25 Years After the Asian Financial Crisis: What Have We Learned

Hoe Ee Khor, Chief Economist
NUS East Asian Institute Distinguished Public Lecture
July 21, 2022
Outline of Presentation

- Causes of the crisis
- Lessons of the crisis
- Reforms of the policy and regulatory framework at the individual country level
- Reforms of the international financial architecture
- New risks and challenges
- Future direction
Once Upon a Time in Asia: Headline News Back in 1997

• “Thai Stocks Tumble as Baht Slides to Weakest in a Decade” (May 14, 1997)
• “Soros Led Attack on Baht, Says Thai Central Banker” (June 24)
• “Thai Currency Reserves Drop to $33.3 Bln After Baht Defense” (June 26)
• “IMF, Japan, Others to Lend Thailand $16 Billion” (Aug 12)
• “Thailand Closes 56 Finance Companies, Two to Reopen” (Dec 8)

• “Indonesia Floats the Rupiah; Currency Sinks 5%” (Aug 15, 1997)
• “Indonesia’s Soedradjad Asks Banks to Cut Loans to Importers” (Aug 15)
• “Indonesia in Talks with IMF on Rupiah Collapse” (Oct 8)

• “Get out of Korea, Right Now!” (Nov 5, 1997; Peregrine Securities Report)
• “Korean President Apologizes to Nation for Seeking IMF Bailout” (Nov 22)
• “IMF Approves $3.58 Bn Installment for South Korea” (Dec 19)
• “Korea, Thailand, Indonesia Ratings Cut to Junk by Moody’s” (Dec 22)

• “Greenspan Blames Asian Policies for Currency Crisis” (Oct 14, 1997)
• “IMF’s Camdessus Says Asian Fund Will Fail if IMF Impaired” (Nov 13)
• “Asia Bailout Fund Evolves toward Cooperative Facility” (Nov 18)

* All headlines are excerpted from Bloomberg news reports in May-Dec 1997, unless otherwise specified.
ASEAN-4 and Korea: “Strong Fundamentals” prior to the AFC

Source: IMF and Haver Analytics
Note: ASEAN-4 comprises Indonesia, Malaysia, Philippines, and Thailand. Data on public debt ratio are included when available.
Causes of the Asian Financial Crisis (1)

The AFC was mainly caused by a combination of macroeconomic imbalances, external developments, and structural weakness in the financial and corporate sectors…

- Excessive external lending and borrowing (original sin)
- Double mismatches (currency and maturity mismatch)
- Outdated policy and regulatory frameworks (pegged exchange rates and regulatory framework)
- Speculative attacks by macro hedge funds and herding behaviour
- Poor corporate governance (corruption, cronyism, and nepotism)
- Breakdown of the Bretton Woods system in 1971 and financial globalization
Causes of the Asian Financial Crisis (2)

… amplified by sharp reversals in capital flows and market confidence (sudden stop).

Selected ASEAN+3: Non-Resident Capital Flows
(USD billion, 4-quarter moving average)

Sources: IMF and national authorities via Haver Analytics; and AMRO staff calculations.
Note: ASEAN-4 comprises Indonesia, Malaysia, Philippines, and Thailand. Data for Malaysia are included from 2001 onward, when they became available.
Causes of the Asian Financial Crisis (3)

The poorly planned financial liberalization and premature capital account opening since the breakup of the Bretton Woods System in the early 1970s also contributed to the build-up of debt vulnerabilities in EMEs.

**Chronology of Financial Crises**

- 1928: Great Depression
- 1970: Oil crisis
- 1978: Latin American debt crisis
- 1982: AFC
- 1986: Tequila crisis
- 1990: European debt crisis
- 2002: GFC

**Frequency of Financial Crises**

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Costs and scarring effects of the Asian Financial Crisis (1)

The AFC immediately triggered a sharp currency depreciation, a loss in investor confidence, and economic contraction.

Sudden Stop Contagion
(Cumulative percent change from June 1997)

Currency

Stocks

Real GDP

Sources: National authorities via Haver Analytics; and AMRO staff calculations.
Costs and scarring effects of the Asian Financial Crisis (2)

while threatening the region’s long-term economic growth.

Sources: National authorities via Haver Analytics; and AMRO staff calculations.
Note: Note: ‘ASEAN 5’ includes the original 5 members: Malaysia, Indonesia, Philippines, Singapore and Thailand.
Costs and scarring effects of the Asian Financial Crisis (3)

The crisis-hit countries were forced to go through a long period of deleveraging and the collapse of investment.

Credit-to-GDP Gaps
(Percent of GDP)

Domestic Investment
(Percent of GDP)

Credit-to-GDP Gaps
(Percent of GDP)

Domestic Investment
(Percent of GDP)


Source: Bank for International Settlements.


