Financial Crisis in Europe and Asia

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The Cost of Currency Crises

- Crisis Countries;
  - Thailand, Indonesia, Malaysia, and Korea
- Countries for comparison;
  - The Philippines and China
- Par capita GDP
  - That of 2004 is about as same as that of 1996
  - That of Thailand was much less
  - Korea is relatively well. But annualized growth rate from 1996 to 2004 is only 3.3%

Per capita income (US dollar)

	1996	**1998**	**2004**	1996/2004
Indonesia	1100	640	1140	104%
Korea	10590	8600	14000	132%
Malaysia	4330	3670	4520	104%
Philippines	1160	1050	1170	101%
Thailand	2930	2160	2490	85%
China	750	750	1500	200%

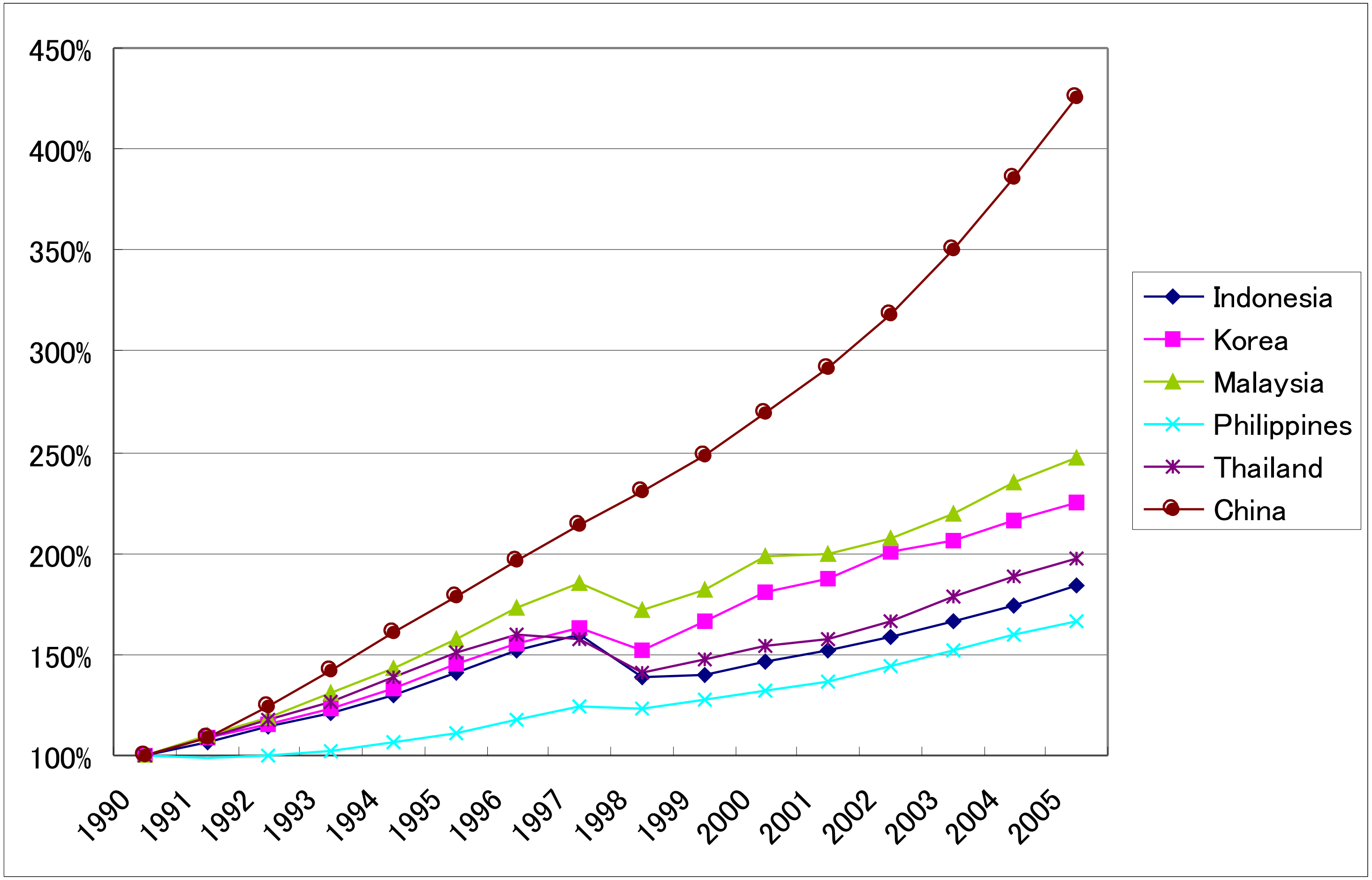
Real GDP Measured in Domestic Currency

- All of the four crisis countries experienced large drop in real GDP during crises.
  - The foregone GDP could not be recovered. It has gone forever.
- Trend GDP growth rates apparently changed after the crises.
- One-time loss and change of trend growth rate are problematic respectively.

cont.

- One-time lost
  - Even after taking into consideration the declined growth trends, lost GDPs amount to 14 to 20 percentage of GDP in 2005.
- Trend lost
  - Comparing a case with 10% growth and one with 5% growth, the former makes GDP 2.6 times higher in ten years, while the latter makes 1.6 times. The balance is a one year worth of GDP at the starting year.

Real GDP (1990 = 100%)



Average growth rate before and after the crisis

	90-96	98-05	GDP lost
Indonesia	7%	4%	20%
Korea	8%	6%	14%
Malaysia	10%	5%	14%
Philippines	3%	4%	5%
Thailand	8%	5%	17%
China	12%	9%	1%

Nominal Depreciation

- 1996 -> 2006
  - Nominal depreciation 16 – 74%
- It seems that the depreciation at the currency crises was not temporary phenomena
- (The recent dollar decline is another story)

Nominal Exchange Rate

	1996	1998	2006	Rate of Change
Indonesia	2342.3	10013.6	9159.32	-74%
Korea	804.45	1401.44	954.79	-16%
Malaysia	2.52	3.92	3.67	-31%
Philippines	26.22	40.89	51.31	-49%
Thailand	25.34	41.36	37.88	-33%
China	8.31	8.28	7.97	4%

BOP and the Composition of the Financial Account

- Current accounts of all countries has been surplus after the crisis. They accumulate foreign reserves
- Financial Accounts show international capital flows and are composed of;
  - Direct investment
  - Portfolio investment
  - Other investment (mostly bank loans)
- Trend of direct investment changed after the crises.

Financial Account

		Before	1997	After	2005
Indonesia	Direct Inv.	2405	4499	−1175	2195
	Portfolio inv.	2085	−2632	787	4237
	Other inv.	2210	−2470	−4656	−11280
	Over all	6700	−603	−5045	−4849
Korea	Direct Inv.	−1064	−1560	1962	26
	Portfolio inv.	7481	14384	6787	345
	Other inv.	3922	−21885	−1513	4096
	Over all	10266	−9150	6861	2804
Malaysia	Direct Inv.	4303	5137	1580	994
	Portfolio inv.	−610	−248	100	−3700
	Other inv.	2788	−2691	−5586	−7041
	Over all	6481	2198	−3939	−9806

Financial Account（Cont.）

		Before	1997	After	2005
Philippines	Direct Inv.	838	1086	1054	970
	Portfolio inv.	975	591	700	2660
	Other inv.	2925	4821	−797	−3536
	Over all	4738	6498	943	51
Thailand	Direct Inv.	1593	3315	3503	4228
	Portfolio inv.	2338	4527	776	6162
	Other inv.	9554	−19898	−9421	−1494
	Over all	13485	−12056	−5198	8370
China	Direct Inv.	20012	41674	45988	67821
	Portfolio inv.	1295	6943	−2815	−4933
	Other inv.	−479	−27580	−6870	−4026
	Over all	20828	21037	36303	58862

