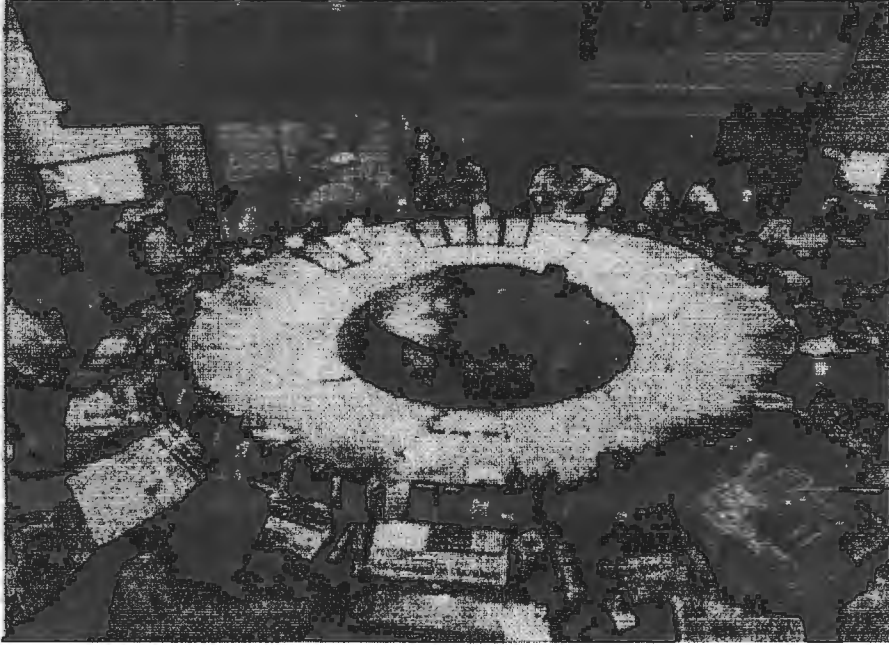


**The Rise and fall of Asia since World War II:
An economic perspective.**



**By
J.J Naude**

The rise and fall of Asia since world war two:
An economic perspective.

by

JACOBUS JOHANNES NAUDE

ACIS, BA

MINI DISSERTATION submitted in partial fulfilment of the
requirements for the degree

MASTERS OF BUSINESS ADMINISTRATION

in the faculty of

ECONOMICS AND MANAGEMENT SCIENCES

at the

**POTCHEFSTROOMSE UNIVERSITEIT VIR CHRISTELIKE Hoër
ONDERWYS**

Study Leader: Prof. Schutte, Petri

POTCHEFSTROOM

1999

ACKNOWLEDGEMENTS

Prof. P.C. Schutte from the Potchefstroomse Universiteit vir Christelike Hoër Onderwys for his assistance.

Dr. J.Geldenhuis for his assistance in the last three years

E.Cook for his financial assistance and encouragement.

Jacques for assisting me with the computer work of this dissertation.

The staff of the Telematic Learning Systems, Potchefstroom.

ABSTRACT

The Asian countries with Japan as the main driving force experienced continued high growth rates in the post war era and it seemed that this would continue indefinitely. In 1990 Japan's economic growth slowed down and a period of stagnation followed. (Delhaise, 1998:3)

The problems in the rest of Asia also became more evident, and in 1997 it created panic in the financial world, converted into a global contagion, spreading through the world economies at a rapid rate.

The 1997 Asian financial crisis caused a global economic conflagration spreading from Asia through to the United States, Latin America, Eastern Europe and even Russia. This shocked the world. The reason for this was that it struck the countries with a sustained record of economic growth over a long period. (Fischer, 1998: 1)

Throughout the 1980's and 1990's Asia's economic growth astonished the world. The region's stock markets achieved record levels and unprecedented economic growth rates were recorded in most of the countries. The world expected this to continue indefinitely but eventually the crash came in 1997, probably with the devaluation of Thailand's currency (the baht) in July 1997. (Mallet, 1999:48)

Japan's role was of paramount importance in the Asian crisis as they invested heavily in the economies of the other Asian countries, and the crisis probably started when their economy started to slow down in 1990. It had been in a sluggish phase for seven years when the Asian crisis started in 1997. (Szamosszegi, 1998:1)

The crisis created rippling effects in all the major economies and in the economies of smaller countries, like South Africa where our currency devalued sharply against all the major currencies, especially the US Dollar. Our stock exchange rallied down sharply and investors lost billions of rands in a short space of time.

In October 1997, the largest stock market in the world, Wall Street, in the United States of America, halted trading early on October 28, 1997 as the Dow Jones Index dropped by more than 7% in one day. (Norris, 1997: 1)

Asia's financial systems have had to rely on 19th century technology according to Miller of the University of Chicago; capital markets were poorly developed and the banks expanded credit excessively. (Delhaise, 1998:1)

The governments in these regions should have done more to manage the fastest industrial revolution the world had ever seen, but they fell into the same traps and pitfalls as the western world. They were ill prepared for the foreign policy challenges that faced them after the financial crisis that started in 1997.

To fully understand the factors that caused the crisis and make recommendations as to the possible prevention of a future crisis it will be necessary to analyse the causes and compare them with the principles of sound business and macro economic policies.

The end result would be to use the results of the research to make recommendations as to the treatment of similar financial shocks in the future.

SAMEVATTING

Die lande in Asië met Japan aan die spits het buitengewone ekonomiese groei ondervind vanaf die Tweede Wêreldoorlog. Hierdie proses het gelyk asof dit onbepaald sal voortgaan.

Vanaf 1990 het Japan se ekonomiese groei 'n insinking beleef en 'n periode van stagnasie het ingetree. Die probleme in Asië het uiteindelik in 1997 oorgekook en 'n ekonomiese krisis het ontstaan wat deur die finansiële en ekonomiese wêreld versprei het. (Delhaise, 1998:3)

Die krisis het vanaf Asië na Amerika, Latyns-Amerika, Europa en selfs na Rusland versprei. Die wêreld was geskok veral omdat dit die lande getref het met 'n rekord van volgehoue ekonomiese groei. Hierdie groei in Asië in die 1980s en 1990s het die wêreld verstom. Effektebeurse in die lande het rekord groei beleef. (Fischer, 1998:1)

Die krisis het waarskynlik begin met die devaluasie van die baht, die geldeenheid van Thailand.

Japan speel 'n belangrike rol in Asië. Dit is die tweede grootste ekonomie in die wêreld en die ekonomiese stagnasie in die land vanaf 1990 was waarskynlik die voorloper van die krisis.

Die krisis het ook Suid-Afrika se ekonomie geknou met 'n skerp devaluasie van die rand, en die effektebeurs het groot verliese getoon. Selfs die grootste effektebeurs in die wêreld, Wall Straat in Amerika moes vroeg sluit en die indeks (Dow Jones); het met 7% in een dag gedaal in Oktober 1997. (Norris, 1997:1)

Een van die groot redes vir die krisis is die verouderde finansiële stelsels wat in die lande gebruik word

Hierdie navorsings-projek handel oor die redes en gevolge van die krisis met die oogmerk om die tekens van 'n naderende krisis vroegtydig te herken sodat regstellende stappe geneem kan word, sodat die uitwerking nie so groot sal wees nie.

ACKNOWLEDGEMENTS	III
ABSTRACT	IV
SAMEVATTING	VI

CONTENTS

Chapter 1	1	INTRODUCTION	1
	1.1	Problem setting	1
	1.2	Objectives of the study	2
	1.3	Research methodology	3
	1.4	Limitations of the study	4
	1.5	Deployment of the study	4
	1.6	Key concepts	5
	1.6.1	Current account of the balance of payments	6
	1.6.2	Exchange rates	7
	1.6.3	Gross domestic product (GDP)	8
	1.6.4	The International Monetary Fund(IMF)	9
	1.6.5	Inflation	9
	1.6.6	Interest rates	10
	1.6.7	World stock markets and indices	11
	1.7	Abbreviations	11
Chapter 2	2	MACRO ECONOMIC PRINCIPLES : A GLOBAL PERSPECTIVE	12
	2.1	Introduction	12
	2.1.1	Full employment	13
	2.1.2	Price stability	13
	2.1.3	Economic growth and minimal fluctuations in economic activity	14

CONTENTS (continued)	2.1.4	External stability	14
	2.2	Macro economic principles	15
	2.2.1	Interest rates	15
	2.2.2	Exchange rates	17
	2.2.2.1	Exchange rates in general	17
	2.2.2.2	Exchange rates in Asia	20
	2.2.2.3	Interest rates and exchange rates	24
	2.2.3	Inflation	25
	2.2.4	Balance of payments and the current account of the balance of payments	27
	2.2.5	Gross domestic product(GDP)	33
	2.2.6	Economic growth and business cycles	35
	2.3	The International Monetary Fund(IMF)	38
	2.4	The effect of the crisis on some of the major economies in the world	41
	2.4.1	The United States of America	41
	2.4.2	Japan	42
	2.5	Conclusion	44
Chapter 3	3.	BRIEF PROFILE OF THE ASIAN COUNTRIES INVOLVED IN THE ASIAN FINANCIAL CRISIS	46
	3.1	In general	46
	3.2	Important chronological events leading towards the Asian financial crisis in 1997	48
	3.3.1	Thailand	50
	3.3.2	Indonesia	52
	3.3.3	Malaysia	53
	3.3.4	The Philippines	54
	3.3.5	Singapore	55
	3.3.6	Korea	56
	3.3.7	China	57

CONTENTS (continued)	3.3.8	Taiwan	58
	3.3.9	Hong Kong	58
	3.3.10	Japan	59
	3.4	A conclusive view	60
Chapter 4	4.	CONCLUSIONS AND RECOMMENDATIONS	65
	4.1	In general	65
	4.2	Recommendations	66
	4.2.1	Reforming the financial and banking systems in Asia	67
	4.2.2	External influences	68
	4.2.2.1	The United States of America	68
	4.2.2.2	Japan	69
	4.2.3	Introduction of sound macro economic and International principles and policies	70
	4.2.4	The International Monetary Fund	71
		BIBLIOGRAPHY	73
		Web Pages	74
		ANNEXURE A	76

CHAPTER 1

INTRODUCTION

1.1 PROBLEM SETTING

During the post World War Two periods the Western economies experienced periods of growth and recessions, and had to face problems with rising inflation and interest rates, combined with violent currency fluctuations that were experienced in some countries.

The Asian countries with Japan as the main driving force as example were different, and they experienced continued high growth rates and it seemed that this would continue indefinitely. But in 1990 Japan's economic growth slowed down and a period of stagnation started. (Fischer, 1998:2-3) The problems in the rest of Asia also became more evident, which in 1997 created panic in the financial world and it then converted into a full-scale financial crisis, spreading throughout world economies in a short space of time.

Eventually the biggest stock market in the world, Wall Street in the USA crashed in October 1997. (Norris, 1997:1-4)

Japan the largest economy in the East is still struggling to recover from the effects of the crisis as bad debts of US\$ 500 billion in bank debt accumulated. (Szamosszegi, 1998:1-11)

The 1997 Asian financial crisis caused a global economic conflagration that spreaded from Asia through the United States, Latin America, Eastern Europe and even Russia, and shocked the world. The reason for this was that it struck the countries with a sustained record of economic growth over a long period.

Throughout the 1980's and 1990's Asia's economic growth astonished the world .The regions stock markets achieved record levels and unprecedented economic growth rates were recorded in most of the countries. (Delhaise, 1998: 1-4)

The world expected this to continue indefinitely despite warnings by some analysts like Krugman of the Stanford University, whom as far back as 1994 in an article published in (Foreign Affairs, November/December 1994) "The Myth of Asia's Miracle" expressed doubts as to the existence of the Asian miracle. (Mallet, 1999:141)

Eventually the crash came in 1997, probably starting with the devaluation of Thailand's currency (the baht) in July 1997.

Japan's role was of paramount importance in the Asian crisis as they invested heavily in the economies of the other Asian countries. They were contributing directly to the causes of the financial crisis when their economy started to slow down from 1990 and did not recover subsequently. It had since been in a sluggish phase for seven years when the Asian crisis started in 1997.

Some analysts aptly describe this phenomena as a bubble that bursted. (Nananukool, 1998:3-6)

Overnight it all fell apart in 1997 and the questions that had to be answered were who or what brought the party to an end?

1.2 OBJECTIVES OF THE STUDY

This research will endeavour to analyse the causes of these problems as this would be of great value to understand the circumstances that led to the Asian economic crisis. It will assist in making assumptions for the future, recognising the danger signs as they develop and taking precautionary measures before it is too late.

By the mid-nineties Southeast Asia and Japan with it's fast-growing economies were an example to the world and the envy of the globe. Asian leaders declared that their society based on hard work and family values were superior to those of the West. (Delhaise, 1998:1)

Unexpected the financial crisis of 1997 shocked the regions.

Asia's financial systems have had to rely on 19 th century technology according to Miller of the University of Chicago; capital markets were poorly developed and the banks expanded credit excessively. (Delhaise, 1998:1)

The governments in these regions should have done more to manage the fastest industrial revolution the world had ever seen, but they fell into the same traps and pitfalls as the western world.

They were ill prepared for the foreign policy challenges that faced them after the financial crisis started in 1997.

To fully understand the factors that caused the crisis and make recommendations as to the possible prevention of a future crisis it will be necessary to analyse the causes, and make recommendations with some possible solutions.

The role of the International Monetary Fund will be discussed as they made more than US\$100 million in loans available to the troubled Asian economies in an effort to stem the tide that swept the financial and economic world from 1997 onwards.(Sachs, 1997:1)

1.3 RESEARCH METHODOLOGY

It is a new field of study and sources are not freely available. However we identified fewer but authoritative sources on this issue, the content of which added substantial value to the analysis of the global matter.

The bulk of this study therefore, consists of a literature survey on the dimensions of a macro economic framework underlying the global trade; and then the economic crash of 1997 in Asia.

This study will endeavour to highlight how sensitive currency and stock markets are to developments in any part of the globe, as it is clear that with the development of the

modern technology traditional boundaries in the global financial market disappeared (especially with the introduction of the Internet).

The crisis in Asia had a rippling effect on all the financial markets and even the South African markets suffered crippling blows as the crisis spreaded worldwide.

Financial indicators such as the exchange, inflation and interest rates will be analysed to show the devastating worldwide effect of the 1997 crash that started in Asia.

1.4 LIMITATIONS OF THE STUDY

The economic crisis which started in Asia, developed only in 1997 therefore the available sources are limited, and the Internet was utilised extensively to research the subject.

Roubini of Stern University in the U.S.A published an article accessible through the Internet, (An introduction to Open Economy Macroeconomics, Currency Crisis and the Asian Crisis: 1998) analysing the factors that caused the Asian crisis.

This will be used as a main reference to develop some of the key factors and principles of the crisis.

