The Asian Financial Crisis

The Asian crisis

– 1996

- Miraculous growth in EA
- But some signs of worsening current accounts in **Korea** and **Thailand**
- Signs of worsening financial institutions in **Thailand**

1997

- January – Hanbo Steel, a large **Korean** chaebol ($6bn in debts; first bankruptcy of a leading Korean conglomerate in a decade)
- Spring: Speculative attacks on **Thai** baht start

Table 22-4 | East Asian CA/GDP

Country	1990	1991	1992	1993	1994	1995	1996	1997
Indonesia	−2.6	−3.3	−2.0	−1.3	−1.6	−3.2	−3.4	−2.3
South Korea	−0.8	−2.8	−1.3	0.3	−1.0	−1.7	−4.4	−1.7
Malaysia	−2.0	−8.5	−3.7	−4.5	−6.1	−9.7	−4.4	−5.9
Philippines	−6.1	−2.3	−1.9	−5.5	−4.6	−2.7	−4.8	−5.3
Thailand	−8.5	−7.7	−5.7	−5.1	−5.6	−8.1	−8.1	−2.0

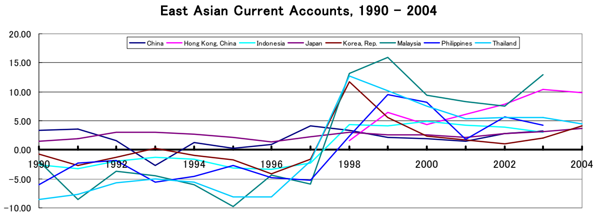
Source: World Bank, World Development Indicators.

Table 22-5 | Growth and the Current Account, Five Asian Crisis Countries

Variable	1996	1997	1998	1999	2000	2001
Real output growth (percent per year)	7.0	4.5	−8.1	6.9	7.0	1.6
Current account (percent of output)	−5.1	−2.7	10.5	7.6	5.1	3.9

The countries are those listed in Table 22-4.

Source: Institute for International Finance.



The Asian crisis

1997

- July 2 – The Bank of **Thailand** announces a managed float of the baht and calls on the **IMF** for "technical assistance."
- August – **Indonesia** abandons its fixed exchange rate for the rupiah against the dollar.
- Summer – "Currency meltdown": speculative attacks on Thai baht, Indonesian rupiah, Malaysian ringgit, HK$
- Fall – Speculative attacks spread to **Taiwan** $
- October – **HK**$ receives heaviest attacks
- October: **Indonesia** asks for help from the **IMF** ($23 bil.)
- October – spec. attacks spread to **Brazil** and **Argentina**
- Oct. 31 – IMF gives **Indonesia** $23B financial support package.

The Asian crisis

1997

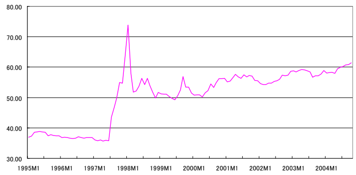
- Nov. 17 – **Hokkaido Takushoku Bank** fails; first major fin. failure in **Japan** since 1960s
- Nov. 21 – **Korea** says it will seek for **IMF**'s rescue
- Nov. 24 – **Yamaichi** Sec. fails
- Dec. 3 – **The won, rupiah, baht and ringgit** were each sent crashing to all-time lows against the US$.

1998

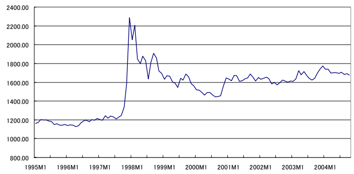
- January on – **Indonesian** rupiah continue to plummet
- May – **Indonesian** Pres. Suharto steps down
- Summer – **Japan** experiences banking crisis (Long Term Credit Bank and Industrial Bank of Japan failed)

