

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

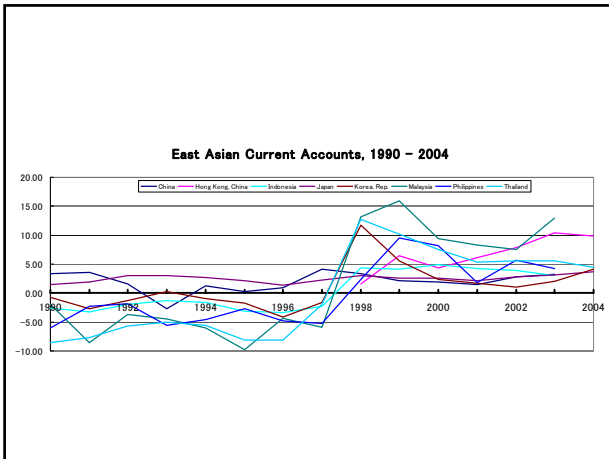
Country	1990	1991	1992	1993	1994	1995	1996	1997
Indonesia	-2.6	-3.3	-2.0	-1.3	-1.6	-3.2	-3.4	-2.3
South Korea	-0.8	-2.8	-1.3	0.3	-1.0	-1.7	-4.4	-1.7
Malaysia	-2.0	-8.5	-3.7	-4.5	-6.1	-9.7	-4.4	-5.9
Philippines	-6.1	-2.3	-1.9	-5.5	-4.6	-2.7	-4.8	-5.3
Thailand	-8.5	-7.7	-5.7	-5.1	-5.6	-8.1	-8.1	-2.0

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

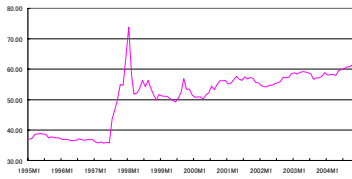
- Nov. 17 – **Hokkaido Takushoku Bank** fails; first major fin. failure in **Japan** since 1960s
- Nov. 21 – **Korea** says it will seek for **IMF's** rescue
- Nov. 24 – **Yamaichi** Sec. fails
- Dec. 3 – **The won, rupiah, baht and ringgit** were each sent crashing to all-time lows against the US\$.

1998

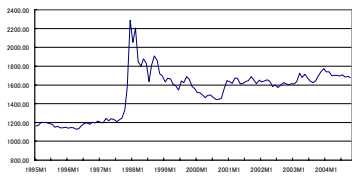
- January on – **Indonesian** rupiah continue to plummet
- May – **Indonesian** Pres. Suharto steps down
- Summer – **Japan** experiences banking crisis (Long Term Credit Bank and Industrial Bank of Japan failed)