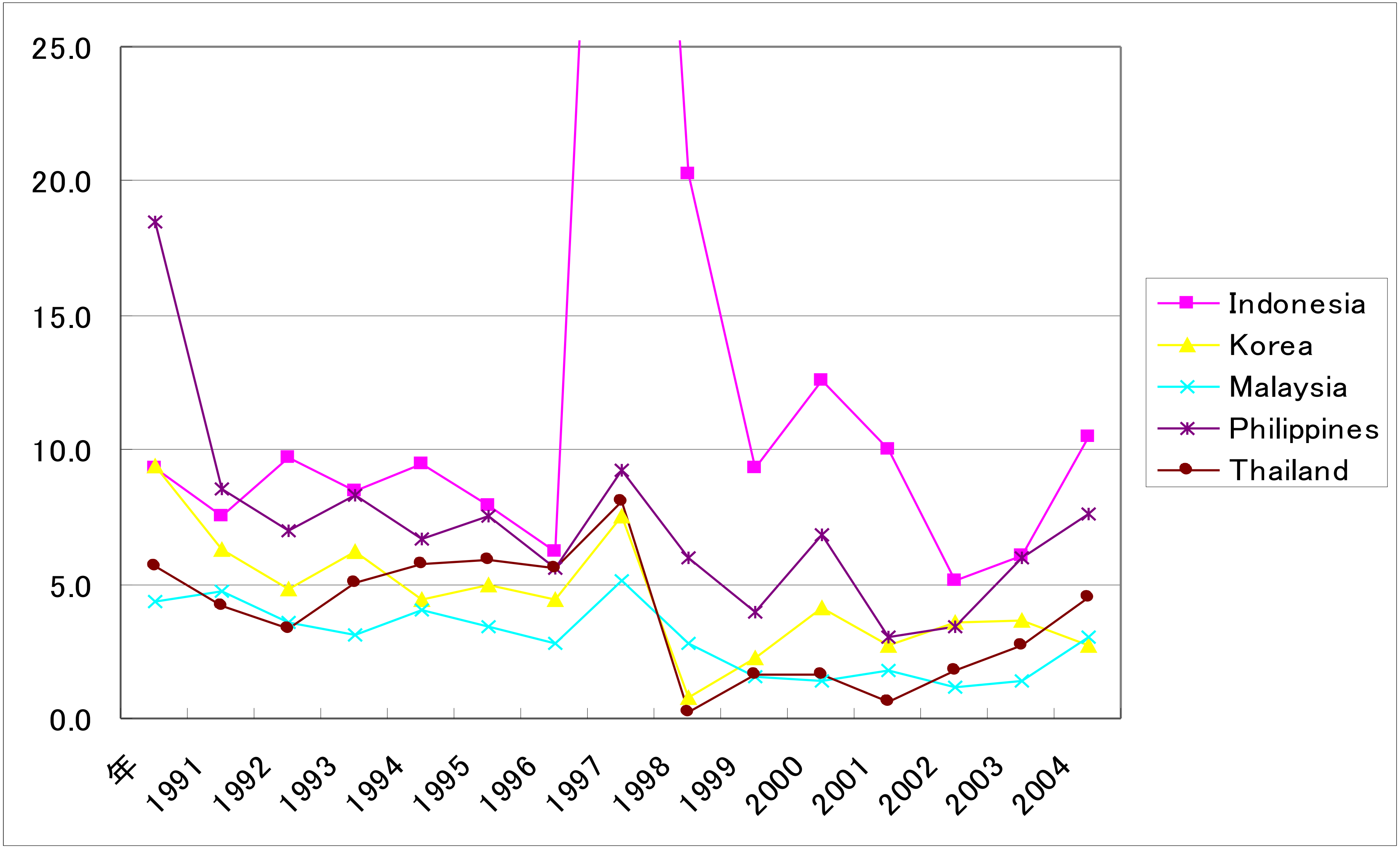
Solvency was not the problem

- External debt problem worsened during crises. But it does not seem to be a serious concern. (except Indonesia)
- Even Indonesia's debt/ GDP ratio in 2004 is slightly lower than that in 1996.
- (Inflation did not a problem except in Indonesia)

External Debt/ GDP Ratio

	1996	1998	2004
Indonesia	58.3	172.5	56.5
Korea	22.3	44	25.2
Malaysia	42	65.3	46.6
Philippines	46.5	70.1	66.8
Thailand	51.4	76.4	32.4

Rate of Inflation



Summary

- Costs of crises measured in terms of GDP were high and had long lasting effect.
- Depreciations of currencies seem to be unavoidable
- Inflation was not a problem.
- Debt sustainability was not a problem.

Asymmetric World

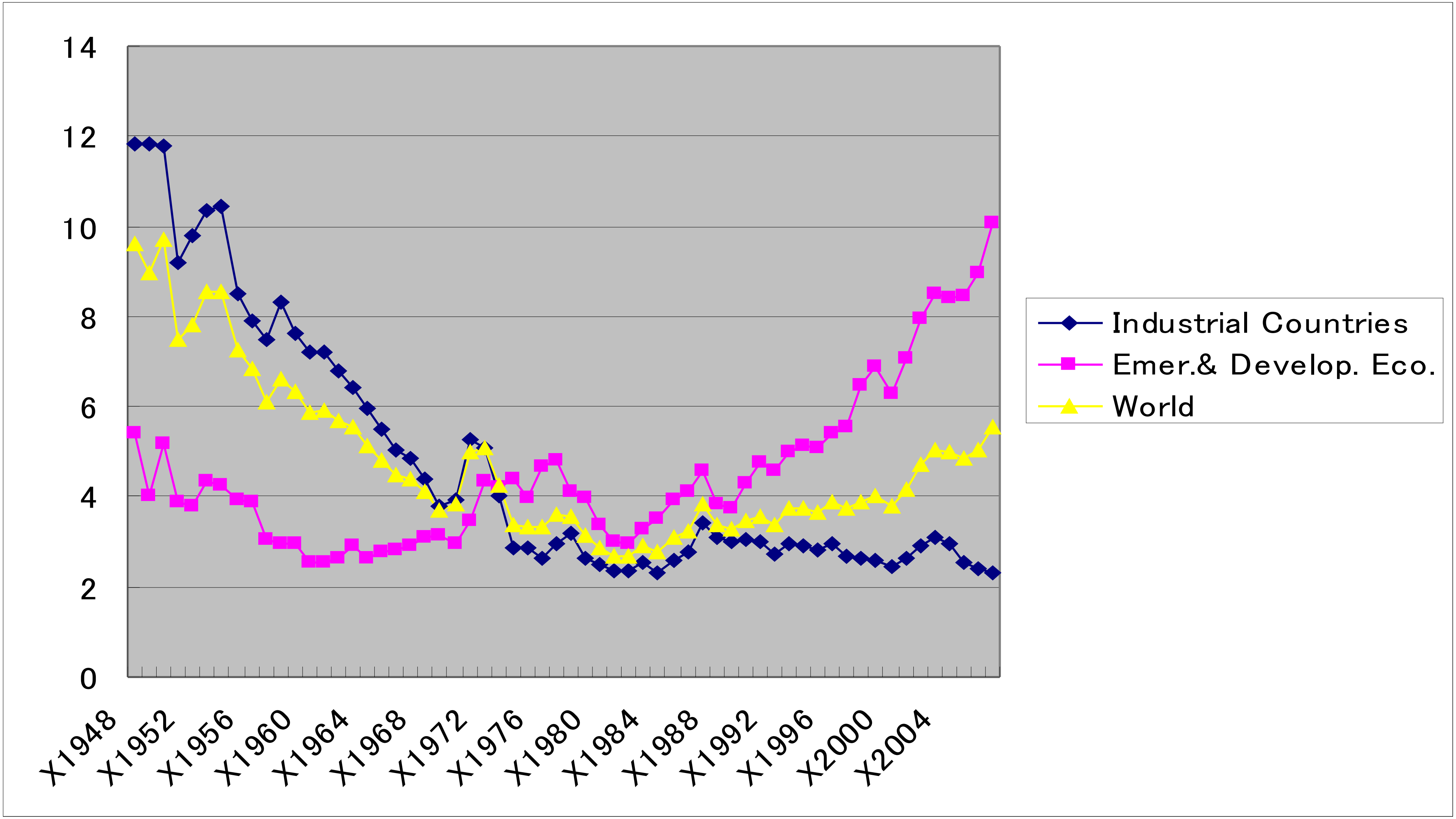
Asymmetry in Policy Reactions

- East Asian Countries (in crises)
  - High interest rate policies
  - Tight fiscal policies
  - Closures of financial institutions
- Developed Countries
  - Low interest rates
  - Fiscal expansions
  - Bail-out of financial institutions

