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Emerging economies should spur growth to weather global financial crisis: Salim Raza

Syed Salim Raza, Governor State Bank of Pakistan has said that developing countries will have to stimulate their domestic economies, increase their capacity to consume surplus production in the wake of shrinking exports and achieving sustainable growth to effectively weather international financial crisis.

Speaking as a Chief Guest at a lecture on “Financial Meltdown and Global Economic Recession: Causes and Effects” organized by Karachi Council on Foreign Relations, Economic Affairs and Law (KCFR) at a local hotel in Karachi today, Mr Raza dwelt at length over the causes and effects of the ongoing crisis in the international financial markets. He said that in the wake of global financial meltdown, emerging markets have suffered a sharp fall in demand for their products, whether commodities or manufactured goods as major economies have contracted, and a sharp slowdown in private capital flows to the order of over $500 billion between 2007 and 2009 has taken place.

He said Pakistan had not been adversely affected by the global financial crisis as the rest of the world. Nevertheless, one impact of the global financial meltdown is that private inflows of the order we witnessed until 2007 have dried up. “The implication is that the role of multilateral inflows has become all the more important. And, the fact that our macroeconomic stabilization program is on the right track will help these type of flows to materialize speedily,” he said.

Mr Raza said that Pakistan’s economy is likely to grow between 4%-4.5% in the next fiscal year. Responding to a query, he said the inflation is likely to be in single digit in the next fiscal year. He said that the Federal Government has successfully implemented macroeconomic stabilization program and added that we have been able to meet all the targets of the International Monetary Fund. Mr Raza also appreciated the role of IMF in the macroeconomic stabilization of Pakistan.

SBP Governor said the pledges of $5.28 billion made at the recently concluded Friends of Pakistan meeting in Tokyo show the confidence of international community over economic performance of the Government.

Mr Raza said that how emerging markets are going to adapt themselves to the changing scenario will depend partly on how the major economies strategically respond to the problem of substantially weakened financial intermediation capacity in their economies and on how far in the future their economies would turnaround.

He pointed out that governments in the West are providing heavy support to banks via capital injections and via purchase of overvalued assets. However, the concern here would be that if the process of reviving bank's capacity to resume active lending, at more normal risk premiums, become conditional on tight regulations and on the repairing of the domestic markets - mainly the mortgage markets – as opposed to the much more global scope of investment and lending, that had become increasingly the practice of financial market leaders since the mid '90s, then there could be a prolonged slowdown in the cross border flows of capital to the emerging markets.

"Secondly, if the resumption of growth in the major economies is delayed, that too will impinge on emerging markets via the slow revival of demand for their exports," he said. "It is not clear at this stage whether or not we are looking at 2010, or beyond as the water shed for the turnaround," he added. He said the shift of the damaged asset pool is itself dependant on the revival of demand, and on the stabilization of the housing market prices which, in turn, is at least partly dependent on bank's capacity and willingness to lend. For the US to lead the revival in demand is going to be difficult. US households' total liabilities have increased by 2.5 per cent to $14,242 billion since mid-2007. Their assets, however, have fallen in value by 16 per cent to $65,719 billion. "So without increase in demand from other parts of the world, and a revived banking system, when sustainable recovery will begin, will remain a somewhat uncertain exercise," he said.

Stressing upon the need to stimulate inter-regional channels of trade, Mr Raza said that what had gone wrong was the increasing disconnect between the real economy and the financial economy, which greatly exaggerated the amount of liquidity that was available for global growth. "This 'leverage' is now progressively being rationalized, and we will see lower growth for sometime as the adjustment occurs," he said, but added it should remain our objective that the globalization of trade and capital flows remains a priority and the world's economic managers discourage protectionism policies firmly.

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