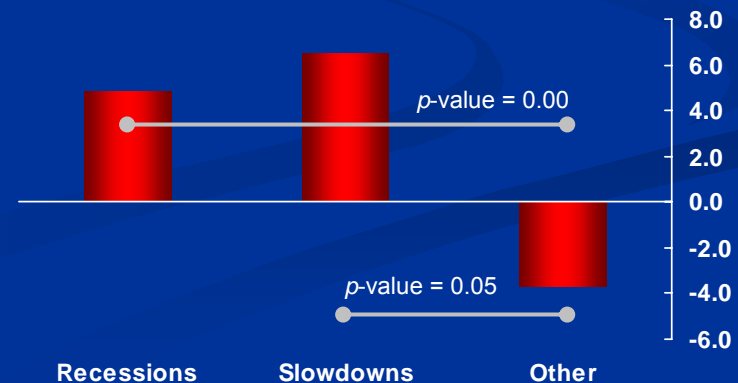
Nonfinancial Corporate Net Lending/Borrowing (percent of GDP; deviation from trend one year before start of financial stress)



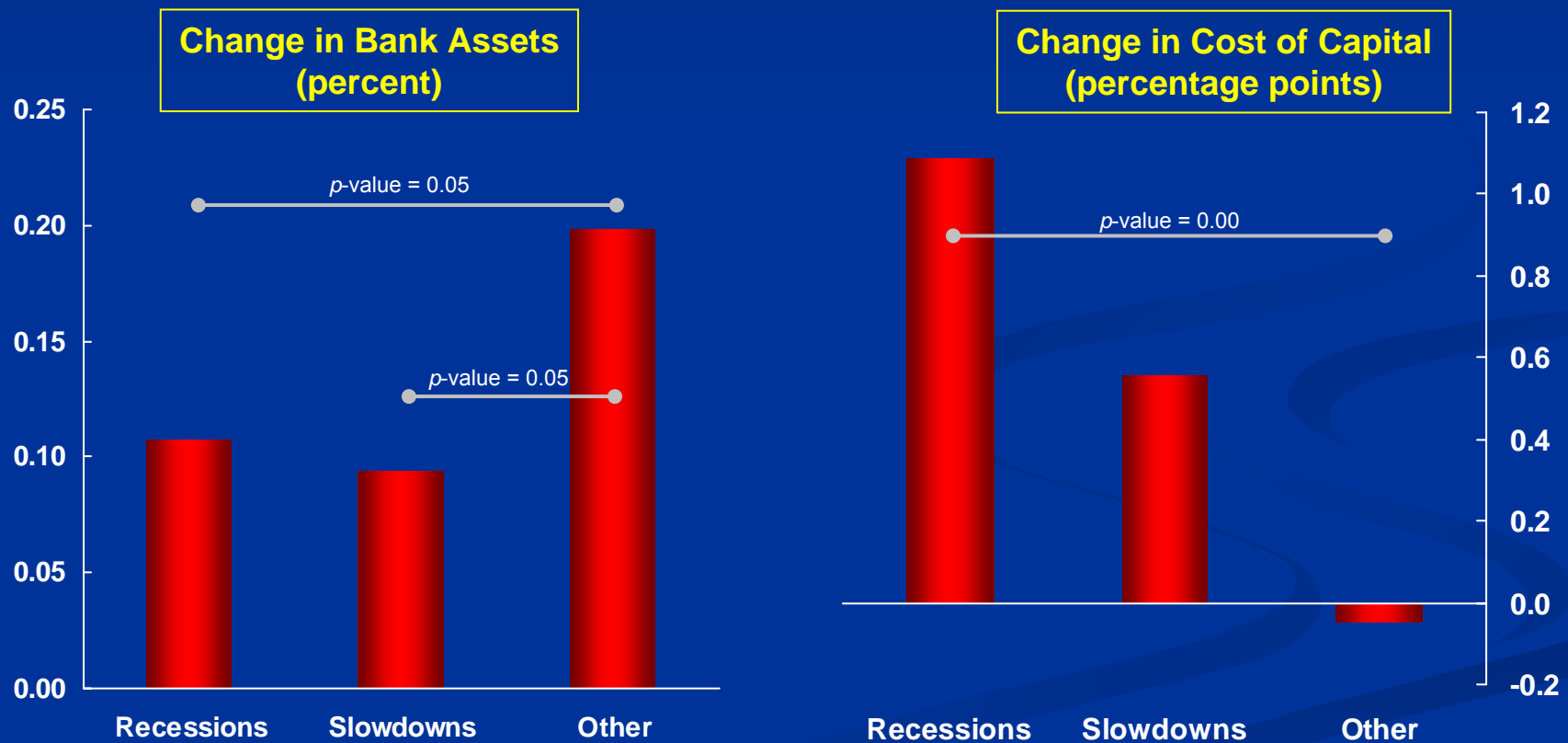
Real House Prices (cumulative percent deviation from trend over six quarters before start of financial stress)