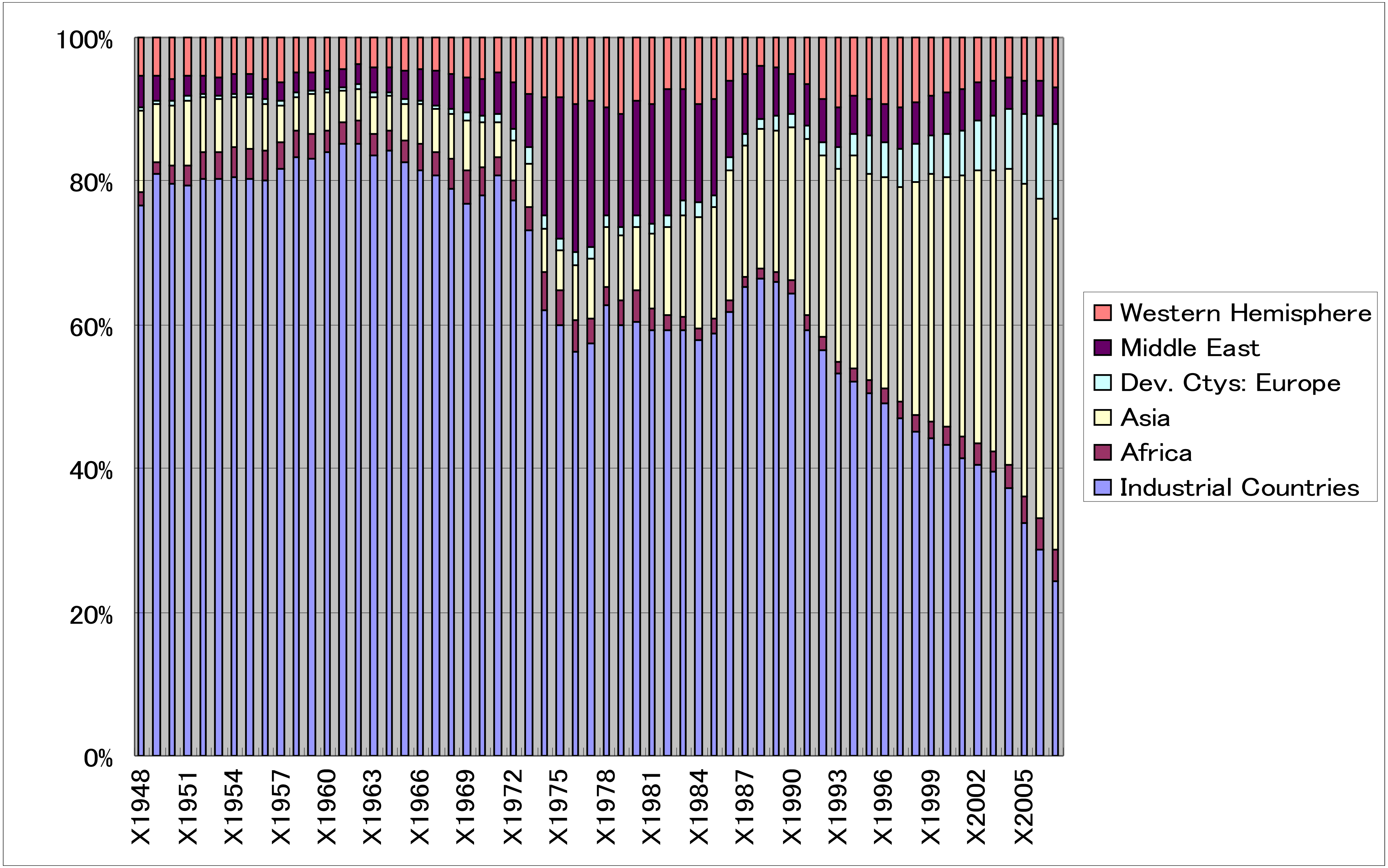
Asymmetry in Hoarding Reserves

- Since the late 80's, developed countries have decreased their foreign exchange reserves (as a percentage of imports). On the other hand, developing countries have increased the reserves.
- As a result, about 70% of world reserves is held by developing countries in 2006, 30% up from about 40% in late 80's.
- Developed countries' reserves cover less than three months' worth of imports now, while those of developing countries cover about nine moths'.

Foreign Exchange Reserves



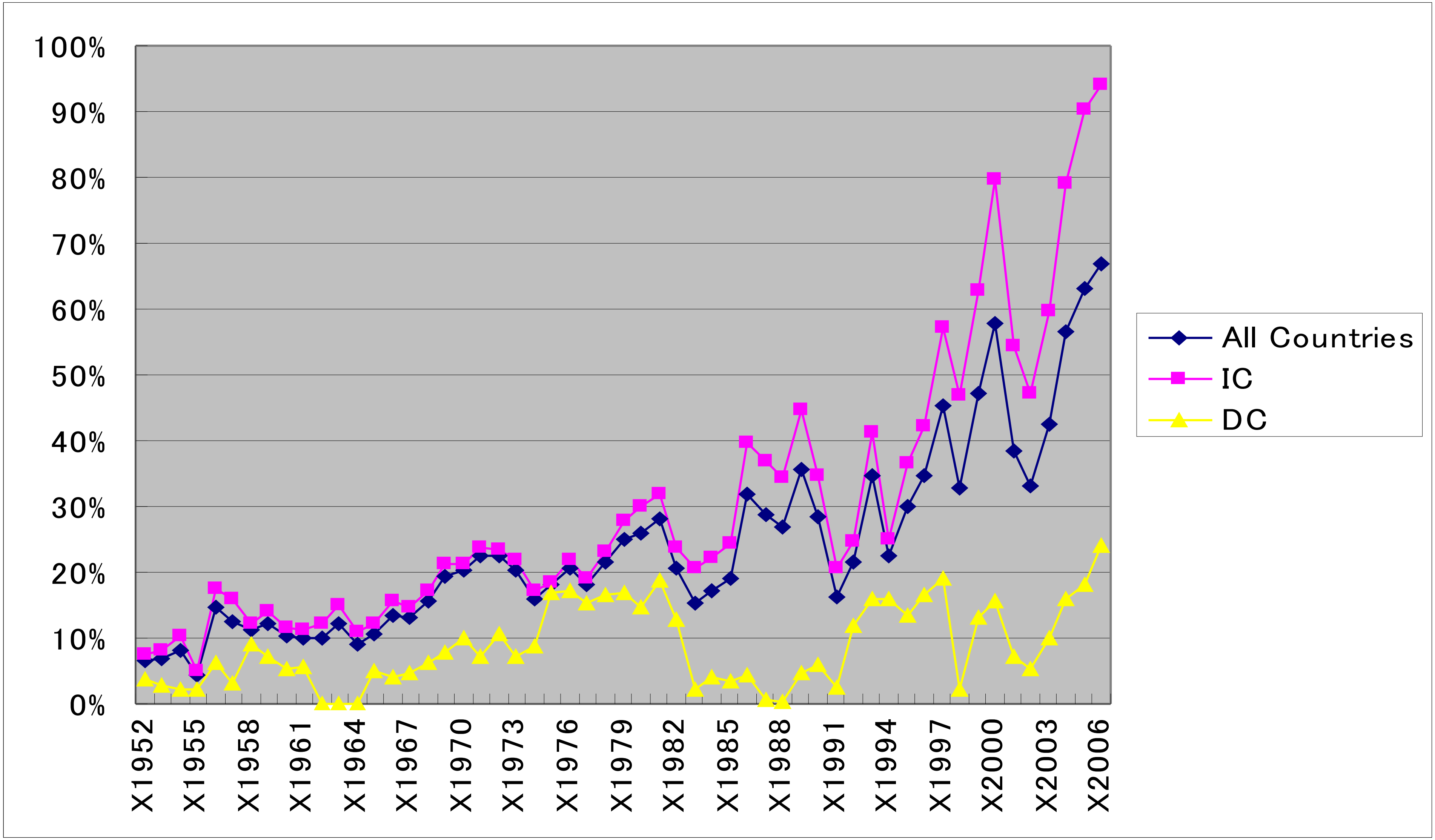
Reserves (share)



Asymmetry in Financial Globalization

- Measured by gross financial account as a percentage of total trade, developed countries have increased international financial transactions (although the volatilities have been large after 90's).
- In contrast, developing countries have experienced several stop-and-go episodes in financial globalization, but, generally speaking, they lagged behind since 80's.

Gross Financial Account / Trade



Stop-and-go Experiences

- Booms in 70's and Latin American debt crisis in 80's.
- Booms in 90's and Asian Currency crisis (plus other crises in late 90's).
- Booms from 2002 and it most possibly has ended this year thanks to recent financial turmoil. A small relief is that, this time, it is not the developing countries that causes the problem.