1.5 DEPLOYMENT OF THE STUDY

This dissertation consists of four chapters. Chapter One gives an introduction explaining what the Asian crisis entails.

In Chapter Two an explanation of sound macro economic principles in the global perspective will be given as this is necessary to understand the background situation of what went wrong in the Asian economies.

In researching the causes of the crisis it is apparent that the Asian countries experienced major macro economic structural problems, others experienced rapid

growth but developed large external deficits in the process. In Chapter Three the background and development of the Asian countries involved in the crisis will be discussed. A literature summary from the analysis and findings of some leading analysts and writers will be discussed to endeavour to arrive at the real causes for the development of the crisis.

As the outcome of the crisis had a prolonged effect on the global economy some of the recent events will be highlighted In Chapter Four. Some recommendations regarding the future treatment of such a financial crisis in the global economy, with the assistance of the International Monetary Fund will be made in Chapter Four.

1.6 KEY CONCEPTS

Asian Crisis:

The Asian crisis can be described as an economic and financial crisis and political turmoil that struck Asia in the middle of 1997.

We will also debate the currencies as listed below:

Table of Currencies applicable to this dissertation:

<u>Country</u>	<u>Currency</u>
China	Yuan
Hong Kong	Hong Kong Dollar
Indonesia	Rupiah
Japan	Yen
Korea	Won
Malaysia	Ringgit
Singapore	Singapore Dollar
Taiwan	New Taiwan Dollar
Thailand	Baht
The Philippines	Peso
United States	US Dollar

The daily turnover in the global currency market is about US\$ 900 billion and it is the largest market in the world. Trading takes place 24 hours a day as multiple time zones are involved. (Foreign Currency AptitudeTest, 1999)

From World War II until 1971 a system of fixed exchange rates existed. (Rates were mostly fixed against the US dollar). Most countries are now using floating exchange rates, with currency values dependent on supply and demand on the open market.

The latest development in the currency markets was in Europe, with an effort by the European nations to establish a system of a fixed exchange rate, and the creation of a single currency for Europe (The currency had been named the Euro). (Blitzer, 1997:170-171) This currency was introduced to the market in 1999.

Currency rates influences our every day lives with the fluctuations in the rates. Rates are normally quoted against the US\$ and could fluctuate every minute of the day. As the local rate deteriorates against the US dollar, imported goods are becoming more expensive.

We are influenced by the ever rising prices of imported goods in South Africa, especially the prices of cars and the price of fuel. The price of fuel was 0,54 cents in 1980, but will probably be in excess of R3.00 a litre by the end of 1999, an increase of 450% over this period. (Fourie, 1994:35)

1.6.1 Current Account of the Balance of Payments:

The current account of the balance of payments is the difference between what a country produces (GNP) and what the country spends (total consumption plus investment).

The current account measures the flow of cash arising from the trade and transfers and indirectly the economy's international financing requirements. (Roubini, 1998:1-2)

The current account of the balance of payments records the current purchases and sales of goods and services with the rest of the world. (Fourie, 1994:185)

If for instance the balance of payments account of South Africa has a current account deficit of R100 million, it must then raise an amount equal to R100 million in foreign borrowings to balance the current account's shortfall.

It is important to realise that when a country has a current account deficit, it means it is borrowing from the rest of the world and its foreign debts will escalate over a period of time.

Large and escalating current account deficits played a major role in the development of the Asian crisis, as some of the Asian countries could not secure sufficient foreign financing for their large and growing current account deficits.

1.6.2 Exchange rates

The rate of exchange is merely the price of one currency stated in terms of another currency. (Gray, 1987:14)

An exchange rate states the price in terms of one currency, at which another currency can be bought. (Haydam, 1997:329)

The foreign exchange market is a market in which money is bought and sold for other money. (Blitzer, 1997:170)

Typically all currencies are quoted against the U.S. dollar. For instance, if the South African rand is quoted at 6,00 rand per U.S. dollar, South Africans will have to pay 6, 00 rand in exchange for one U.S. dollar.

If for instance the rate weakens to R6, 30 to the U.S.dollar, it is a 5% decline and the prices of imported goods will increase by 5%.

Exporters will however, receive 5% more for the goods they had exported.

Currency fluctuations are one of the major problems that our Government, the South African Reserve Bank and governments and central banks in the world has to deal with on a daily basis. If they allow the currency to deteriorate, imported goods would become more expensive and the inflation rate will go up. Exporters will however benefit and more foreign exchange would be earned.

Widespread convertibility now permits the easy exchange between most of the world's major currencies in the global village. (Driscoll, 1998:2)

Two important factors relating to exchange rates are the depreciation and appreciation of currencies. A currency appreciates when the exchange rate changes so that a unit of its own currency can buy more units of a foreign currency. A currency depreciates when the exchange rate changes so that a unit of its own currency can buy fewer units of a foreign currency.

These are critical factors when goods are ordered for delivery at a future date, or an investment or loan is made, maturing at a future date. If the currency depreciates, more units of the local currency will have to be paid on a loan or for the goods ordered, making it more expensive.

This will also effect the interest rates of the country. If the local currency depreciates, interest rates will tend to increase in the economy.

1.6.3 Gross Domestic Product (GDP):

Gross domestic product is the measure of total production of goods and services in the economy. (Roubini, 1998:1) Closely linked to the GDP are economic growth rates and business cycles.

GDP can be defined as the total market value of all final goods and services produced within the borders of a country during a certain period of time, (usually one year). (Haydam, 1997:24)

As the total of everything that is produced in an economy, GDP shows whether a country is getting richer or poorer from one year to the next.

GDP figures for the U.S.A over the last thirty years shows an average annual growth (after allowing for inflation) of 2,7%. (Blitzer, 1997:88-89)

GDP can also be used to establish whether an average citizen of a country is better off, from one year to the next by comparing it with the population growth. (Blitzer, 1997:88-89)

The measurement of the GDP is important to a country as this measure whether the economy is growing as well as the total output and the price level of the economy.

1.6.4 The International Monetary Fund:

The IMF is an organisation established after World War Two to control the balance of payments situations globally and to assist countries in trouble with loans and advice.

The IMF's membership now numbers 182 countries, and membership is open to every country that conducts its own foreign policy. They must however, adhere to the IMF's charter of rights and obligations. (Driscoll, 1998:5)

The IMF's role in the global economy has grown in stature with the financial problems experienced in Brazil, Russia and in Asia. They should however be more proactive in recognising problems in the economies of the world. In all the crisis countries they only reacted after the event and this caused havoc in all the financial and stock markets in the globe.

1.6.5 Inflation:

Inflation in the economy of a country as a whole, is a persistent and considerable increase in the general price level of the economy. (Fourie, 1994:10)

Inflation is how we measure the changes in the value of money and the inflation rate reflects the annual change in price levels. If for instance the prices go up by 10% the inflation rate would probably also increase by 10%. Price indexes are used to measure the inflation rate. (Blitzer, 1997:56)

The two most widely used indexes, also in South Africa are the consumer price index (CPI) and the producer price index (PPI).

The CPI consists of a market basket of goods and services. The basket is based on surveys of consumer spending.

The PPI refers to producer prices with market baskets and weights based on a single year. (Blitzer, 1997:57-67)

1.6.6 Interest Rates

The difference between the value of money today and next year is what is referred to as the interest rate. If for instance you invest R100 today and you expect to receive R110 on your investment in a year's time the interest rate is equal to 10%. ($10/100$). (Blitzer, 1997:37-39)

Interest rates are determined by the risk involved in the investment and the period it is invested for. The riskier an investment the higher the interest rate demanded by the investor would be.

The longer the period the higher the interest rate would be, as for example more can happen in three years to influence the risk attached to the investment than in one year. Interest rates are either the observed interest rate or pure interest rate and this can be described as follows:

Observed interest rate:

Is equal to the pure interest rate plus a premium for the risk and administrative costs.

Pure rate of Interest:

Pure rate of interest rate is the rate that is paid on a perfectly riskless asset in a purely competitive market.

1.6.7 World Stock Markets and Indices:

In the global economy and free trade the stock markets play an important role in the investment and transfer of funds. Stock prices are compiled and translated into averages and listed as indices. Some of the major stock markets and the applicable indices are listed and discussed below.

<u>Stock Market</u>	<u>Index</u>
Hong Kong	The Hang Seng Index
Japan	Nikkei
United States (Wall Street)	Dow Jones

On the stock markets stock prices are compiled into averages and indexes to keep "score" in the market. The U.S.A has got the Dow-Jones industrials, England the FT-SE 100, Germany has got the Dax, Tokyo the Nikkei and Hong Kong has the Hang Seng. (Blitzer, 1997:73) All these markets were severely effected by the Asian financial crisis.

1.7 ABBREVIATIONS

GDP: Gross Domestic Product

IMF: International Monetary Fund

USA: United States of America

USD: United States Dollar

WWII: World War Two

CHAPTER 2

MACRO ECONOMIC PRINCIPLES: A GLOBAL PERSPECTIVE

2.1 Introduction

In the new globalised financial market, volatility had become an increasing fact of life. Faced with such volatility, what broad principles should guide the macro economic management of a country?

Macro economic objectives are concerned with the economy as a whole and focus on aspects such as the stability of the general price level (inflation), full employment, economic growth, government spending and the nation's money supply.

Macro economic policies that are sound and solid should be meeting the objectives of steady growth, full employment, stable prices and a viable external payments situation. (Dailami, 1998: 1)

Other goals of importance should be:

- A rising standard of living;
- Fair distribution of income;
- Less fluctuation in economic activity; and
- Insulation from unpredictable and adverse shocks to the economy, such as the Asian crisis. (Haydam, 1997:15)

The main issues in macro economics arising from the above are full employment and the control of inflation in a country and they are discussed below under the following headings:

- Full employment;
- Price stability;
- Economic growth and minimal fluctuations in economic activity; and
- External stability

2.1.1 Full employment

Full employment in a country ensures social and political stability. Governments in power are blamed for high levels of unemployment and this could lead to political unrest.

Any form of unemployment can be seen as a potential loss of production and the result of unemployment will be a drop in the standard of living in a country.

The above can clearly be seen in the performances of countries like Japan and Singapore with unemployment rates of 2% and less for the last two decades. (Delhaise, 1998:185). They had experienced high economic growth rates.

The effect of the Asian financial crisis can clearly be recognised in the change in the unemployment statistics of some of the effected countries from the years 1997 to 1998. (Korea increased from 2, 5% to 8,0% and Thailand from 3,7% to 7,0%.) (Delhaise, 1998: 86 & 106)

The United States of America's unemployment rate for the 1990's had been in the region of 5% and this had been directly responsible for the economic growth experienced in the country. (Blitzer, 1997:113)

2.1.2 Price stability

Price stability is measured by the changes in the inflation rate.

An inflation rate of 1% to 2 % is regarded as a "healthy' inflation rate for highly developed western countries. Developing countries will reflect higher inflation rates. (Haydam, 1997:16)

The United States of America had experienced an inflation rate of 2% and below for the last few years and had been experiencing healthy economic growth rates and price stability. (Blitzer, 1997:60).

2.1.3 Economic growth and minimal fluctuation in economic activity

Economic growth and employment work in tandem and these two objectives must be treated as one.

It is virtually impossible to have increased employment without first creating economic growth.

The effected countries in Asia, including Japan will have to stimulate economic growth by creating a climate of investment in Asia thereby creating more employment opportunities.

The economic growth should not be erratic, and should be without violent up and down movements in the economic growth figures from one year to the next. (Haydam, 1997:17)

2.1.4 External stability

Countries do not operate in a close environment but trade in a global economy, and a country's economic growth rate is dependent on their foreign trade.

An economic boom period in the United States of America will demand more goods from other countries and would consequently require an increase in their local production output. This will lead to economic growth and higher employment.

It is important to maintain a balance between the value of imports and exports to stabilise the exchange rate. If a country exports more goods than it imports the local currency will become stronger, but foreign countries would stop buying as the local goods are becoming more expensive in the foreign markets

This will lead to a drop in local demand and unemployment would increase.

It is therefore important to create external stability in an economy.

Factors like monetary, fiscal and interest rate policies, the level of foreign exchange reserves and the openness of the capital account and currency control are all factors contributing to meeting the above objectives.

It is also important to realise that unemployment causes social and political instability in a country.

2.2 MACRO ECONOMIC PRINCIPLES

To understand the fundamental inefficiencies in the Asian economies that contributed to the 1997 crisis the following critical macro economic factors will be discussed, with a concluding reference to the IMF:

- Interest rates;
- Exchange rates in general and in Asia;
- Inflation;
- Balance of payments and the current account of the balance of payments;
- Gross domestic product; and
- Growth and business cycles

2.2.1 INTEREST RATES

According to Pointdexter (1976:177), two aspects can be identified in the determination of interest rates in a local economy, the pure and observed interest rates:

The pure rate of interest, or the interest rate that is paid on a perfectly riskless asset, in a purely competitive market.

The observed interest rate is the pure interest rate plus a charge for administrative costs and the risk attached to the asset.

It is clear that in every country more than one interest rate will be in operation.

Graphically it can be explained as in table 2.1:

TABLE 2.1 THE COMPOSITION OF INTEREST RATES IN A COUNTRY
PURE INTEREST RATE OBSERVED INTEREST RATE

Gross interest rate = 5%	=5	Gross interest rate = 8%	=(5+2+1)	Gross interest rate = 18%	=(5+5+8)
Risk attached to asset=0%		Risk attached to asset =1%		Risk attached to asset =8%	
Administrative Costs = 0%		Administrative Costs = 2%		Administrative Costs = 5%	
			←		←
Pure Rate		Pure Rate	Mortgage Bond	Pure Rate	Unsecured asset
Interest =5%		Interest =5%		Interest =5%	

Source: (Pointdexter, 1976:177-178)

Interest rates are substantially different in countries across the world. For instance the prime overdraft rate in South Africa is currently 15.50%(October 1999) compared to 6% in the United States. (Sake Beeld, October, 20 1999:p1)

Interest rates are closely linked to the price of the local currency and it is used in policies of monetary and fiscal control, to control the fluctuations of their currency by central banks and governments in the world.

Central banks control the interest rates through two main policies:

The open market policy and discount rate policy.

This entails the sale (discounting) or purchase (rediscounting) of negotiable liquid assets by central banks to the private banking sectors, thereby regulating the money supply level and interest rates of a country.

This works as follows:

If the central bank sells a government bond of say US\$1000 million to the banking sector; they draw on their money supply to buy these bonds thereby they are decreasing the money supply by US\$1000.

