

## *Talk to UCLG, Istanbul, Sunday November 30, 2008*

### Title Slide

Good morning. I would like to express a warm **Thank You** to you, the United Cities and Local Governments, for inviting me, and to Mayor Topbaş for hosting us here in Istanbul... .. in this beautiful location in this amazing and wonderful city ... where it is easy to forget for a few hours that the world is in a deep economic and financial crisis.

### This global crisis is here. It affects us all ...

- ... some of us in this room directly and personally;
- ... all of us in some way, directly or indirectly.
- We read about bank and business failures and layoffs in our cities.
- We see the signs advertizing special sales in shop windows. Here in Istanbul, some stores offer *Yüz de Elli, Yetmiş, Doksan İndirim*, 50-70-90% discounts.
- Shopkeepers and taxi drivers tell us their business is down by half or more.
- We hear graduating students say they have no hope of finding a job.
- We see more homeless people in our streets.
- We see the angst in people's faces on buses, on ferry boats, in the metro.
- We know that street crime has begun rising in many places.
- We recognize that the economic plight of so many people has played, and will play, a major role in past and future elections in our cities and countries—as voters blame current leaders and put their hopes in new ones.

### This morning, my objective is

1. to give you a **global perspective** on how we see the global financial crisis playing out in terms of **real economic effects** next year.
2. to share some thoughts from the Bank's urban group on how the crisis may **affect urban areas and their governments**.
3. to explain how the World Bank Group – as part of the international system – **aims to respond** to these problems.

### Slide 2: Economic Growth is Down

- First, as this graph shows, **we expect that the world economy will grow marginally in 2009.**
- **We do not project a global contraction at this time.** Indeed, a contraction of the world economy has never occurred since the second world war.

- But there is **huge uncertainty** about next year. Projections vary widely and keep changing rapidly. So a global contraction **is not impossible**.
- The slowdown is likely to be most acute in Europe and in the US—where the financial deleveraging process is most acute.
- Developing country economies will still grow a bit more than 4%, much lower than the recent past, but higher than the high-income countries.

### **Slide 3: Economic Growth in Large Developing Countries**

- If we look at all the large developing country economies, we see important differences, but we also see that they all will grow much more slowly.

### **So, how deep will the effects be and how long will this crisis last?**

### **Slide 4: Housing Prices**

- The slowdown will be driven in large part by **asset price declines**.
- This graph shows an index of house prices in the US. It shows that **house prices are falling**. So families have less **wealth**, and therefore they consume less. US Households are already cutting back.
- This is bad news. **Recessions tend to be deeper and last longer** if they are accompanied by asset price “busts” of this kind than if they are not.
- The graph also shows that asset prices **movements may differ greatly across cities**. Los Angeles experienced the largest house price bubble in the US, while at the same time house prices in Dallas were far better behaved.

### **Slide 5: Equities**

- In addition to housing prices, stock prices have also fallen all over the world:
- in developed markets such as the US (top left) and Japan (bottom left), or emerging markets such as China (top right) or Brazil (bottom right) ...
- ... and the same picture holds true for London or Frankfurt, India or Russia.

### **Slide 6: External Financing & Financial System Vulnerabilities**

- The depth and length of the impact of the crisis will also depend on countries' financial vulnerability, that is, the vulnerability of their banking and financial systems, and the vulnerability of their financing positions.
- For example, if a country has a relatively larger current account deficit, as shown in this graph, it is relatively more vulnerable to the drying up of liquidity in international capital markets.

### **Slide 7: Capital Flows to Developing Countries**

- **So, what are the prospects for capital flows to developing countries, and how vulnerable are countries to international illiquidity?**
- This graph shows the **EMBI plus**, the emerging market bond spread index produced by JP Morgan. It measures the cost of capital for emerging market sovereign borrowers. You can see how this cost has risen in recent months.
- **Nobody knows how fast financial markets will “thaw” and, if they do, how much risk aversion** there will be towards lending to countries, large corporations, banks, and sub-national governments in the developing world.
- **We do know, however, that, with virtual certainty, most municipalities in developing countries will face even higher costs than these.**

### **Slide 8: Exports Down**

- The final **important channel of contagion** between countries' economies is **trade flows**.
- The World Bank estimates that **world trade will fall next year** by more than 2%, the first fall since the recession of the early 1980s.
- **This will have** serious implications for exporting industries and for the urban areas that are home to many of them.
- To give you one example, I have traveled extensively around Turkey and talked with managers and workers in industries in different cities. Turkey has many vibrant urban economies, including here in Istanbul but also places like **Gaziantep with its textile industry** and **Bursa with many of Turkey's automotive producers**. Bursa in particular has been hit very hard by the **slump in demand for car exports**.
- **The cities that depend most on export industries will likely face the biggest downturns**. In Turkey, for example, this includes the shipping, automotive, and construction industries: all three are heavily export oriented and all three are already suffering greatly. Similarly in other countries.