Credit (percent of GDP; cumulative percent deviation from trend over six quarters before start of financial stress)



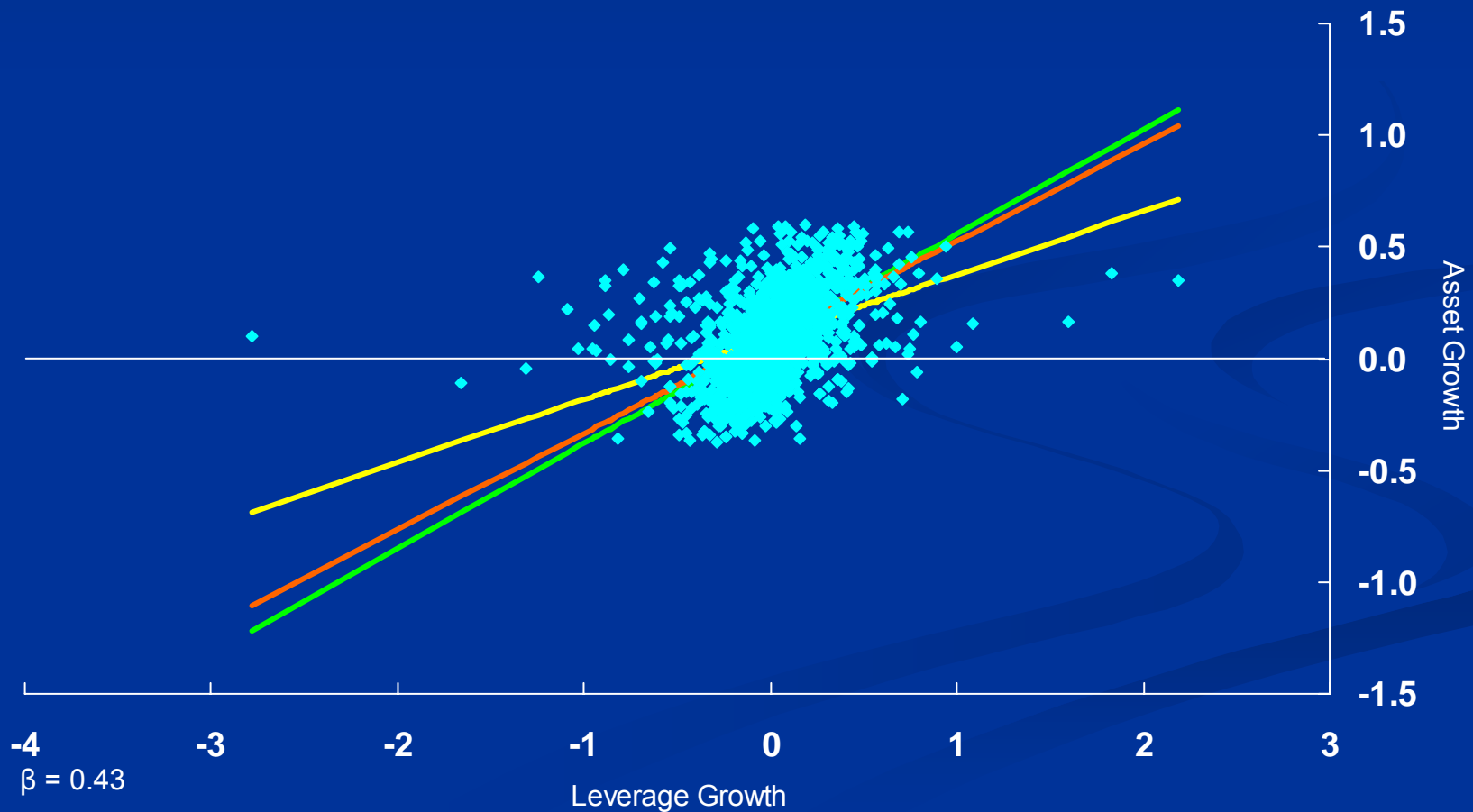
Evidence of “credit crunch” in banking-related recessions