Financial Globalization and Developing Countries

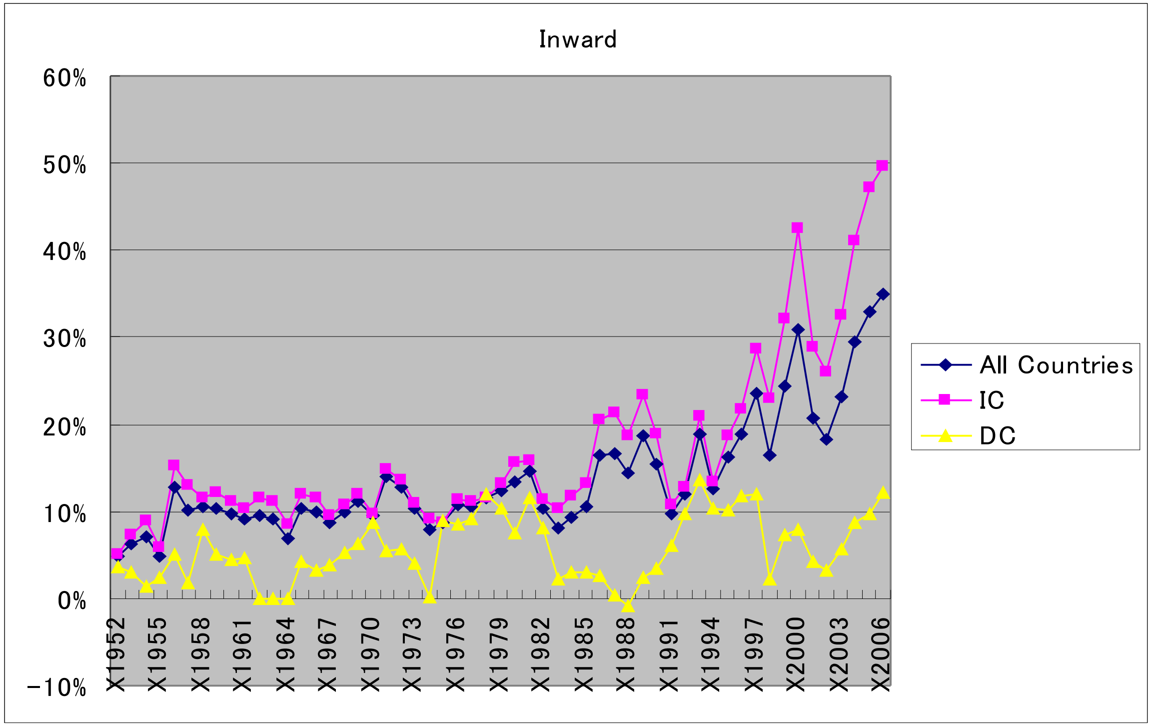
- It seems that the policy makers in developed countries are feeling more secured, the more their economies financially globalized (so that they reduced their reserves).
- In contrast, the policy makers in developing countries seem to have learned that their economies are getting more vulnerable, the more they are financially globalized.

Good News and Bad News

- Only a few months ago, it was argued that many developing countries, especially East Asians, have been accumulating needlessly huge reserves. But thanks to them, many of the developing countries seems to escape serious currency crisis this time. (Important exceptions are countries of emerging Europe)
- Still, their economies are suffering in two aspect; one is reversal of the capital flows, and the other is the sharp declines of export demands.

An Important Difference

- Except emerging Europe, capitals have been outflowing from, as well as inflowing to, the countries.
- Net financial flows have been about balanced. (Except emerging Europe)
- That was good and bad;
  - Good for their BOP positions
  - However, capitals flowing out from developing countries might have inflated financial bubbles in developed countries.


