



BEYOND LENDING:  
MDB'S FINANCIAL ROLE  
AFTER THE CRISIS

Guillermo Perry

Center for Global Development

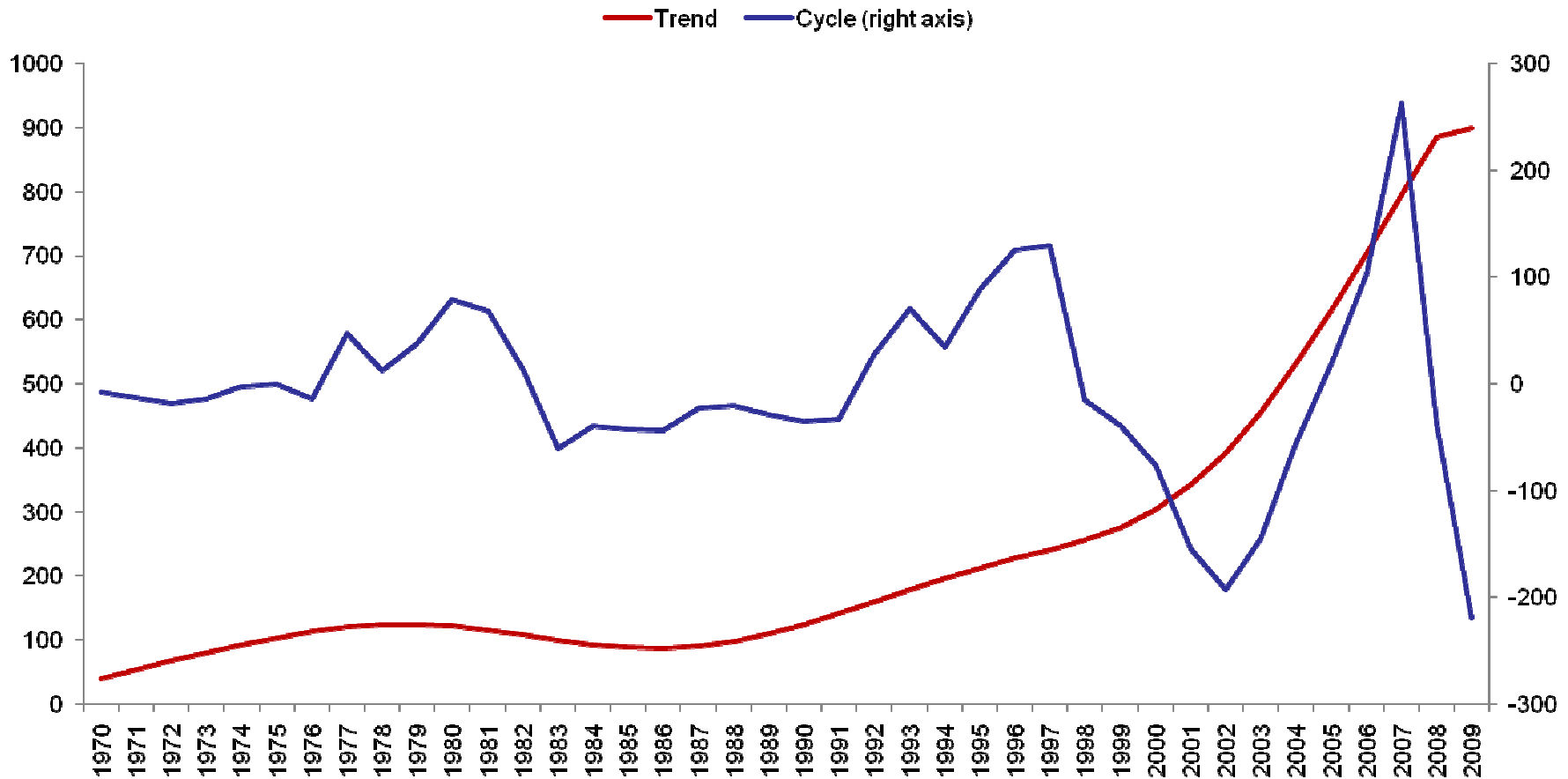
***Innovative Financial Solutions for Development***

***AFD, WB and Gates Foundation***

***Paris, March 4-5***

# THE FACTS: Growing access of emerging countries to private markets, but with high volatility

Cyclical Component and Trend of Net Private Flows to Emerging Developing Countries (1970-2008)

