ASIAN FIANANCIAL CRISIS

EE 460: Thai Economy
Semester 1 / 2019
Faculty of Economics, Thammasat University

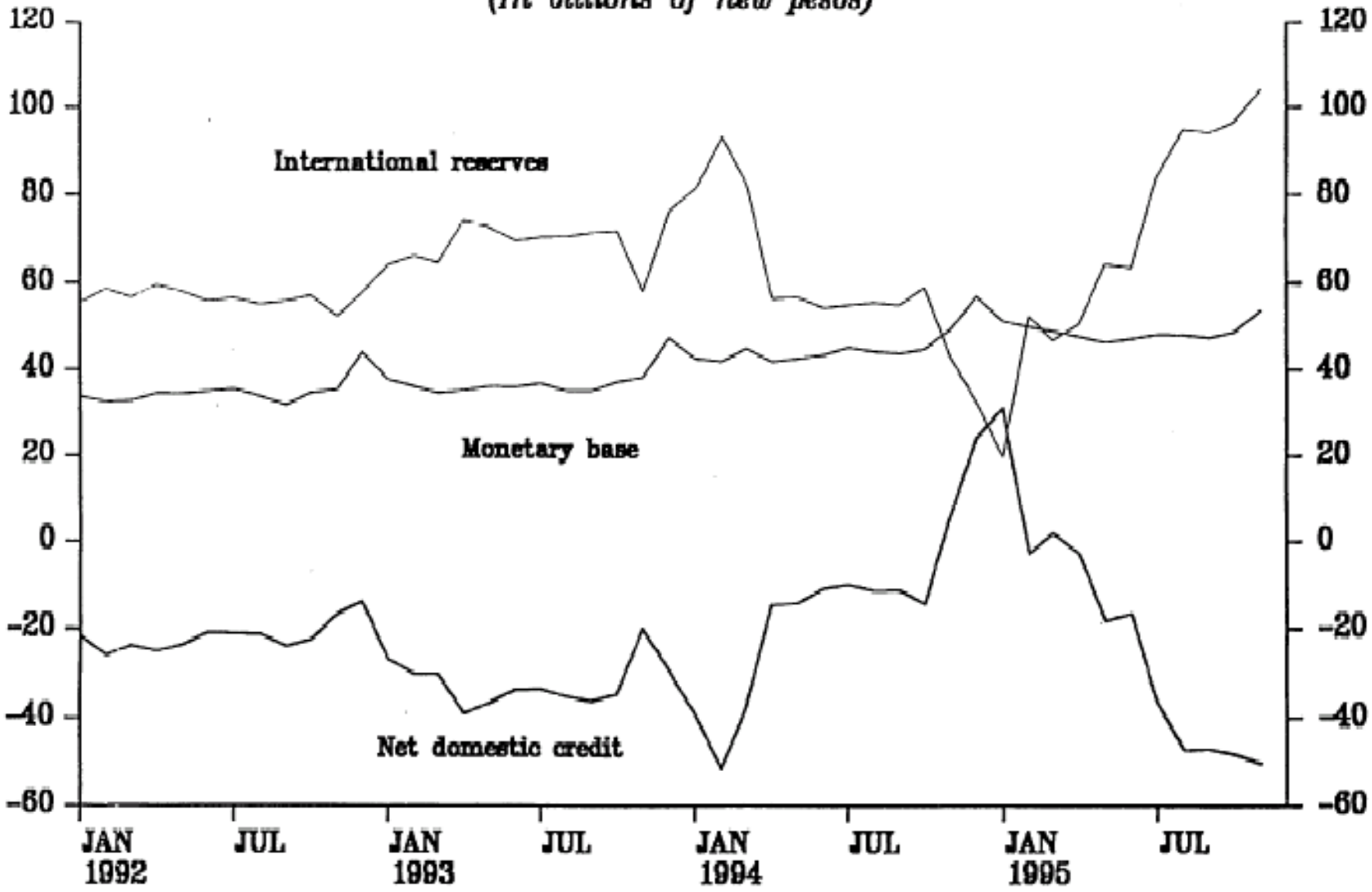
Mexican Crisis (1994)

Mexican Crisis

- Mexican crisis began with the problem in banking sector, where the ratio of NPL to total loan increased from 2% in 1990 to 8.3% in 1994.
- Some of the NPL amount was written-off and banks received the governmental support through the extended loan guarantees.
- Under the exchange rate regime of fixed EXR (imposed since 1992), Mexican banks aggressively extended their businesses to derivatives operations, causing the large accumulation of foreign liabilities.
- This banks' behavior led to the sharply reducing amount of foreign reserves.
- The peso was eventually devalued on Dec 20, 1994 and triggered the financial crisis

Figure 6. Mexico: Base Money by Component, January 1992-November 1995

(In billions of new pesos)



Source: Banco de Mexico, Indicadores Economico, Feb & Dec. 1995.

Asian Financial Crisis (1997)

Asian Financial Crisis

- Before the crisis in 1997, the economic indicators of most Asian economies reflected the good expansion and stability.
  - high GDP growth
  - low inflation
  - high export
  - low public debt
- One main incident was the downturn of the cycle of semiconductor sector, and the devaluation of the Chinese Yuan (with the magnitude of around 40 percent)
- During the expansion of the Asian economies, there were massive capital inflows which led to the pressure on the exchange rates to appreciate.

Asian Financial Crisis

- With the large amount of capital inflows, the current account deficit of most Asian countries were widening during 1995-1996. For example;
  - Thailand : 8.1% – 8.2% of GDP
  - Indonesia : 3.6% – 3.9% of GDP
  - The Philippines : 2.7% – 4.3 % of GDP
- Although there was current account deficit for most Asian countries, these ratios were still lower than those of Latin American countries (except for Thailand).
- Among these Asian economies, Thailand was the only country experiencing the high current account deficit with high ratio of foreign debt per foreign reserve.
- Theses facts indicate the "weak fundamentals" of Thailand.

Thailand

	1995	1996	1997*	1998**
			(percent change)	
Real GDP growth	8.8	5.5	-0.4	-4.0 to -5.5
Consumer prices (end of period)	7.4	4.8	7.7	10.0
			(percent of GDP; a minus signifies a deficit)	
Central government balance***	3.0	2.4	-0.9	-2.4
Current account balance	-7.8	-7.9	-2.0	6.9
			(billion U.S. dollars)	
External debt	82.6	90.5	91.8	89.7

Sources: Thai authorities; and IMF staff estimates

* Estimate

**Program

***Fiscal year, which runs from October 1 to September 30.

Korea

	1995	1996	1997	1998*
			(percent change)	
Real GDP growth	8.9	7.1	5.5	-1 to -2
Consumer prices (end of period)	4.7	4.9	6.6	8.2
			(percent of GDP; a minus sign signifies a deficit)	
Central government balance	0.3	0.3	0.0	-1.7
Current account balance	-1.9	-4.7	-1.9	7.3
			(billion U.S. dollars)	
External debt	119.7	157.5	154.4	163.3
Of which :short-term debt	78.7	100.0	68.4	39.6
			(percent of GDP)	
External debt	26.4	32.5	34.9	51.5