In times of inflation the central bank will discount (sell) various bills in order to withdraw money from circulation. Less money in circulation will cause money to become more expensive and interest rates will increase. The demand for credit will decrease, eventually causing higher unemployment. (Haydam, 1997:276-280)

The two policies work the same as a pair of scissors; the one blade represents money supply and the other interest rates, which implies that central banks cannot control both at the same time. To regulate the money supply they must accept the level of the interest rates. To regulate the interest levels in the economy they must accept the money supply patterns. (Haydam, 1997:276)

Various factors (an increase in the future expected exchange rate, an increase in the foreign interest rate and an increase in the risk premium on domestic assets) will all

lead to a depreciation of the domestic currency. The reasons for this are that they all lead to an increase in the expected return on foreign assets or a fall in the risk-adjusted return on domestic assets. These factors played an important part in the rapid depreciation of the currencies in Asia in 1997. (Roubini, 1998:24)

The only way to combat the above is to raise domestic interest rates considerably to prevent such devaluations, which was done in some cases, even in South Africa this was done and our interest rates were increased to more than 25 % (1998), in the period following the crisis.

This policy might prevent a devaluation of the local currency but could lead to a recession in these countries. High interest rates usually lead to a fall in domestic demand for investment and a decrease in production.

2.2.2 EXCHANGE RATES

2.2.2.1 EXCHANGE RATES IN GENERAL

The rate of exchange is merely the price of one currency in terms of another currency. (Gray, 1987:14)

This implies that if the one exchange rate increases in its value then the other exchange rate will automatically decrease in its value as well.

Foreign trade involves payment in foreign currencies and importers would have to pay for goods imported with local currency exchanged for the foreign currency. There is therefore a demand for the foreign currency. (Fourie, 1994:194)

The rate of exchange represents a ratio, but it is also a price determined by supply and demand

The exchange rate is the dollar price of a foreign currency, and like most prices expressed in dollars, for example if it is expressed against the Japanese yen:

US \$/Yen =Dollars require to buy one yen

If "\$" increases the dollar is depreciating or it takes more \$ to buy one unit of yen.

If "\$" decreases the dollar is appreciating or it takes less \$ to buy one unit of yen

A currency is said to appreciate when the exchange rate changes so that a unit of its own currency can buy more units of a foreign currency. A currency is said to depreciate when the exchange rate changes so that a unit of its own currency can buy fewer units of a foreign currency. (Roubini, 1998:12)

Currencies are traded in foreign exchange markets, which determine the rate of exchange through demand and supply.

Exchange rates can be fixed or be allowed to float. If it floats (fluctuates) the price is determined as with any commodity by the supply of the currency and the demand for the same currency. (Haydam, 1997:337)

A fixed exchange rate is a rate set and maintained by the government in conjunction with the central bank of the country. (Haydam, 1997:339)

The fundamental causes for changes in the supply and demand of a currency are found in the balance of payments and specifically in the current and capital accounts. (Haydam, 1997:339)

From the above statement to grasp why movements in the balance of payments account determine exchange rate fluctuations an explanation of this is necessary. (Large deficits on the current account of the balance of payments in countries in Asia was one of the main contributing factors of the development of the financial crisis)

The balance of payments account consists of two accounts, the capital account and the current account. Together these two accounts must be in equilibrium or in balance. (Fourie, 1994:203)

The current account represents the goods and services account and the capital account represents the flow of financial transactions between different countries.

This can graphically be explained as in table 2.2 below:

TABLE 2.2 THE BALANCE OF PAYMENTS ACCOUNT

	<u>Current Account</u>	
Exports (+)		Imports (-)
	<u>Capital Account</u>	
Exports (+)		Imports (-)

Source (Haydam, 1997:308)

Each account represents the sum total of all imports and exports during a certain period of time.

A deficit means that imports exceeds exports creating a negative balance on the balance of payments, and it is an indication that the country lived beyond its means, in other words it consumed more than what it produced.

A depreciation of the local exchange rate therefore makes foreign imported goods more expensive, and would probably lead to a reduction in the demand for imported goods and an improvement of the local trade balance.

An appreciation will have the opposite effect and would worsen the local trade balance.

A depreciation of the local exchange rate makes domestic goods exported cheaper in foreign countries, and an increase in demand for the exported goods in the foreign countries. This increase will improve the local trade balance.

The depreciation of the nominal exchange rate will lead to an increase in the relative price of foreign to domestic goods and a depreciation of the real exchange rate.

Currency depreciations and sometimes devaluations make imported goods more expensive, domestic exports cheaper abroad and would improve the trade balance generated through the fall in imports.

A prolonged deficit on the current account would cause the supply of foreign currency to decrease, resulting in a depreciation of the local currency. This is exactly what happened to the Asian countries and contributed to the 1997 financial crisis.

Examples of this are the following as per table 2.3 below:

TABLE 2.3 CURRENT ACCOUNT BALANCES IN RELATION TO
MOVEMENTS IN CURRENCIES IN ASIA
(US\$ Billions)

	Current	Account	Balances	Exchange	Rates	(Against	US\$)
	1994	1995	1996	1994	1995	1996	1997
Thailand	(8,09)	(13,56)	(14,69)	25.09	25.19	25.61	47.25
Indonesia	(2,79)	(7,02)	(7,80)	2,200	2,308	2,348	5,400
Malaysia	(4,15)	(7,30)	(6,20)	2.56	2.54	2.52	3.88

Source: (Delhaise, 1998; 86,126,153)

It is clear that the deficits on the current account of the balance of payments in the period preceding the financial crisis, in these countries were building up at a rapid pace, but the currencies remained static. Once the crisis erupted violent currency adjustments were experienced in some of the countries.

Sound macro economic policies will prevent the buildup of large deficits, which cannot be sustained for an indefinite period of time.

2.2.2.2 Exchange Rates in Asia

When an analysis of the exchange rates in the Asian countries of the 1990's is made, (as per the table 2.4 below). The massive influences the 1997 crisis had on the exchange rates are clearly visible, and this is a clear indication that exchange rates cannot be controlled by pegging currencies or by ignoring other macro economic factors and indicators.

TABLE 2.4 ASIAN EXCHANGE RATES IN RELATION TO THE US\$ FOR THE YEARS 1991 TO 1997(End of year)

		1991	1992	1993	1994	1995	1996	1997
Korea	Won/US\$	760.80	788.40	808.10	788.70	774.70	844.20	1695.8
Indonesia	Rupiah/US\$	1,992	2,062	2,110	2,200	2,308	2,348	5,400
Malaysia	Ringgit/US\$	2.72	2.61	2.70	2.56	2.54	2.52	3.88
Philippines	Peso/US\$	26.65	25.10	27.70	24.42	26.21	26.29	39.50
Singapore	S\$/US\$	1.63	1.64	1.61	1.46	1.41	1.4	1.68
Thailand	Baht/US\$	25.28	25.52	25.54	25.09	25.19	25.61	47.25
Hong Kong	HK\$/US\$	7.78	7.74	7.73	7.74	7.74	7.73	7.75
Taiwan	NT\$/US\$	25.75	25.40	26.63	26.24	27.27	27.49	32.55
Japan	Yen/US\$	124.90	124.86	111.85	99.58	103.51	115.7	130.58

Source: (Delhaise, 1998:86,104,126,153,164,183,185,187,188)

Some of the countries that experienced these violent currency fluctuations after the 1997 financial crisis are plotted on the graphs as per tables 2.5 to 2.8 below:

Comparison of some of Asia's Exchange Rates:

TABLE 2.5 THE PHILIPPINES

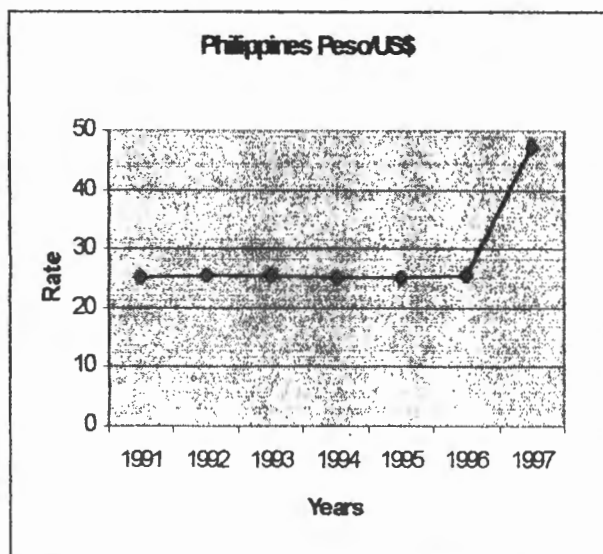
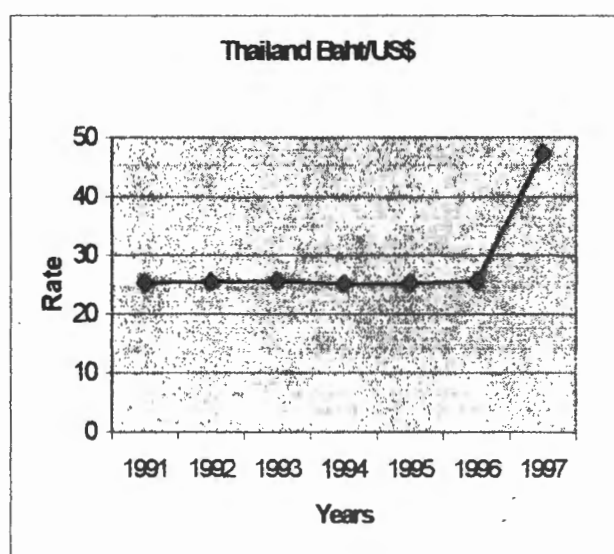


TABLE 2.6 THAILAND



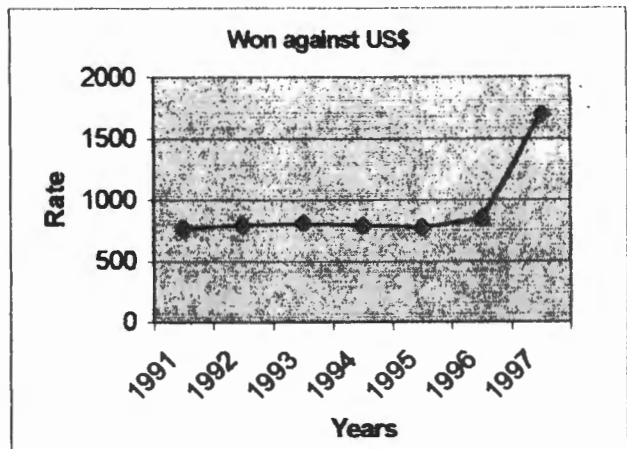
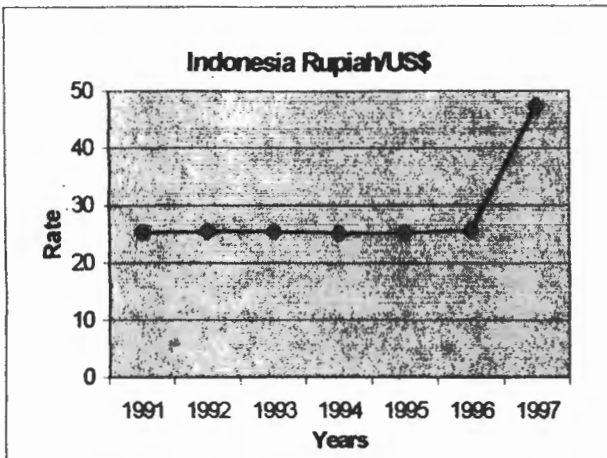


TABLE 2.7 INDONESIA

TABLE 2.8 KOREA

Source: (Delhaise, 1998:86,104,126,153,164,183,185,187,188)

The above graphs with the sudden upward movement of the curves in 1997 clearly reflect the violent effect the 1997 Asian financial crisis had on the exchange rates in Asia

If December 1997 is taken as a base by September 1997 the baht had depreciated by 42%, the rupiah by 37%, the ringgit by 26% and the peso by 28% relative to the US\$. (Roubini, 1998:27)

The official exchange rate policy in many of the countries was one of pegging (fixing) their currencies to the U.S.dollar. (Roubini, 1998:11)

Hong Kong had a currency board with the parity tied to the U.S. dollar. (Roubini, 1998:11)

In Malaysia the ringitt moved in an approximate range of 10% (2.7 to 2.5 to the U.S. dollar) from 1990 to 1997. In Thailand the baht was fixed in a narrow range of 25.2 to 25.6 baht to the U.S. dollar in the same period. The Philippine peso fluctuated in a 15% range of 28 to 24 peso to the dollar and for practical purposes fixed at 26.2 in the beginning of 1997. (Roubini, 1998:11)

The Korean won was allowed by the authorities to fluctuate more and depreciated in nominal terms from 700 to 800 won to the U.S. dollar from 1990 to the beginning of 1993. It then traded in a narrow range of 800 to 770 won to the dollar to middle of 1996, but depreciated to 884 won to the dollar by the end of 1996. (Roubini, 1998:11-12)

Other countries followed policies of real exchange rate targeting allowing its currencies to fluctuate as dictated by the markets. Indonesia allowed the rupiah to fall from 1900 in 1990 to 2400 to the U.S. dollar in 1997. Taiwan in a similar fashion allowed the New Taiwan dollar to deteriorate from a level of 24 to the dollar in 1990 to 27.8 to the U.S. dollar by the end of 1996. (Roubini, 1998:11-12)

Singapore with its fast developing economy and high growth rate experienced a currency appreciation against the U.S. dollar (from 1.7 in 1990 to 1.4 in 1996). (Roubini, 1998: 12)

In China the currency depreciated slightly between 1990 to 1993 but it was then devalued by nearly 50% in 1994. Subsequently it remained quite stable and they were not severely effected by the 1997 financial crisis. (Roubini, 1998: 12)

The policy of pegging their currencies against the U.S dollar ensured the stability of the nominal exchange rate relative to the U.S currency, but the result was that the real exchange rate was effected, in relation to the Japanese yen and the European currencies. (Roubini, 1998: 12)

The problem in Asia really started in 1995, when the U.S. dollar, relative to all the world currencies, started appreciating (from 80 yen per U.S. dollar in 1995 to 125 in 1997, or a 56% appreciation). The Asian countries were tied in nominal terms to the dollar thus causing a loss of competitiveness for the countries. (Their exports to Japan and Europe became more expensive and imports from these countries cheaper). This led to the misalignment in the short term of the currencies, and the problems with their current accounts had worsened their trade balances, which played a big part in the ensuing crisis in 1997. (Roubini, 1998: 11)

To summarise the following can be observed from the above discussion of the exchange rates in Asia in the period ensuing the financial crisis of 1997:

- In the long run, exchange rates generally reflect prices and monetary policies;
- In the short run, the only certainty is that exchange rates are highly uncertain;
- Adapting to currency movements is one of the central issues facing an international business and any country in the global markets; and
- Fixed exchange rates may lead to real appreciation, currency value misalignment, and loss of competitiveness and current account deficits.

2.2.2.3 Interest Rates and Exchange Rates

Interest and exchange rates are closely linked and if central banks or governments endeavour to control both at the same time, this policy could eventually lead to disaster.