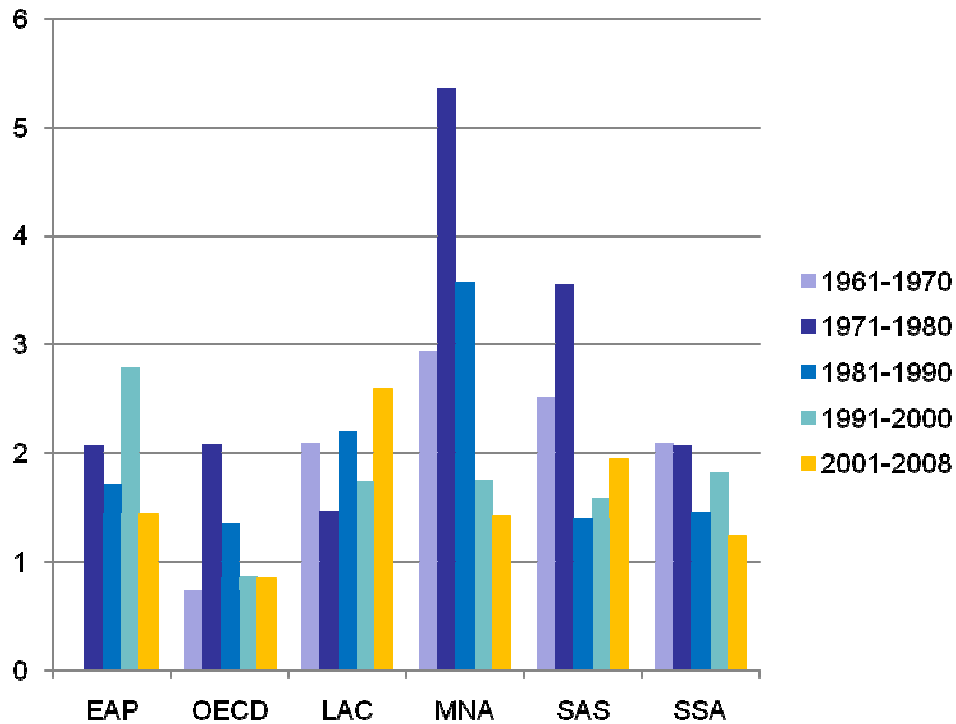


Source: Own estimates, WB, Bloomberg

# THE PROBLEM TO SOLVE:

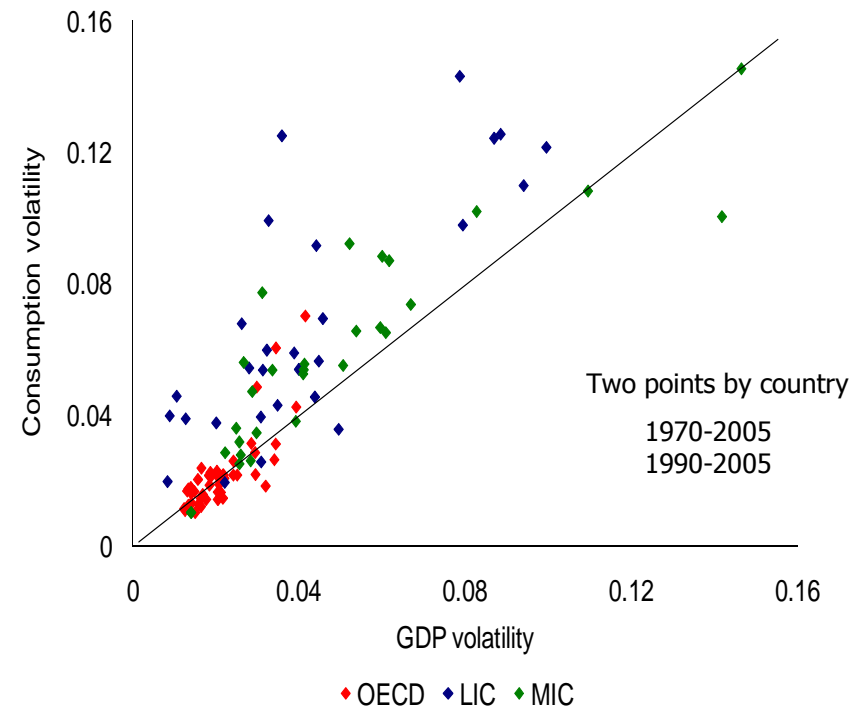
## Developing Countries high volatility and vulnerability limits growth and welfare

GDP Volatility, by region (1961-2008)