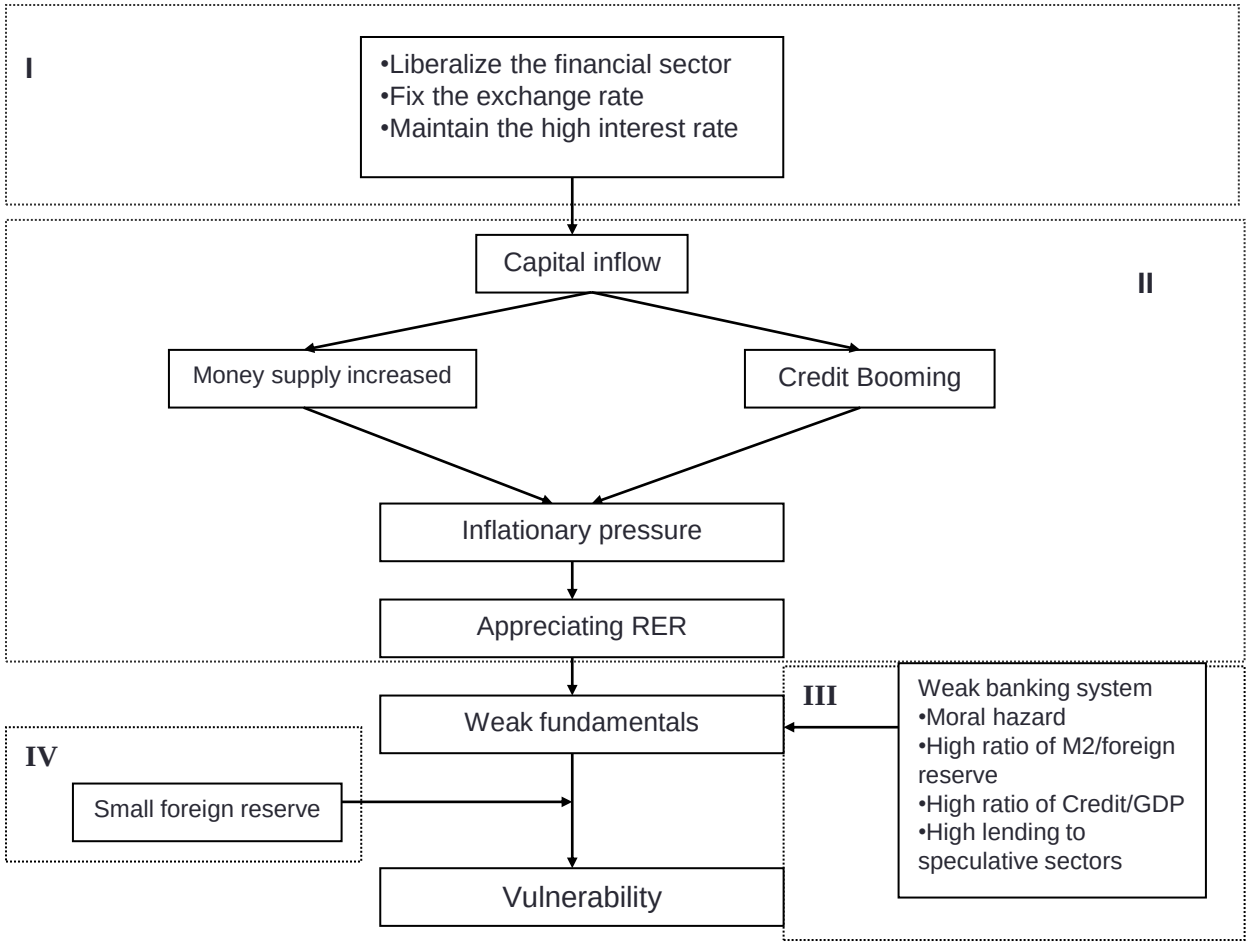
Sources: Korean authorities; and IMF staff estimates

Indonesia

	1995	1996	1997*	1998
			(percent change)	
Real GDP growth	8.2	8.0	4.6	-13 to -14
Consumer prices (end of period)	9.0	6.6	11.6	80.6
			(percent of GDP; a minus sign signifies a deficit)	
Central government balance**	0.9	1.2	-0.9	-8.5
Current account balance**	-3.2	-3.3	-1.8	1.6
			(billion U.S. dollars)	
External debt	107.8	110.2	136.1	135.0
Of which :short-term debt	9.5	13.4	18.8	.....
External debt as a percent of GDP	53.3	48.5	64.5	162.7

Sources: Indonesian authorities; and IMF staff estimates
* Estimate
**Fiscal year, which runs from April to March 31.

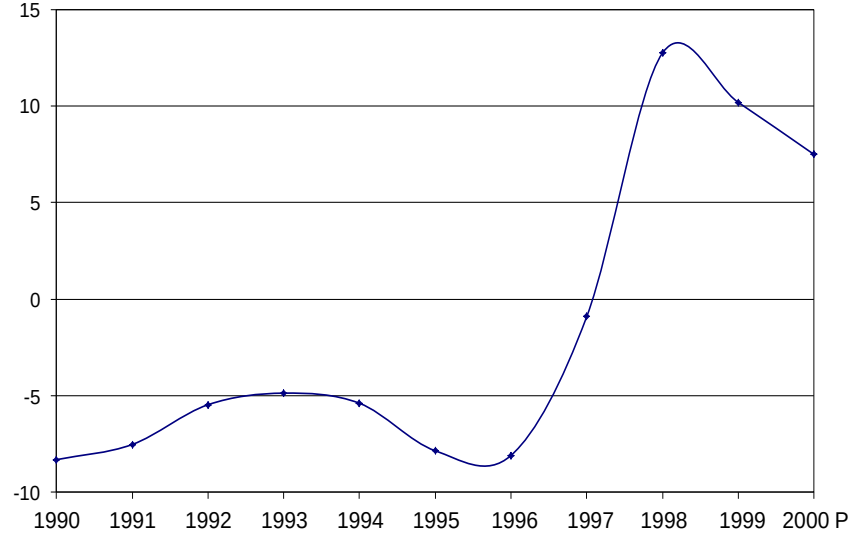
Analysis of Vulnerability : Thailand



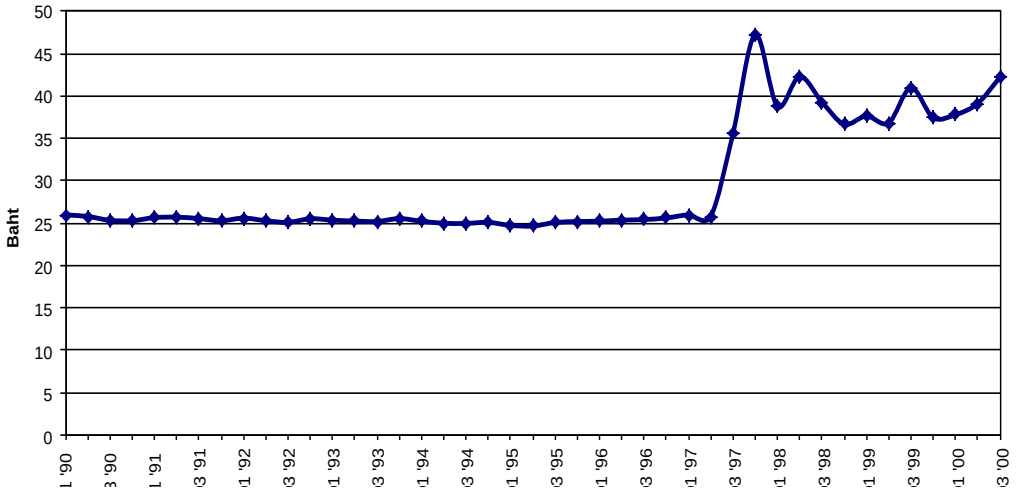
Key Indicators : Thailand

Source : IMF – IFS Database

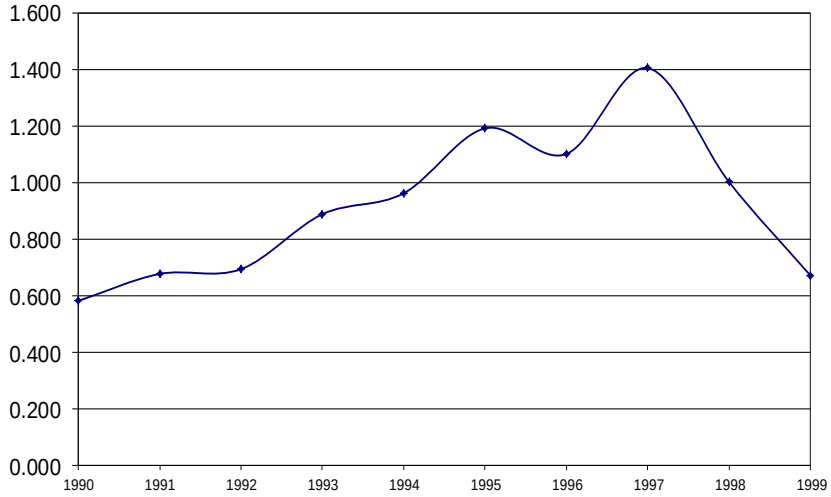
Current Account Balance (% of GDP)



