Differential Impact: Why Some Countries Were Hit Harder Than Others during the Global Crisis-A Review+

Dakup D. Koplamma*

I. Introduction

Though many analysts are of the opinion that the global financial crisis was triggered by the US sub-prime mortgage crisis of 2007/2008, the truth remains that its impact is still being felt by many economies around the globe. The crisis, generally manifested in form of inadequate liquidity as a result of credit crunch in the financial markets, and a general rapid and high decline in economic activities of production, distribution and consumption of goods and services. Without doubt, the financial crisis affected the global economy. However, its impact was different for every economy due to trade or financial openness, underlying vulnerabilities to external forces or the strength of their economic policies. In Nigeria, for instance, the crisis affected several sectors of the economy but with minimal impact when compared with other countries of the world. The focus of this paper, therefore, is to examine the various ways in which different economies were impacted by the economic crisis and why some felt it more than others.

II. Summary of the Paper

The authors began with a brief description on how the global financial crisis spread into many advanced, emerging and developing economies through various channels. They stressed that the crisis spread to advanced and emerging economies mainly through financial linkages and to developing economies through trade linkages. Consequently, most economies were flung into recession with its attendant effect of job losses. However, the world economies felt the impact in varying degree.

In examining why some economies fared better than others, the authors based their analysis on the revision in gross domestic product (GDP) growth forecasts before and after the crisis using a sample of 40 emerging market economies and 126 developing countries. The survey used consensus forecasts and changes in growth forecasts from the IMF'S World Economic Outlook (WEO). Growth forecast revisions for 2009 ranged from -18 per cent to -1.5 per cent, with the largest growth decline occurring in the Eastern European and Central Asian economies; the effects in Latin America were better as the economies in the region are mainly food exporters.

+Written by Pelin Berkmen, Gaston Gelos, Robert Rennhack and James P. Walsh and Published in Finance and Development, March 2010

*Dakup is a Youth Corps member of Research Department, Central Bank of Nigeria, Abuja. The views expressed in this paper are those of the author and do not necessarily represent the views of the institution to which he is or its policies.

The authors' analysis suggested that countries with more leveraged domestic financial systems and more rapid growth in lending to the private sector tend to suffer larger downward revisions to their growth outlook. To them, flexible exchange rate regimes helped countries to reduce the impact of the shock while countries with pegged exchange rate regimes were relatively worse-off.

They opined that the growth revision in 40 emerging markets was determined by financial factors and that:

- Countries with rapid credit growth faced much more pronounced revisions in their output forecasts than countries with smaller increase in credit.
- The stock of international foreign exchange reserves measured in numerous ways such as share of GDP, exports, or short term debt, did not have a statistically significant effect on the growth revisions.
- Countries with prudent fiscal policies, prior to the global crisis, were less prone to the effect and were in a better position to adopt stimulus measures during the slowdown.

The authors further examined growth revisions for 126 developing economies (including emerging economies). Here, the trade channel appeared to matter in this sample, although not for emerging markets. They revealed that the share of commodities (both food and overall) in total exports was associated with smaller downward growth revisions, and the share of manufacturing products in total exports was correlated with worse growth performance for all developing countries. This was consistent with the notion that countries exporting manufacturing goods to advanced economies seemed to have been hit harder by the decline in demand from these markets, while countries exporting food appear to have fared better. In conclusion, the authors suggested some preliminary policy lessons which include: exchange rate flexibility, prudent regulation and supervision of banks and solid fiscal policies.

III. Comments

The strength of the paper lies in the authors' ability to explain why some countries were hit harder than others during the global crisis. Their analysis was explicit and timely for a country like Nigeria where the impact of oil price-shocks was severely felt during the crisis compared to the impact on other countries in the region; this was because of its almost total reliance on crude oil export as a source of revenue to government. According to authors, the transmission of shocks to countries with lower financial linkages to the world (such as Nigeria) tend to occur predominantly through trades, whereas the financial channel is more relevant for countries with close financial ties to the advanced economies where the crisis originated. They also expressed that trade finance, which declined sharply at the end of 2008, affected nearly all economies (advanced, emerging market and developing), though with varying impact.

However, the prescription in favor of exchange rate flexibility is useful but over generalized to serve any meaningful and specific policy purpose. The channel of transmission of monetary impulses need to be clearly investigated in order to validate the usefulness or otherwise of having a flexible exchange rate regime as a reliable cushion to contain external shocks.

IV. Lesson for Nigeria

Nigeria was included among the sample of 126 developing economies (including emerging markets). The authors identified trade linkage as a major vehicle for transmitting the crisis to developing countries like Nigeria .This was true because crude oil price declined precipitously from US$147 per barrel in July 2008 to $47 per barrel in January 2009, leading to a decline in external reserves and hence accruable revenue. Nevertheless, the Nigerian government can overcome this crisis through the following means: Nigerian economy should investigate the channel of transmission of monetary impulses in order to validate the usefulness or otherwise of flexible exchange rate regime; ensure that the real economy benefits from the financial sector through timely and effective lending to the sector towards diversifying the economy; critical issues that support business development and enhancement in productivity such as electricity generation should be attended to; there is need for regulatory authorities to strengthen their supervisory roles towards ensuring an enabling environment for economic growth and development; and government should increase spending on agriculture as the dominant sector of Nigerian economy which engages more than 70 percent of the country's population and provides nearly 88 percent of non- oil foreign exchange earnings. It also contributes about 41 per cent of the GDP of Nigeria.

V. Conclusion

The study is vital especially for a country like Nigeria where the crisis has hit its major exports commodity (crude oil) which has in turn affected other sectors of the economy. The unpalatable effects of the oil price shocks on the Nigeria economy was in line with the opinions of the authors that the transmission of shocks to countries with lower financial linkages to the world (such as low- income economies) tends to occur predominantly through trade. This, however, does not deny the facts that the global crisis affected Nigeria foreign reserves, foreign direct investment (FDI) and equity investment, remittances inflow, foreign aid and commercial lending. This is because our economy is partly integrated with the international capital market and has strong trade ties with the United States and Euro Area. As it is, the lesson enlisted above can be leveraged upon to position the Nigerian economy to be more resilient against the impact of future financial crisis.