Source: Own estimates

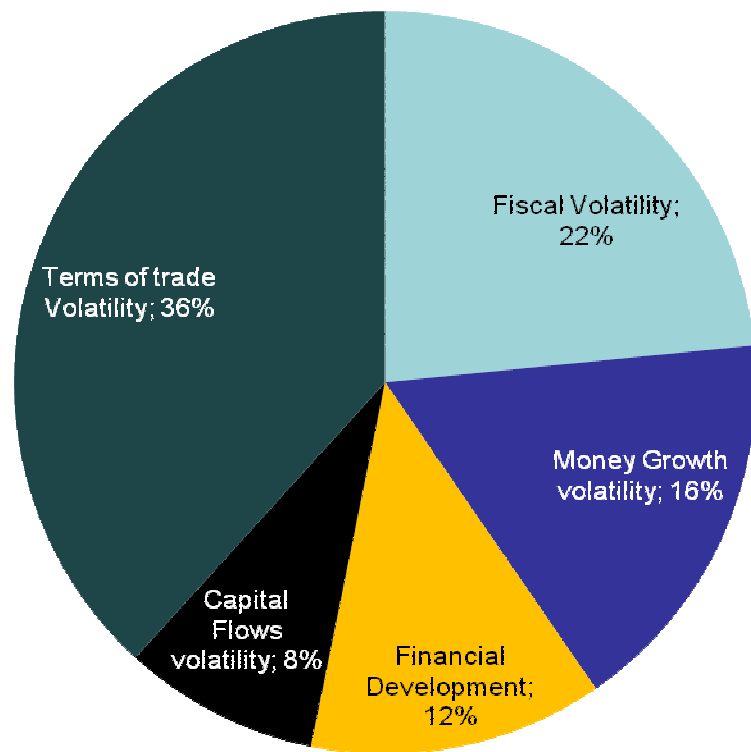
GDP Volatility and Consumption, by country groups



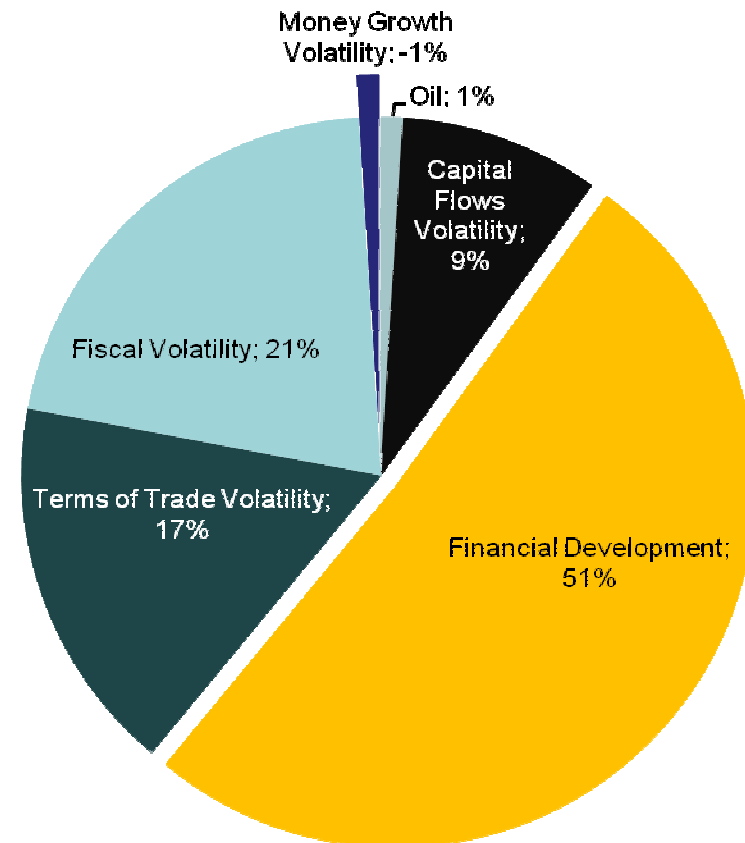
Source: own estimates based on WDI and IFS.