Investment banks' leverage is procyclical

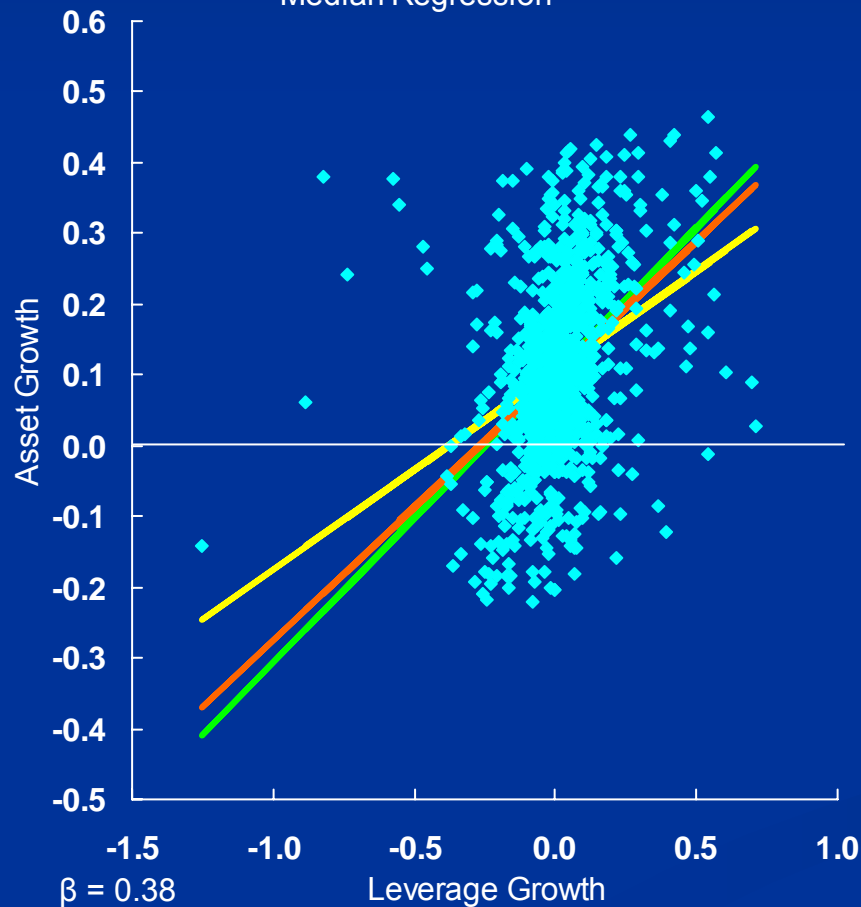
Top 50 Investment Banks

◆ Investment Banks — Linear Regression — Linear Regression (excl. outliers) — Median Regression