Inward
60%
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All Countries
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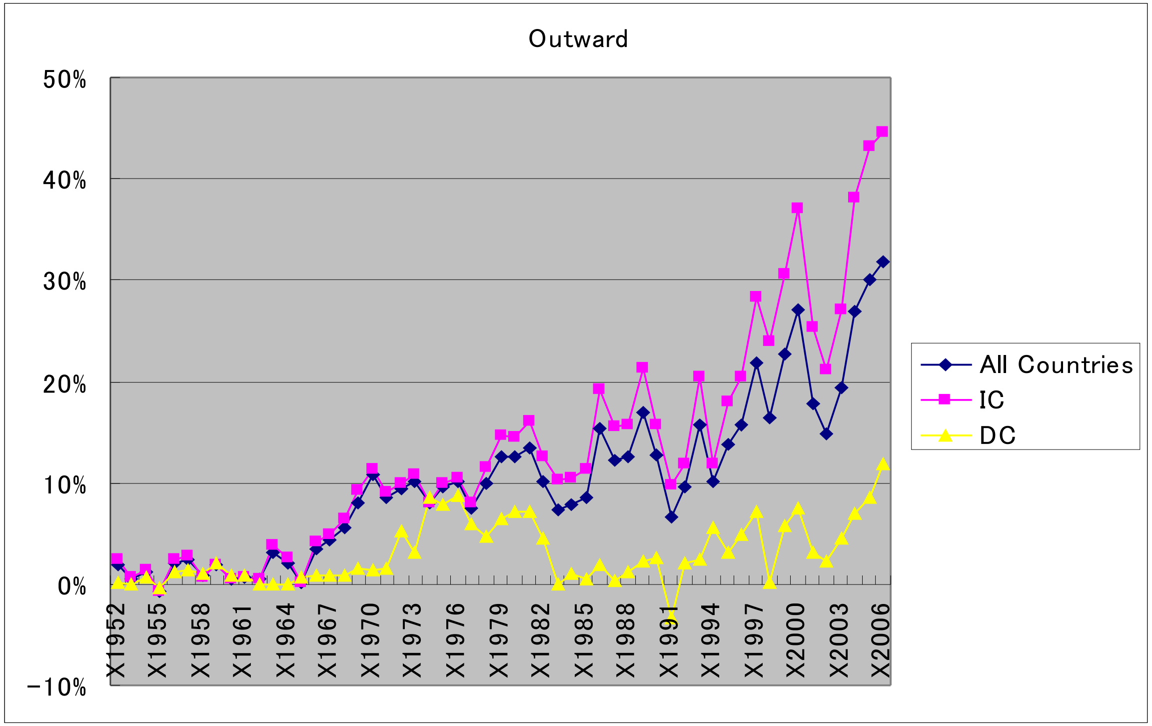
Outward
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All Countries
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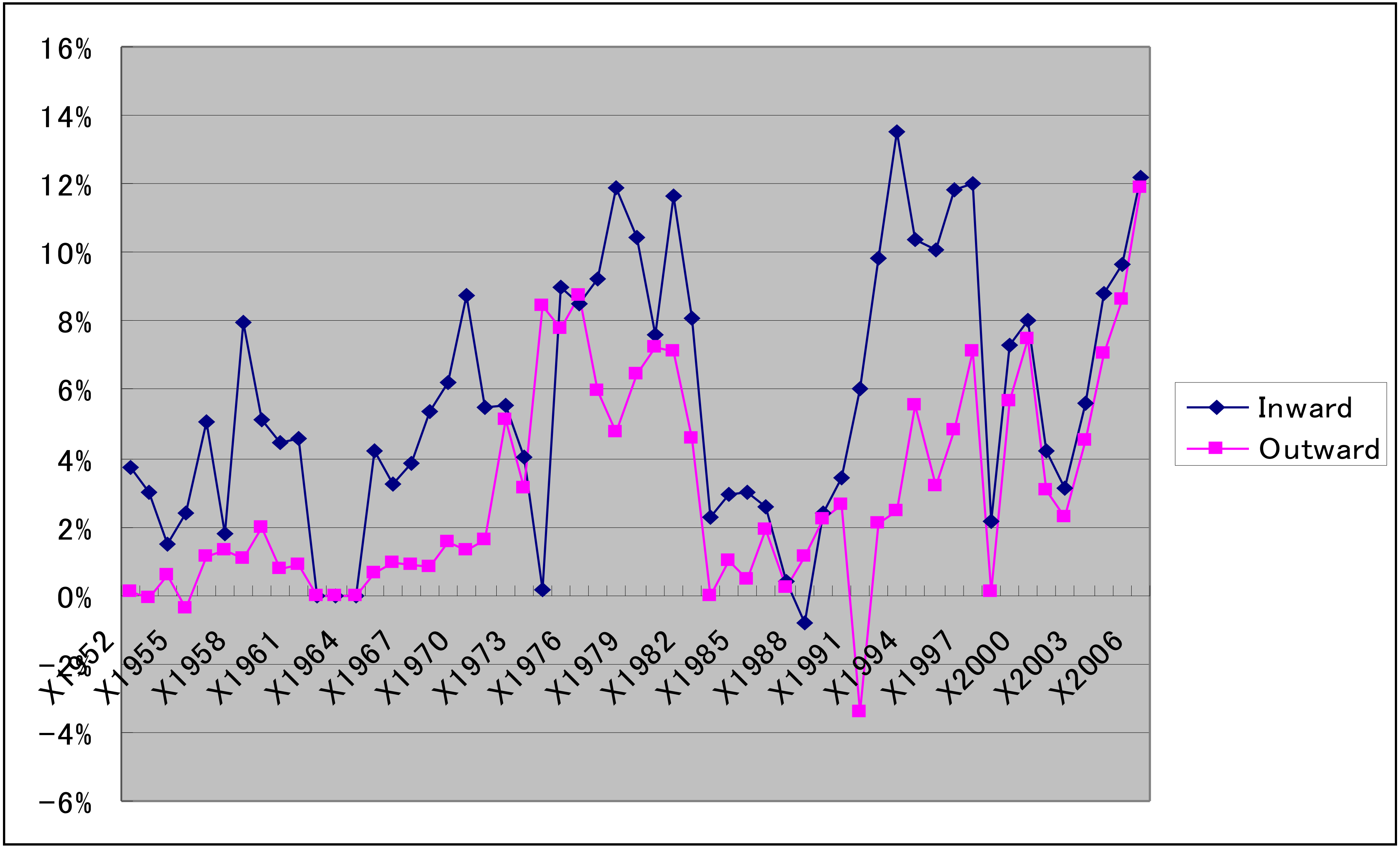
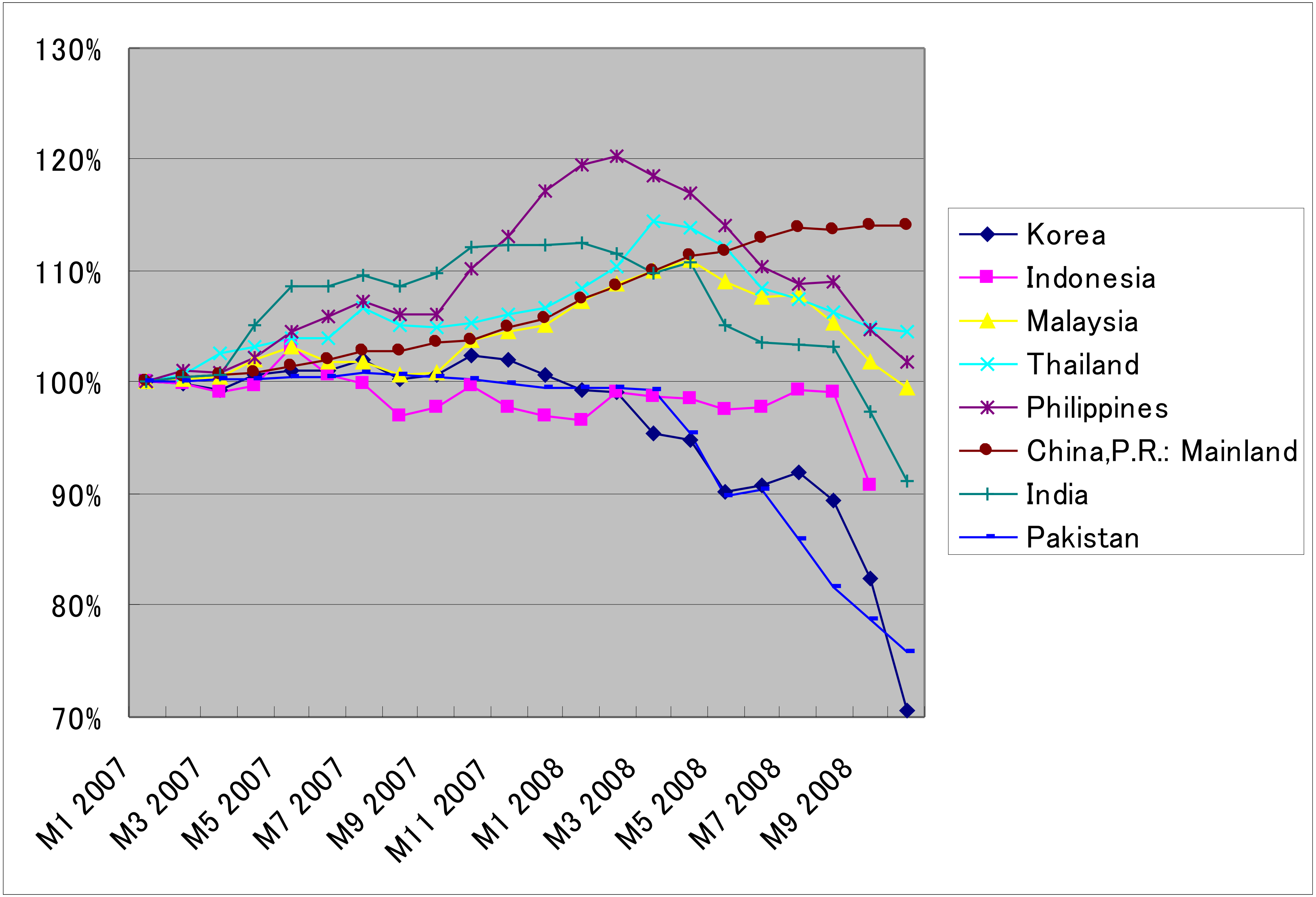
Financial Inflows vs. Outflows