Various factors (an increase in the future expected exchange rate, an increase in the foreign interest rate and an increase in the risk premium on domestic assets) would all lead to a depreciation of the domestic currency.

Reasons for this are that they all lead to an increase on the expected return on foreign assets or a fall in the risk-adjusted return on domestic assets. (Roubini, 1998:24).

These factors played an important part in the rapid depreciation of the currencies in Asia in 1997.

The only way to combat the above is to raise domestic interest rates considerably to prevent such devaluations, which was done in some cases, even in South Africa this was done and our interest rates were increased to more than 25 % (1998), in the period following the Asian financial crisis.

This policy might prevent a devaluation of the local currency but could lead to a recession in these countries. The high interest rates usually lead to a fall in domestic demand for investment and a decrease in production.

Indonesia is probably the best example of this as their interest rate increased from 21.82% in 1997 to 34.00% in 1998 as per the table 2.9:

TABLE 2.9 INTEREST RATES IN INDONESIA

1994(%)	1995(%)	1996(%)	1997(%)	1998(%)
17.76	18.85	19.22	21.82	34.00

Source(Delhaise,1998:126)

2.2.3 INFLATION

In the economy of a country as a whole, a persistent and considerable increase in the general price level in an economy is referred to as inflation. (Haydam, 1997:106)

Inflation is generally regarded as evil as it influences real interest rates and the investment decision process. Imports would become more expensive, and disposable income will be eroded. The country's products will be less competitive in the world markets.

Inflation effectively devalues the currency of a country and their exports become more expensive in the international markets.

The effect of inflation on real interest rates can be illustrated with the following example:

TABLE 2.10 THE EFFECT OF INFLATION RATES ON THE INTEREST RATES IN DIFFERENT COUNTRIES

	<u>USA</u>	<u>RSA</u>
Interest rate	6,0%	15,5%(Prime)
Less inflation rate	<u>3,0%</u>	<u>7,0%</u>
Real interest rate	3,0%	8.5%

Source: (Haydam, 1997:342)(Sake Beeld, October 20, 1999: 1)

From the above data it is evident that the interest rates in South Africa are high compared to the U.S.A to ensure that foreigners invest in South Africa and also to negate the effect of the high inflation rate on interest rates.

Inflation had not been a major problem in Asia during the past 30 years up to 1996, especially when it was compared with other developing nations. The effect of the 1997 financial crisis on inflation and interest rates is clearly demonstrated with the following data:

TABLE 2.11 INFLATION RATES IN ASIAN COUNTRIES

	INFLATION			
	1994(%)	1995(%)	1996(%)	1997(%)
Thailand	5.1	5.8	4.8	8.0
Indonesia	9.2	8.6	6.6	11.6
Malaysia	3.7	3.4	3.8	2.8
Korea	6.2	4.5	5.0	4.5
Philippines	9.1	10.9	5.1	6.0

Source: (Delhaise, 1998:86,106,126,153,164)

The effect of the increase in the inflation rate on the interest rates is clearly demonstrated in the table below:

TABLE 2.12 INTEREST RATES IN ASIAN COUNTRIES

	1994(%)	1995(%)	1996(%)	1997(%)	1998(%)
Thailand	14.38	15.50	15.00	18.00	N/A
Indonesia	17.76	18.85	19.22	21.82	34.00
Malaysia	7.62	7.60	9.20	8.40	11.05
Korea	8.50	9.00	8.80	9.00	N/A
Philippines	15.06	14.68	14.84	16.26	15.25

Source: (Delhaise, 1998:86,106,126,153,164)

In Indonesia the inflation rate jumped by 5% after the 1997 financial crisis and they increased the local interest rate from 21.82 % to 34.00%. Other countries made smaller increases in their lending rates to adjust for the effect of the increases in the inflation rates.

2.2.4 BALANCE OF PAYMENTS AND THE CURRENT ACCCOUNT OF THE BALANCE OF PAYMENTS

The balance of payments refers to the movement of capital into and out of a country. (Haydam, 1997:339)

The balance of payments account consists of the current and capital accounts.

The balance of payments could reflect the following:

TABLE 2.13 BALANCE OF PAYMENTS (EXAMPLE)

Balance on the current account	US\$ 500
Less: Outflow of capital on the Capital account	<u>-US\$ 600</u>
Equals Balance of payments	US\$ -100(Deficit)

Source (Haydam, 1997:340)

It is important to realise that when a country has a current account deficit, it means it is borrowing from the rest of the world and its foreign debts will escalate over a period of time. This has the same effect as what happens to a company's balance sheet, as two important events take place. The flow of capital translates into stock of capital, a balance sheet item and a deficit on the current account. This represents a fall in the country's wealth, as they will have to borrow to pay for the excess of consumption over income.

To finance the deficit each year the country would in effect borrow from the rest of the world an amount equal to the shortfall of income over consumption.

The above played an important part in the Asian crisis in 1997, as most of the Asian economies recorded large and ever increasing current account deficits during the 1990's.

A list of the current account balances for the major Asian countries in the years preceding the crisis as per table 2.14 below reveals the following: -

TABLE 2.14 CURRENT ACCOUNT BALANCES (AS A % OF GROSS DOMESTIC PRODUCT)

	1990	1991	1992	1993	1994	1995	1996
Korea	-1.24	-3.16	-1.70	-0.16	-1.45	-1.91	-4.89
Indonesia	-4.40	-4.4	-2.46	-0.82	-1.54	-4.25	-3.41
Malaysia	-2.27	-9.08	-4.06	-10.11	-11.51	-13.45	-5.99
Philippines	-6.30	-2.46	-3.17	-6.69	-3.74	-5.06	-5.86
Singapore	9.45	12.36	12.38	8.48	18.12	17.93	16.26
Thailand	-8.74	-8.61	-6.28	-6.50	-7.16	-9.00	-9.18
Hong Kong	8.40	6.58	5.26	8.14	1.98	-2.21	0.58
China	3.02	3.07	1.09	-2.17	1.17	1.02	-0.34

Source: (Roubini, 1998:25)

Most of the Asian countries experienced current account deficits of 3 percent and even in excess of 10% from the 1990's onwards.

If a country produces less than what it spends, as most of the Asian countries listed in the table above, (the excess demand of goods for consumption and investment purposes, over income/production) must be a net imported result from the rest of the globe (a negative external balance).

The result of the above is that the external balance would be negative and it would be equivalent to a current account deficit.

The above scenario played an important part in the Asian crisis in 1997, as most of the Asian economies recorded large and ever increasing current account deficits during the 1990's, as their national income (GNP) was below their domestic absorption which resulted in an accumulation of foreign debt that could not be controlled over a long period of time.

Large current account deficit balances as experienced in the Asian countries before 1997 contributed to the accumulation of foreign debt; eventually it became unsustainable and was one of the direct causes of the 1997 financial crisis.

The ensuing panic in the currency and foreign debt markets led to a depletion of the central banks foreign reserves in these countries, and the inability to raise further international financing created the crisis.

A current account deficit might be caused by:

- An increase in national investment; and
- A fall in savings (private savings), or an increase in a budget deficit (a fall in public savings).

A more detailed analysis of these factors follows below:

- A current account deficit created by a boom in investment is generally not critical. It happened in the case of some of the Asian countries that they experienced long periods of economic growth, sometimes as high as 8% per annum. Many of them were financing excessive investments in the non-traded real estate sector (residential and commercial buildings). Due to an oversupply in these sectors real estate rates dropped rapidly and contributed to the crisis. Current account deficits and foreign debt accumulation were some of the factors that caused the crisis in Asia, with too many investments at low profit margins;
- A current account deficit may be caused by a fall in national savings, and a distinction must be made between private and public savings. A fall in public savings

can cause more problems than a fall in private savings as it creates an unsustainable build-up of foreign debt; and

- The problem with running large current account deficits and borrowing in the foreign markets to finance budget deficits is that it will eventually lead to a debt crisis. Fiscal deficits like these cannot be self-financing.

Other macro economic factors that contributed towards the sustainability of the large current account deficits were:

- The country's economic growth rate;
- The composition of the current account deficit;
- The degree of openness of the economy ; and
- The size of the current account deficit relative to GDP.

A more detailed analysis of the above factors is:

The country's economic growth rate

High GDP growth tends to lead to higher investment rates as expected profitability increases. At the same time, high growth might lead to higher expected future income. If nothing else changes higher growth will lead to a smaller increase in the foreign debt to GDP ratio, enabling the country to service its external debt. The Asian countries had average growth rates, in some cases in excess of 7 %, but excessive optimistic expectations that the high economic growth would persist in the long term, led to big private consumption (a fall in private savings) and a growth in foreign debt which became unsustainable. This caused the currency and debt crisis. (Roubini, 1998:18-19)

The composition of the current account deficit

If the current account balance equals the sum of the trade balance and the net factor income from abroad, it will effect the sustainability of any given imbalance. A current account imbalance may be less sustainable if it is the result of a large trade deficit, which may indicate structural competitiveness problems. (Roubini, 1998:19)

The degree of openness of the economy, or the relationship of the ratio of exports to GDP.

Another important factor is a country's ability to service its future foreign debts. This depends on its ability to generate foreign currency receipts or the size of exports in relation to the GDP (the country's openness). (Roubini, 1998:19)

The size of the current account deficit relative to GDP

Most of the incidents of unsustainable current account balances occurred when the current account deficits were very large in relation to GDP. (Roubini, 1998:19)

Whether a country can sustain current account deficits and large foreign debt over a long period depends on certain variables in the current account:

- A current account deficit is less sustainable when the Gross Domestic Growth is low;
- Budget deficits are high due to the fact that government spending is high (negative government savings);
- Private savings are low;
- Investment rates are low or in the incorrect sectors or industry; and
- Openness is low and the Current Account deficit is high relative to GDP.

An existing large burden of international debt would make it more difficult to finance current account imbalances as this could be a factor that would deplete export revenues and prohibit the importation of investment goods necessary for growth, thus leading to a debt trap.

Financial variables that effect the sustainability of large current account deficits are:

- The composition and size of the capital inflows;
- Fragility of the financial system; and
- Political instability.

A more detailed analysis would be as follows:

The composition and size of the capital inflows

Short-term capital inflows are more serious than long-term capital flows, and equity flows are more stable than debt creating inflows. This was experienced in the case of the Asian crisis, the countries had a large stock of short-term loans from foreign banks, and they refused to extend (roll over) the loans at the maturity dates.

The current account deficits were the result of an imbalance between national savings and investments out of current income, financed by a capital inflow or accumulation of debt. An existing large international debt burden resulting in low foreign reserves would make it difficult to finance a current account imbalance.

In Asia in 1997 a large proportion of the debt was of a short-term nature and international creditors, acting on market indicators refused to extend these loans. If a country defaults on their foreign debt repayments they cannot sustain the current account deficit for long, resulting in a debt crisis.

Fragility of the financial system

The soundness of the domestic financial system, particularly the banks had a substantial bearing on the countries ability to sustain a current account deficit. In some of the Asian countries the bond and security markets were not well developed and often controlled by corrupted officials. Capital inflows required a large intermediation role by domestic banks, but this was lacking in Asia.

A collapse of the banking system led to uncertainty and instability and the inflow of foreign capital became non-existent quite quickly.

Political instability and uncertainty about the economic environment

Political instability and the uncertainty about economic policies would basically have the same result as the instability of the banking sector as described above. Thus a

government not committed to sound macro economic policies can block foreign investments to finance the current account deficit.

A deterioration in expectations about the political and financial environment in a country can lead to panic in the currency and stock markets in that country, which is exactly what happened in some of the effected Asian countries.

2.2.5 GROSS DOMESTIC PRODUCT (GDP)

GDP statistics is used to analyse the performance or the total output and price level of an economy as a whole, to enable us to make some meaningful assumptions. This is what we refer to as the "Gross Domestic Product" of an economy. (Haydam, 1997:23)

Gross Domestic Product is a measure of the total production of goods and services in an economy. Since WWII, GDP figures generally reflect an upward trend with short-term fluctuations that indicate the business cycles; these two issues are economic growth and business cycles. (Roubini, 1998:1)

'Domestic' refers to local and 'Product' to the production in a country. It is also defined as the market value of all final goods and services produced within the boundaries of a country during a certain period (normally one-year). (Fourie, 1994:23)

GDP of a country could further be defined as the year-on-year growth rate of the quarterly GDP results in a country. (Roubini, 1998:2)

The most important measures of how fast an economy is growing are real GDP growth and real GDP growth per person. (Blitzer, 1997:88)

The growth in GDP is the economic factor that determines why some countries are richer and grow faster than others. Countries that grow faster would eventually be richer. (Roubini, 1998:1)

GDP growth rates are normally adjusted for the effect of inflation to reflect the real GDP growth rates.

Using the above as a measure of wealth for countries, although Japan made massive strides since WWII, in 1985 the U.S.A as a country was still 30 percent richer than Japan. If the same measurement is applied to two Asian countries, China and Korea, China is the poorest but they are growing rapidly and are now the worlds third largest market. (Roubini, 1998:1-2)

Japan experienced rapid and sustained growth rates since WWII but has had a period of stagnation since 1990. Between the period 1992 to 1995 the growth rate per year was close to zero. Growth in Japan recovered to 3% in 1996 but the economy slumped again in 1997, and this contributed to the Asian crisis. (Roubini, 1998:28-29)

Japan is the main export market for many East Asian countries and the stagnation of growth in Japan contributed to the reduction since 1995 of the export growth in these countries. (Roubini, 1998:3)

In 1996 it seemed like Japan's economy was recovering but an increase in the consumption tax rate in April 1997 caused another slump.

Low interest rates and the continued depreciation of the yen against the US dollar, coupled with the fact that Japanese banks lent heavily to other Asian countries contributed to the crisis. This contributed to the worsening of the financial conditions of the Asian banks and caused the insolvency of many large banks and corporate companies. (Roubini, 1998:3)

Table 2.15 demonstrates the rapid growth some of the Asian countries experienced in the years preceding the 1997 financial crisis and the effect of the crisis on the GDP growth rates thereafter:

TABLE 2.15 REAL GDP % CHANGE IN THE ASIAN ECONOMIES

Year	1991	1992	1993	1994	1995	1996	1997	1998
Korea	9.1	5.1	5.8	8.4	9.0	7.1	5.5	-2.0
Indonesia	7.0	6.5	6.5	7.3	8.1	7.8	4.7	-5.0
Malaysia	8.7	8.5	8.3	9.2	9.6	8.2	7.0	2.0
Philippines	-0.6	0.3	2.1	5.3	5.7	5.7	5.1	2.4
Singapore	6.7	5.8	9.9	10.1	8.8	7.0	7.8	2.5
Thailand	7.0	7.1	8.2	8.6	8.7	6.7	-0.4	-3.0
Hong Kong	5.1	6.3	6.1	5.4	4.6	5.0	5.2	-1.0
Taiwan	7.6	6.8	6.3	6.5	6.1	5.7	6.8	5.5

Source: (Delhaise, 1998:86,104,126,153,164,183,185,187,188)

If one purely analyse the GDP statistics it is understandable that analysts and even the IMF did not expect that a financial crisis would emanate from Asia as the economic growth rate figures were satisfactorily to outstanding.