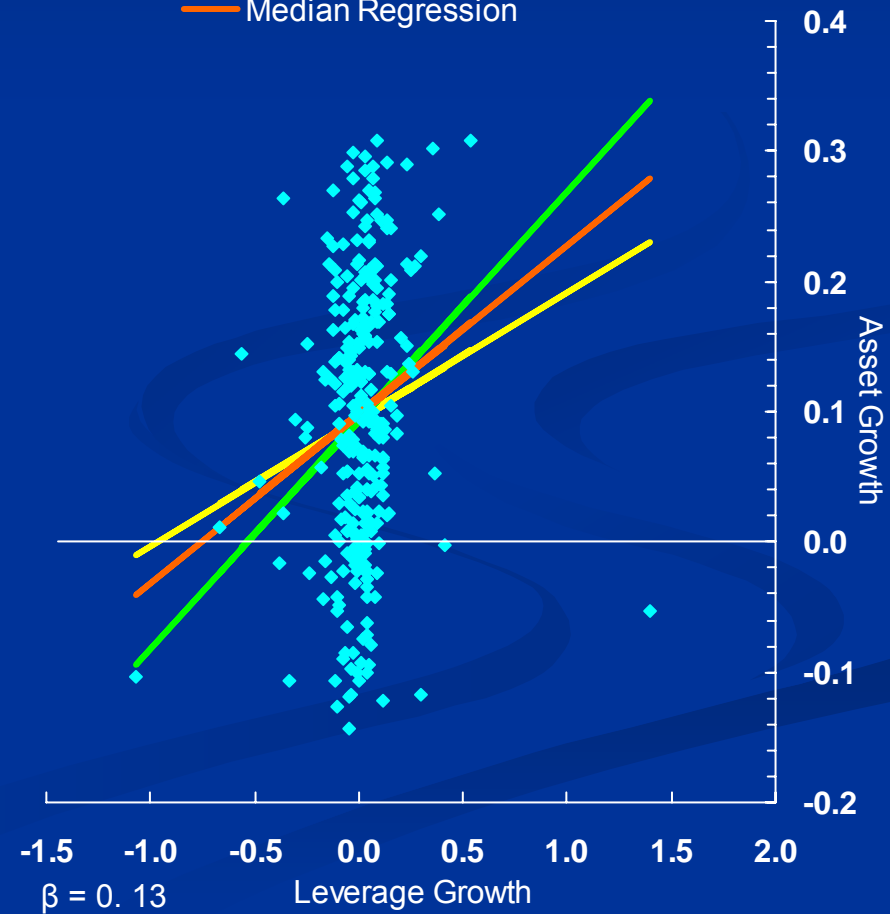


...while for commercial banks evidence is mixed

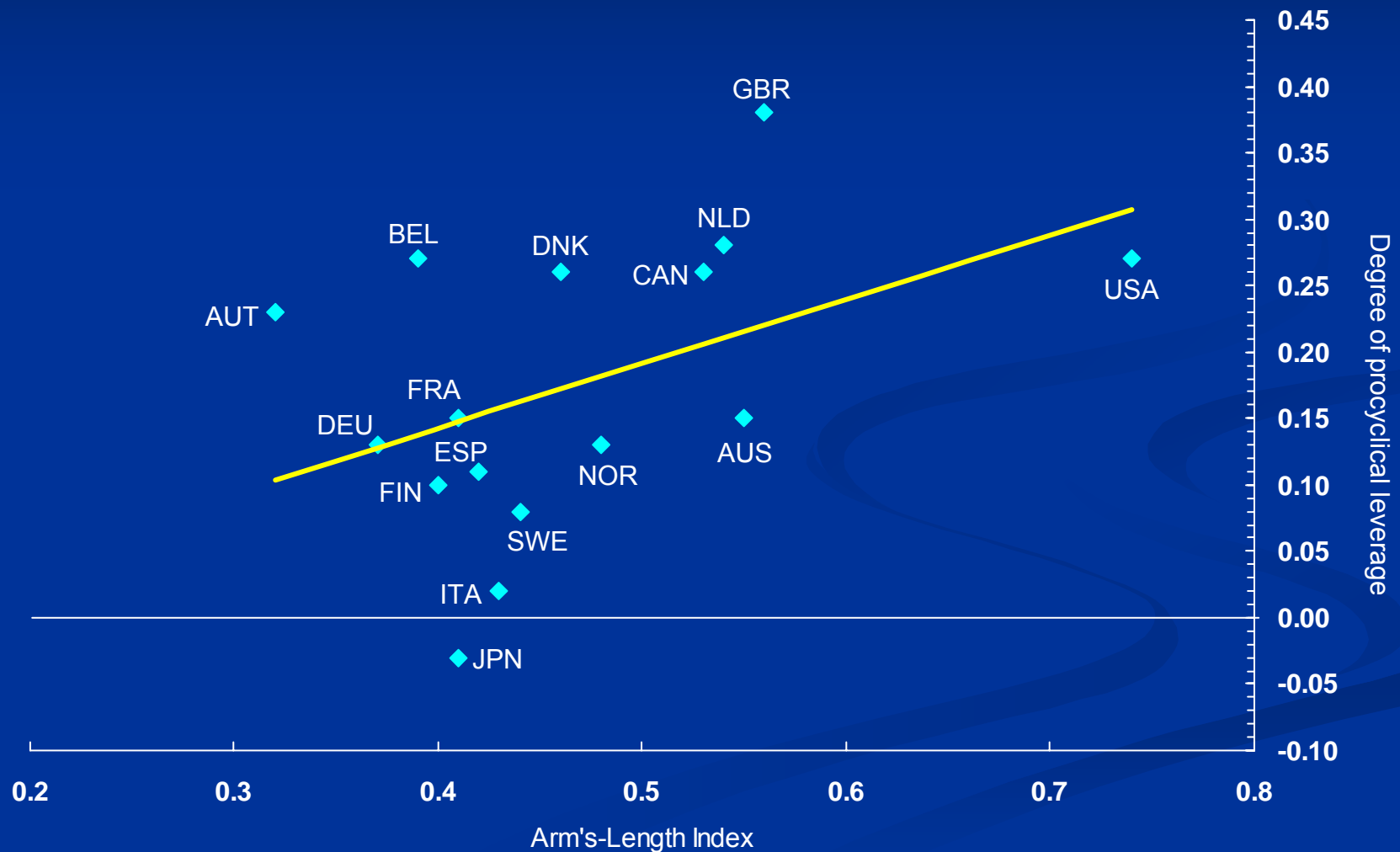
- ◆ United Kingdom, Commercial Banks
- Linear Regression
- Linear Regression (excl. outliers)
- Median Regression