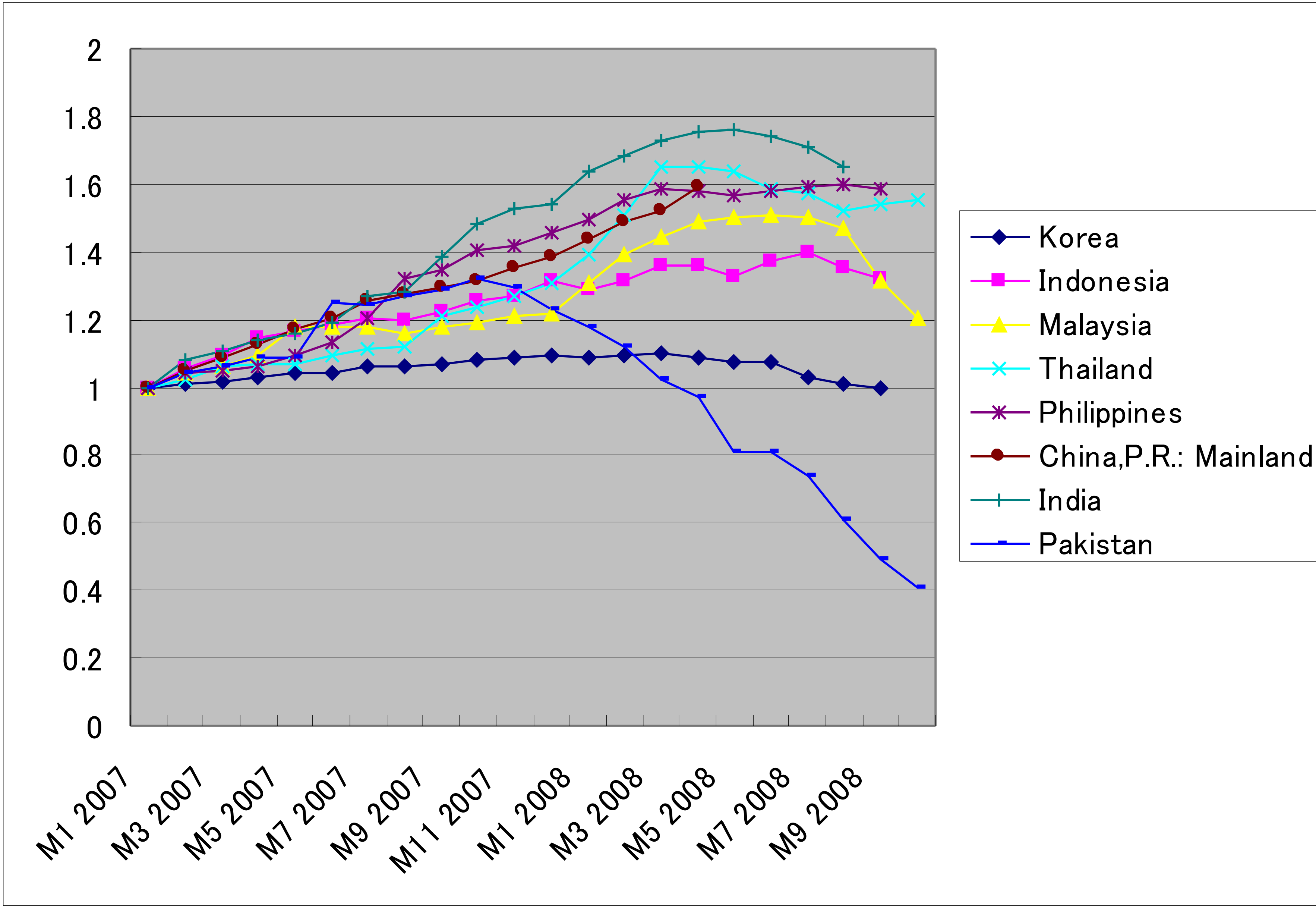
Risks of the Financial Globalization

- In East Asia, Korea was thought as a best student to the IMF until recently. However, Korea is the most affected country by the recent financial turmoil.
- To explain why, we will see the break-down of the financial inflows.

Exchange Rates



Reserves



2
1.8
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M3 2007
M5 2007
M7 2007
M9 2007
M11 2007
M1 2008
M3 2008
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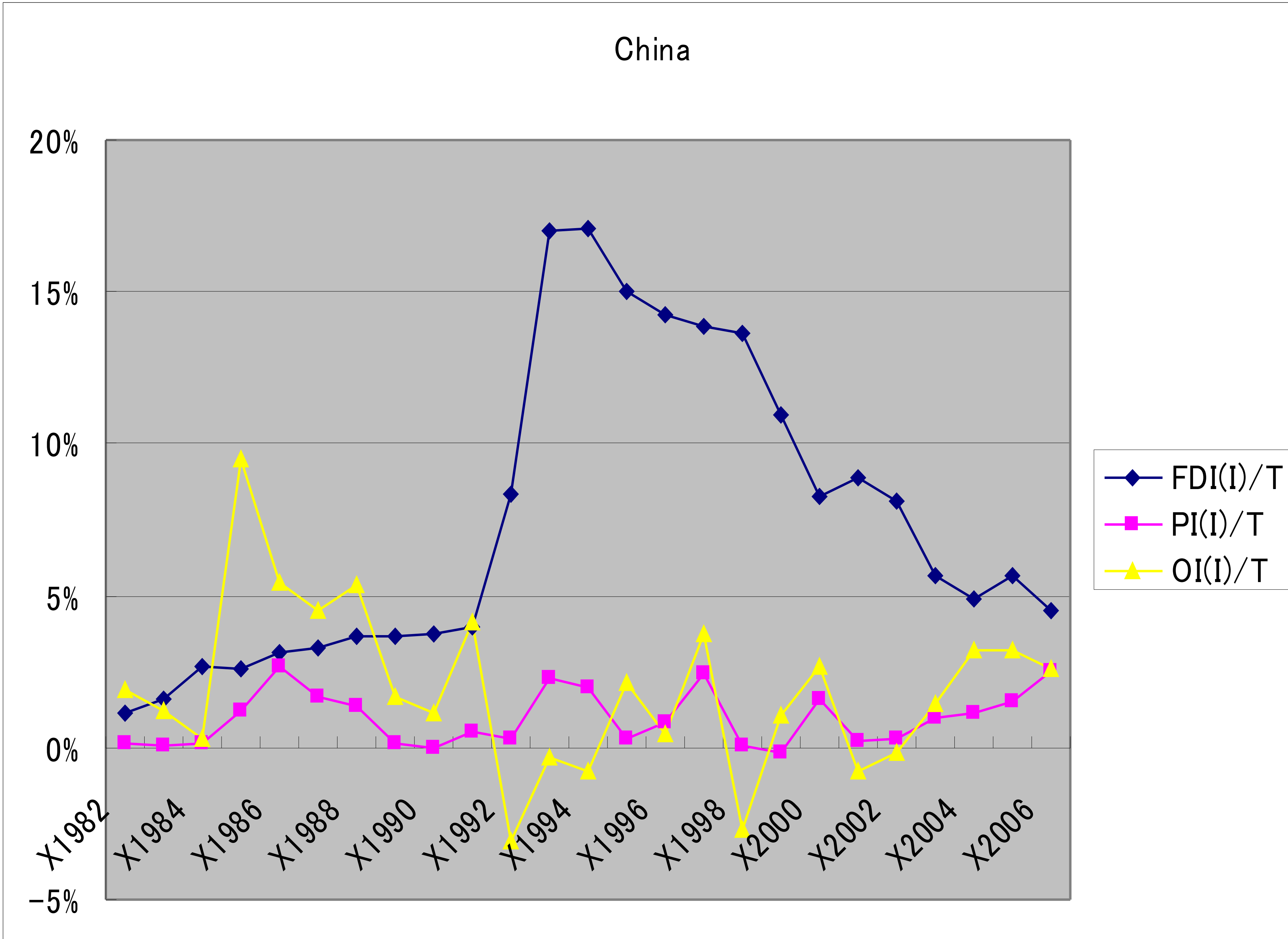
Korea
Indonesia
Malaysia
Thailand
Philippines
China,P.R.: Mainland
India
Pakistan


China
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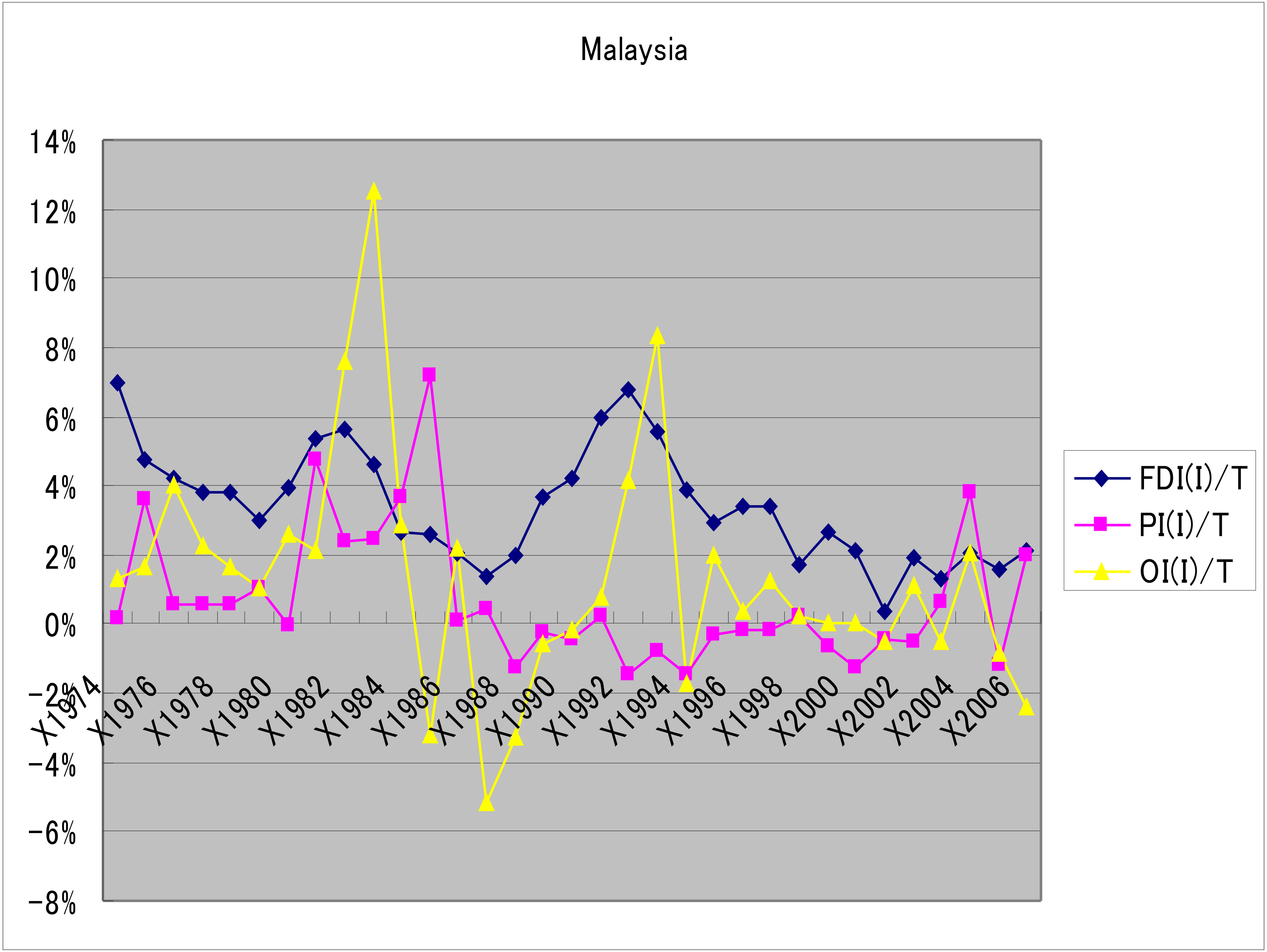