It is only when the economic growth statistics are analysed and compared with the deficits on the current accounts (see table 2.15 above); that they should have raised the alarm bells and the IMF should have instituted measures to prevent an economic crisis in Asia.

2.2.6 ECONOMIC GROWTH AND BUSINESS CYCLES

Arising out of the discussion of the GDP of an economy, two important factors that require a more detailed discussion are economic growth and business cycles.

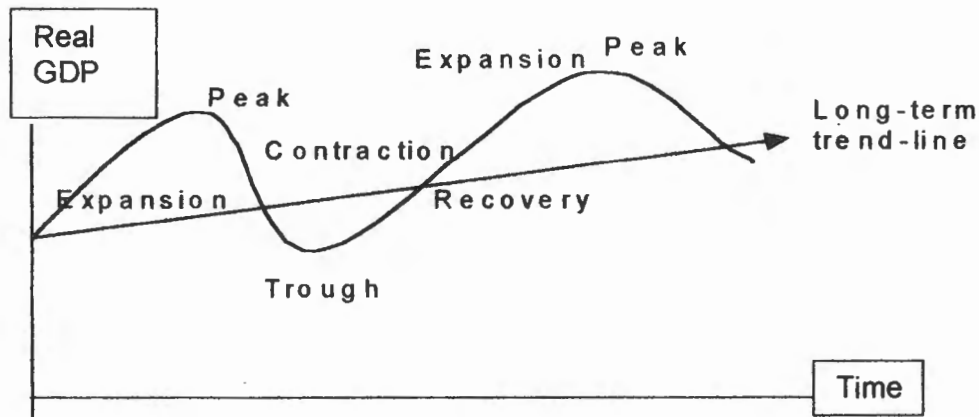
Short term fluctuations and changes in an economy are what we refer to as business cycles and five phases are normally evident:

- The trough phase or the lowest (worst) point of the economy;
- The recovery phase where the economy starts moving upwards;
- The expansion phase where the pace of economy accelerates;
- The peak (boom) period; and

- The contraction and decline phase and can lead to recession or depression with high interest rates and a shortage of credit.

Graphically it can be explained as per table 2.16 below:

TABLE 2.16 BUSINESS CYCLES



Source: (Haydam, 1997:163)

The vertical axis measures total production in the economy and the horizontal axis indicates time. (Haydam, 1997:163)

It is very important for central banks and governments to recognise the various phases of the economic cycles, as different phases require different monetary and fiscal measures to either stimulate or to slow their economies down.

The Asian countries experienced a sustained period of growth and the signs of a contraction phase were ignored.

At the trough phase the economy is at its lowest or worst points. High levels of unemployment and low levels of stock and production are experienced. As nobody is spending money, a surplus of cash is available and interest rates are low.

The recovery phase will begin when production starts moving upwards as the fall in inventories come to an end and the government introduces measures to stimulate the economy. Exports would be encouraged to earn valuable foreign reserves for the country. (Haydam, 1997:164)

In troubled countries the IMF would introduce measures to assist in the recovery phase of the economy. This is also the phase that most of the Asian countries are experiencing at the moment, as the corrective actions and measures instituted by the IMF are starting to stimulate their economies.

In the expansion phase the pace of the economy becomes faster and the production of goods in all sectors of the economy increases. The balance of payments will revert to a deficit and the inflation rate would increase. Prices of goods would increase and the exchange rate would deteriorate. (Haydam, 1997:165)

In the peak- or boom phase the stimulus created by the expansionary phase created a self-feeding boom. Investment would be high and interest rates at a high level. The boom could end when interest rates become too high and cause the consumption to slow down. Governments could introduce measures to combat the increase in inflation. (Haydam, 1997:165-166)

When the economy slows down and the stock market declines, or rising profits ends, forcing companies to cut back causing unemployment, it might be some of the signs of a contracting phase evident in the economy. (Haydam, 1997:165-166)

Economists, the IMF and the governments in Asia failed to recognise the signs of the contraction phase and the eventual recession, which contributed, to the Asian financial crisis.

Gross Domestic Product (GDP) is a measure of the total production of goods and services in an economy. Since World War Two, GDP figures generally reflected an upward trend with short-term fluctuations that indicated the business cycles. (Roubini, 1998:3)

Business cycles, especially in Japan exacerbated the financial crisis in Asia in a number of ways. Since 1990 Japan experienced a contraction or slump in their economy. In 1996 it appeared that an economic recovery was returning in Japan after five years of zero growth, but the increase in consumption tax introduced in April 1997, created the beginning of another recession. The results were low interest rates and a continued decline of the yen against the US\$.

Japan had heavily lent to other Asian countries and this contributed to the financial crisis of 1997. (Roubini, 1998:3)

Recessions are periods of negative growth and it is important for governments and central banks to recognise the various phases that the economy goes through and the effect of monetary and fiscal policies on the various phases.

Japan had rapid and sustained growth rates since World War Two and expected this to continue indefinitely. But a period of stagnation developed since 1990. Between 1992 and 1995 the growth rate per year was close to zero. Growth in Japan recovered to 3% in 1996. By making the wrong decision on the introduction of the consumption tax in 1997 the economy slumped again, and this contributed to the Asian crisis.

2.3 THE INTERNATIONAL MONETARY FUND

From the discussion of the macro economic factors and monetary and fiscal controls above it is clear that we all operate in a global economy with no real boundaries. Events in one part of the globe will also effect most of the world's economies. Without proper control chaos could break out in the financial world and the need for some body or organisation existed to exercise these controls. This organisation is known as the International Monetary Fund.

The need for an organisation like the IMF became evident during the Great Depression that eroded the world economy in the 1930's, when thousands of banks and institutions failed and unemployment was rive. (Driscoll, 1998:3-4)

The need for a permanent organisation to control the international monetary system was recognised by White and Keynes and they made proposals to that effect. The decision to establish the IMF was taken at Bretton Woods in 1944. (Driscoll, 1998:3-4)

The IMF began operations in Washington, D.C. in May 1946 with 39 members, to assure balance of payment cooperation in the world economy, and to maintain sanity in international financial matters. (Driscoll, 1998:3-4)

The IMF's membership now numbers 182 countries. (Driscoll, 1998:3)

The system is based on a system of deposit quotas depending on the size of the economy of a country. In times of distress, or current account deficits they will lend money to the country in distress and provide advice on the correction of the problem. (Driscoll, 1998:5)

The IMF also controls the currency arrangements in the global economy, but they agreed that each member might choose its own method of determining the exchange value of its money. (Driscoll, 1998:6)

The basic strategy of the IMF-supported programs in Asia had three elements:

- To tighten macro economic policies to stabilise the exchange rates, control inflation and stop capital flight;
- To mobilise large-scale external assistance from multilateral and bilateral sources, to help break the vicious cycle of capital outflows, currency depreciation, and deterioration in the financial sector; and
- To tackle the key structural problems (mainly in the financial sector), to address the root cause of the financial crisis.

Some of the actions taken by the IMF to assist the Asian nations in the crisis of 1997 and the reactions thereon were: -

August 11 1997-The IMF announced a rescue package for Thailand, which included loans of US\$16 billion from the IMF and other Asian countries. (Delhaise, 1998:244)

August 20 1997-The IMF approved a US\$3.9 billion credit package for Thailand. The total package was US\$16.7 billion as a further US\$500 was added by Brunei, bringing it to a total of US\$17.2 billion. (Roubini, 1998:2)

August 21 1997-IMF Managing Director, Michel Camdessus stated, "The worst of the crisis is behind us". (Delhaise, 1998:245)

October 31 1997-concerns over the fate of the financial markets dominated the news in the United States.

Indonesia received a \$23 billion financial support package from the IMF. (Roubini, 1998:4)

November 3 1997-Asian stock markets improved as the financial aid package for Indonesia helped to restore calm to the region. (Roubini, 1998:4)

November 18 1997-The failure to pass financial reform bills in Korea indicated that the IMF would be required to rescue Korea. Asian currencies were under pressure. (Thai baht lost 3.5%, the Philippine peso 2.9% and Malaysian ringgit 2.8%).(Roubini, 1998:10)

November 24 1997- Korea announced that they would request assistance from the IMF for their troubled economy. (Roubini, 1998:15)

November 25 1997- the yen tumbled to its lowest level against the dollar in more than 5 years. (Roubini, 1998:15)

December 4 1997-Package of U.S\$57 billion in aid to South Korea was announced by the IMF, which helped to restore some stability to the markets. (Roubini, 1998:20)

December 8 1997-After a few days of stability was experienced in the markets problems again appeared in South Korea with the takeover by the government of a major bank. (Roubini, 1998:23)

The IMF eventually advanced in excess of US\$100 billion to the Asian countries and dictated economic conditions to 350 million people, but this did not resolve the crisis, and it had continued throughout 1998 and into 1999.

2.4 THE EFFECT OF THE CRISIS ON SOME OF THE MAJOR ECONOMIES IN THE WORLD

2.4.1 The United States of America

During the period October 20 –23, 1997 fears of high interest rates and pressures on the Hong Kong dollar caused the Hong Kong stock market to lose nearly a quarter of its value in four days. The Heng Seng index deteriorated by 23.34%(Delhaise, 1998: 245).

The downward spiral also hit other markets and on October 27, 1997 Wall Street in the U.S.A. as well. The Dow Jones industrial average dropped by 7.18%, its single-biggest point loss ever.

Since August 6, 1997 the Dow Jones had fallen by 13.3%. (Norris, 1997:1).

The reason for this can be directly attributed to the Asian financial crisis and in particular the fear of profit deflation emanating from Asia.

The Asian problems threatened the profits of many multinational companies.

The biggest economic news of 1997 was the turmoil in Asia and most Americans were grossly underestimating the recessionary and disinflationary-deflationary forces of what was happening in Asia.

In an article in the Wall Street Journal January 5, 1998 (Biggs) expressed the following views:

- By competitively depreciating its currencies, Asia is exporting its deflation, its overcapacity and lack of growth to the West, particularly the USA;

- This could result in a synchronized global slowdown-recession;
- The USA and Europe were on the brink of deflation in consumer prices, and with a large Asian depreciation and deep recession, competition and deflation pressures will grow;
- Exports will slow down with more pressure on corporate profits, combined with an increase in imports from Asia would result in fierce foreign competition for USA firms;
- Rising American trade deficits of even 50% and higher than 1997 levels could be experienced; and
- Downward pressure on U.S.A prices and wages.

It was clear that the U.S.A would not have escaped from the effects of the Asian financial crisis.

2.4.2 JAPAN

In the case of Japan, the world's second largest economy, the largest in Asia, and the world's largest creditor country, the economic performance deteriorated even further after the crisis erupted. (Noland, 1999:2)

Their economy experienced an annualised negative growth rate of more than three percent in 1997.

The Japanese currency (the yen) weakened and a free-falling yen had put tremendous pressure on the rest of Asia. (Noland, 1999:3)

At the end of 1997 Japan had exposure of US\$ 250 billion in the seven distressed countries in Southeast – Asia alone. (Delhaise, 1998:16).

Japan accounts for 60 percent of East Asia's gross domestic product

The crisis prompted action by the Japanese government and in 1998 they committed six percent of GDP, to deal with banking sector weaknesses. (Noland, 1999:2)

They made a substantial concerted intervention in the exchange markets to reverse the slide of the yen (July 1998).

Faster growth in Japan would benefit the rest of the world as well as Japan. It would facilitate the economic recovery in the rest of Asia by providing a market for Asian goods. To achieve economic recovery they would have to stimulate local demand, address the financial problems especially in the banking system and undertake structural reforms. (Noland, 1999:2)

From the description of what sound macro economic principles entails, the application of the principles to the Asian economies resulted in recognising the principles that they had ignored, and the severe effect it had resulting in the 1997 financial crisis. The effect the crisis had on interest rates, exchange rates, inflation and economic growth in the Asian countries was highlighted.

Long periods of sustained economic growth in the Asian countries led the world to believe that nothing could go wrong, but when Japan's economy slumped from 1990 onwards the world should have looked more closely to the rest of the Asian countries and their macro economic fundamentals.

It is of critical importance that governments and central banks follow the correct procedures when implementing monetary and fiscal policies in the various phases of the business cycles.

It is clear that countries not following these principles would eventually experience major problems with their currencies, interest rates and balance of payments.

It is also clear that in the global economy the IMF must control the implementation and enforcement of sound macro economic principles to prevent a repeat of the Asian financial crisis.

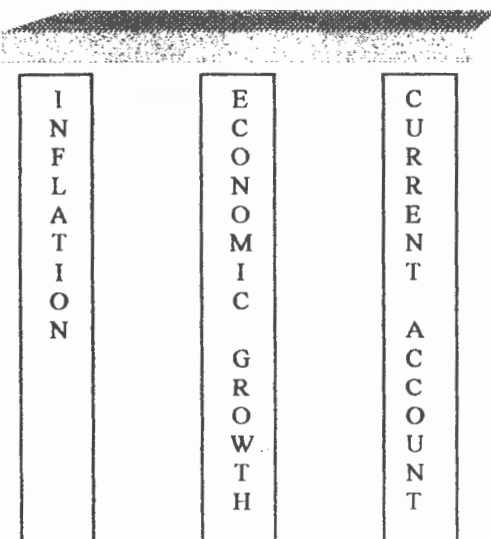
In chapter 3 the Asian countries effected by the financial crisis would be discussed in more detail, and the hardship it has caused to the citizens of the countries involved will be highlighted. (Unemployment)

2.5 CONCLUSION

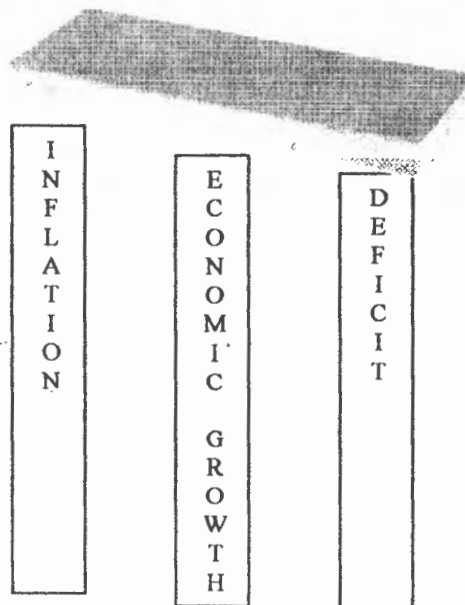
We defined the macro economic and international business principles and objectives as the principles concerned with the economy as a whole. One aspect cannot be treated in isolation. We focussed on aspects such as the stability of the general price level (inflation), full employment, economic growth, balance of payments, interest rates, GDP and exchange rates.