# Developing Countries excess volatility is due to exogenous and endogenous causes

1975-2005



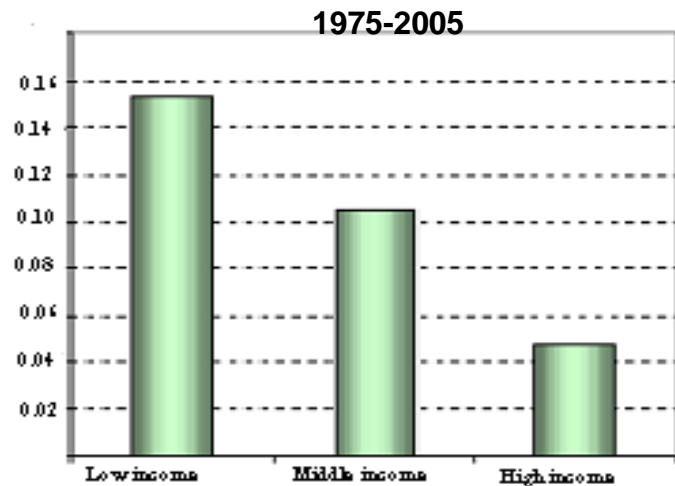
1990-2005



Source: Own calculations.

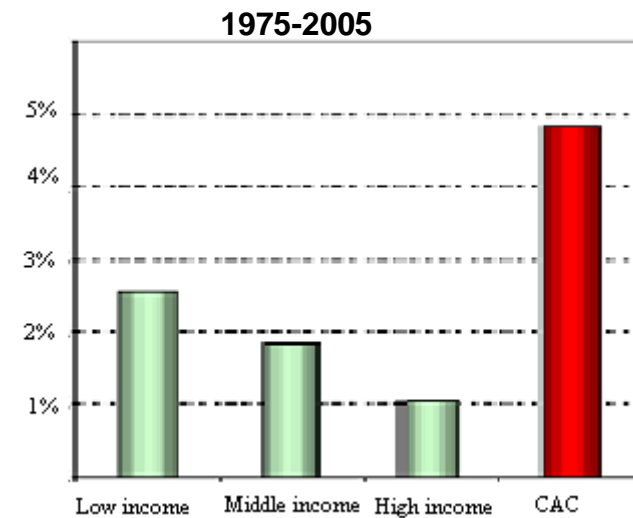
# Higher exposure to Exogenous Shocks

## Volatility of Terms of Trade



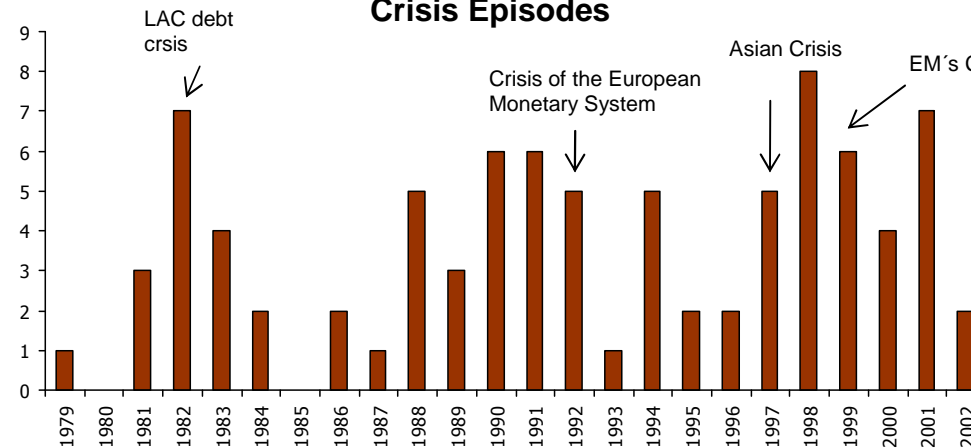
Source: Calderón, C, World Bank. (2007).

## Frequency of natural disasters



Source: Calderón, C, WB (2007)

## Crisis Episodes



Source: Cavallo and Frankel (2006).