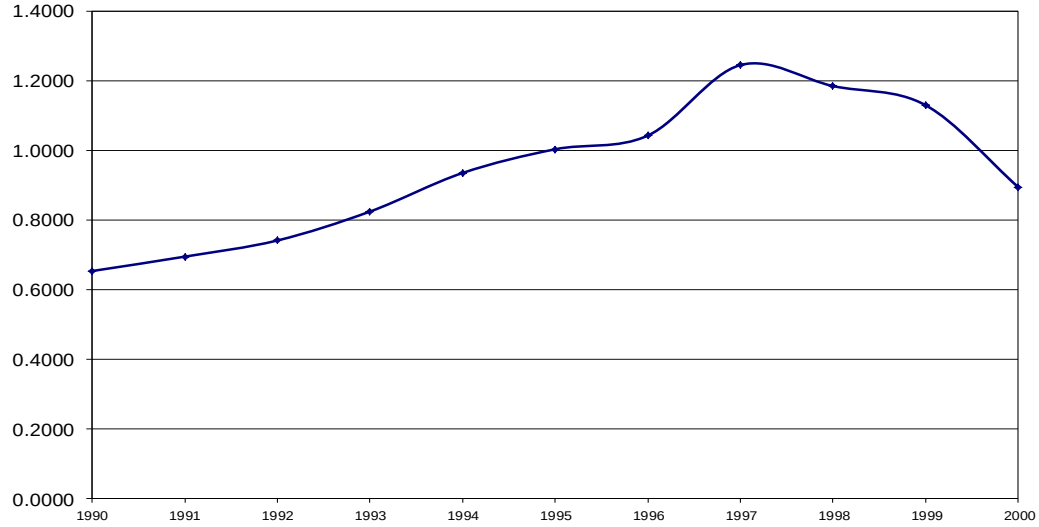
Exchange Rate (Baht/US$)



Ratio of short-term debt/foreign reserve

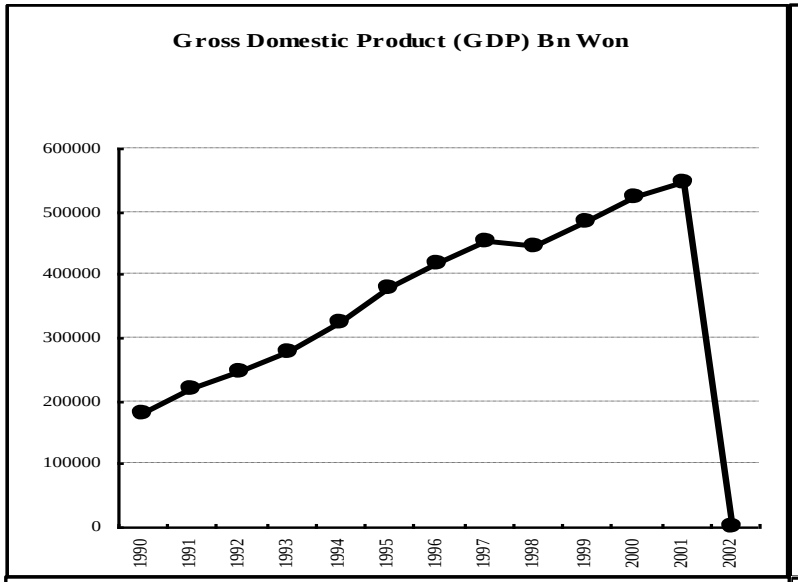


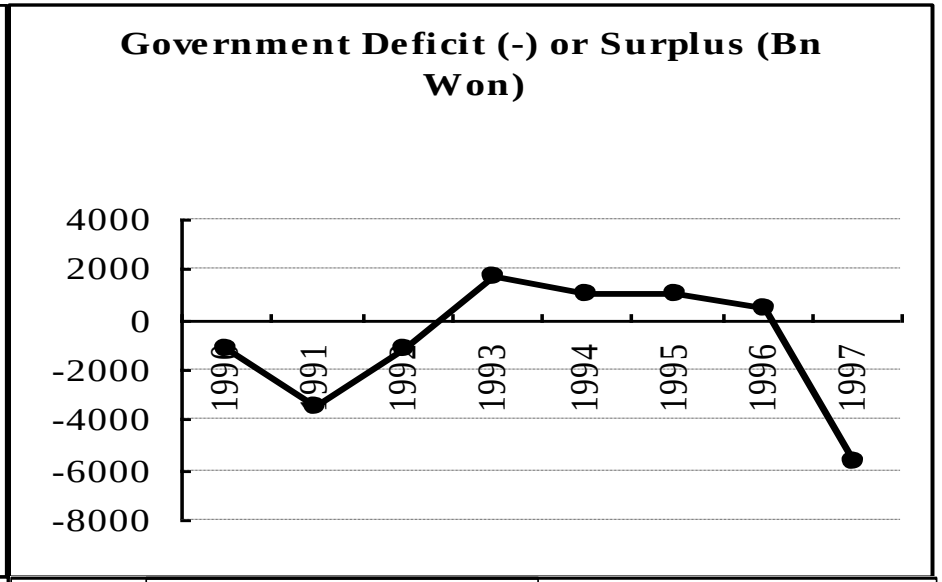
The ratio of bank credit lending to private sector/GDP