Currency crises

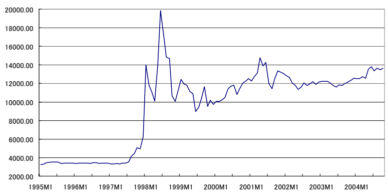
Thai Baht per US dollar



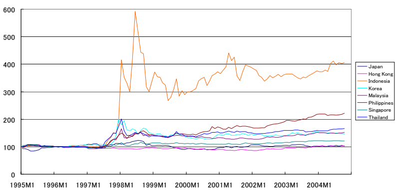
Korea Won per US dollar



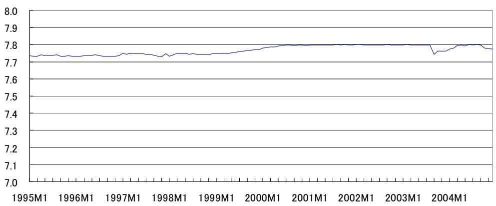
Indonesia Rupiah per US dollar



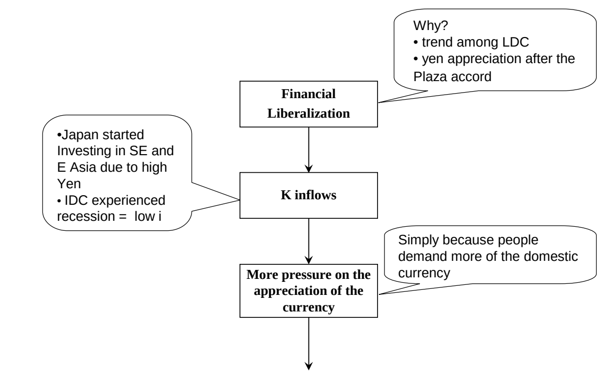
Exchange rates w/ 1996M1=100

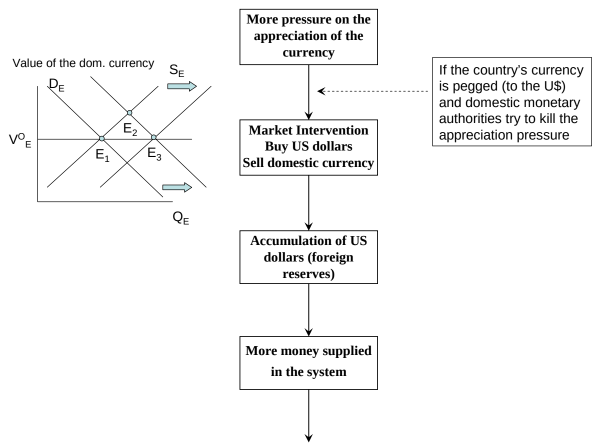


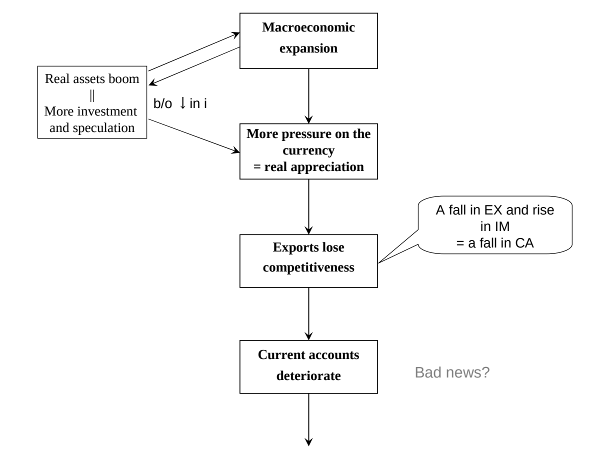
Hong Kong Dollars per US dollar
1990:1 – 2004:12

