

The Asian Financial crisis 1997



Introduction

- A period of financial crisis - Beginning July 1997
- Started in Thailand
 - Floating the pegged currency
 - Real estate driven financial over extension
 - Excessive foreign exposure
 - Resulting collapse of the Thai Baht
- Also affected Indonesia, South Korea, Hong Kong, Malasia, Phillipines.
- IMF - \$40 billion to stabilize their currencies



Overview

- The Asian Miracle (pre-crisis scenario)
- What happened in
 - Thailand, Indonesia
 - South Korea, Phillipines, Malaysia
 - Japan, US & China
- Consequences
- Role of IMF (International Monetary fund)



The Asian Miracle

- 1960s-1990s: Thailand, South Korea, Hong Kong, Singapore, Taiwan, Indonesia
 - Maintain very high growth rate (8-12%)
- Primarily due to:
 - Maintained high interest rates to attract foreign investments
 - Rapid industrialization
 - Industrial Policies supporting exports
 - Below market interest rates for exporting industries, etc



Pre-crisis scenario

- Foreign Capital inflows:
 - US was in recession → low interest rates
 - Asian Tigers - 50% of capital inflows in Asia
 - Dramatic run-up in Asset prices
- Pegged Currencies
 - Encouraged external borrowing
- High exports - driving rapid economic growth
 - Export to GDP ratio grew from 35% to 55%
- Excessive exposure to forex movements



The Bubble

- Thailand's economy - bubble fueled by Hot money
- Debt-GDP Ratios went up to 180%
- More and more was required as the bubble grew
- Development money went in a largely uncontrolled manner to certain people only, not particularly the best suited or most efficient, but those closest to the centers of power.
- Real estate speculation
- Countries became excessively dependent upon exports for their economy
- Very high leverage & exposure to forex risk



The Tipping point

- U.S. economy recovered from a recession in the early 1990s.
- Began to raise U.S. interest rates to head off inflation.
 - This made the U.S. a more attractive investment destination relative to Southeast Asia, which had been attracting hot money flow through high short-term interest rates.
 - And raised the value of the US dollar
 - For Asian currencies pegged to the U.S. dollar, the higher U.S. dollar caused their exports to become more expensive and less competitive in the global markets.
 - At the same time, Southeast Asia's export growth



The down turn...

- Asset prices began to collapse
 - Causing individual & companies to default
 - Panic among lenders - led to withdrawal of funds
 - Credit crunch & bankruptcies
- Depreciative pressure on exchange rates
- **Government action:**
 - Raised interest rates tremendously to prevent capital flight
 - Buying up excess domestic currency at fixed rate to maintain the peg
- Not sustainable in the long run (due to limited supply of forex reserves)



- Capital fleeing could not be stopped
- Central government allowed currencies to float
 - Drastic Depreciation
 - Further increasing the debt obligations and worsening the crisis...



Thailand

- Prominent economy of Southeast Asia
- During 1985-96 was growing at highest rates of 9%
- Real estate sector was booming
- High interest rate attracted investments from US and west.
- Export growth was very high.



Reason for failure

- Thailand Baht was pegged at 25 to US\$
- At the same time US had increased interest rate to curb inflation.
- This made US investors to take their money from Thailand and invest in US.
- This trigger the outflow of \$US, resulted in devaluation of baht and it reached its lowest point of 56 unit per \$US.



- This made foreign loan costlier by three times.
- It resulted in collapsed of various company and biggest financial corporation “Financial One” .
- There was fear among foreign investors about their money so they started pulling money from this markets.
- The deepen crisis, due to this many people lost their jobs.
- Political instability.



Indonesia

In June 1997 Indonesia seemed far from crisis because of

- Low inflation
- Trade surplus
- Huge foreign reserves \$23bn
- Good banking system.



- Its currency Rupiah was appreciating due to this various company borrowed loans from foreign institutes.
- Thailand floated its currency due to this Indonesian authority also widened rupiah band from 8% to 12%.
- In August rupiah comes under severe speculative attacks which devalued it to greater extent.



- Some condition occurred in Indonesia foreign corporate loans became costlier.
- Due to this Jakarta Stock Exchange touched historic low and Indonesia lost 13.5% of its GDP.
- Before crisis 1USD cost 2600 rupiah but during crisis it reached historic low of 11000 rupiah for 1USD.
- This conditions improved when IMF provided bailout package.



South Korea

- High NPA's (Non Performing Assets)
- Great Conglomerates owned by government
- Debt to equity : 30%
- No return and Profits on these NPA's
- Excessive debt lead to takeovers
- Daewoo motors sold to General Motors



Philippines

- Stock market fell to 1000 points from 3000
- Raised interest rates by 3.75%
- Overnight rates jumped from 15% to 32%
- Huge outflow of money



Malaysia

- Attacked by Speculators
- Overnight rates jumped from 8% to 40%
- Stock markets fell by 50% from 1200 to 600
- All sectors were hurt, construction sector contracted 23.5%, manufacturing shrunk 9% and the agriculture sector 5.9%
- 3.80 peg against dollar
- First ever recession



Role of IMF

- Bailouts
- Conditional Financing
- Structural Adjustment Package
- IMF and Interest rates