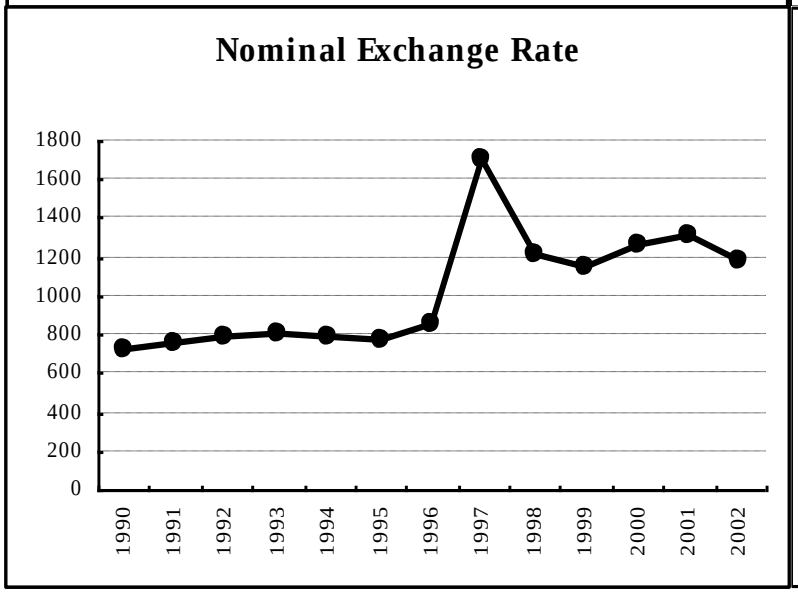


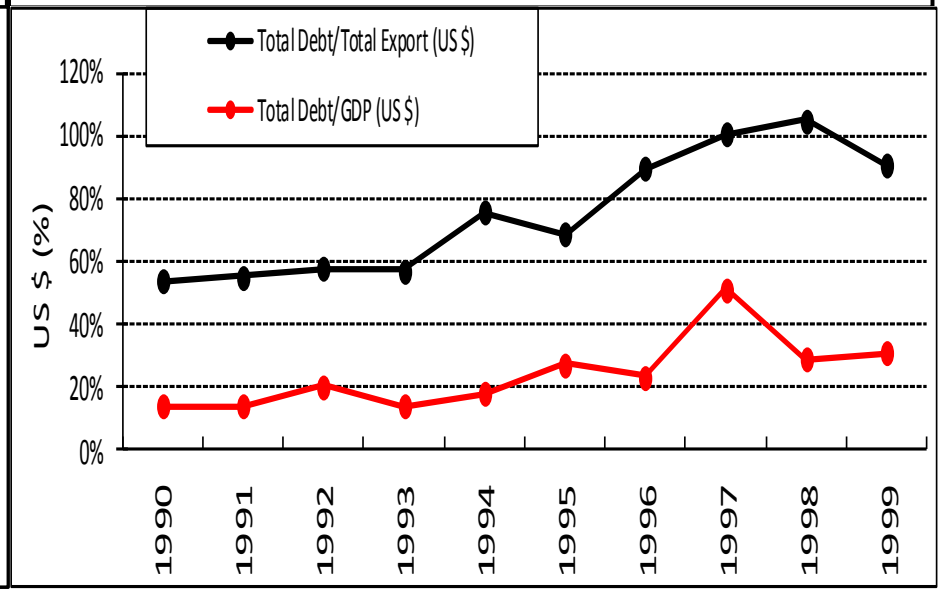
Key Indicators : South Korea

Source : IMF – IFS Database







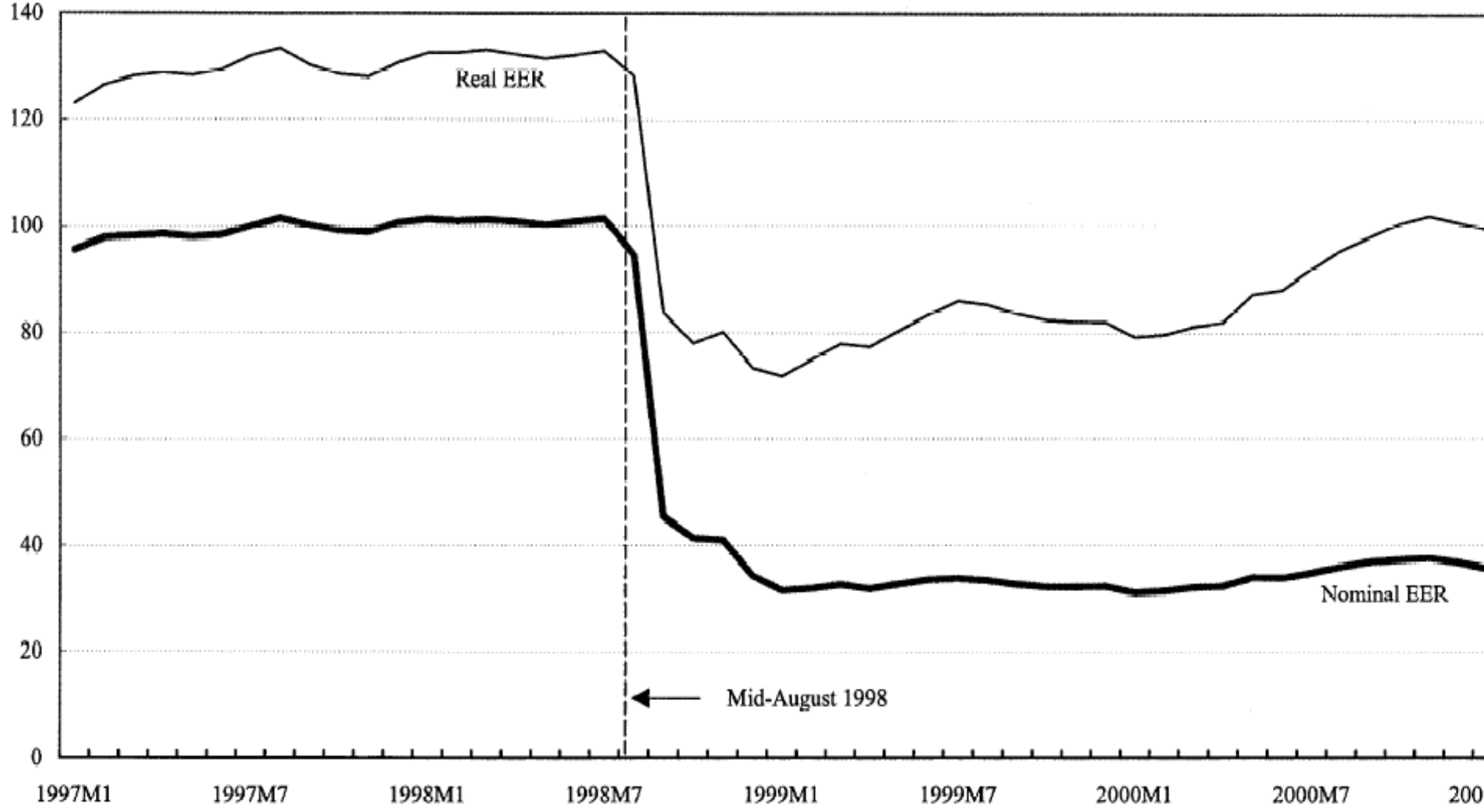


Asian Financial Crisis

- For Asian economies, economic activities were expanding rapidly along with domestic credits. And these domestic lending were substantially funded by foreign loans.
- The ratios of short-term foreign loans per foreign reserves were :
  - 1.7 for Indonesia
  - 1.5 for Thailand
  - 2.0 for South Korea.
- These high ratios indicated the vulnerability and influenced the speculative attacks on depreciation of local currencies.
- Therefore, although most macro economic indicators were impressive, the financial sectors and foreign reserves of most Asian countries were vulnerable.

Russian Crisis (1998)

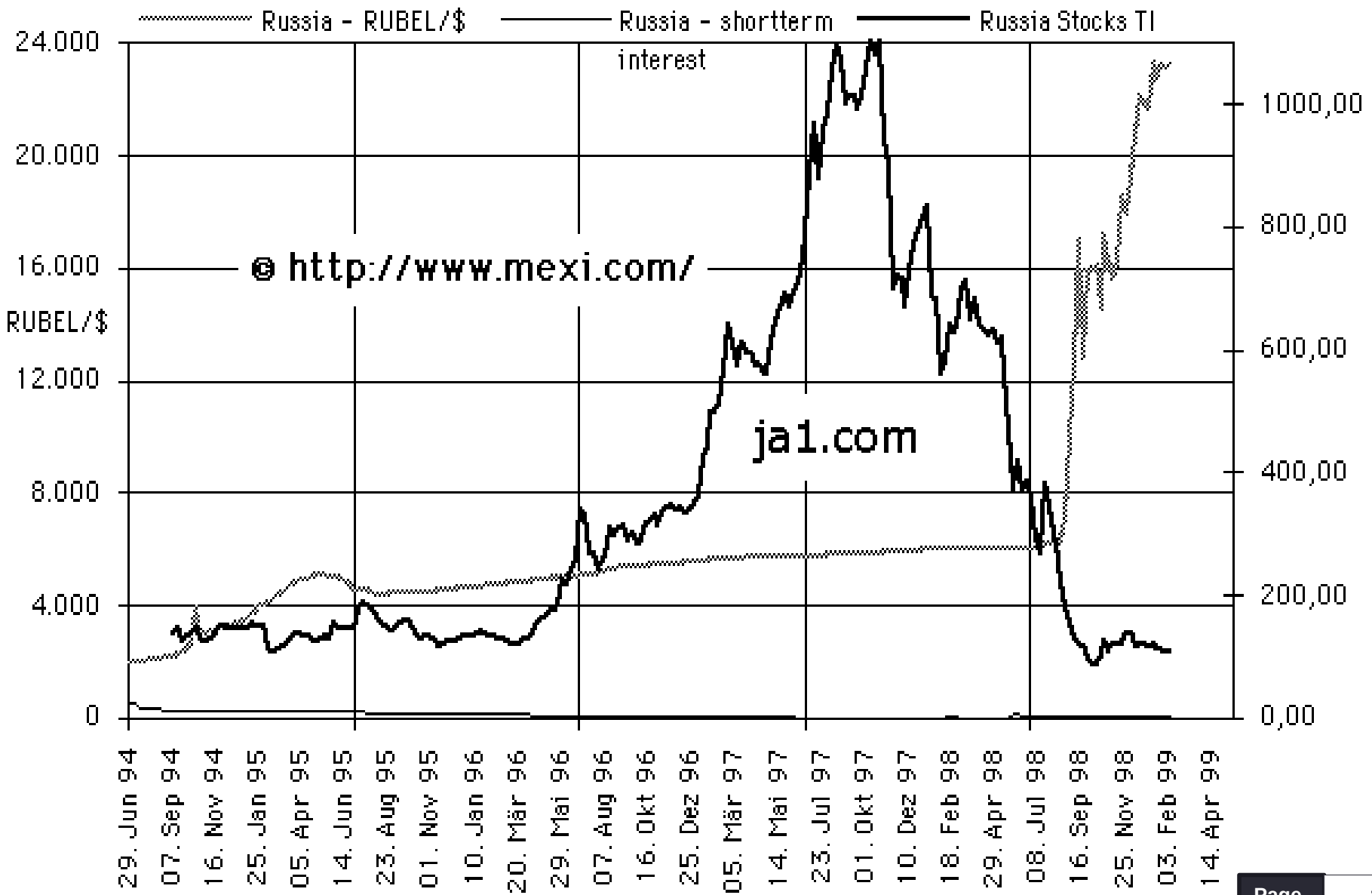
Figure 1: Russian Federation: Nominal and Real Effective Exchange Rate Indices, Jan 1997 - Jan 2001 [1/]
(1995=100)



Source: International Monetary Fund; Economic Data Sharing System (EDSS) databank.

1/ The trade weights are the average of 1994-95. The weights were built up from trade flows as reported in the IMF Direction of Trade Statistics.

Russian Stock Market Index



Russian Crisis

- During 1989-1996, the 7 consecutive years of recession cause the 40% drop of real GDP, together with the hyperinflation (2 digits of annual rate) and continuous depreciation of local currency (ruble).
- These macro economic indicators reflected the "weak fundamentals" of Russian economy, (i.e. satisfying all conditions of warning indicators)
- Although there was a privatization of state-owned enterprises undertaken during 1992-1994, it was merely the transfer of ownership. There was no substantial improvement of technology and productivity.
- In addition, there was a lack of development of legal and institutional systems.
- These weak fundamentals led to the rent seeking activities and widened the income inequality. The high-income groups gained most of the return on economic activities, mostly from concession-related businesses.