The sound macro economic and international business principles discussed in this chapter, are the pillars that keep a country's economy in balance and healthy. If one or more of the factors are ignored in the running of the economy by the government it will cause an imbalance and eventual collapse of the economy of the country. (See tables below)

**TABLE 2.17: SOUND MACRO
ECONOMIC BUSINESS
PRINCIPLES**



**TABLE 2.18: SOUND MACRO
ECONOMIC BUSINESS
PRINCIPLES NOT FOLLOWED**



In chapter 3 we will focus on the macro economic and international business principles, discussed in chapter 2, that were ignored by the Asian countries that eventually caused the down fall of their economies in 1997.

CHAPTER 3

3. BRIEF PROFILE OF THE ASIAN COUNTRIES INVOLVED IN THE FINANCIAL CRISIS

3.1 In General

After the Second World War the United States and Japan markets were open to Asian exports and the latter invested heavily in the region. Some ethnic businesses, as a direct result became multi-billion dollar conglomerates.

A stable Asian economic environment developed in which local and foreign businesses blossomed and grew.

Growth rates had been extraordinarily high in Asia over the past three decades, but the financial systems did not grow fast enough to accommodate the fast growth and were fragile and vulnerable.

Especially the banking systems, and Delhaise in his book, *Asia in Crisis*, described this as the implosion of the banking and finance systems.

It is for this reason, the lack of best practice Banking systems, that the five major Asian countries; Thailand, Korea, Indonesia, Malaysia and the Philippines experienced the collapse of their currencies and stock markets in 1997. (Delhaise, 1998:4)

Before the 1997 crash savings were high and taxes low, and countries like Singapore, Malaysia and Thailand became global economic powers. (Mallet, 1999:140)

Tycoons in Asia admired for their entrepreneurial skills often destroyed the environment and exploited their workers. After 1997 they will never again be regarded with uncritical admiration. (Mallet, 1999:140)

For years some analysts warned that there were inherent weaknesses in the Southeast Asian economies but economic growth rates of 8% and more for decades pointed towards a sustained Asian boom. Optimistic economists predicted that the Asian economies would eclipse the United States and European economies early in the new millennium. (Mallet, 1999:141)

One of the most prominent sceptics was Krugman, economics professor at Stanford University, who declared in 1994 that there was no Asian Miracle. (Mallet, 1999:141)

Among other analysts there were no signs of unease about Asia's economy as early as 1996, even when it became clear that corporate profits would be curbed by a surplus of expensive manufacturing capacity in the electronics industry, and export growth was slowing down. (Mallet, 1999:141)

Analysts have various theories about the causes of the collapse of the currency and stock markets.

After analysing the various theories it seems that the most acceptable ones were the implosion of the banking and financial systems mainly due to the quality of their financial management, a proper credit culture and cash flow analysis coupled with the control of currencies. (Delhaise, 1998:1)

Another important factor was the linking or pegging of their currencies to the U.S.dollar. Macro economic theories show that the price of doing this can indeed be very high as in the case of the Asian countries.

One common link between all the countries severely effected by the crisis was a long period of sustained economic growth; the Asian crisis was therefore a crisis of growth, which escalated to the currency and stock markets. (Mallet, 1999:144)

3.2 IMPORTANT CHRONOLOGICAL EVENTS LEADING TOWARDS THE FINANCIAL CRISIS IN 1997

To appreciate the situation in Asia in 1997 and the buildup to the financial crisis the chronology of the important events and factors that led to the Asian currency and the stock market collapse for the early part of 1997 would be as follows:

(To fully appreciate the full extent of the crisis it is necessary to include the full 1997 chronological developments in this dissertation. (See Annexure A)

(This chronology of the financial crisis was based on information from several news sources (Reuters, Wall Street Journal, New York Times, CNNfn and Financial Times) as detailed in (Roubini, 1998:p1-51)

January 1997: Hanbo Steel the first major Korean Company to go insolvent in a decade was liquidated with a total debt burden of US\$6 billion. (Roubini, 1998:1)

February 5, 1997: Samprasong became the first major company in Thailand to default on foreign debt repayments. (Roubini, 1998:1)

March 1997: Sammi Steel another Korean Corporation failed to meet corporate debt payments. (Roubini, 1998:1)

May 14-15, 1997-Thailand's currency (the baht) was attacked by speculators after it was allowed to float, caused by the slow down of the economy and political instability. (Roubini, 1998:1)

The Philippines was also effected and the central bank raised the overnight interest rate to 13% and they dumped some dollars in the market.

May 1997-Japanese officials, concerned about the decline of the yen,

indicated that they were considering raising their interest rates. This was one of the first signs of the Asian financial crisis. Global investors started to sell off Southeast Asian currencies, creating a downward trend in the currencies and stock markets. (Roubini, 1998:1)

May 23, 1997-Efforts to save Finance One, Thailand's largest finance company, failed. (Roubini, 1998:1)

June 19, 1997- Thailand's Finance Minister resigned and the Prime Minister declared that the baht would never be devalued. (Roubini, 1998:1)

June 27, 1997- The Central bank of Thailand instructed 16 cash-strapped finance companies to draft merger or consolidation plans. Their operations were suspended. (Roubini, 1998:1)

July 1997-Korea's third largest car manufacturer Kia, requested the granting of emergency loans due to credit and cash flow problems. (Roubini, 1998:1)

July 2, 1997-Devaluation of the baht to 28.80 to the dollar, and the Bank of Thailand requested technical assistance from the IMF. (Roubini, 1998:1)

The events listed above should have alerted the IMF that the financial situation in Asia was becoming extremely dangerous to the world economy and drastic measures should have been taken to stop it from escalating.

A more detailed analysis of the troubled Asian countries from publications by Mallet, 1999: and Delhaise, 1998: provided more in depth information on the Asian countries. A short description of each of the countries follows:

3.3.1 THAILAND

The crisis erupted in Thailand in 1997 when Finance One, the largest finance company in the country with assets in the region of US\$4 billion failed to meet its obligations.

Thailand experienced a staggering growth in the last two decades, which could not be financed with local capital, and with the encouragement of the IMF and the World Bank commenced in the early 1990's with a strategy of substantial financial liberalisation.

Externally this meant that the almost all foreign exchange controls were abolished, and internally the deregulation of the financial sector, giving the banks more freedom in matters like asset mix and interest rates. Thai banks ended up being part of the least liquid banking system in Asia.

In Thailand, the baht had for a long period carried an interest rate premium, coupled to a stable currency without a high risk, but when the financial crisis erupted the currency deteriorated at an alarming rate. The currency table as at the end of December for the years 1991-1997 and as at June 1998 demonstrates this clearly.

TABLE 3.1 CURRENCY TABLE: BAHT PER US\$

<u>Dec</u> <u>1991</u>	<u>Dec</u> <u>92</u>	<u>Dec</u> <u>93</u>	<u>Dec</u> <u>94</u>	<u>Dec</u> <u>95</u>	<u>Dec</u> <u>96</u>	<u>Dec</u> <u>97</u>	<u>Jun</u> <u>1998</u>
25.28	25.52	25.54	25.09	25.19	25.61	47.25	43.76

Source: (Thomson Bank Watch Inc and Delhaise, 1998:86)

The baht deteriorated year on year by 84% from December 1996 to December 1997. Early in 1997 it was becoming clear to external analysts that it would become increasingly difficult to defend the parity of the bath.

The Bank of Thailand kept on wasting their valuable reserves to maintain an artificial high level for the baht, which in turn contributed to the start of the Asian currency crisis of 1997.

The question was whether the baht was overvalued?

On fundamentals, Thailand's currency didn't necessarily need a drastic adjustment, but the authorities should have been alerted to the danger of linking a quasi-peg baht to the strong U. S. dollar.

The Bank of Thailand had ample reserves, around US\$33 billion, the problem was that they did not stop their efforts in time and wasted the valuable reserves in an effort to defend the baht. Some of the fundamentals are listed in the table 3.2 below:

TABLE 3.2 MACRO ECONOMIC FUNDAMENTALS IN THAILAND

	<u>Dec</u> <u>1991</u>	<u>Dec</u> <u>92</u>	<u>Dec</u> <u>93</u>	<u>Dec</u> <u>94</u>	<u>Dec</u> <u>95</u>	<u>Dec</u> <u>96</u>	<u>Dec</u> <u>97</u>	<u>Jun</u> <u>1998</u>
Real GDP %	7.0	7.1	8.2	8.6	8.7	6.7	0.4	-3.0
Inflation %	5.7	4.1	4.6	5.1	5.8	4.8	8.0	9.0
Current account US\$ B	-7.57	-6.30	-6.36	-8.09	-13.56	-14.69	-3.40	7.0

Source (Delhaise, 1998:86)

The fundamentals probably did not warrant such drastic adjustment but the deficit on the current account grew too quickly. The adjustment had the desired effect and as at June 1998 the deficit converted to a surplus of 7.0% as reflected in the above table.

3.3.2 INDONESIA

The Asian financial panic effected Indonesia more than any other country and its currency deterioration had a devastating effect on the economy. The banking system eventually grounded to a halt.

The causes for this situation were the political and social systems in the country. Banking licenses were issued to everybody. With a GDP growth of 8% and the money supply measured by M2, this had expanded by more than 20% per annum. Indonesia had long been "underbanked" and was using private sector money lending to cover the shortfall. Delhaise (1998:121-142)

Liquidity had therefore been a problem in the private banking sector, and although the asset quality had improved by 1995 it was already evident then that problems were looming.

As the crisis developed the Indonesian currency (the rupiah) went up and down at will with daily fluctuations as high as 10% per day.

The table for the years 1993 to 1997 and as at June 1998 clearly demonstrates the fall of the rupiah during this period:

TABLE 3.3 RUPIAH AGAINST THE US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
2,110	2,200	2,308	2,348	5,400	7,500

Source: (Delhaise, 1998:126)

The rupiah devalued effectively by 130% year on year from 1996 to 1997.

Indonesia was also facing a political upheaval, as the general feeling was that General Suharto after 32 years in power needed to step down. Riots and dissent eased him out of power shortly thereafter.

It is evident that strict control over the banking sector is of utmost importance in a country and the financial systems must be sound and trusted. Indonesia did not do this and they paid a heavy price for this. The interest rate had to be increased to 34% in 1998 to stem the deterioration of the rupiah.

It is also clear that without political stability Indonesia experienced financial instability.

3.3.3 MALAYSIA

Malaysia had not been as severely effected by the crisis as the other countries and they avoided requesting financial assistance from the IMF.

The Asian panic reached Malaysia after it started in the neighbouring countries. Malaysia was hit without real justification in 1997, but they would have been in trouble on the macro economic fundamentals in 1999 or 2000 anyhow, due to the fragile property market with a large oversupply of office, retail and residential space available.

Another big problem was the weakness of the stock market and that 48% of the total foreign debt was attributable to the private sector, with 75% of the total expressed in US\$. When the ringgit started deteriorating they were severely effected as the table of the currency below clearly reflects (ringgit to the U.S. dollar).

TABLE 3.4 RINGGIT TO US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
2.70	2.56	2.54	2.52	3.88	3.70

Source: (Delhaise, 1998:153)

The ringgit lost 54% of its value from 1996 to 1997 as reflected in the table above.

By early 1998 rescue operations by the government commenced to save the many non-bank institutions that were in serious trouble in the country.

It is clear that events in one country could have an effect on the global economy. This was clearly demonstrated in the case of Malaysia as the financial crisis reached them by contagion from their troubled neighbours. Governments and central banks must observe financial trends in their own country and trends in other countries to take early measures to safeguard their economy when it becomes clear that problems exist in their economy or elsewhere.

3.3.4 The Philippines

The Philippine's central bank reacted quickly to the crisis that effected Asia, (with US\$12 billion in reserves at March 1997 and US\$45 billion foreign debt) allowing the currency to react to market trends, They allowed the peso to float on July 11, 1997. (Delhaise, 1998:161-174)

The banking system was in a better position to fight the crisis as the government had taken steps to put the industries house in order. They were in the best position of the five countries hit by the currency and asset crisis to defend their economy.

When the Asian crisis contagion spreaded the peso and the stock market suffered purely due to the fact that they were part of the group of Asian countries that suddenly were doubted by the world.

The currency table for the years 1993-1998 shows the extent of the damage.

TABLE 3.5 PESO per US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
27.70	24.42	26.21	26.29	39.50	41.00

Source: (Delhaise, 1998:164)

The peso lost 50% of its value from 1996 to 1997.

On fundamentals alone, or that the Asian countries had too much foreign debt the Philippines should largely have been spared the onslaught on its markets. In September 1997, its total foreign currency debt was only US\$46 billion or 56% of GDP. (81.5% of this was long term).

The value of an efficient central bank was clearly demonstrated by The Philippine's central bank as they reacted quickly and managed to escape some of the worst effects of the financial crisis. They allowed market forces to take over as they realised the peso were overvalued and it was hampering their competitiveness on world markets. The valuable lesson learned from this is that market forces (supply and demand) must determine the level of a currency.

3.3.5 SINGAPORE

Singapore's currency was not as severely effected by the crisis as demonstrated per the currency table for the years from 1993 to 1998 listed below.

TABLE 3.6 SINGAPORE \$ TO US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
1.61	1.46	1.41	1.40	1.68	1.70

Source: (Delhaise, 1998:185)

Singapore is a paragon of high-technology efficiency. (Mallet, 1999:263).

The banking systems are comparable to some of the best in the world. They are highly competitive and the least bureaucratic and corrupt country in Asia.

Some of the fundamental macro economic indicators are listed in table 3.7:

TABLE 3.7 MACRO ECONOMIC FUNDEMENTALS IN SINGAPORE

	<u>Dec</u> <u>1991</u>	<u>Dec</u> <u>92</u>	<u>Dec</u> <u>93</u>	<u>Dec</u> <u>94</u>	<u>Dec</u> <u>95</u>	<u>Dec</u> <u>96</u>	<u>Dec</u> <u>97</u>	<u>Jun</u> <u>1998</u>
Real GDP %	6.7	5.8	9.9	10.1	8.8	7.0	7.8	2.5
Inflation %	3.4	2.3	2.5	3.1	1.7	1.4	2.0	3.0
Current account US\$ B	4.88	5.62	4.21	11.28	15.09	13.25	15.35	14.60

Source (Delhaise, 1998:185)

Whilst other Asian countries endeavoured to control the levels of their currencies by pegging it to the US\$, Singapore allowed market forces to determine the level of the Singapore dollar. They even experienced an appreciation in 1994/95. This in conjunction with the sound macro economic fundamentals in the above table explains why they escaped most of the damage caused by the 1997 financial crisis.