Currency crises

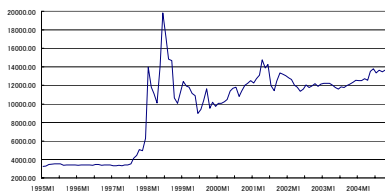
Thai Baht per US dollar



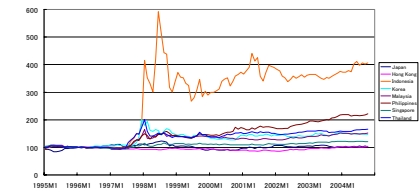
Korea Won per US dollar



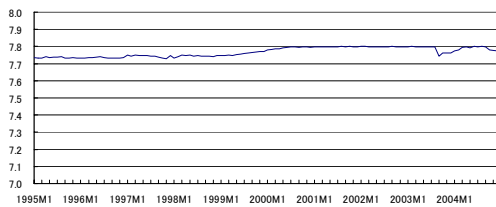
Indonesia Rupiah per US dollar



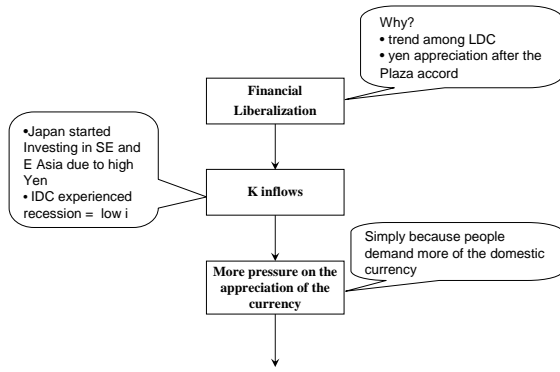
Exchange rates w/ 1998M1=100

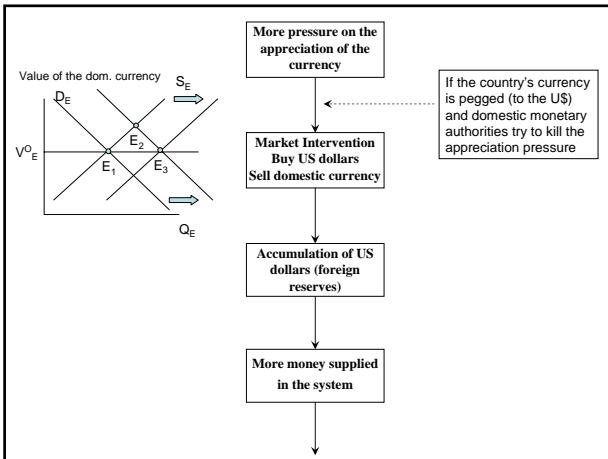


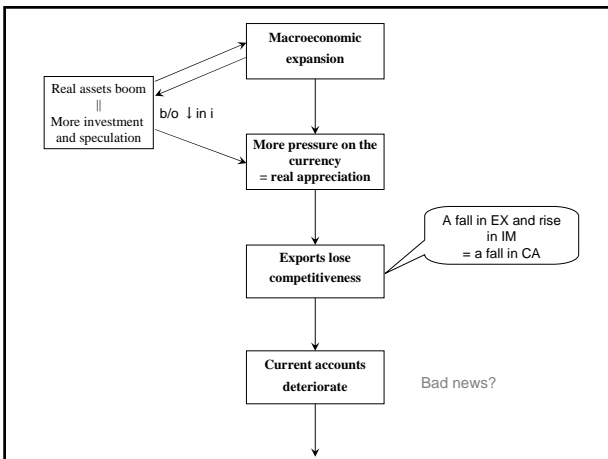
Hong Kong Dollars per US dollar
1990:1 - 2004:12