Source: International Monetary Fund.
Country case (1): Thailand

With the corporate sector’s debt restructuring, investment declined substantially from the pre-crisis level, and contributed little to the post-crisis recovery.

Thailand: Real GDP
(Logs of THB million)

Thailand: Post-Crisis Changes in Growth Driver
(Percent of GDP)

Source: National Economic and Social Development Board; Chalongphob (2022) Chapter 14, “Trauma to Triumph – Rising from the Ashes of The Asian Financial Crisis”
Country case (2): Korea

Chaebols’ investment booms in 1994-1996, led by excessive leverage, was normalized with drastic debt restructuring and financial sector reforms in the post-AFC period.

Korea: Real GDP
(Logs of KRW million)

Korea: Private Investment and Corporate Credit
(Percent of GDP)

Sources: National authorities via Haver Analytics; and AMRO staff calculations.

Source: Bank of Korea; Hahm and Kim (2022) Chapter 17, “Trauma to Triumph – Rising from the Ashes of The Asian Financial Crisis”
Country case (3): Malaysia

After the AFC, the decline in the manufacturing sector and exports led to the economy’s greater dependence on the services sector and domestic demand, partly explaining a shift to a lower level of economic growth.

Malaysia: Real GDP
(Logs of MYR million)

Crisis-hit Economies: Manufacturing Share of GDP
(Percent of GDP)
Country case (4): Indonesia

The growth of credit and investment tumbled due to the restrictive macroeconomic policy, a disconnect between monetary policy and real sector, and the lure of higher returns from investing in financial assets.

Indonesia: Real GDP (Logs of IDR million)

Crisis-hit Economies: Domestic Credit to GDP (Percent of GDP)

Sources: National authorities via Haver Analytics; and AMRO staff calculations.

Source: World Bank via Haver Analytics
Lessons from the Asian Financial Crisis (1)

Handling Economic Challenges

Key lessons from the AFC

- Policymakers should pay more attention to the dynamics of cross-border capital flows and global financial markets
- Exchange rate should be more flexible and supported by ample reserves and policy buffers

Enhanced macro-financial policy framework

- More disciplined monetary policy framework
- Fiscal consolidation to establish fiscal discipline
- Strengthening of the financial regulatory framework
- Better prudential oversight to deal with financial stability risks

Strengthened economic fundamentals

- Economic growth momentum regained
- Financial health restored by repairing the balance sheets of corporates and banks
- Deleveraged and rebuilt fiscal space
- External position strengthened with a significant build-up in FX reserves
Launching Regional Financial Cooperation

- **Strengthening Financial Safety Net**
  - Launch of the CMI at the ASEAN+3 FM Meeting (2000)
  - **Upgraded to the CMIM** (2010), CMIM-SF totaling USD 120 billion (2010) and CMIM-PL doubling the size of the facility to USD 240 billion (2014)
  - **The IMF-delink portion raised** from the initial 10% to 40% (2021)

- **Upgrading Economic and Financial Surveillance**
  - Establishment of AMRO as regional surveillance arm of the CMIM (Apr 2011)
  - AMRO’s official designation as an IO (Feb 2016)

- **Financial Market Development**
  - Creation of the Asian Bond Funds (ABF) under the initiative of EMEAP (Jun 2003)
Timeline of the Regional Financial Cooperation

**Asian financial crisis** occurred in Thailand, Indonesia, and Korea.

- **Jul-Dec 1997**
- The first ASEAN+3 Finance Ministers’ Meeting was held, aiming to create a regional financial facility.

- **May 1999**
- ASEAN+3 finance ministers launched the Chiang Mai Initiative (CMI).

- **May 2000**
- ASEAN+3 agreed to strengthen the CMI into a single multilateralized arrangement, namely, the CMIM.

**Global financial crisis** occurred with the collapse of Lehman Brothers.

- **Sep 2008**
- AMRO was established as a company in Singapore.

- **Feb 2009**
- ASEAN+3 Finance Ministers agreed to establish an independent regional surveillance unit.

- **Mar 2010**
- The CMIM Agreement came into effect.
  - Size: USD 120 bn
  - IMF De-Linked Portion (IDLP): 20% of borrowing quota

- **Apr 2011**
  - The amended CMIM Agreement came into effect
    - Doubling the size of the facility to USD 240 bn
    - Raising IDLP from 20% to 30%
    - Introducing a crisis prevention facility (CMIM Precautionary Line)

- **Feb 2016**
  - AMRO Agreement entered into force, establishing AMRO IO.

- **Mar 2021**
  - The amended CMIM Agreement entered into force
    - Increasing IDLP from 30% to 40%
    - Institutionalizing LCY contributions for the CMIM crisis financing

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Sources: national authorities' website, as of March 2022; AMRO staff calculations
Lessons from the Asian Financial Crisis (3)

Sizing Up the Global Financial Safety Net

Schematic of the Global Financial Safety Net

- National level: Foreign reserves; fiscal space
- Bilateral level: BSAs
- Regional level: RFAs
- Global level: IMF resources

Evolution of Global Financial Safety Net (USD trillions)

Sources: ESM; IMF; and AMRO staff illustration.