# Amplifiers of exogenous shocks

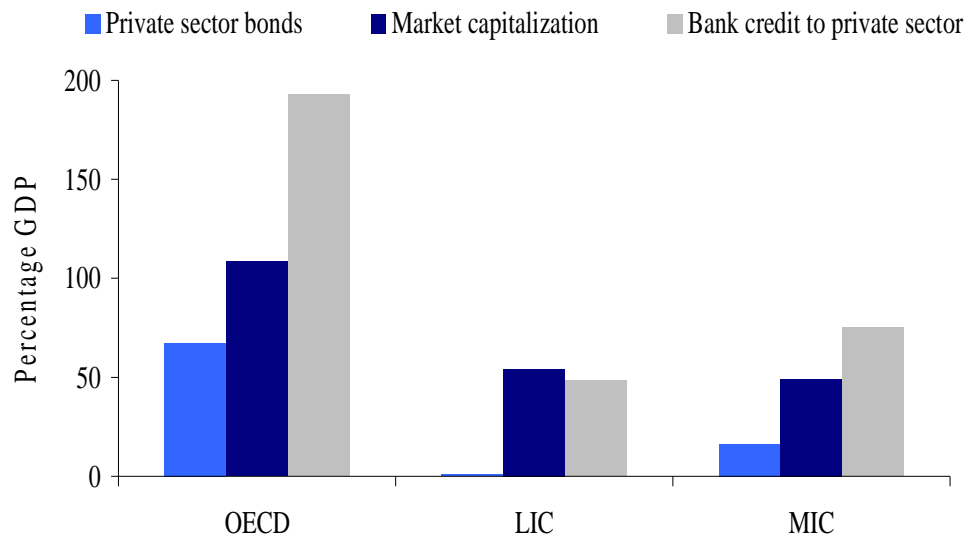
1. Procyclicality of private capital flows
2. Balance sheet (currency) risks:
  - Composition of private and public debt
  - Weak development of capital markets in local currency
  - Significant advances in some countries since 1998
3. Procyclical monetary policy.
  - Major change: countercyclical monetary policy in countries with inflation targeting
4. Procyclical fiscal policy:
  - With few exceptions (e.g. Chile)

# Dealing with exogenous shocks: potential options

<b>Action</b> <b>Shock</b>	<b>Coping after the fact</b>	<b>Prevention: Risk Reduction</b>	<b>Self Insurance: Saving</b>	<b>Market Insurance/ Hedging</b>
<b>Terms of Trade</b>	Current Account and (pro cyclical) fiscal adjustment, Aid	Diversify Exports	Stabilization Funds	Commodity Price Futures, Forwards and Options/ Indexed Debt (TOT, CP)
<b>Natural Disasters</b>	Aid, Fiscal adjustment	Zoning Building codes	Emergency Funds	Insurance & Reinsurance/ CAT's
<b>Capital Flows</b>	Current Account and (pro cyclical) fiscal adjustment, Aid	Debt level & composition Capital Market Development De dollarization	International Reserves	Contingent Credit Lines Currency and interest derivatives Indexed Debt (GDP) External debt in domestic currencies

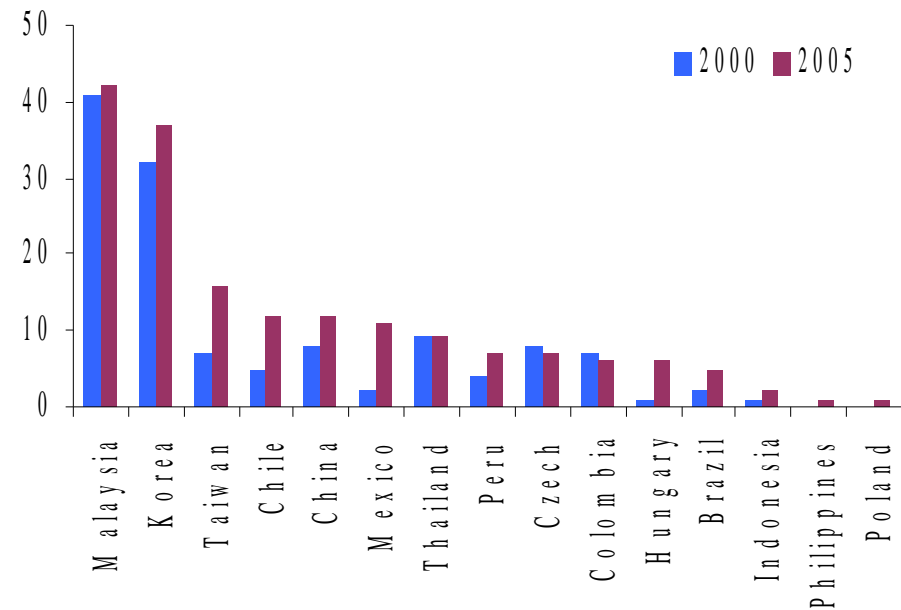
# CHALLENGE: Domestic capital markets in EM are still shallow, especially for firms