Russian Crisis

- In 1995, the IMF introduced the stabilization program to Russia. The main target was to prevent the expansion of government budget through central bank's balance-sheet expansion. Also IMF suggested the Russia policy maker to set the nominal EXR as a target.
- There IMF-led policies contributed to the stabilization of inflation and exchange rate, and GDP growth signaled the recovery process during 1996-97.
- However, the there was the side effect on the economy, the monetary contraction led to the credit crunch and the high interest rate, influencing the slowing expansion of new investments in the manufacturing sector.
- Moreover, the shortage of supply of credits subsequently led to the substantial accumulation of unpaid wage to employees working in both governmental offices and private enterprises.

Russian Crisis

- Although the recovery process took place during 1997-98, it was coincident with the wide spreading Asian Financial Crisis.
- The Asian Financial Crisis caused the declining world prices of energy-related commodities and minerals, which were the main export products of Russia.
- In the first half of 1998, Russia's export dropped by 11%, causing a problems on both the trade balance and the government's revenue. The official budget deficit in the first half of 1998 was 4.5% of GDP.
- The fiscal deficit was financed through the issuance of the government securities called "GKO", which was the collaterals for borrowing from internal financial markets.
- With the current account deficit, the tighten monetary policy was implemented. This caused the GKO rate to increase by more than 100% and sharply decreased the GKO's price.

Russian Crisis

- Under the worsening situation, the foreign creditors called for additional collaterals to compensate with the drop of GKO's price.
- However, with the tighten monetary policy, the interbank rates increased sharply and some Russian banks were forced to repay their interbank borrowings in dollars.
- In July 1998, the IMF, the World Bank and Japan offered the rescue package by providing US$17 billion.
- However, the cost of market intervention to stabilize the value of rouble was US$4 billion per month, while rouble's value declined and reached the rate of 6.1 per dollar.
- Finally, in August 1998, the market intervention was aborted and the Russian government implemented the new exchange rate regime which allowed the exchange rate to fluctuate out of the previously imposed band of 25%.
- The Russia's total outstanding of foreign debt amounted $200-250 billion. Most of lenders were from Western Europe (Germany banks' proportion was 50% of the total outstanding debt.)

Russian Crisis

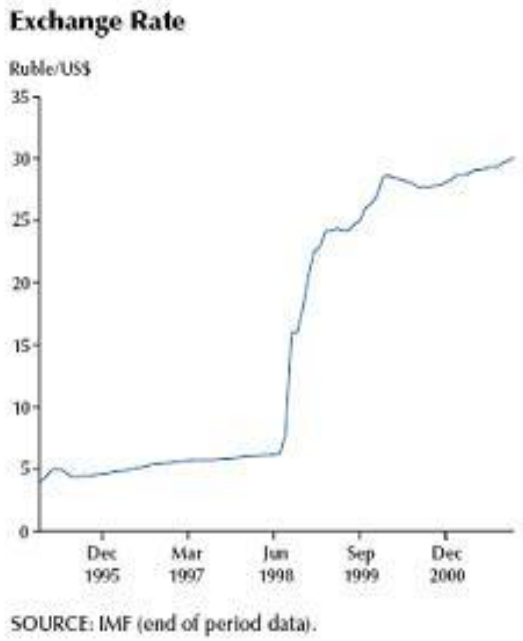
Lesson learned: main factors

- weak domestic fundamentals on financial and legal institutions.
- mismanagement of fiscal and monetary policies
- the concentration of export products and the decrease of commodity prices caused by Asian crisis
- the decline of asset price (GKO bond)
- irrational exuberance and herd behavior of investors

The Russian financial crisis

August 25, 1998

- Russian President Boris Yeltsin's fired of his whole cabinet, and this caused panic spread among international investors and fund managers.
- The ruble losing 9% of its value against the dollar, which was the worst



Source of pictures: news.bbc.co.uk/2/hi/special_report/1998/08/98/russia_crisis/164125.stm , http://www.telegraph.co.uk/finance/newsbysector/epic/hmv/8303237/Alexander-Mamut-profile-probably-the-most-powerful-oligarch-you-have-never-heard-of.html

The Russian financial crisis

August 26, 1998

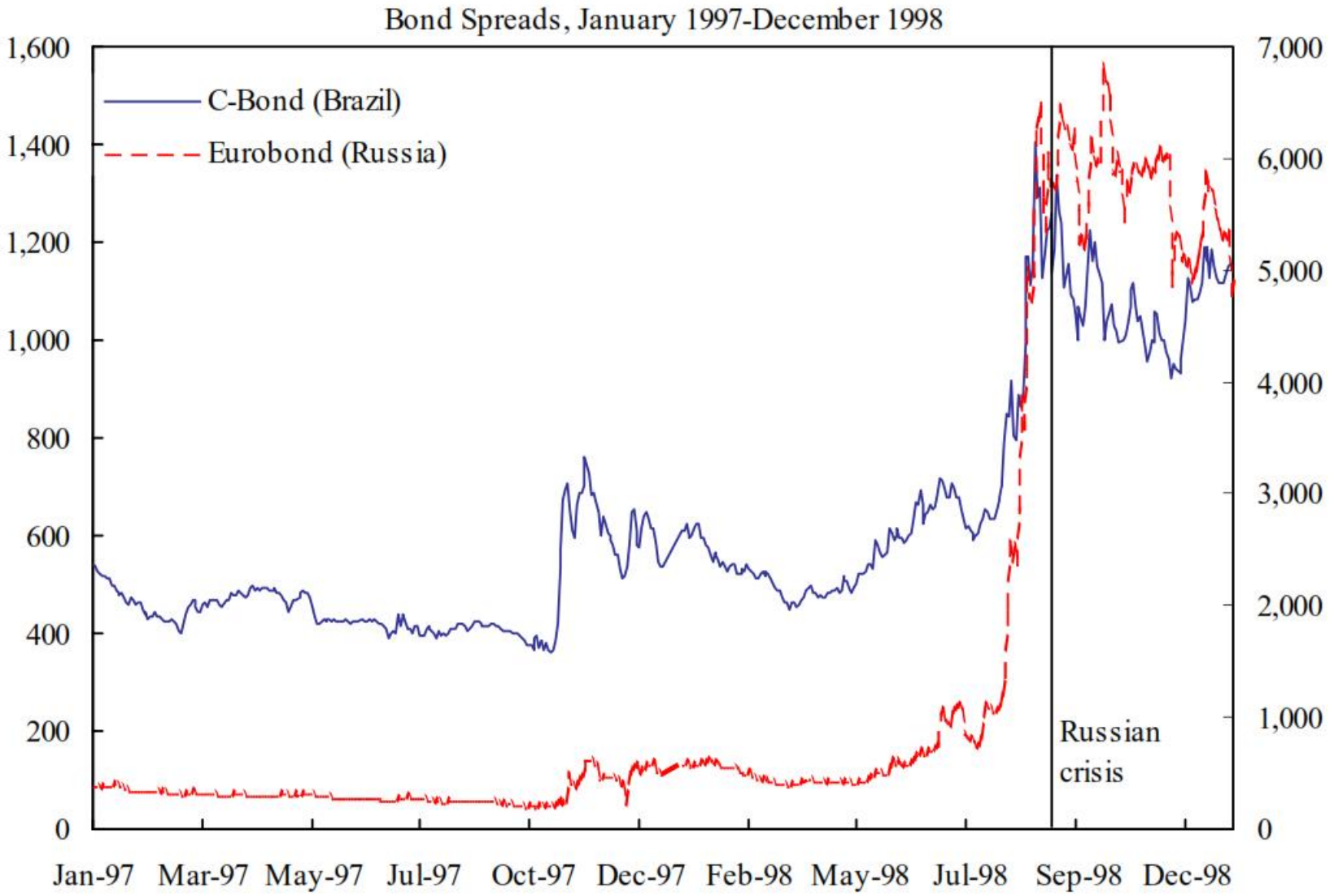
- The Russian central bank closed all ruble/dollar trading after the ruble started to fall again in the morning.
- Some Russians ran to their own banks to sell their rubles for dollars, but many banks stopped selling dollars today for fear of running out of currency.
- Most stores are closing in Moscow, as merchants try to figure out how to price their products.
- The ruble depreciated nearly 41 percent of its value against the German mark.
- In other regions of the world, economic woes are raising concerns among U.S. investors as well.