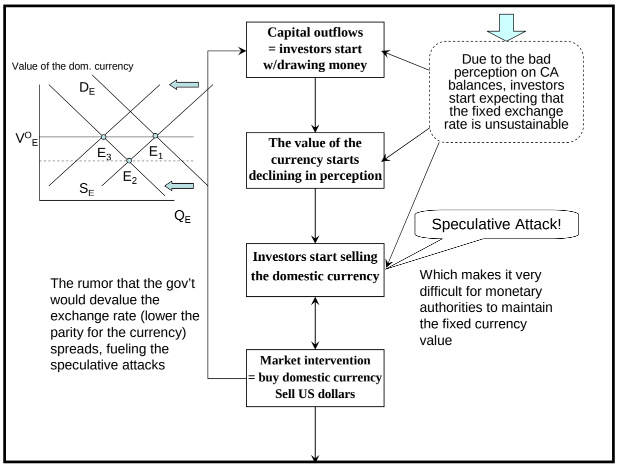


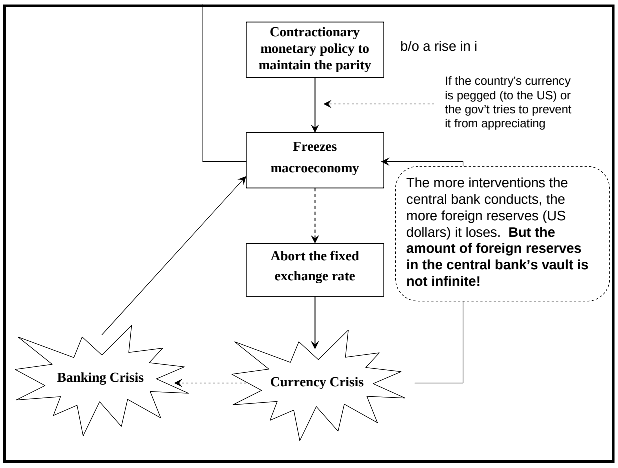
Mechanism of the Currency Crisis



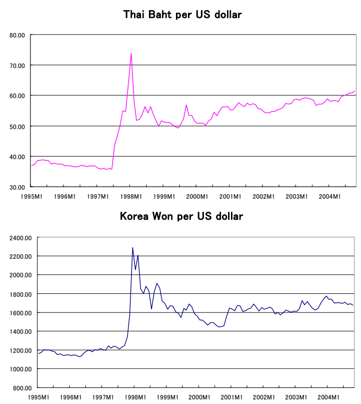


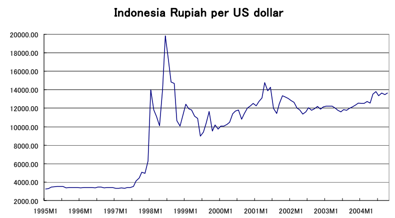


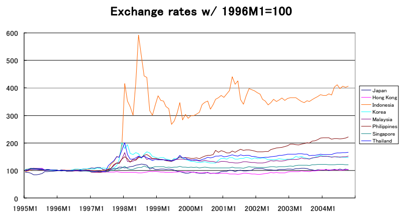


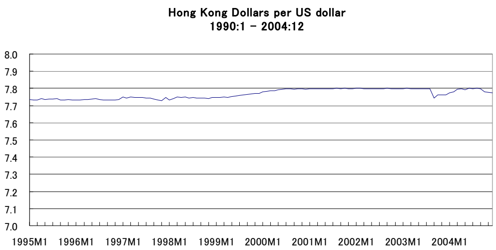


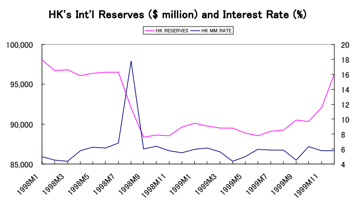
Currency crises



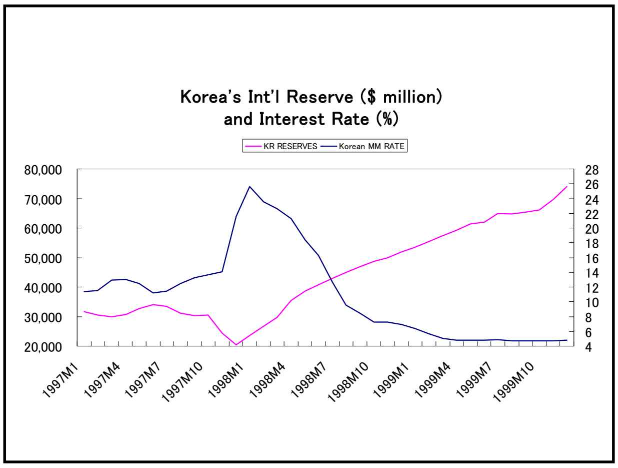

Indonesia Rupiah per US dollar
20000.00
18000.00
16000.00
14000.00
12000.00
10000.00
8000.00
6000.00
4000.00
2000.00
1995M1 1996M1 1997M1 1998M1 1999M1 2000M1 2001M1 2002M1 2003M1 2004M1