## Financial Sector Development Indexes



Source: Own elaboration based on WDI and BIS data

## Domestic Corporate Bonds as % of GDP

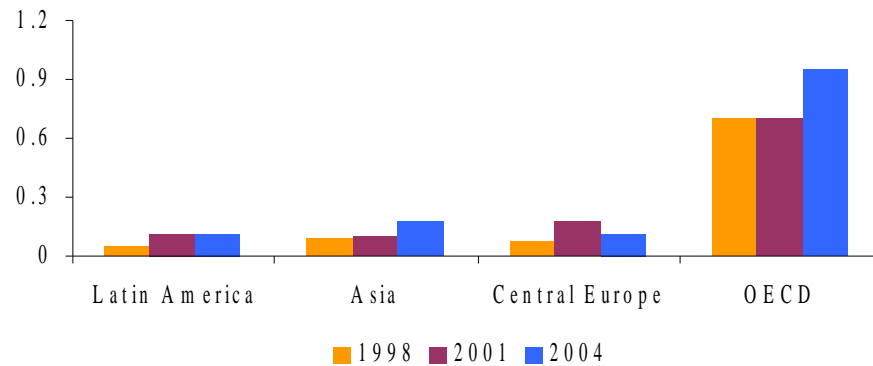


Source: Own elaboration based on BIS, 2007.