Capital Flows (Latin American Countries)

(4 quarters, millions of US dollars and average in % of GDP)

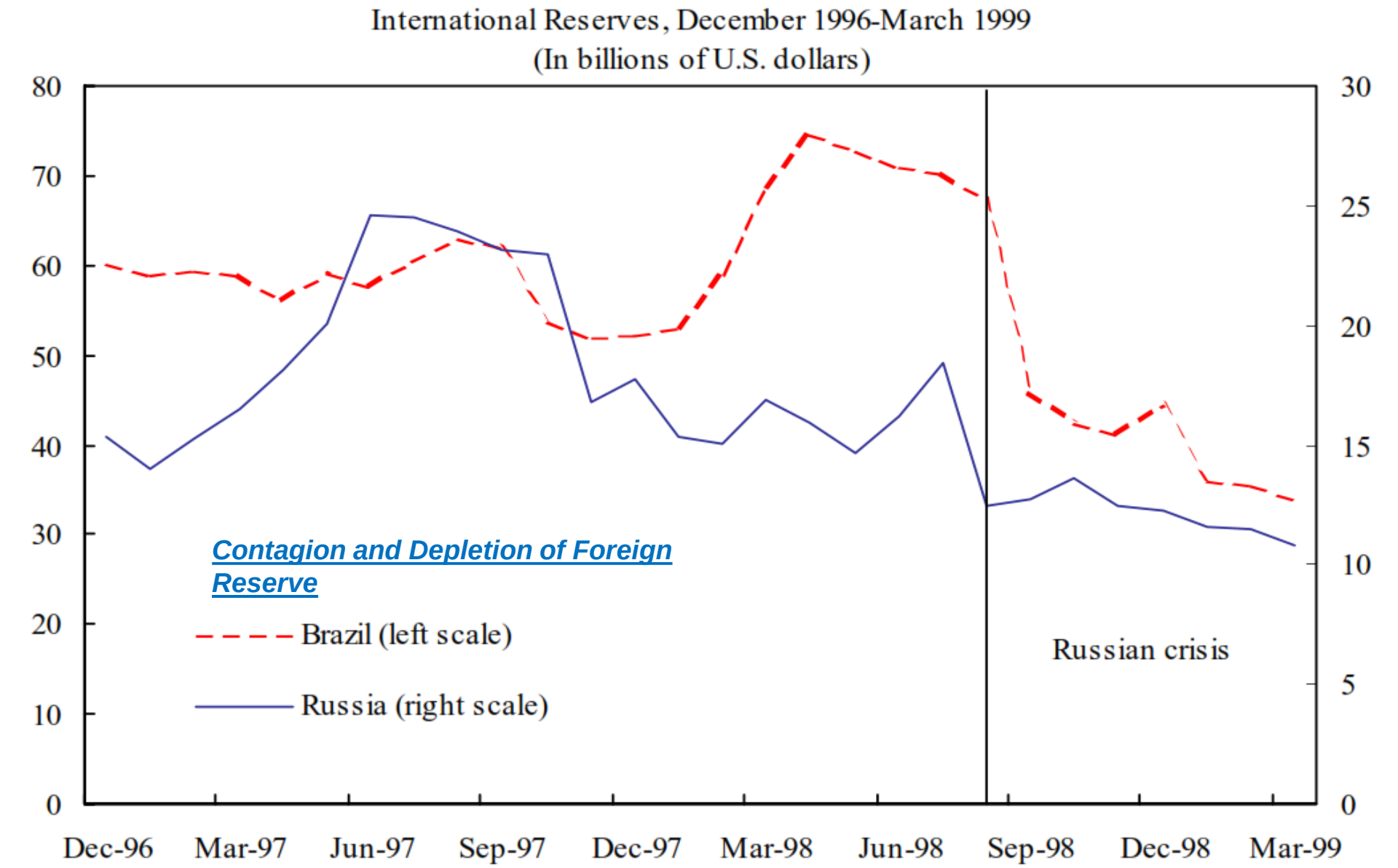
Includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela

Contagion : Russia and Brazil



Source: http://www.imf.org/external/pubs/ft/wp/2000/wp00160.pdf

Contagion : Russia and Brazil



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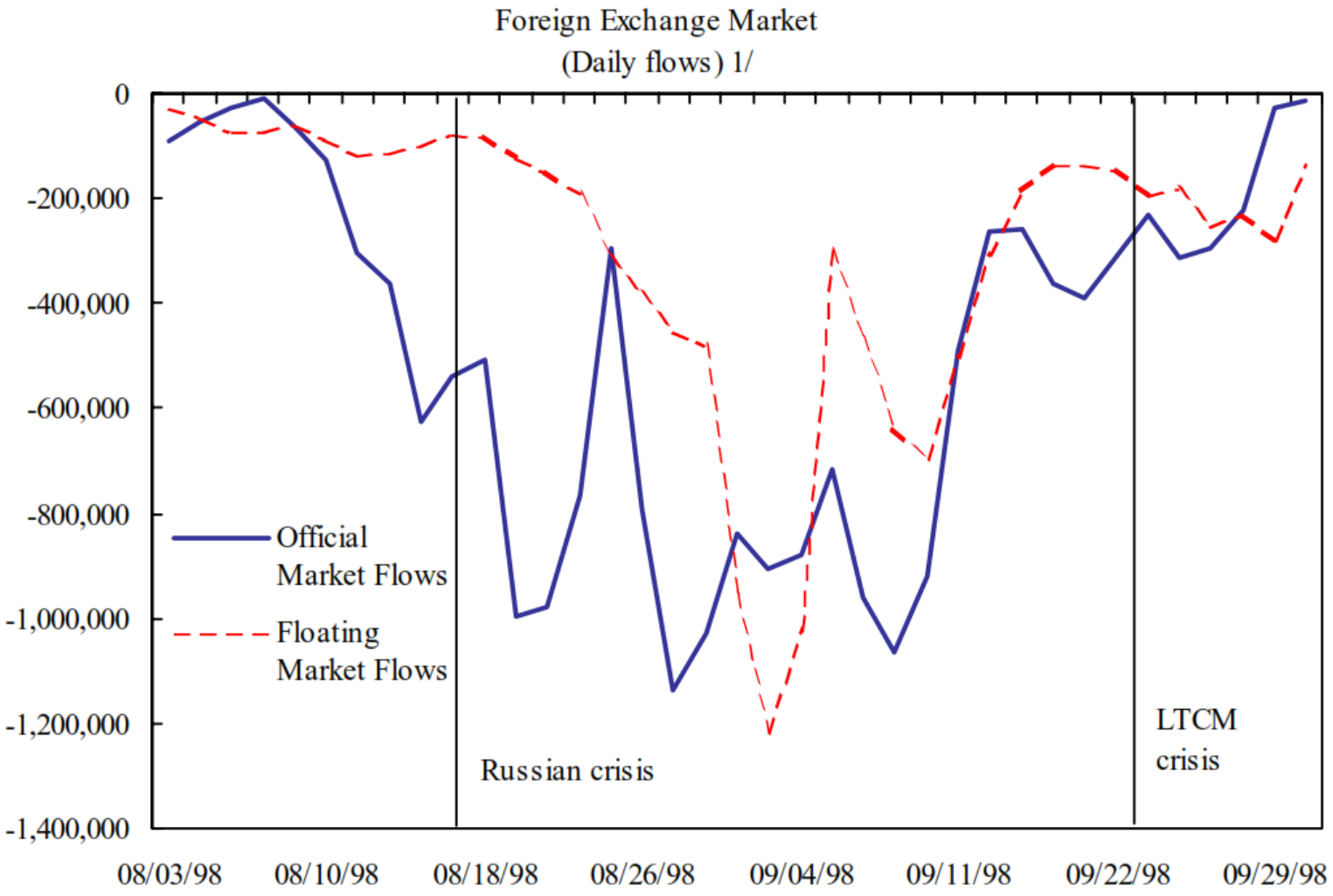
Contagion : Russia and Brazil