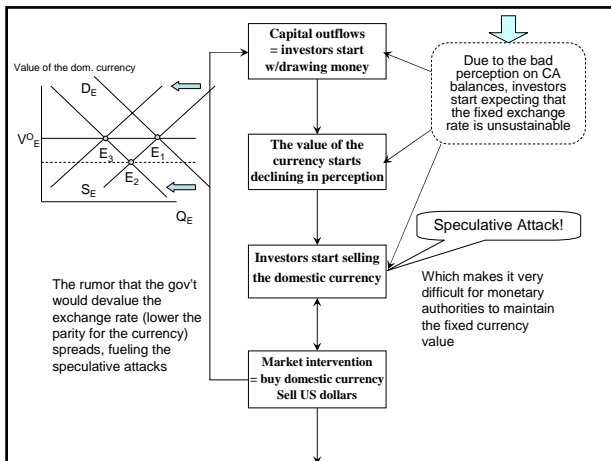


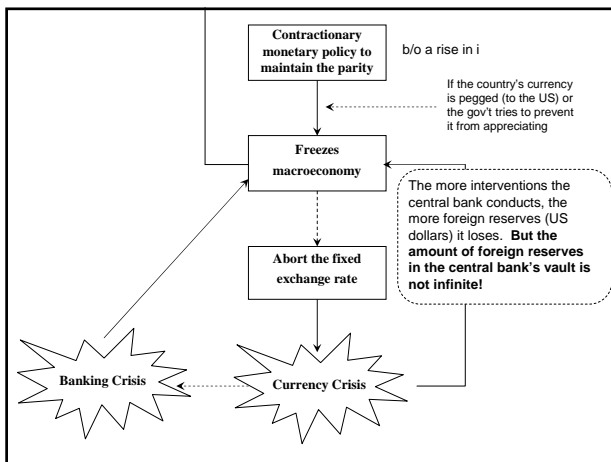
Mechanism of the Currency Crisis

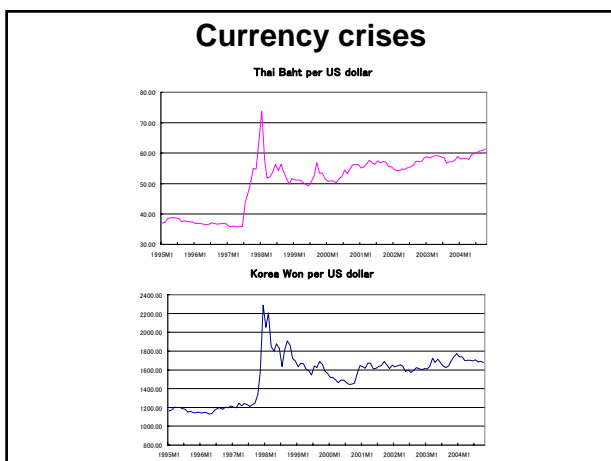


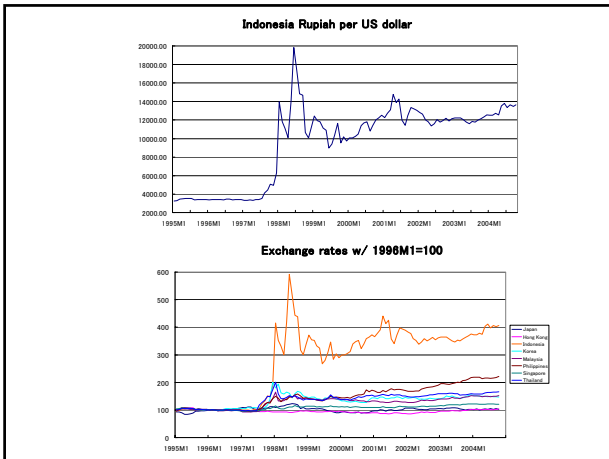


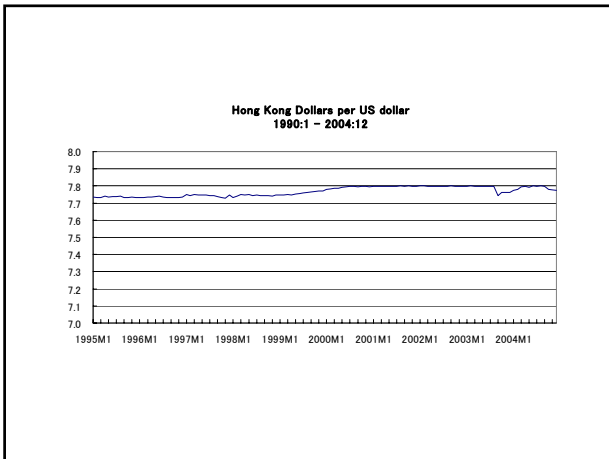


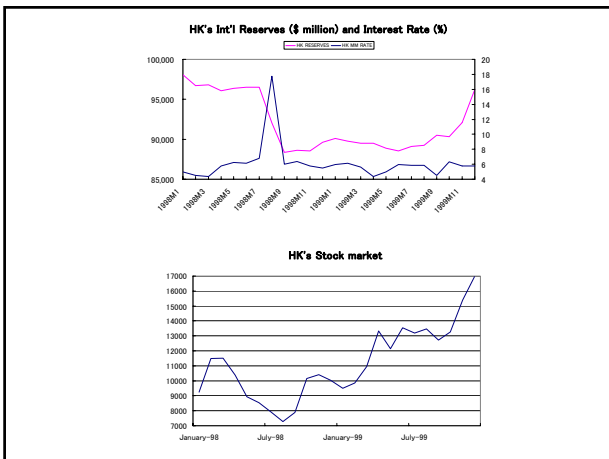


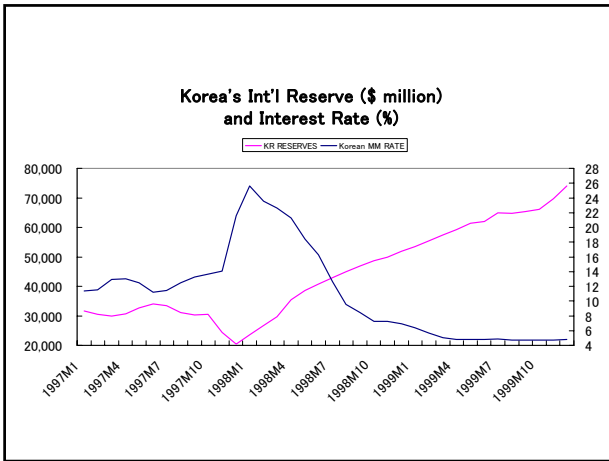


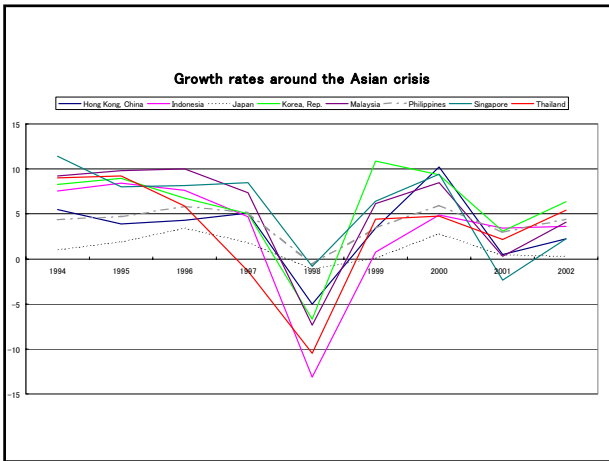


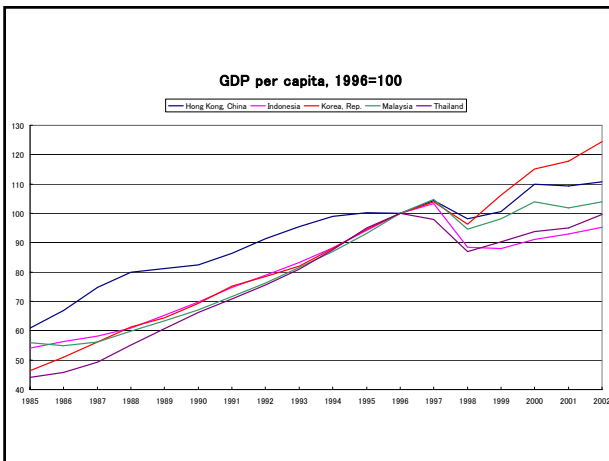












Chaos in East Asia

- 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 be 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 be 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