- ◆ Germany, Commercial Banks
- Linear Regression
- Linear Regression (excl. outliers)
- Median Regression



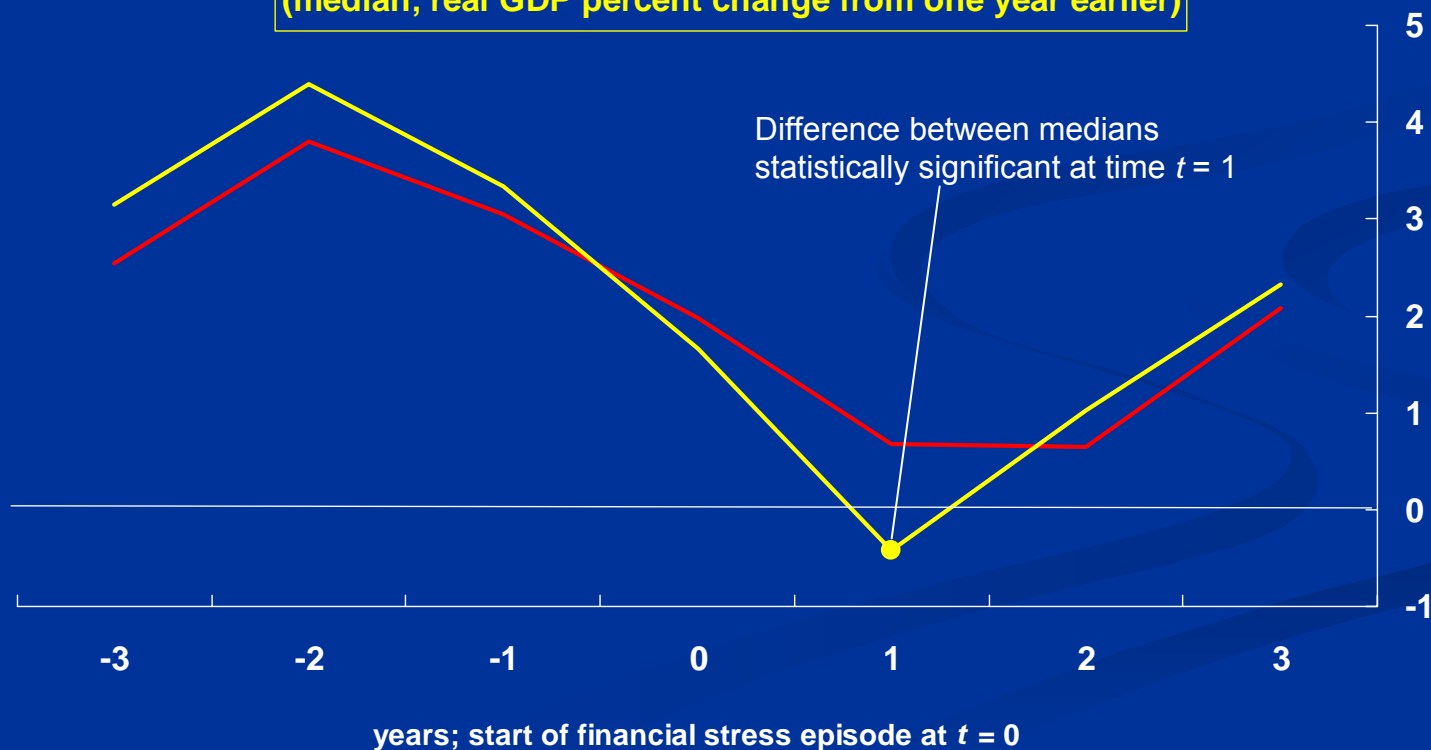
More evidence of procyclical leverage in arm's-length financial systems...