### **Slide 9: Impact on Cities**

- **which leads me to the profound impact of the crisis on cities ..**
- The **declining property prices** will hurt families, firms, and municipal balance sheets. Foreclosures and vacant buildings may increase.

- **Municipalities' revenues will fall, and borrowing will be harder and cost more, so there may be no or limited scope for deficit spending.**
- The crisis creates major **social challenges**. Financial crises tend to hit the urban poor hardest. During the 1994 crisis in Mexico, for example, many urban households lost 1/3 or half of their income.
- Overall, **unemployment** will be higher; **migration** into some cities will increase; and **crime** will likely rise too in many cities.
- Reduced finances and increased needs pose a double whammy. And governments and cities face a particular dilemma if they are forced to cut infrastructure investments, which are crucial for long-term growth. During the Asian crisis, for example, Indonesia's public infrastructure investment fell from **7% of GDP in 1995 to 2% in 2000**. There are no magic solutions, but as much as possible productive investments should be maintained.

### **Slide 10: The Global Crisis Demands Global Solutions**

- **What can be done, and what is being done?**
- At the G-20 summit in Washington, world leaders called for global solutions to this global crisis. The communiqué stated: "*We agreed that a **broader policy response is needed, based on closer macroeconomic cooperation, ...***" And: "*... through continued **partnership, cooperation, and multilateralism**, we will overcome the challenges before us and restore stability and prosperity....*"
- In their communiqué, the G20 leaders stressed the **important role of the International Monetary Fund in crisis response**. This slide shows the four IM led international bailout packages in recent weeks. There will be more.
- Many other measures are being discussed. I would like to focus on 3 points:
  1. **Transparency, Integrity, and Effective Regulation are key, especially in financial markets**. I would like to highlight that this includes sound and prudent public financial management by cities, and strong national central-local fiscal frameworks.
  2. **Continued open global trade flows are crucial**. Food products and the still high world food prices provide one example. The production cuts and layoffs in export industries I mentioned, and how they affect the working poor all around the world, provide another example.
  3. **Policy coordination matters**. Especially on trade, on deposit insurance and financial regulation, and on fiscal and macroeconomic policies.

### **Slide 11: Role of the World Bank Group**

- The G20 communiqué stated: *“We are mindful of the impact of the current crisis on developing countries, particularly the most vulnerable. We reaffirm the importance of the Millennium Development Goals.”*
- *And: We “encourage the World Bank and other multilateral development banks (MDBs) to use their full capacity in support of their development agenda, and we welcome the recent introduction of new facilities by the World Bank in the areas of infrastructure and trade finance.”*
- The World Bank is **well-capitalized and liquid**, and we will use our financial capacity as needed. We expect to **more than double IBRD lending to middle-income countries and emerging market economies over the next 3 years— with up to about 30 billion dollars per year available during 2009-11 for good projects and good programs that can make use of these funds.**
- Here **in Turkey**, for example:
  1. we are increasing our credit lines to SMEs, for exporters, and for private sector investments in energy efficiency and renewable energy; and we are also increasing policy lending in support of competitiveness and jobs;
  2. and in our advisory and technical work, we are working with the government on ways to increase technology-related investment, and, for example, improve the efficiency of public spending, both crucial for growth in the current environment.
- IDA donors have committed US\$42 billion for the next 3 years which can be frontloaded to meet the needs of the poorest countries.
- The **IFC**, the World Bank Group’s private sector arm, has rolled out 3 new facilities: (1) a 1.5-3 billion USD expanded **trade financing** program; (2) a **bank recapitalization fund**—with 1 billion USD from IFC and 2 billion USD from Japan so far; and (3) an **infrastructure crisis facility**, with 300 million USD from IFC to mobilize 1.5-10 billion USD from other sources.
- Some of this WBG financing will go **to municipalities**, for example, for water, transport, other infrastructure, or human capital investments; or through social safety net programs such as **conditional cash transfers**.

**Slide 12:** Finally, I would like to emphasize that **the Long-Term Global Agenda Must Continue. We all Must Help Address Climate Change.** All of us—individuals, families, business, and cities alike—can and must contribute.

**Slide 13: Thank you.**