Malaysia
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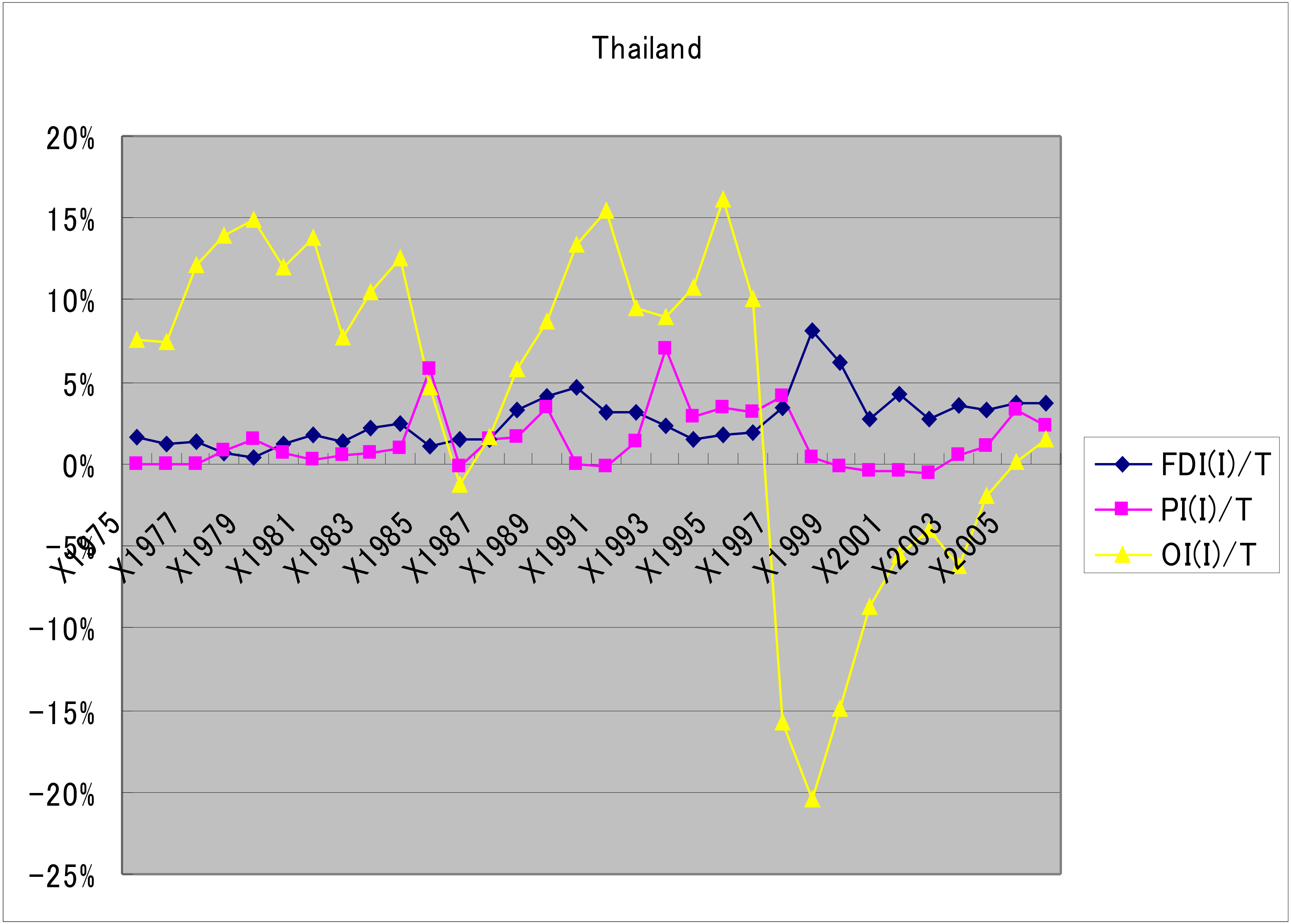

Thailand
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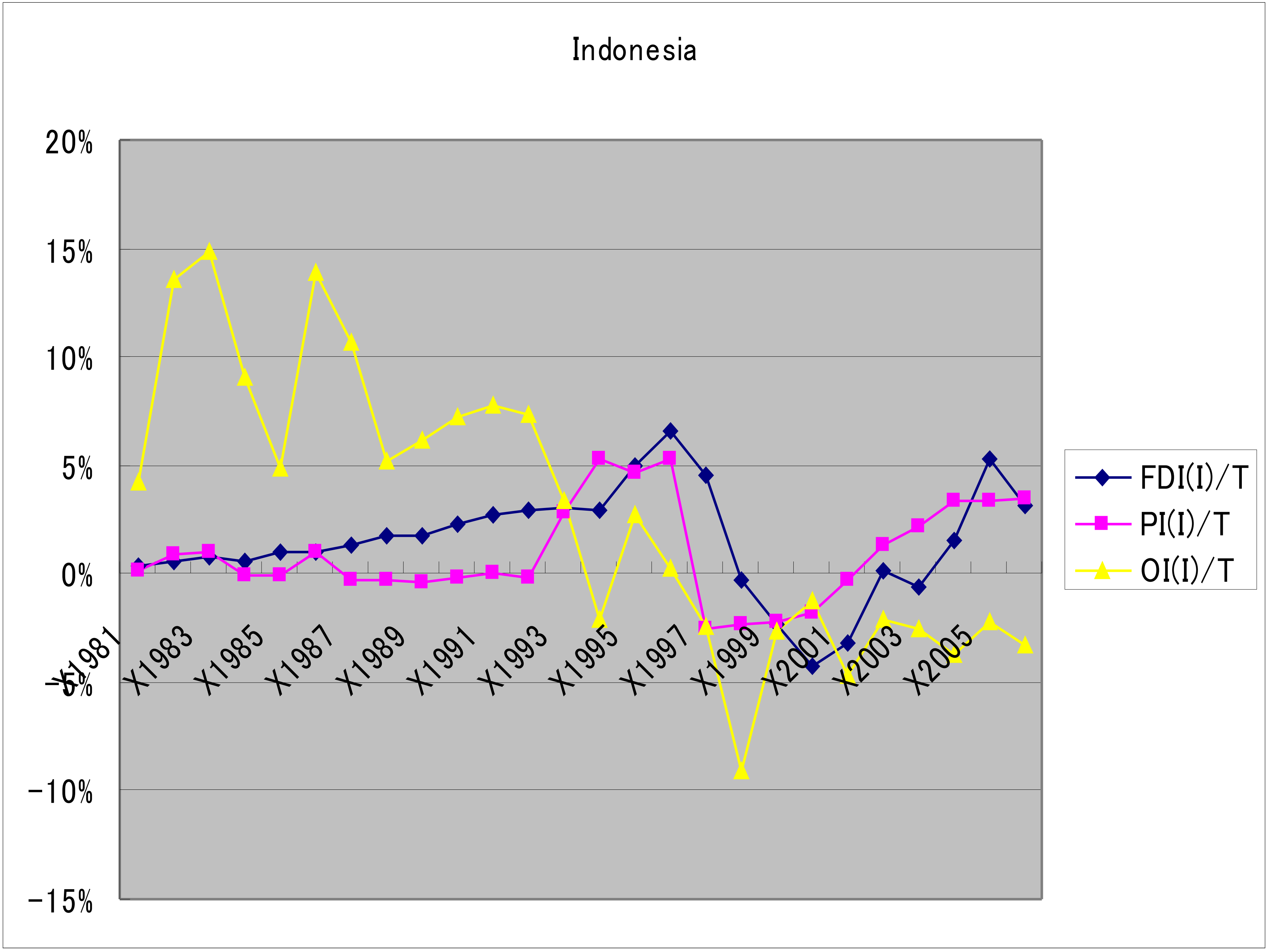
PI(I)/T
OI(I)/T