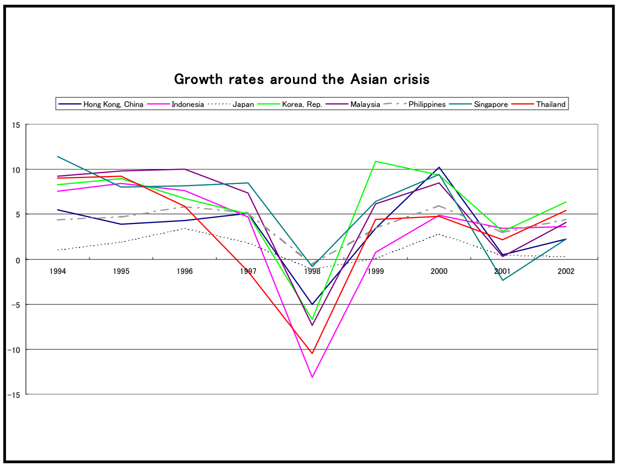

Exchange rates w/ 1996M1=100
600
500
400
300
200
100
0
1995M1 1996M1 1997M1 1998M1 1999M1 2000M1 2001M1 2002M1 2003M1 2004M1
Japan
Hong Kong
Indonesia
Korea
Malaysia
Philippines
Singapore
Thailand

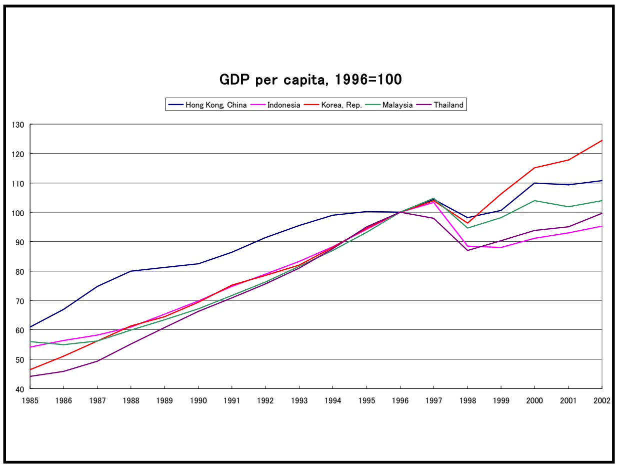

Hong Kong Dollars per US dollar
1990:1 - 2004:12
8.0
7.9
7.8
7.7
7.6
7.5
7.4
7.3
7.2
7.1
7.0
1995M1 1996M1 1997M1 1998M1 1999M1 2000M1 2001M1 2002M1 2003M1 2004M1


HK's Int'l Reserves ($ million) and Interest Rate (%)
100,000
95,000
90,000
85,000
20
18
16
14
12
10
8
6
4
1998M1 1998M3 1998M5 1998M7 1998M9 1998M11 1999M1 1999M3 1999M5 1999M7 1999M9 1999M11


HK's Stock market
17000
16000
15000
14000
13000
12000
11000
10000
9000
8000
7000
January-98 July-98 January-99 July-99


Korea's Int'l Reserve ($ million)
and Interest Rate (%)
KR RESERVES
Korean MM RATE
80,000
70,000
60,000
50,000
40,000
30,000
20,000
28
26
24
22
20
18
16
14
12
10
8
6
4
1997M1
1997M4
1997M7
1997M10
1998M1
1998M4
1998M7
1998M10
1999M1
1999M4
1999M7
1999M10


Growth rates around the Asian crisis
Hong Kong, China
Indonesia
Japan
Korea, Rep.
Malaysia
Philippines
Singapore
Thailand
15
10
5
0
-5
-10
-15
1994
1995
1996
1997
1998
1999
2000
2001
2002


GDP per capita, 1996=100
Hong Kong, China
Indonesia
Korea, Rep.
Malaysia
Thailand
130
120
110
100
90
80
70
60
50
40
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002

Chaos in East Asia

- The Asian crisis affected most of the economies in East Asia including Japan, but excluding China
- Taiwan didn't experience a currency crisis, but did experience a moderate banking crisis
- The Asian crisis became mirage
- People questioned Asian "crony capitalism" and globalization
  - Was there such a thing as the Asian model?
  - What about the development state argument?
  - Is globalization no good?
- Who really started the crisis?