Other countries in Asia must introduce the same business principles as Singapore's banking system together with the central bank controls to ensure that they don't experience a collapse of their financial systems in the future again.

3.3.6 Korea

The crisis that originated in Thailand quickly effected Korea. Korea's industrial and financial sectors needed reforms desperately, as banks on average were bankrupt even before the crisis.

South Korea's performance in the last four decades was remarkable as the country was devastated by the war in the early 1950's. For a considerable period they were dependent on foreign assistance, mainly from the U.S.A. (Delhaise, 1998:102-103)

Their main driving forces were hard work and a high level of education, which they pursued with unrelenting passion.

By 1962, foreign capital was financing 82% of their total investment. Realising their dependency on foreign investments they developed a five-year plan, which encouraged the development of export driven industries.

This plan proved to be highly successful as real GNP grew by an average of 8% per annum. The country had a low inflation rate and unemployment rate, with a high growth rate. To sustain the growth they fell into the same trap as so many other countries by borrowing excessively from the rest of the world. By 1997 Korea's economy was the world's 11 Th largest.

Korea's problems stemmed mainly from the concentration of power. The 30 largest conglomerates (Chaebols) controlled 85% of the industrial sector by the 1990's. Cross-subsidies within the conglomerates were very harmful to the economy.

The Chaebols prevented the development of an open economy and the introduction of foreign companies into Korea was virtually impossible.

At the end of 1996, six major commercial banks had stock losses, and as a result the Korean banking system entered 1997 with shaky accounts and large foreign debts.

A string of large corporate failures such as, Hanbo Steel (January 1997), Sammi Steel (January 1997), Jinro Distillery (April 1997) and KIA Group (July 1997) started effecting Korea in early 1997. (Delhaise (1998:115-118)

The Korean won was severely punished in the 1997 crisis after years of relative stability, as the currency table listing the currencies performance from 1993-1998 below clearly demonstrates;

TABLE 3.8 WON AGAINST THE US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
808.10	788.70	774.70	844.20	1695.80	1400.00

Source (Delhaise, 1998:106)

The won lost year on year 100% of its value from 1996 to 1997.

The real danger of big private or corporate groups controlling the economy of a country came to the fore in the case of Korea; therefore governments must be alert to this and take precautionary measures to prevent this before it is too late.

3.3.7 CHINA

China was not as severely effected by the 1997 financial crisis.

The reason was that there was no capital account convertibility thus, making it virtually impossible to bet against the Chinese yuan.

China also enjoyed a huge current account surplus, which accumulated in the preceding four years.

The banks are in the hands of the state. Liquidity in the local currency would therefore never present a problem.

The asset deflation in China pointed towards an overvaluation of the yuan and it needed some form of adjustment, although some analysts argued that it was undervalued and that it needed no adjustment.

At the end of 1998 they were still not effected by the financial crisis and expected a trade surplus of US\$35 to 40 billion for the year. (Finansies & Tegniek, 27 November 1998:28)

3.3.8 TAIWAN

Taiwan had a huge current account surplus and its currency was not completely convertible.

Taiwan was spared some of the worse effects emanating from the Asian crisis and this can be seen from the table below. Only a small depreciation of the New Taiwan dollar was experienced.

TABLE 3.9 NEW TAIWAN DOLLAR AGAINST THE US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
26.63	26.24	27.27	27.49	32.55	36.00

(Source) Delhaise, 1998:183)

3.3.9 Hong Kong

Hong Kong escaped the 1997 crisis, but suffered from asset deflation, a problem created by pegging the currency to the US\$ since 1983.

TABLE 3.10 Hong Kong DOLLAR AGAINST THE US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
7.73	7.74	7.75	7.73	7.75	7.75

(Source) Delhaise, 1998:187)

Hong Kong had huge foreign reserves and tight financial controls.

TABLE 3.11 FOREIGN RESERVES (US\$ Billions)

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
43.00	49.00	55.00	63.80	70.00	95.00

(Source) Delhaise, 1998:187)

The advantage of tight monetary and fiscal control was evident in the foreign reserve statistics in the above table and was an example to be followed by the rest of Asia and the world.

One disadvantage of pegging the currency to US\$ is that Hong Kong had become a very expensive city, and being a major tourist destination this might slowly drive it out of contention.

With the depreciation of the currencies in other countries they have become cheaper for the U.S.A. tourists to visit.

3.3.10 JAPAN

The question to be asked was whether Japan directly had any influence on the Asian crisis?

It appeared that the weakness of the yen was one of the major factors, as it contributed to the loss of competitiveness of Korea and other Asian countries. The main reason was that Japan competed in the global financial markets with the Western banks, at low

interest margins, forcing Asian banks to do the same to remunerate capital funds, leading to excessive debts and low profit margins.

Japan experienced economic problems from 1990 onwards, after their extraordinary growth since the war. A combination of hard work and discipline brought wealth and respectability to Japan. The turnaround came in 1990, and Japan's economy had subsequently been in a sluggish phase for seven years before the Asian crisis arose in 1997.

Japan is a major partner to Asia as an investor, lender, buyer and seller. Japan's fate in the future will be the catalyst for Asia's survival.

The Japanese banking system had not been in a good condition for some time and the yen had been a low-interest currency and the interest margins were thin.

The currency table listed below for the yen for the years from 1993 to 1998 does not reflect the huge deterioration evident in the currencies of some of the other Asian countries.

TABLE 3.12 YEN AGAINST THE US\$

<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>June 1998</u>
111.85	99.58	103.51	115.70	130.58	146.22

(Source): Delhaise, 1998:188)

Japan is the big player in Asia and measures to stimulate their economy must be increased. As the rest of Asia starts to recover from the 1997 financial crisis they will need a market for their goods and Japan must provide this.

3.4 A CONCLUSIVE VIEW

The real causes for the Asian financial crisis had been analysed by analysts, academics and writers and some of the theories and results are included in this dissertation. This is necessary to substantiate the theories and to establish some common denominators,

linking it to the above analysis of the Asian countries that contributed to the financial crisis.

This will assist us in the process of assessing what went wrong in Asia and to make some observations and recommendations for the future.

Delhaise, (1998:1) attributed the crisis to macro economic fundamentals and to a growth crisis. The core to the problem according to his findings was antiquated financial systems, (Miller described it as 19 th century technology) that relied exclusively on commercial banks to provide capital for economic expansion, but they were too highly leveraged and poorly regulated. They eventually could not support the high-sustained growth experienced by most of the region for nearly three decades.

Banks expanded credit excessively on the upside of the business cycle, misallocated capital funds and employed weak credit controls.

The causes according to the author could thus be attributed to intelligent people making unjustifiable but understandable mistakes about economic growth.

The view of Delhaise seems too simplistic, but being a banker he focussed on the banking and financial systems in his book and some of the core problems were discussed.

Victor Mallet had been a foreign correspondent for the Financial Times since 1986 when he moved to Bangkok in 1992 to cover the Southeast Asia region for them.

His book provided valuable information on the ten countries forming Southeast Asia, where the crisis first developed.

Mallet, (1999:284) came to the conclusion that rapid economic growth; an upsurge of nationalistic self-confidence; the push for political reform; migration to the cities and the erosion of traditional family ties and other social changes; the rise of unscrupulous tycoons; pollution and other environmental damage were the main problems leading to the financial crisis in 1997.

It is clear that the author who lived in the region has had first hand knowledge and experience of the inherent problems that existed in the regions, and he recognised not only financial and economic problems, but also social and political factors contributing to the crisis.

The Institute for International Economics assessed the ongoing monetary and economic crisis in Asia, which had already had a major global effect (including on the USA), and published a statement by their director Bergsten, on the 13 November, 1997. These findings are discussed below:

They distinguish among three sets of countries in the region and classify the problems accordingly:

- The Northeast Asians, Japan and Korea experienced major structural problems in their financial systems. Japanese economic growth stagnated since 1990;
- The Southeast Asians: Thailand, Indonesia, the Philippines and Malaysia experienced rapid growth but in the process developed large external deficits on their current accounts. They also suffered from extremely fragile financial sectors; and
- The strong centre: China, Hong Kong, Taiwan and Singapore had been enjoying rapid growth and had extremely strong external positions inclusive of large trade surpluses and healthy levels of reserves.

According to their statement the crisis were multifaceted and dated back to at least in 1994 when China effectively devalued their currency by 40 percent. During 1995 and 1996 the Japanese yen depreciated by in excess of 25 percent against the US\$. These devaluations placed tremendous pressure on the trade positions of the rest of Asia resulting in large deficits in Korea and Southeast Asia.

The crises erupted when the rest of the world began doubting the sustainability of the external positions of some of the countries with their apparent weak financial systems.

Nananukool (1998:1) are looking at external influences on the financial crisis and two external factors in particular according to his analysis contributed to the escalation of the crisis:

- Japan made large sums available for lending at a very low interest rate; and
- The US dollar stayed undervalued since 1988 to the middle of 1995. This allowed the Asian countries to export their goods and services at highly competitive prices, creating a comfort zone that they were very competitive in the world markets. As a result most Asian currencies became over-valued creating opportunities for speculative attacks in the global economic and currency arenas.

It was exactly what happened to the Thai baht in July 1997 when speculators attacked the currency and triggered the Asian financial crisis.

(Ellen (Chair Council of Economic Advisors), 1998:1) quite correctly said that attempts to identify the fundamental causes of the crisis inevitably suffered from the problem of distinguishing insight from hindsight.

The crisis according to her assessment was the consequence of overvalued exchange rates, large current account deficits, short-term capital inflows, opaque financial systems, "crony capitalism," and the "Japanese Model" of capital markets.

"A key element in any successful explanation of the crisis must therefore be an answer to the question of how a system that worked so well for so long could suddenly fail"?

Ito and Portes (1998:2) stated that the Asian macro economic fundamentals were good and the Asian crisis could be attributed to primarily private-sector problems, rather than high inflation, the serious feature of the crisis was debt deflation, or bursting of a bubble.

Some pattern emerged from the analysis of the above-mentioned writers, economists and organisations in conjunction with the analysis of the Asian nations in this chapter:

- They had weak banking systems and started 1997 with overvalued exchange rates (some of them pegged but not all of them). Common factors are that some of them were pegged to the dollar resulting in an overvaluation and large current account deficits, and excessive private sector foreign borrowing;
- They experienced a sustained period of growth;
- Some of them had major environmental and political problems;
- They thought they were highly competitive on world markets but soon realised they were wrong, once the financial crisis erupted and their currencies plummeted;
- They were heavily dependent on Japan for foreign financing at low rates and being an export market for their goods; and
- They were controlling their currency rates artificially not allowing market forces to determine the levels.

The Asian financial crisis certainly provided expensive lessons to the countries involved and to the world sound macro economic principles and policies cannot be ignored indefinitely, sooner or later the bubble would burst!

CHAPTER 4

CONCLUSIONS AND RECOMMENDATIONS

4.1 IN GENERAL

The eruption of the Asian financial crisis underlined the fact that economies cannot operate in isolation any more as they are all part of the global village.

Economic superpowers like Japan, Europe and especially the United States of America must realise that decisions they make internally would eventually effect all other economies in the globe as well.

Analysts have various theories about the causes of the collapse of the global currency and stock market in 1997.

After analysing the various theories it seemed that the most acceptable ones were the implosion of the banking and financial systems in Asia, mainly due to the quality of their financial management, linked to a proper credit culture and cash flow analysis, coupled with the control over their currencies. Another important factor was the linking or pegging of their currencies to the U.S.dollar.

One common link between all the countries so severely effected by the crisis was that they experienced a long period of sustained economic growth; the Asian crisis is therefore mainly a crisis of growth, which escalated to the currency and stock markets.

Pertinent to the crisis the following were critical facets: -

- The crisis did not start in 1997 but was brewing for a long time, and will continue for some time even into the new millennium;
- The banking systems of the five most distressed countries (Korea, Thailand, Indonesia, Malaysia and the Philippines) would have cracked sooner or later with the inherent deficiencies of the systems;

- A large proportion of the banks operating in the Asian system was basically insolvent when proper criteria's like real capital ratios were used to judge them; and
- Disclosure of financial information was below acceptable standards, and "creative accounting" was employed to bolster results and returns. The disclosure by banks in Asia of financial statements was limited and ratios published were normally misleading, Scores of banks were insolvent. (It was just very well disguised in the published financial statements).

External factors also contributed to the development of the crisis, mainly by the U.S.A and Japan.

The crisis was multifaceted and dated back to at least 1994 when China effectively devalued their currency by 40 percent.

During 1995 and 1996 the Japanese yen depreciated by in excess of 25 percent against the US dollar.

The crisis showed the inability of the IMF to manage and control the global economy contagion.

4.2 RECOMMENDATIONS

The recommendations would centre around four main areas:

- Reforming of the banking and financial systems;
- External influences or the economic and financial controls by economic superpowers in their own economies;
- Introduction of sound macro economic and international business principles; and
- Control by the IMF.

4.2.1 Reforming the financial and banking systems

The starting point of any reform must be the financial and banking systems in the distressed countries by:

- Strengthening of the banking systems by making sure that they are not undercapitalised and have weak lending standards, with strong supervision from the central banks and governments in the distressed countries.
- Leverage or the high ratio of debt to equity must be addressed, and particularly by the banks and financial intermediaries whose assets are less liquid. High leverage can hide inadequate underlying profitability. This was where it all started in 1997 when scores of banks and financial institutions went insolvent and closed.
- Strong central banks must be developed that is independent, leaving them free to introduce monetary policies without the interference of political authorities.
- Strong legal structures that will delimit the government's intrusion into commercial disputes.
- The main protection from adverse financial disturbances internally is an effective system whereby through government regulation and supervision an environment will be created that the potential credit risks in transactions would be regulated.
- The banks must make a concerted effort to rebuild the credibility they lost.

In this highly developed technological world it is unthinkable that some of the Asian countries are still operating with outdated and ineffective systems.

Reliable and efficient financial systems and ratio analysis are critical in the smooth running of an economy and the banking systems. Singapore's banking system is one of the best in the world and the Asian countries could develop their banking systems in line with Singapore's.

These countries will then be able to provide the IMF with reliable and meaningful financial data enabling them to assess the performance of the countries accurately. This will certainly prevent a repeat of the 1997 Asian financial crisis.

4.2.2 External influences of economic superpowers

The economic superpowers, Japan and the USA played such a vital role in the development and eruption of the financial crisis that without their cooperation and assistance it would be impossible for the Asian nations to recover.

Japan had experienced an economic contraction since 1990 and they must introduce monetary and fiscal policies to stimulate economic growth.

The U.S.A economy had been in a boom phase but is heading towards a deficit of 4% of GDP by 2000(Roach, 1999:2) and must be aware of the fact that the same scenario existed in the Asian countries. If the economy of the U.S. A collapses it would have catastrophic consequences for the world's economies.