...which may explain larger real spillovers from financial crises in these economies

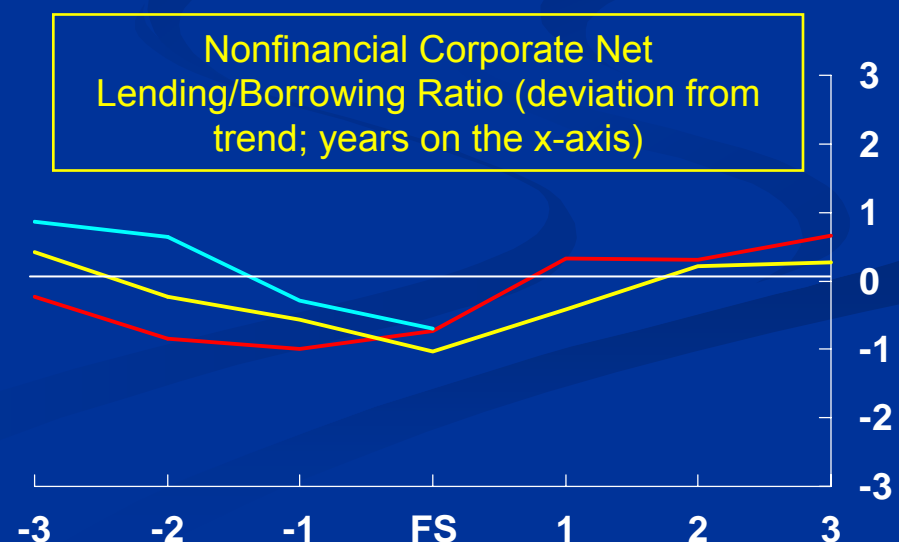
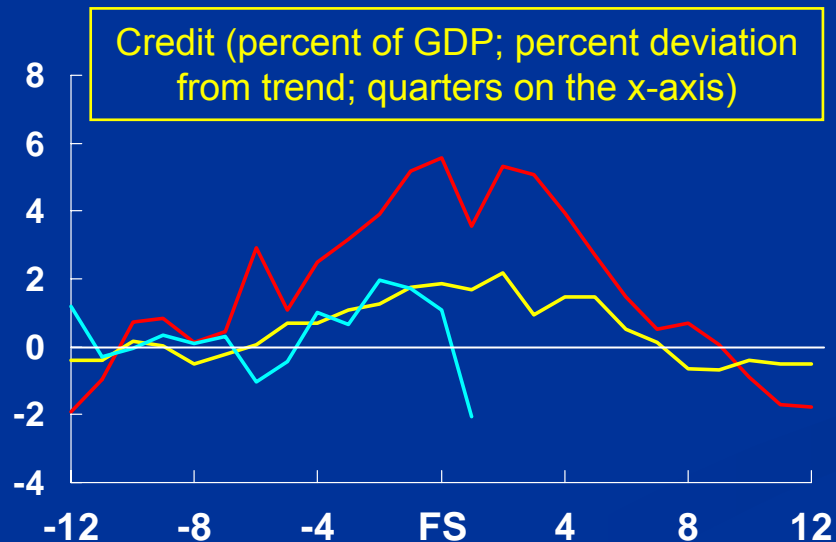
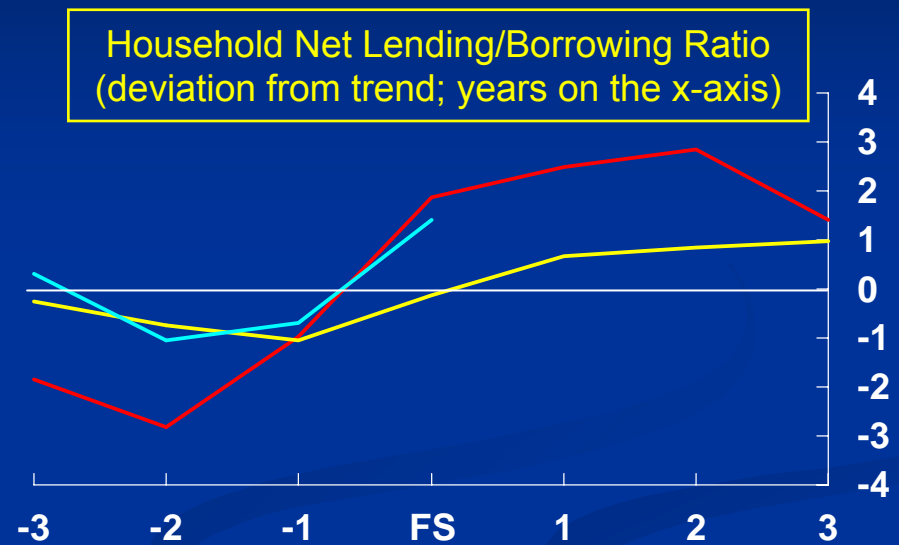
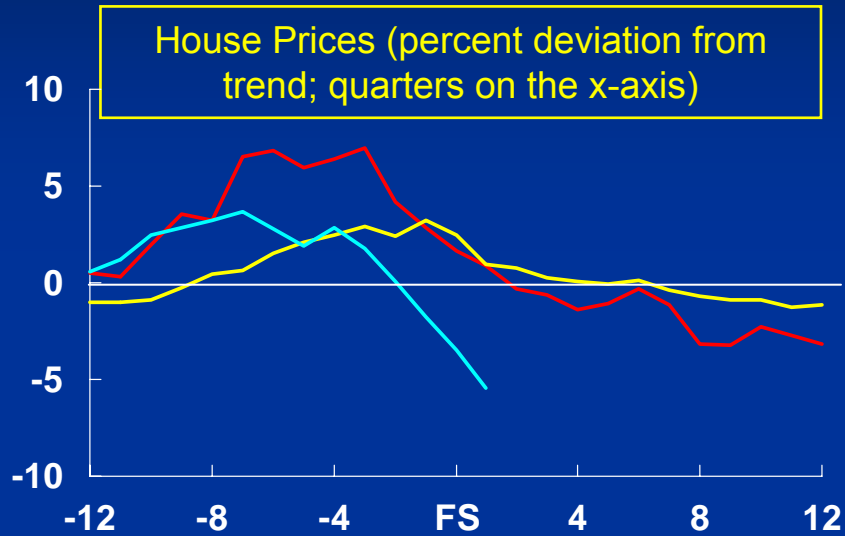
- Countries with above-median arm's-length financial systems
- Countries with below-median arm's-length financial systems