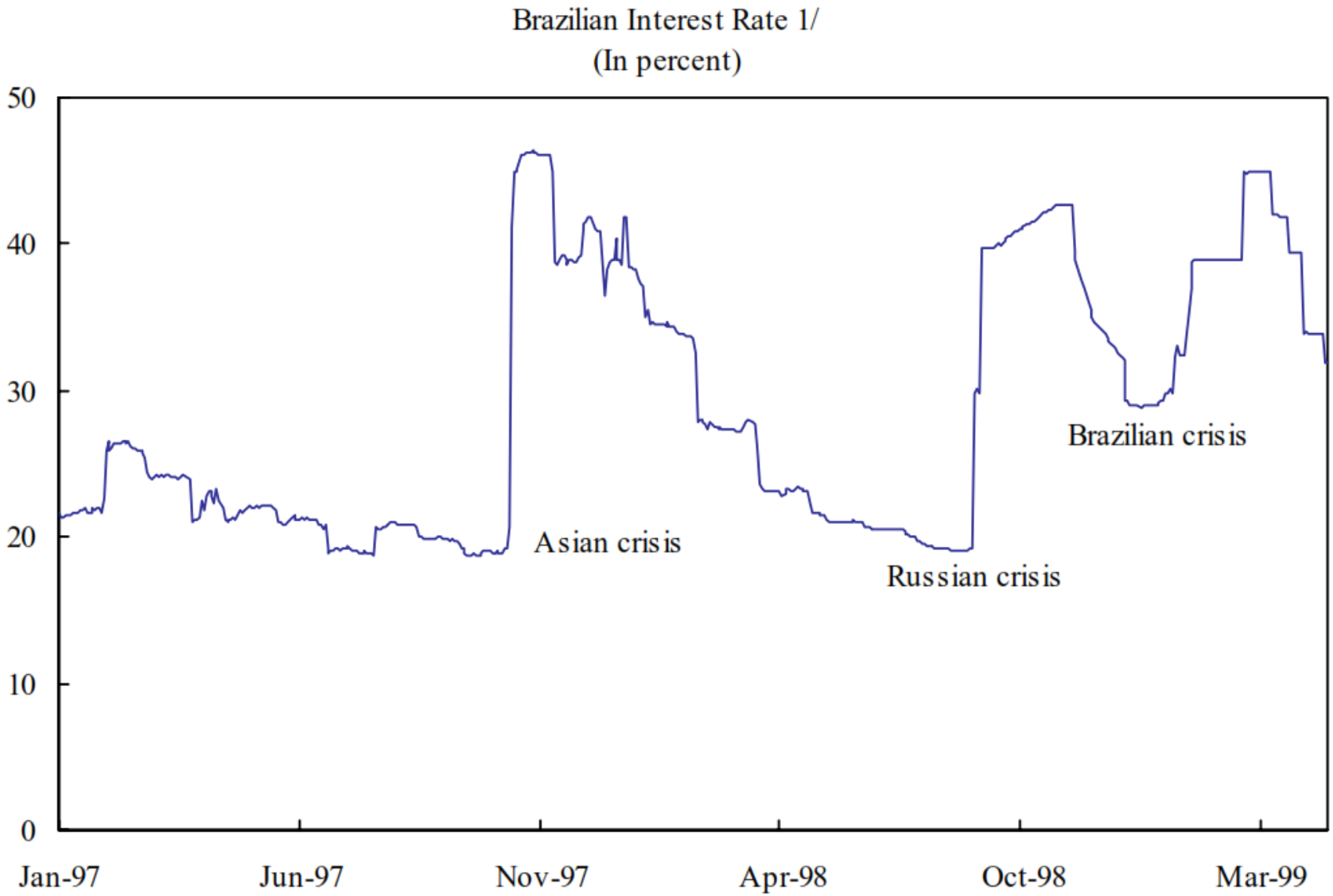


Source: Central Bank of Brazil; and Bloomberg.

1/ Negative sign denotes outflow.

Source: http://www.imf.org/external/pubs/ft/wp/2000/wp00160.pdf

Contagion : Russia and Brazil



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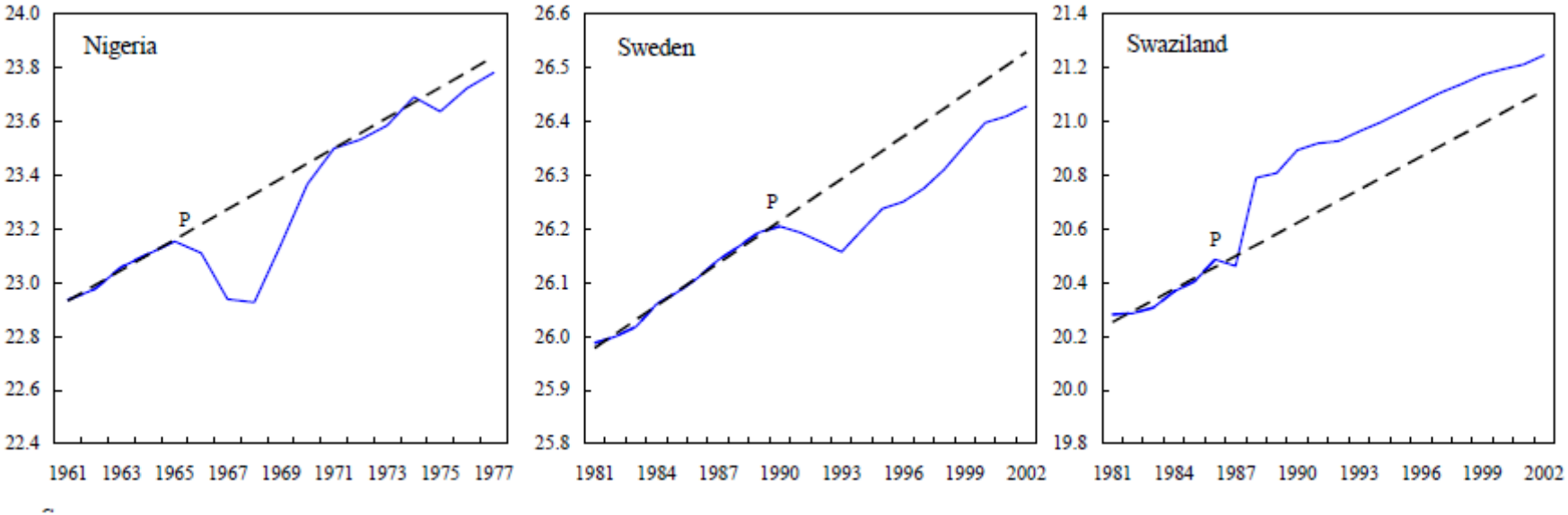
Growth Dynamics : The Myth of Economic Recovery by Valerie Cerra and Sweta Chaman Saxena



Percentage of Negative Growth Years Explained by:

Civil War	13
New Government	17
Currency Crisis	37
Any of above	51

Source: www.imf.org/external/pubs/ft/wp/2005/wp05147.pdf

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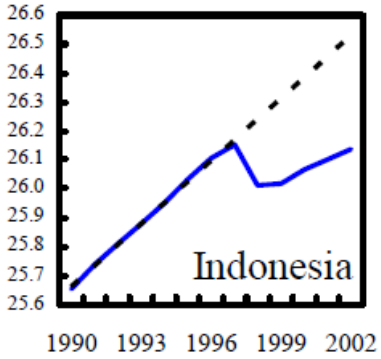
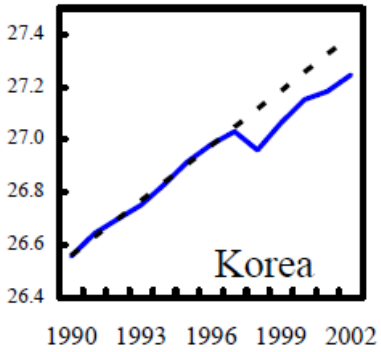
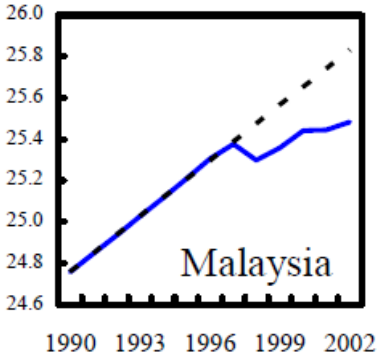
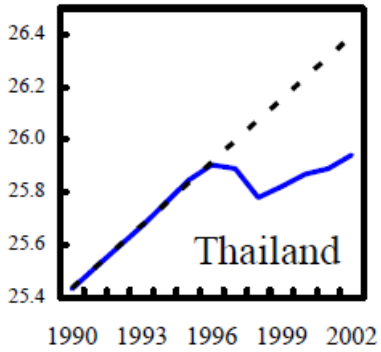
Asian Crisis Countries