Note: Since the safety net is comprised of different currencies, its USD value fluctuates with exchange rate changes.
Lessons from the Asian Financial Crisis (4)

Strengthening the international financial cooperation

Setting Up the Financial Stability Forum

- In October 1998, the Group of Seven (G7) financial authorities held the first meeting.
- The Financial Stability Forum (FSF) and the Group of Twenty (G20) were set up in February and September 1999, respectively.
- Clearly recognized the need to strengthen regulatory and supervisory measures for highly leveraged hedge funds, offshore markets, and short-term capital flows

Group of Twenty (G20)

- Elevated the FSF to the Financial Stability Board (FSB) in April 2009
- Issued principles for cooperation between the IMF and RFAs

The IMF Reforms

- Conducted surveillance reforms (e.g. IMF FSAP 1999 and International Capital Markets Dept 2001)
- Streamlining structural conditionality
- Formalizing cooperation with regional financing arrangements
- Use of capital control
Timeline on the Evolution of FSF and G20

1997
Asian Financial Crisis

1998

April & Oct 1998
G22 Finance Ministers & CB Governors Meetings held

March & April 1999
G33 Finance Ministers & CB Governors Meetings held

1999

Dec 1999
G20 Finance Ministers & CB Governors Meeting launched

Mar 1999
Financial Stability Forum (FSF) established

G20 Finance Ministers & CB Governors Meetings held

April & Oct 1998
G22 Finance Ministers & CB Governors Meetings held

1997
Asian Financial Crisis

2008
Nov 2008
G20 Leaders’ Summit elevated from the Finance Ministers & CB Meeting

2009
Apr 2009
Financial Stability Board (FSB) elevated from FSF

1999

Sep 1999
G20 established

Feb 1999
Financial Stability Forum (FSF) established

Oct 1998
G7 Finance Ministers Meeting held
New Risks and Challenges (1)

Transitioning to the endemic and boosting structural reforms

- Safeguarding public health remains top priority
- Coping with when and how to exit smoothly from stimulus policies

- Structural reforms and investment to facilitate the transition to a new sustainable, green and digital economy
- Reconfiguring GVCs; adopting technology; strengthening healthcare & social protection; and rebuilding policy space
- Addressing long-term impact of prolonged stimulus policies
- Managing highly indebted public and private sectors, and possible inflationary pressures
### New Risks and Challenges (2)

The outbreak of the COVID-19 pandemic highlights the need for broadening the AMRO’s mandate to cope with structural issues, such as climate change, and growing demand for longer term finance.

<table>
<thead>
<tr>
<th>Expanding CMIM toolbox with greater flexibility</th>
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<tbody>
<tr>
<td>• Currently designed to focus solely on BoP and short-term liquidity difficulties</td>
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<td>• Expand lending conditions further in maturity length, or the scope of liquidity crisis</td>
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<tr>
<td>• Strengthen collaboration with BSAs</td>
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<tr>
<td>• Reduce IMF-linked portion over time</td>
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<table>
<thead>
<tr>
<th>Enhancing AMRO capacity for surveillance and program design</th>
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<tbody>
<tr>
<td>• Enhance functional/sectoral surveillance capacity</td>
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<tr>
<td>• Expand the scope of surveillance toward more structural issues</td>
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<tr>
<td>• Build up expertise on program design</td>
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<tr>
<th>Seeking complementarities with the IMF</th>
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<tbody>
<tr>
<td>• Seek to play an essential complementary role to the IMF in providing an independent regional perspective and in helping to shape IMF views more even handed</td>
</tr>
<tr>
<td>• Establish own institutional views on key policy issues, reflecting country-specific factors and regional perspectives</td>
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Beyond the CMIM: Coping with Longer-term Financing Needs

Growing needs for long-term financing during the pandemic

- Most financing has come from MDBs to assist ASEAN+3 members in development, structural reforms and budget support.

CMIM’s focus on short-term BoP liquidity crisis

- The current mandate of the CMIM may be too narrow to cover the needs for longer-term financing.

Exploring alternative ways to support longer-term financing needs in the region

- AMRO to increase capacity to provide TA for low-income countries
- Closer cooperation between the CMIM/AMRO and the ADB
- ASEAN+3 members may consider ramping up the current framework of regional financial cooperation toward strengthening long-term financing support.

Source: IMF, World Bank, ADB and AIIB websites; AMRO staff calculations (as of 9 September 2020, except for Myanmar as of 6 May 2021; as the calculation method is different in each institution, the validity of the quoted amounts is subject to further confirmation)
Thank you

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