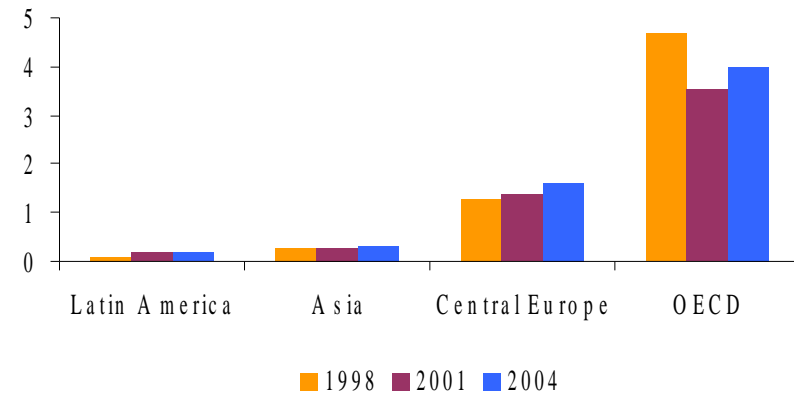


# CHALLENGE: Use of currency derivatives by EM's still very low

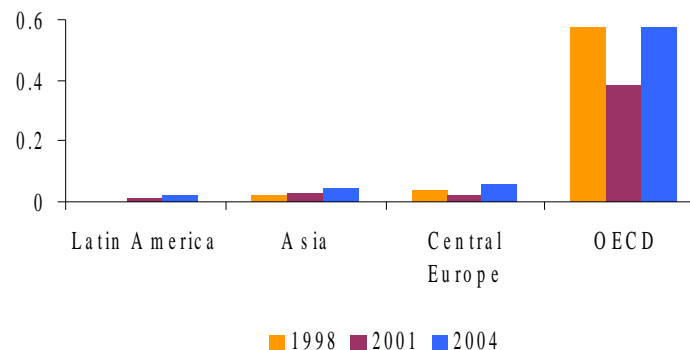
## FX Forwards as % GDP



## FX Swaps as % GDP



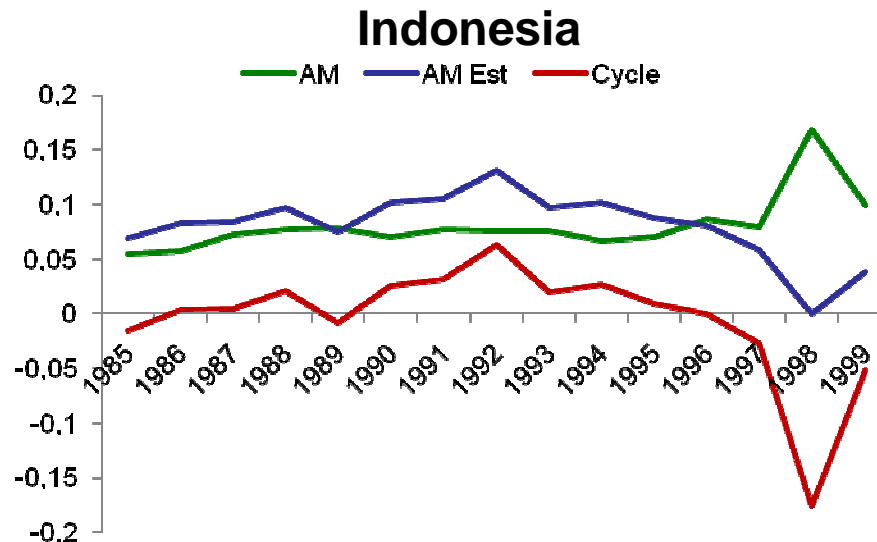
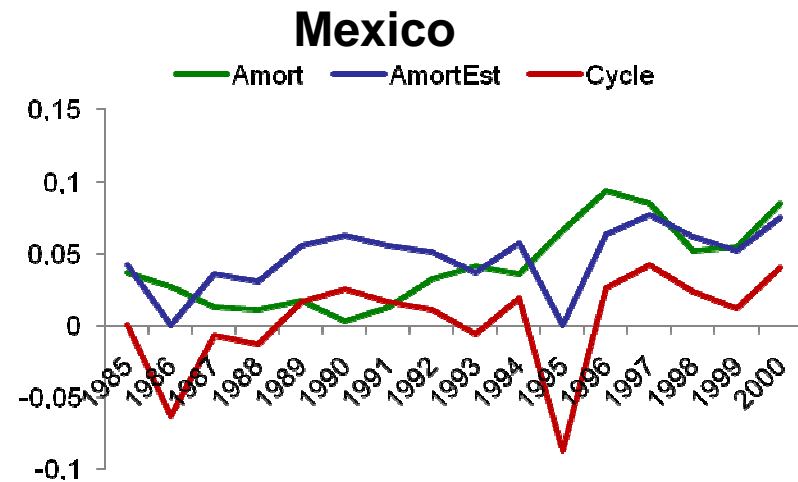
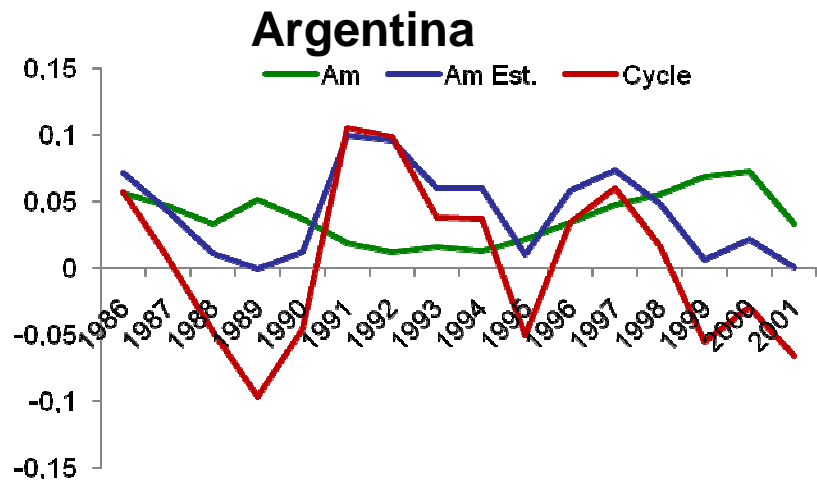
## FX Options as % GDP



# OPPORTUNITY: MDB's Current Practices and New Initiatives in Local Currencies

- Current practice:
  - Small fraction of the portfolio
  - Limited to intermediate Currency Risks
  - Limited to countries with already developed local currency and swap markets
- In spite of potential of regional and global diversification of currency risks.
- New Initiatives:
  - IFC Match**
  - TCX**
  - GEMLOC**

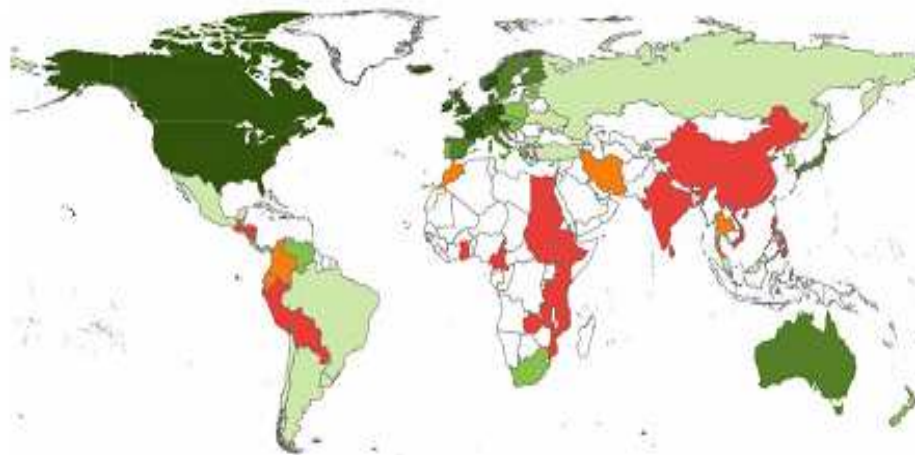
# OPPORTUNITY: High Stabilizing Potential of GDP indexed bonds



Fuente: Cálculos propios, WDI, IMF.