Indonesia
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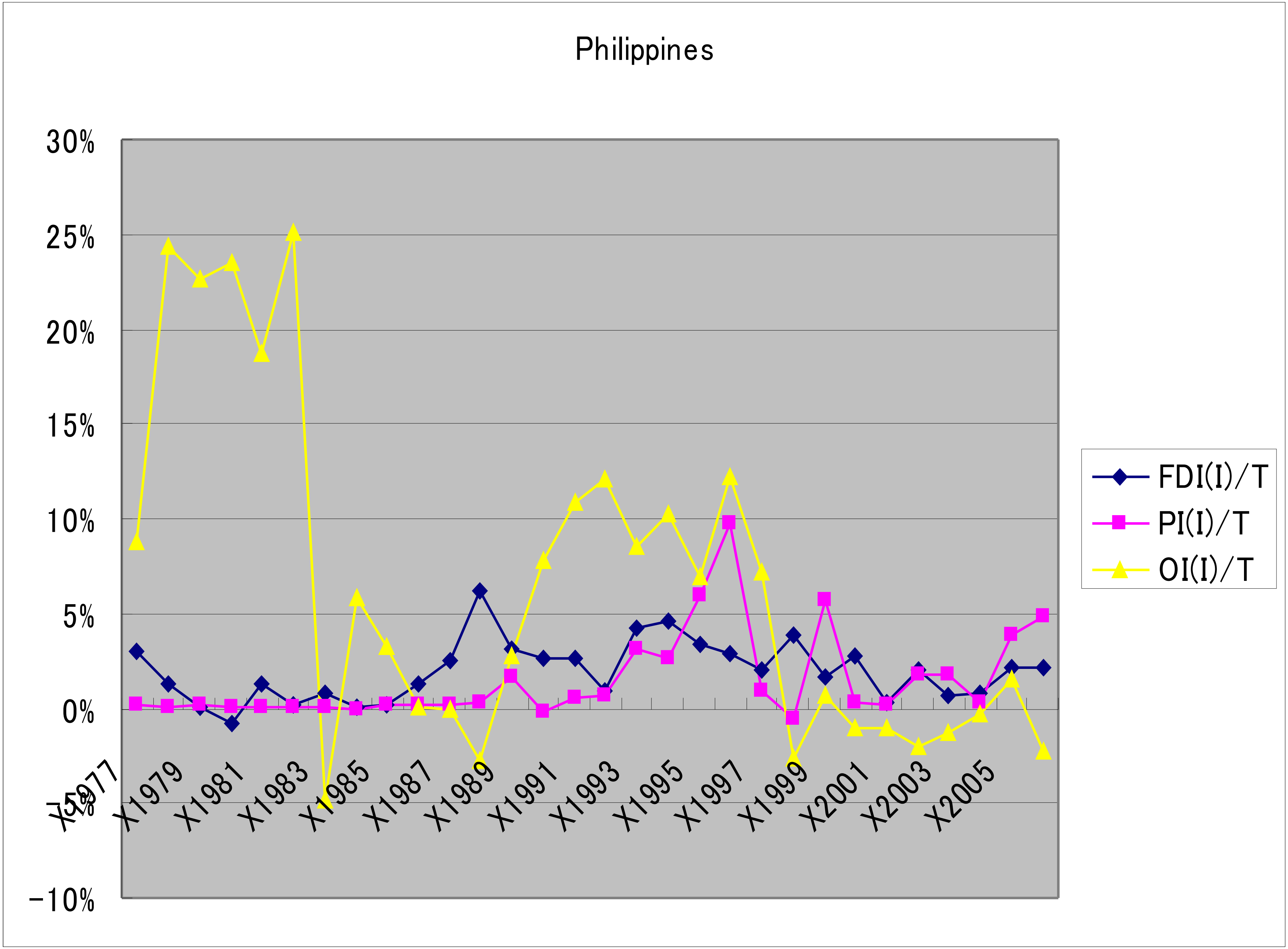
FDI(I)/T
PI(I)/T
OI(I)/T


Philippines
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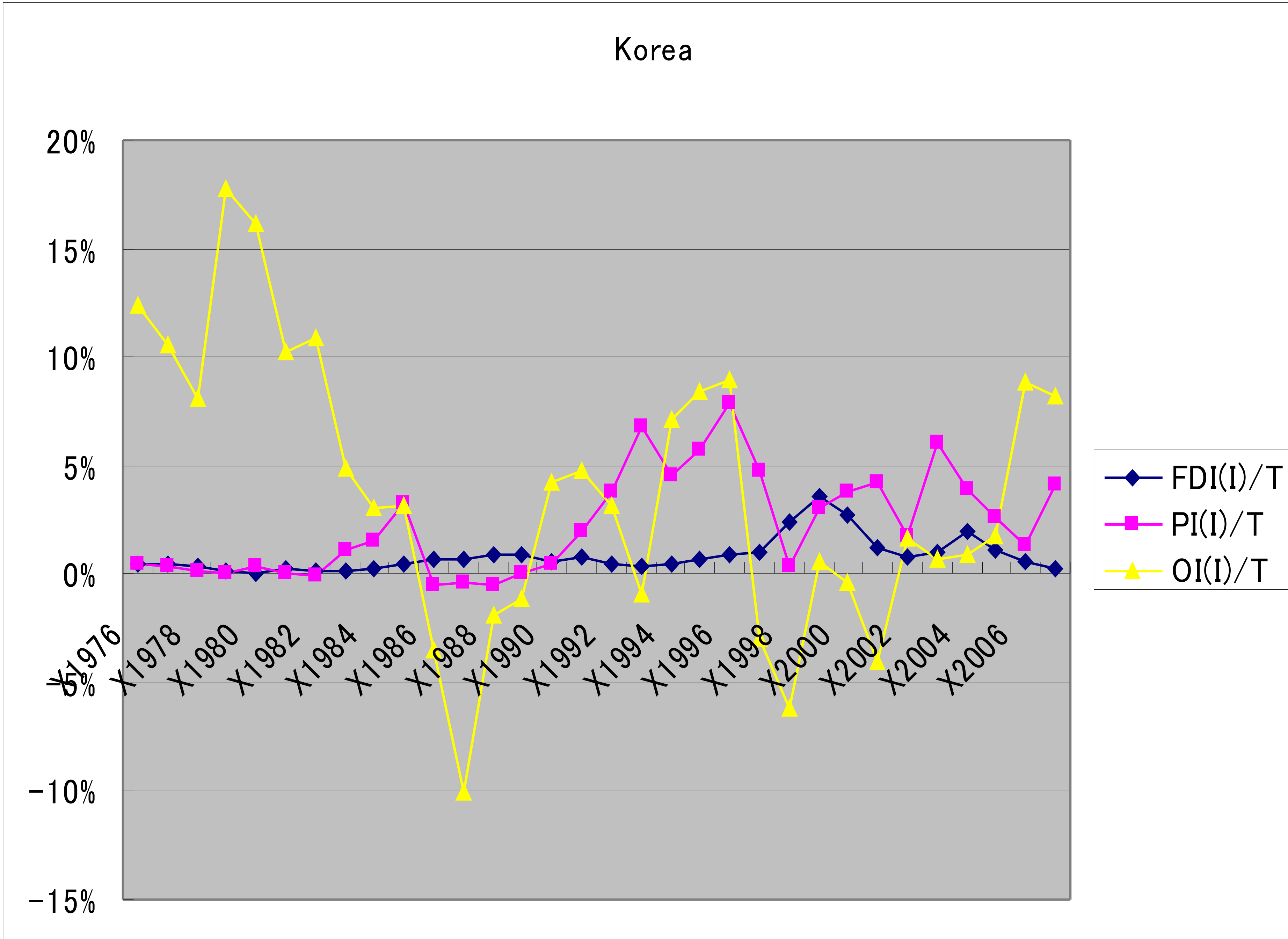
PI(I)/T
OI(I)/T



Korea
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FDI(I)/T
PI(I)/T
OI(I)/T