The blame game

- Some said it is Japan that started the crisis
  - Reform of the weak banking sector was neglected for a long time, leading to the occurrence of the banking crisis of 1998. The banking crisis contributed to rapid depreciation of the yen
  - The prolonged recession did not create demand in the EA region that could have absorbed excess supply in the region
- Others said that China is to blamed
  - The foreign exchange reform devalued the renminbi and made Chinese exports more competitive and also easier for China to receive FDI
  - Relocation of production from SE Asia to China may have started even before the occurrence of the crisis
- Some others also blamed the U.S., George Soros, and globalization

Globalization – double-edged sword

Good side

- Financial liberalization/opening can 1) help a (saturated) financial system to diversify business and/or become more competitive through foreign competition, and 2) help (mature) domestic businesses to procure capital from the rest of the world (ex. Korea and Japan)
- Financial liberalization/opening can 1) help a country to utilize a pool of savings more efficiently through foreign financial institutions and/or 2) create access to foreign capital if domestic savings are not very available (ex. Thailand, Malaysia, Indonesia)

Globalization – double-edged sword

Down-side

- FL exposes the domestic system directly exposed to international standards → weakness of the legal systems and other political/social institutions can amplify the weakness of the entire system; “foreigners are mean!”
- FL bring volatilities in cross-border capital flows

Some Asian economies seem to have recovered quickly, but why?

- The US economy was booming
- Linkage with the ROW
  - Lee and Park (2001) say the higher the ratio of exports to GDP, the more quickly the Asian crisis-hit economies tend to recover.
  - Ito (2004) says the more open financial markets *and* the more developed the legal system and other institutions, the smaller the size of the output loss of the crisis-hit economies tend to experience and the more quickly they tend to recover.

Some Asian economies seem to have recovered quickly, but why?

- Portfolio investment w/drew, but FDI didn’t.
  - Still positive evaluation on the long-term growth
- China wasn’t affected by the crisis
  - Japan/EU/US established production network in the Asian region connecting Asia and China

Implications of the crisis on Japan

- Japan received fierce criticism as the crisis-starter
- The post-crisis recession, many believed, could been shortened if Japan recovered – "Japan as the locomotive in the region"
- The Japan model or the Asian growth model was criticized as crony capitalism
- At least, Japanese leaders realized that Japan is not as unwelcomed by other East Asian nations as they thought it is.
- But at the same time, Japan needs to balance its efforts to increase its presence in the region and its relationship w/ the U.S.

Implications of the crisis on China

- "FL can be very risky": At least, domestic institutions need to be developed enough before FL
- "A closed financial system isn't too bad!"
- Foreign reserves are important ammunitions to fight a crisis
- It's better to rely upon long-term debt to foreigners than short-term ones
- There is no short-cut in development

Implications of the crisis on Other East Asian countries

- China is the biggest rival
- Asian nations should be self-reliant
  - ASEAN started studying the possibility of adopting a current union like the euro
- It's better to pursue development w/ minimal reliance on the U.S.
- Foreign reserves are important ammunitions to fight a crisis
- It's better to rely upon long-term debt to foreigners than short-term ones
- There is no short-cut in development

Implications on other developing countries

- China is the biggest rival
- IMF is not always helpful.
  - IMF isn't familiar with domestic socio/political-situation, especially the areas outside Latin America/Africa
  - The conditionality may end up hurting the economy even more
- Moral hazard issue, domestic vs. international
- Regional cooperation is good to reduce reliance on the U.S.
- Foreign reserves are important ammunitions to fight a crisis
- It's better to rely upon long-term debt to foreigners than short-term ones