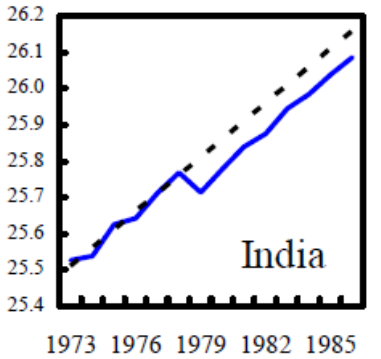


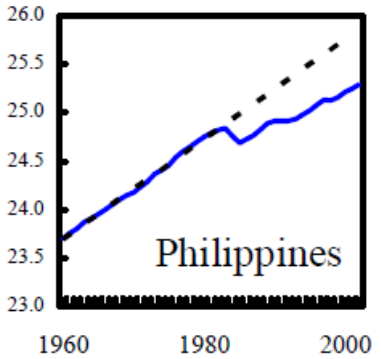


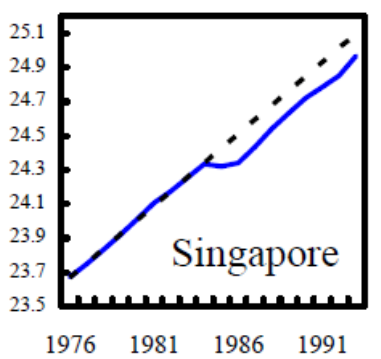


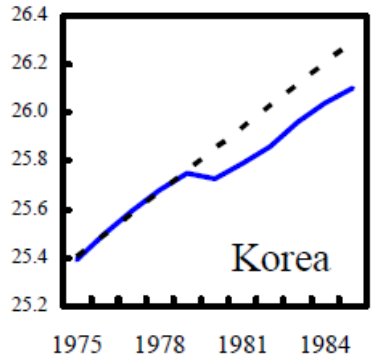


Other Asian Episodes









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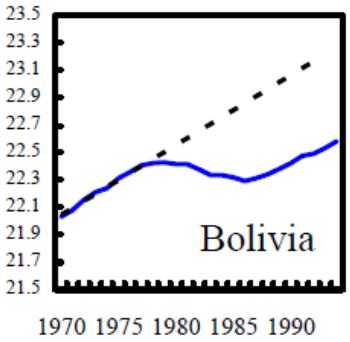
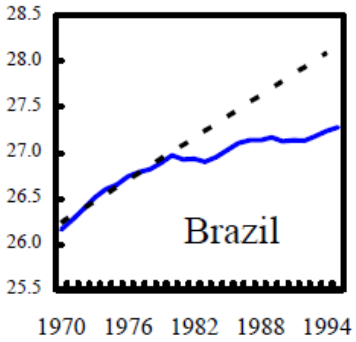
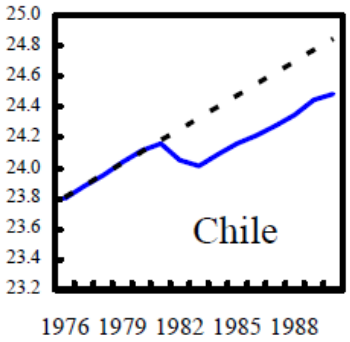
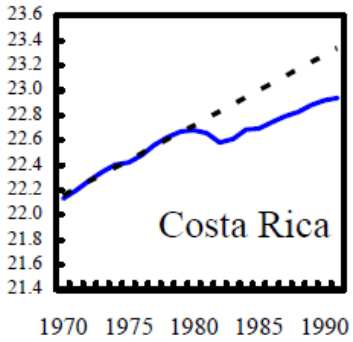
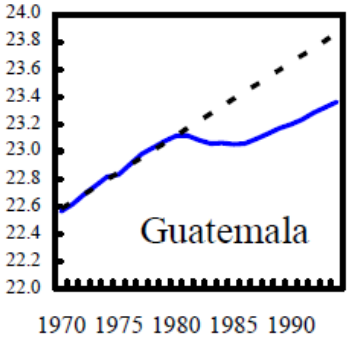
Debt Crisis of 1980s

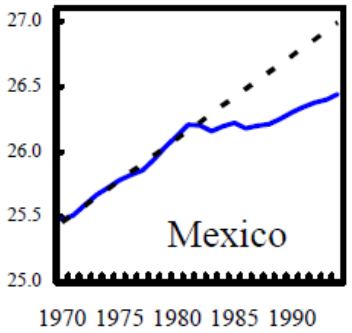


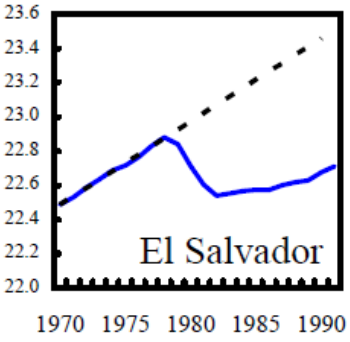


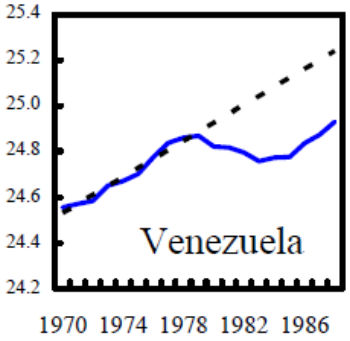












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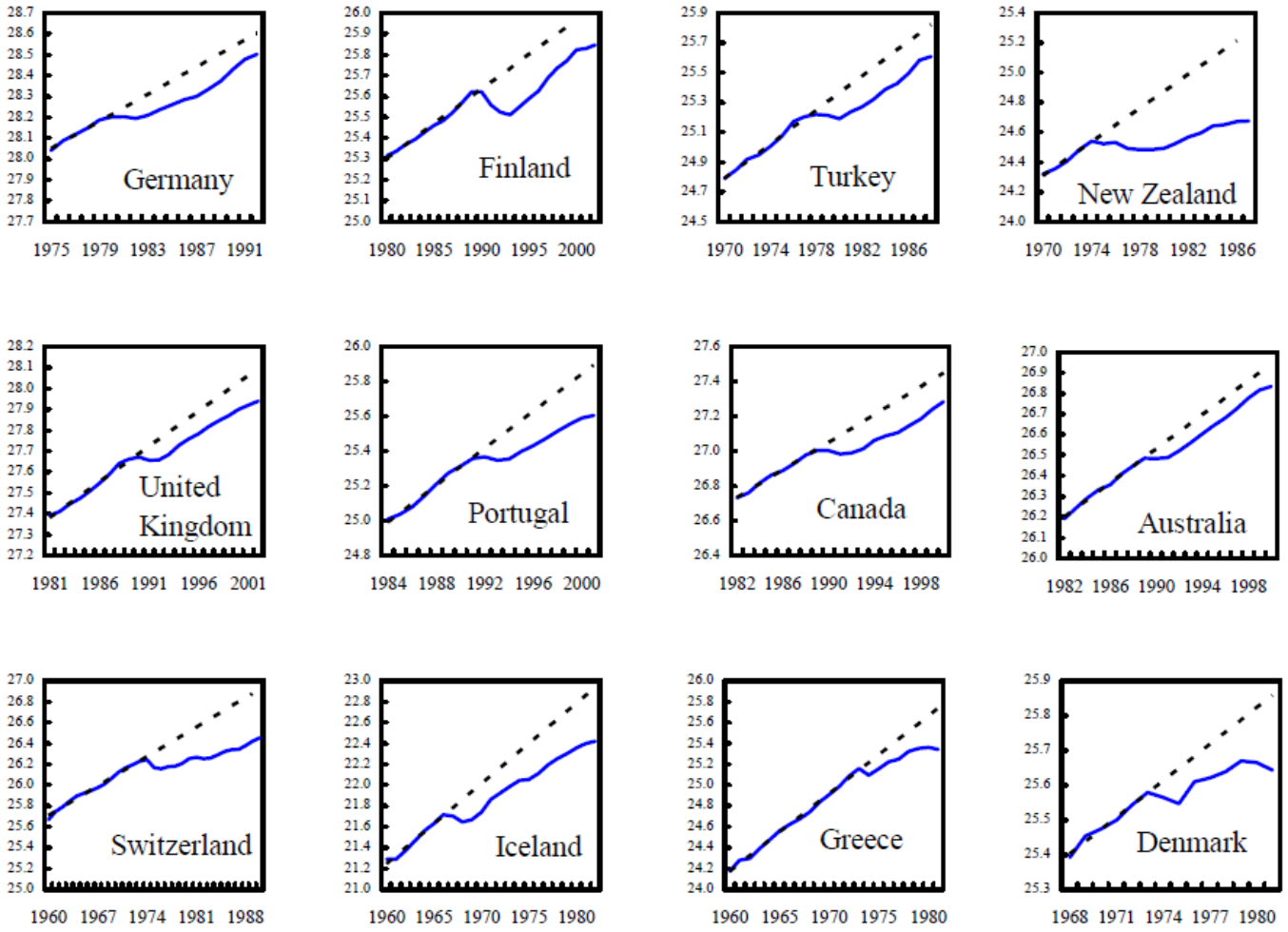
Developed Countries



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