# CHALLENGE: Low Catastrophe Insurance penetration in DC's

**Global Distribution of Insurance Premiums per capita**



Property insurance premium (non-life including health) per capita per year



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**Expected economic loss insured (Approx.)**

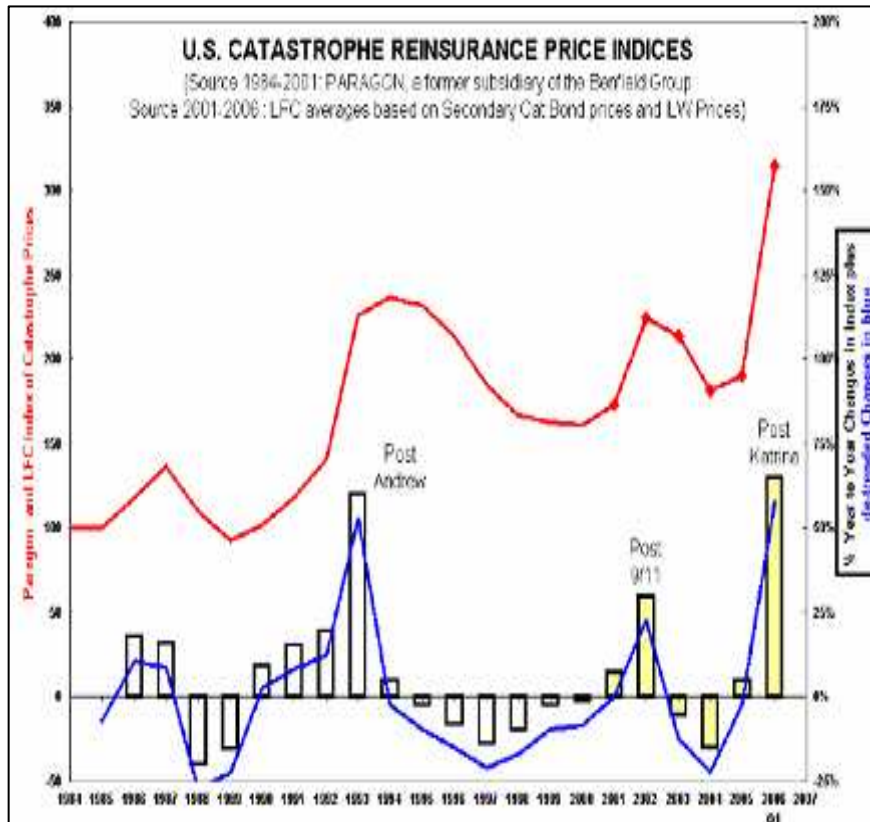
	1980	2006
Industrial C	20%	40%
Developing C <sup>1</sup>	3%	3%

1. From 0.5 to 4% of households

Source: Gurenko, Paul and Zelenko (2007).

# CHALLENGE: High and volatile fees of Catastrophe Reinsurance

**US catastrophe reinsurance price indices**



**Mexico Insurance premia of hidrometeorological risk  
 As percentage of insured values**

Zoning (Insured Property Location)				
Zone Alfa 1				
	Yucatán Peninsula	South Pacific	Gulf of Mexico	Interior
Homes	0.35% 0.60%	0.12% 0.30%	0.15% 0.30%	0.08% 0.08%
Buildings	0.35% 1.40%	0.13% 0.50%	0.15% 0.50%	0.12% 0.12%
Industrial Property	0.60% 1.60%	0.25% 0.80%	0.30% 0.80%	0.14% 0.14%

\* / -500 m from high tide on the beach. Red numbers are values for 2004, black color for 2006

# OPPORTUNITY: WB recent and potential initiatives in catastrophic insurance

- **Sovereign Short Term Cash Needs:**
  - Contingent loans: a second best solution.
  - Caribbean Catastrophic Reinsurance Facility (CCRF): significant price reduction.
  - Global CAT Mutual Bond (GCMB)
- **Issue:**
  - Shifting AID from ex post relief to ex ante insurance
- **Private Sector Insurance Penetration**
  - Global Catastrophic Reinsurance Facility (GCRF)

# CONCLUSIONS

- MDB's have a key potential role in helping to develop insurance and hedging instruments and markets for developing countries.
- Thus helping them reduce vulnerabilities and macro volatility, that hinder long term growth, welfare and poverty reduction.
- The current urgent liquidity needs of EM's should not lead MDB's into complacency and set back efforts in financial innovation that were taking place before the crisis.