Financial Stress Followed by Recessions: Output (median; real GDP percent change from one year earlier)



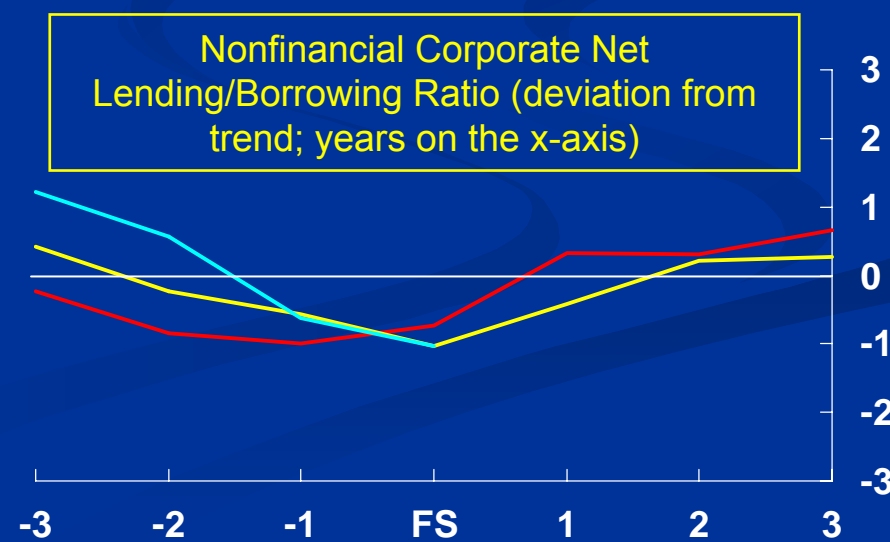
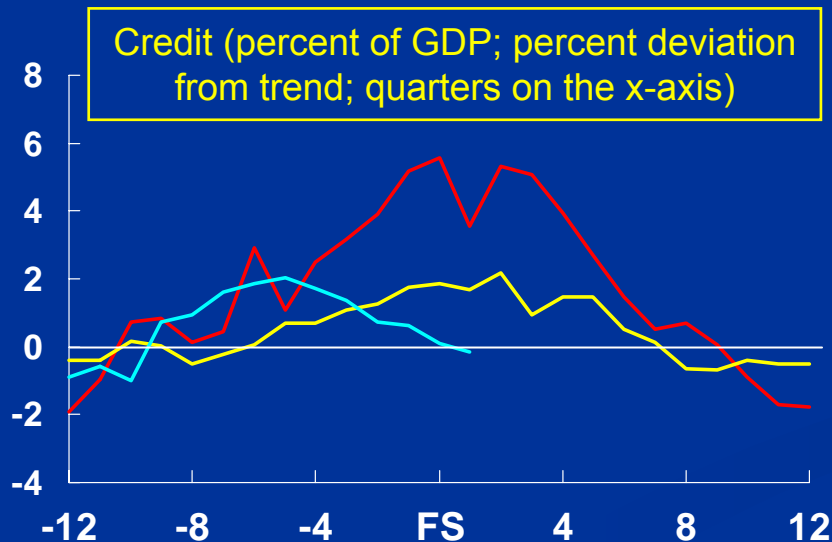
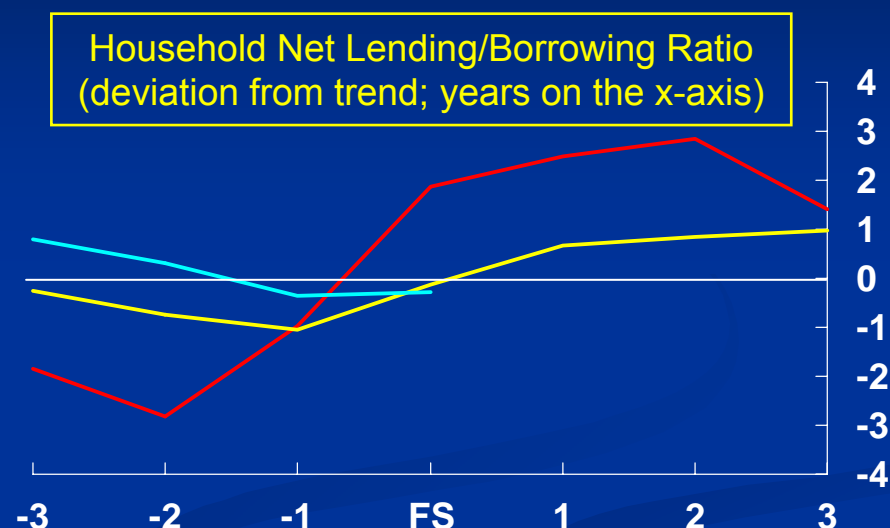
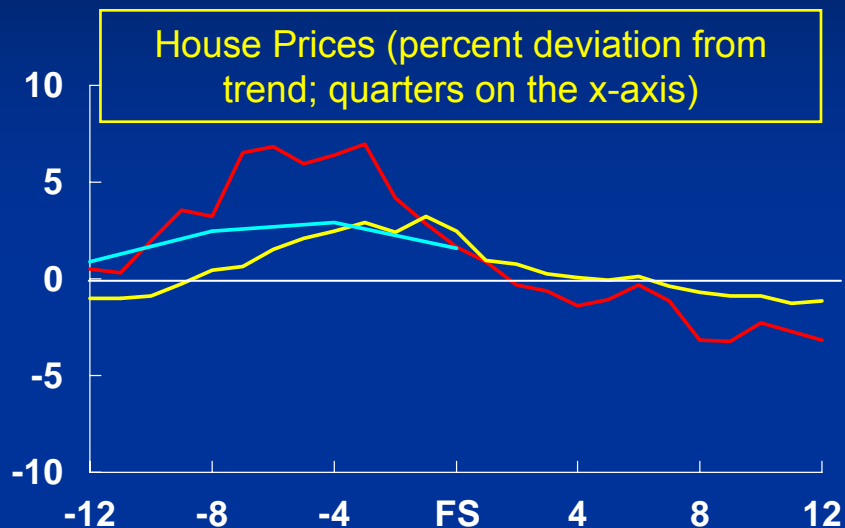
The Current Episode in Historical Context: United States

- Median across financial stress episodes for six case studies
- Median across financial stress episodes followed by recessions
- United States (current episode)



The Current Episode in Historical Context: Euro area

- Median across financial stress episodes for six case studies
- Median across financial stress episodes followed by recessions
- Euro area (current episode)



Policy Message

- One important take-away from this analysis is the importance of core financial intermediaries in the transmission of financial shocks to the real economy.
- This underlines the importance of restoring the capital bases of these institutions to help alleviate economic downturns.