A discussion of the influences of the superpowers follows below:

4.2.2.1 United States of America

It is clear that the regulatory measures introduced in their economy by the United States of America contributed to the development of the Asian financial crisis.

It is understandable as pressures like the state of the economy and political factors like the presidential elections all influence policy and decision-making on monetary and fiscal matters in the country.

As at January 30 1998 Asian equity losses since June 1997, excluding Japan, exceeded US\$ 700 billion and more than US\$ 30 billion has been lost by U.S. investors. (Greenspan, 1998:1-2)

In the case of the U.S.A there must be a shift in tactical and strategic thoughts on monetary policy. They are basically experiencing no inflation and interest rates are very low.

The low interest rates are boosting domestic demand but import growth continues unabated contributing to an ever-widening current account deficit probably about 4% of GDP by 2000. Greenspan, (1998:1)

The emphasis must be less on traditional considerations of inflation targeting and more on correcting imbalances in asset markets and current accounts.

This shift will be a major focus of monetary policy for financial markets over the next few years.

The authorities had taken cognisance of the warning factors and had increased the interest rates in the U.S.A recently. (1999)

4.2.2.2 Japan

Japan's economy had now been in a stagnation phase for the last eight years and the Asian crisis left the financial institutions with more than US\$ 500 billion in bad debts. (Szamoszegi, 1998:2-3).

The Japanese economy is producer-oriented, strictly controlled by the government and financed by banks. When their economy displayed healthy signs of high savings and large export surpluses they were flooding the markets with huge loans at low rates.

Other Asian countries followed and when the crisis swept through their economies they could not sustain the pressure.

Japan would have to relax the government controls and increase the efficiency of their banking and financial systems. Interest on loans must be market related and based on sound business principles, to minimise the occurrence of bad debts.

This must include the early identification and immediate closure of insolvent institutions, the disposing of problem loans and the adoption of international disclosure standards.

Japan was the driving force behind most of the Asian nations economies, therefore measures to promote growth by targeting particular industries to promote exports and to abolish the policy of protected domestic industries, must be introduced.

Japan is responsible for 60% of East Asia's GDP and had only managed an average of 1% in economic growth since 1990(Fischer, 1998:5)

4.2.3 Introduction of sound macro economic and international business principles and policies.

In the global arena it is critical that macro economic principles must be introduced (IMF) and followed to prevent more financial and economic disasters from raising its head, destroying nations economies as well as individual and corporate wealth.

The answer probably lies in the Keynesian principle that states that in the economic world experience shows that in the short run an increase in the demand for goods and services would increase real GDP, as the idle unemployed resources would be available for the production of new goods and services. (Haydam, 1997:55).

Following the above principle would result in full employment, and make goods and services available for exporting. This would strengthen the current account of the balance of payments.

The following policy principles must be followed:

- **Interest rates**

Banks must refrain from lending long and funding short especially if they experience low capital-asset ratios. This would ensure that for instance banks in Thailand again experience liquidity problems.

- **Exchange rates**

The countries in Asia learned a valuable lesson, that by pegging their rate of exchange eventually would lead to disaster. China for instance had to devalue their currency with 40% in 1994.

Exchange rates must be allowed to float freely as the rule of supply and demand dictates. The exchange rate must be allowed to float when problems arise, before it is using up too much foreign exchange reserves.

The most crucial policy requirement in the short term must be to avoid at all cost a new spiral of competitive currency depreciations.

- **Balance of payments and the current account of the balance of payments**

Countries must not be allowed to build up large current account deficits as this effectively mean that they are not in a position to repay their foreign debts. They are also paying large amounts of interest on outstanding loans in the foreign market.

- **Gross domestic product (GDP)**

A country's ability to service its external debt depends on the ability to generate foreign currency receipts .It is therefore critical that growth in their economies and production are stimulated to enable them to export more than what they import.

- **Inflation**

Inflation is evil and must be controlled to keep the countries competitive in the world markets. Exports must be increased to generate foreign currency reserves. The twin evils of macroeconomics are unemployment and inflation and must be controlled. The statistics listed in the preceding chapters for the Asian countries speak for itself and tell a tale of economic disaster and extreme hardship for the Asian nations.

4.2.4 The International Monetary Fund

The International Monetary Fund must be the factor that binds all the recommendations together in a unit.

The IMF must tighten macro economic policies in the initial stages when it becomes clear that a crisis is brewing in a country, in order to stabilise exchange rates to stop capital transfers and inflation

Tackle the key structural problems mainly in the financial institutions, which were the root causes of the crisis. Making these reforms more widespread by rehabilitating banks and to restore economic growth.

To tackle social and political problems by containing inflation and to recognise the needs of the poor in any rescue operation. This can be achieved by providing income support for the unemployed through subsidies for instance on food and health services.

Ensure that they analyse and interpret data and statistics correctly.

Three months before the crisis of 1997 the IMF praised Korea for their continued impressive macro economic performance.

Thailand's remarkable economic performance was applauded.

The IMF should not act as a credit rating agency and should not mislead the markets.

At the writing of this dissertation some of these measures had been introduced, quite successfully in some cases.

The Thailand currency (the baht) had appreciated by 11% by June 1998 from the level at the end of 1997 and the Korean currency (the won) had appreciated by 20%.

The literature sources that were used for this dissertation basically spelled out that an economy couldn't grow and prosper without inherent sound and proper macro economic principles and policies. We trust that this dissertation would assist central banks and governments in this process.

BIBLIOGRAPHY

- Blitzer, D.M. 1997. What's the Economy trying to tell you? New York: McGraw-Hill.
- Delhaise, P.F. 1998. Asia in Crisis, The Implosion of the Banking and Finance Systems. Singapore: John Wiley & Sons (Asia) Pte Ltd.
- Gray, H.P. 1987. International Economic Problems and Policies. Rutgers University New York: St. Martins Press Inc New York.
- Haydam, N. 1997. The Principles of Macroeconomics. Pretoria, J.L Van Schaik Academic Publishers.
- Husted, S & Melvin, M. 1993. International Economics. New York: Harper Collins College Publishers.
- Fourie, L.J. & Van Den Bogaerde, F. 1994, Basic Macro Economics. 1994 Fourth Edition: J.L. Van Schaik.
- Mallet, V. 1999. The Trouble with Tigers. London Harper Collins Publishers, United Kingdom.
- Pointdexter, J.C. 1976. Macroeconomics. North Carolina State University: The Dryden Press.
- Roubini, N. 1998. Chronology of the Asian Currency Crisis and its Global Contagion. Stern University Web Home Page.
- Roubini, N. 1998. What Caused Asia's Economic and Currency Crisis and its Global Contagion. Stern University Web Home Page.
- Roubini, N. 1998. An Introduction to Open Economy Macroeconomics, Currency Crisis and the Asian Crisis. Stern University Web Home Page.

Web Pages

Biggs, B., 1998. Can the U.S. Weather Asia's Storm?

Wall Street Journal January 5, 1998, p 1-8.

Dailami, M. and Haque, N. 1998. What Macroeconomic Policies are "Sound?"

Web Home Page World bank.

Driscoll, D.D. 1998. What is the International Monetary Fund?

International Monetary Fund's Web Home Page.

Fischer, S. 1998. The Asian Crisis, The IMF, and the Japanese Economy.

International Monetary Fund's Web Home Page (Speeches 1998), p1-7.

Greenspan, A. 1998. Testimony of Chairman Alan Greenspan, January 30, 1998.

Federal Reserve Board's Web Home Page.

Ito, T. and Portes, R. 1998. Dealing with the Asian Financial Crisis.

International Monetary Fund's Web Home Page (Research Department), p 1-6.

Nananukool, S. 1998. Learning from the Asian Crisis – An Insider View from Thailand.

Bangkok Thailand. Thammasat University Thailand. P 1-44.

Noland, M., Robinson, S. and Wang, S. 1999.

The Continuing Asian Financial Crisis: Global Adjustment and Trade.

Institute for International Economics Working Paper March 1999.

Norris, F. 1997. Stocks Fall 554 Points, Off 7%, Forcing Suspension in Trading.

The New York Times, October 28, 1997, p 1-4.

Sachs, J. 1997. IMF is a power unto itself.

Financial Time's Web Home Page.

Sachs, J. 1997. Personal View.

July 30 1997. Financial Time's Web Home Page.

Segal, P. 1998. Getting a Fix on Asia's Floating Currency Factor.
International Herald Tribune, p 1-4.

Sugisaki, S. 1999. Economic Crisis and recovery in Asia and its Implications
for the International Financial System.
IMF Web Home Page.

Szamosszegi, A.Z. 1998. How Asia Went from Boom to Gloom.
The Economic Strategy Institutes Web Home Page.

Wolf, C. 1998. Too Much Government Control.
Wall Street Journal, February 4, 1998, p 1-3.

Yellen, J. 1998. Lessons from the Asian Crisis.
Web Page The Whitehouse Government U.S.A.

ANNEXURE A

(This chronology of the financial crisis was based on information from several news sources (Reuters, Wall Street Journal, New York Times, CNNfn and Financial Times) as detailed in (Roubini, 1998:p1-51)

Chronological developments of the Asian crisis for 1997: -

January 1997- Hanbo Steel the first major Korean Company to go insolvent in a decade was liquidated with a total debt of US\$6 billion debt burden.

February 5 1997 –Samprasong became the first major company in Thailand to default on foreign debt repayments.

March 1997-Sammi Steel another Korean Corporation failed to meet corporate debt payments.

May 14-15 1997-Thailand's currency the baht was attacked by speculators after it was allowed to float, caused by the slow down of the economy and political instability.

The Philippines was also effected and the central bank raised the overnight interest rate to 13% and they dumped some dollars in the market.

May 1997-Japanese officials, concerned about the decline of the yen, indicated that they were considering raising the interest rates. This was one of the first signs of the Asian crisis. Global investors started to sell Southeast Asian currencies, creating a downward trend in the currencies and stock markets.

May 23 1997-Efforts to save Finance One, Thailand's largest finance company, failed.

June 19 1997- Thailand's Finance Minister resigned and the Prime Minister declared that the baht would never be devalued.

June 27 1997-Central bank of Thailand instructed 16 cash-strapped finance companies to draft merger or consolidation plans. Their operations were suspended in the mean time.

July 1997-Korea's third largest car manufacturer Kia, requested emergency loans due to credit and cash flow problems.

July 2 1997-Devaluation of the baht to 28.80 to the dollar and the Bank of Thailand requested technical assistance from the IMF (International Monetary Fund).

The Philippine's currency the peso was heavily supported by the central bank.

July 8 1997-Malaysia's central bank had to do the same for the ringgit.

- July 11 1997-After the Philippines abolished attempts to defend the peso it lost 12% of its value in a few hours.
- July 14 1997-Malaysia's central bank stopped defending the ringgit.
- July 24 1997-The ringgit deteriorated to 2.6530 to the dollar.
- July 25 1997-Thailand and Malaysia requested Japan to assist in creating a regional rescue fund.
- July 28 1997-Thailand requested the IMF to step in to resolve the crisis.
- August 8 1997-Thailand announced a complete restructuring of the finance sector and the central bank suspended 8 finance companies.
- August 11 1997-The IMF announced a rescue package for Thailand, which included loans of US\$16 billion from the IMF and other Asian countries.
- August 13 1997-Indonesia's central bank had to defend the rupiah.
- August 14 1997-The central bank of Indonesia allowed the rupiah to float.
- August 15 1997-Speculators shifted their attacks to the Hong Kong dollar which forced the central bank of Hong Kong to increase overnight interest rates by 150 basis points.
- August 20 1997-The IMF approved a US\$3.9 billion credit package for Thailand. The total package totaled US\$16.7 billion as a further US\$500 was added by Brunei, bringing it to a total of US\$17.2 billion.
- August 21 1997-IMF Managing Director, Michel Camdessus states "The worst of the crisis is behind us".
- Sept. 4 1997-Malaysian ringgit deteriorated further and broke through the 3.00 to the U.S. dollar resistance level.
- October 1 1997-Malaysian ringgit traded at level of 3.4080 to the dollar.
- October 8 1997-Indonesia officially requested assistance from the IMF.
- October 17 1997-Malaysia presented a budget intended to decrease the current deficit, to stop the country from sliding into a recession.
- October 20-23 1997-The Hong Kong stock markets suffered its heaviest pounding ever, losing nearly a quarter of its value in four days. The Heng Seng index (stock market indicator) deteriorated with 23.34 % over this period.
- October 27 1997-The Heng Seng index lost another 5.80%. On Wall Street the Dow Jones Industrial average recorded its single-biggest loss ever, falling by 554.26 points or 7.18%.

October 30 1997-Speculators shifted their attention to markets outside Asia, causing heavy losses in Brazil, Argentina and Mexico.

October 31 1997-concerns over the fate of the financial markets dominated the news in the United States.

Indonesia received a \$23 billion financial support package from the IMF.

November 3 1997-Asian stock markets improved as the financial aid package for Indonesia helped to restore calm to the region.

November 6 1997-The Bank of Korea once again intervened to halt the local currency's slide against the dollar.

November 7 1997-Asian stocks nose-dived as currency fears shook South Korea and high interest rates and falling property prices rattled Hong Kong. South Korea the world's 11th largest economy and the prospect of a financial crisis had put everybody on edge.

November 12 1997-Currency and stock markets nervousness resulted in steep declines in Japan and Hong Kong.

November 18 1997-The failure to pass financial reform bills in Korea indicated that the IMF would be required to rescue Korea. Asian currencies were under pressure. (Thai baht lost 3.5%, the Philippine peso 2.9% and Malaysian ringgit 2.8%.)

November 24 1997-Bad news for Asian economies came from two sources and again caused panic in the world markets. First, Yamaichi Securities (debt of \$23.6 billion), Japan's fourth largest brokerage firm announced that they were closing their doors. Secondly Korea announced that they would request assistance from the IMF for their troubled economy.

November 25 1997- the yen tumbled to its lowest level against the dollar in more than 5 years.

December 2 1997- Federal Reserve chairman Alan Greenspan said the financial crisis in Asia would subside and would leave the nations with stronger economies.

December 3 1997- South Korea's delay in signing a loan agreement with the IMF again caused the Asian markets to spiral downwards.

December 4 1997-Package of U.S\$57 billion in aid to South Korea was announced by the IMF, which helped to restore some stability to the markets.

December 8 1997-After a few days of stability was experienced in the markets problems again appeared in South Korea with the takeover by the government of a major bank.

An USA economist expressed concerns that the \$57 billion bailout package would not be sufficient.

December 9 1997-Rumours that Indonesia's President Suharto was gravely ill swept the Southeast Asian battered currency markets, causing the rupiah to fall dramatically.

It was evident that 1997 was a troubled year for Asia, probably the most since the war, and indeed for the entire globe, and it was clear that the developments in these parts had a severe effect on the international currency and stock markets