

# Essay A

## A Report on the Asian Meltdown (Question #2)

Amaris Ayala ([aayala@mit.edu](mailto:aayala@mit.edu))  
O. Mac Chinsomboon ([omac@mit.edu](mailto:omac@mit.edu))  
Tomoko Yano ([t\\_yano@mit.edu](mailto:t_yano@mit.edu))

15.012 Macroeconomics  
Friday, April 16, 1999

*An online version is available at [www.chinsomboon.com/omac/reports](http://www.chinsomboon.com/omac/reports)*

The 'Asian Flu', as it was called, rapidly spread through the emerging markets of Asia after the Thai baht was devalued in July 1997, causing stock markets and currencies to tumble, property bubbles to burst, followed by banking and manufacturing woes. Some of the countries and currencies affected as a result of the ensuing contagion were those that often regarded as part of the Asian miracle: Hong Kong, Singapore, Taiwan and Korea. The tiger-cub (also called the ASEAN-4) economies of Thailand, Malaysia, Indonesia and the Philippines were directly in the line of fire. From sustained growth at phenomenal rates, the region's economies collapsed in a way that no one predicted and has had a profound and prolonged effect on both emerging and developed markets elsewhere in the world. The economies of Japan, China, and India are completely different stories all together and are not considered in this discussion.

At the time, a slowdown in export growth heightened investor concern about whether the large current account deficits they had been running, ranging from less than 4% of gross domestic product in Indonesia to nearly 8% in Thailand, were sustainable. This then produced a reversal of the large-scale capital inflows upon which these economies depended.

With regards to recovery of the tiger-cub, Indonesia still has a tangled political web that needs to be resolved. Even though Malaysia has halted its downward spiral, its own political uncertainty to anemic foreign investment still threatens to postpone recovery. Before the crisis, the Philippines was in a recession and thus weren't considerably affected by the Asian flu.

Considering all the activity of the tiger-cubs since June 1997, Thailand seems poised as having done the best job of stabilizing their economy. The goal is sustainable recovery, and not quick fix 'band-aid'. In Thailand, currencies have stabilized, interest rates have fallen, and output and

demand may at last be bottoming out. An economic turnaround requires rescheduling the large short-term foreign liabilities of Thai firms, restoring high rates of export growth to finance foreign liabilities, and extensively recapitalizing the banking system.

After the crisis, the IMF was invited into Thailand and prescribed standard contractionary macroeconomic adjustment policies, monetary and fiscal policy. The IMF required tight fiscal policy, despite the fact the major underlying causes for the current account deficits did not lie in the government sector. The IMF also required financial system restructuring. In Thailand, the IMF de facto required liquidation of 56 finance companies out of a total of 91. So the financial system restructuring is now underway, but this has had a tremendous contractionary impact on the economy. After shrinking by 7-8% in 1998, Thailand's economy should stop contracting by the second half of this year, if not sooner.

In October 1997, a new constitution was passed which aimed at stamping out political corruption that many Thais blame for the nation's worst economic crisis in decades. While Chuan Leekpai, Thailand's Prime Minister, now has the power under the revised constitution to deal with abuses of public office, it appears that he has taken the view that reforms can wait until the next election, and that restoring the economy must take precedence over anti-corruption reforms. However, as public sentiment popularizes the call to the government to put an end to corruption, postponements of reforms cannot continue to be ignored.

The Thai government has increasingly come to see privatization of state enterprises as a means of achieving some of its objectives. In September 1998, the cabinet released a schedule for

privatizing key state enterprises, with public monopolies in energy, transport, telecommunications and water services to be dismantled progressively and the agencies responsible either “corporatized” as competing businesses or sold off. At least BT600bn is expected to be raised from the sale of public assets, providing the government with much needed revenue. There have also been changes to foreign ownership rules aimed to ease share-holding restrictions and regulatory hurdles, long held to be main disincentives from the viewpoint of foreign investors. Success of these initiatives will have a critical bearing on the government’s ability to restore offshore confidence in the shattered economy and acquire the funding and technology needed for restructuring. About 60 major deals involving foreign firms have already been negotiated on the basis of the promised concessions, and several hundred others are expected to be finalized by mid-1999.

Thailand seems to have been successful in dealing with “capital account crisis” as opposed to current account crisis. An IMF \$ 17billion rescue package in August 1997 was more than 10 times of Thai IMF quota to provide liquidity. The conditions of the package include low inflation, high interest rate, and budget balance.

The abruptness of a swing in capital outflow was observed in 1997 in the size equal to 20.3% of GDP. The sudden shortage of foreign currency reserve triggered floating currency. The currency has been stabilized since mid 1998 with political stability, prospects in financial system, increasing foreign investment. In order to stimulate the domestic economy, it lowered Prime Rate in February 1999 to 7.0%, first time after the crisis. Domestic demand has finally stopped weakening evidenced partly by the increased auto sales since October 1998. The trade balance

turned into a surplus in 1998 growing every quarter in 1998. The government seems to have been successful despite it faces naïve situation in domestic politics.

In order to win confidence in foreigners, especially given the size of the country's debt problems, the government passed new transparent bankruptcy and foreclosure laws. Having such frameworks ready to implement, and conducted a few auctions of assets with FRA with improving discount from 82% to 78%, Thailand is in a better position than other neighboring countries to solve financial problems while attracting foreign investment. Additionally, Thai culture is more receptive to foreigners than many other Asian cultures.

The government has claimed that it is on the stage of stimulating its economy rather than recovery and that it managed to make a deal with the IMF to run a budget deficit of 6% in March 1999, 1 % higher than the last revision, show that Thailand is one step ahead of the other tiger-cubs.

Looking forward, as hard economic scrutiny suggests that while a rebound may now be in focus, real recovery lies a long way off. Overall, the next two years will continue to be difficult for Thailand and the rest of Asia both economically and politically. Only in this way would Asia be in a position to capitalize on the benefits generated by the currency devaluation, and to regain the growth momentum. Few doubt that Asia's recovery is a matter of "when," not "if." And even if the region does not resume it's former growth rates, it will nevertheless be one of the world's major trading regions.

**References:**

- Investment Dealers Digest. 11. 1999 Feb 15.  
Far Eastern Economic Review. 162(4): 46. 1999 Jan 28.  
Barclays Economic Review. 24-25. 1999 First Quarter.  
Economist. 350(8106): 70-71. 1999 Feb 13.  
Far Eastern Economic Review. 162(9): 45. 1999 Mar 4.