Thai Financial Crisis

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Outline

- Thai Financial Crisis: Overview
- Causes of Thai Financial Crisis
- Impacts of the Crisis
- Recovery Strategies
- The Aftermath
- Conclusion

Thai Financial Crisis:

Overview

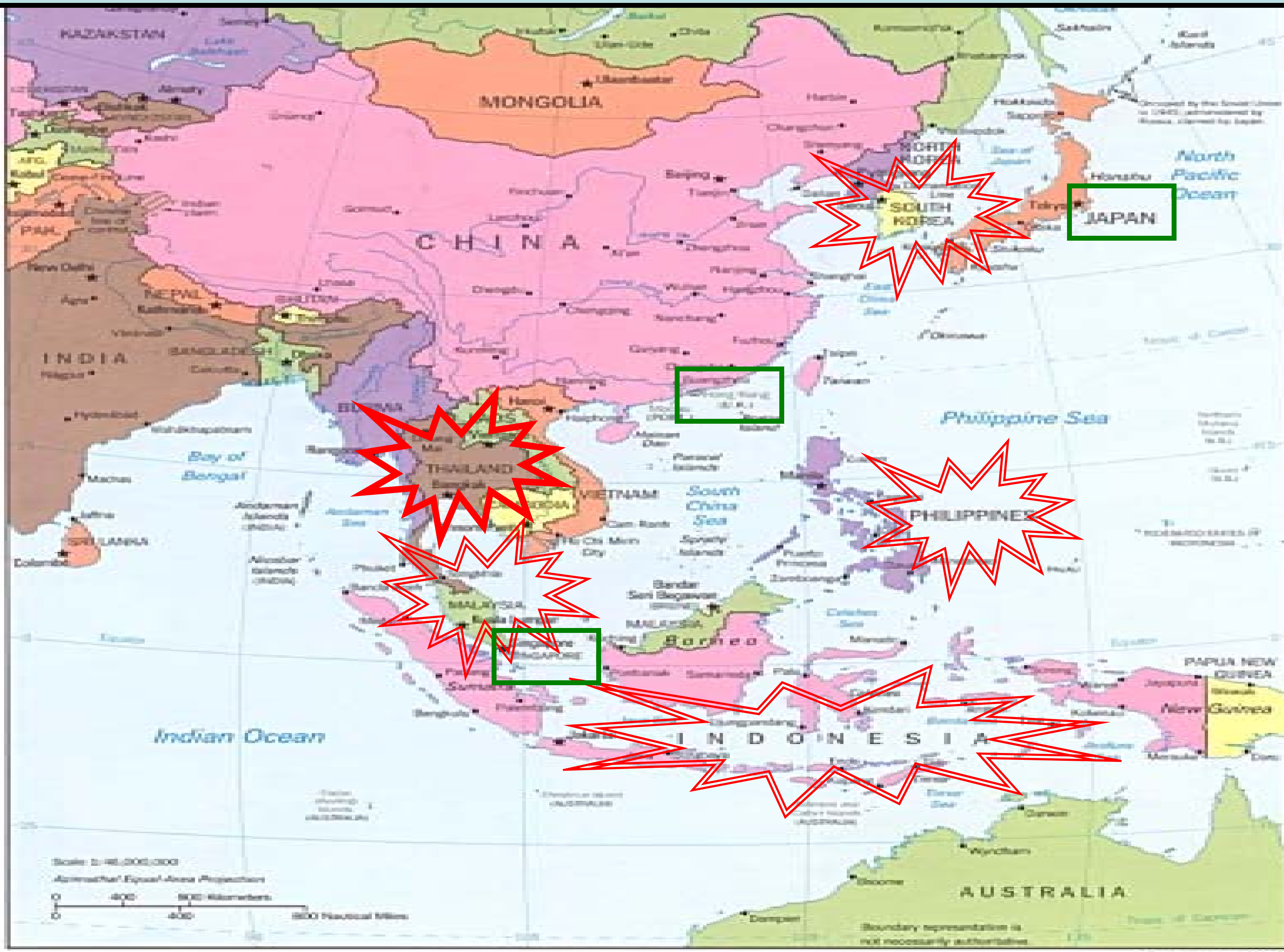
Thai Financial Crisis: Overview

1988-1995	Thai economic boom periods but with chronic CA deficit, weak financial systems and overvalued domestic currency.
May, 1997	Foreign speculators attack the baht. Thailand spends 90% of foreign reserves to defend the baht against speculative attack.
July 2, 1997	Thailand changes its exchange rate system from fixed exchange rate to managed-floated. At the same time, the Thai government also requests "technical assistance" from the IMF.
Aug. 5, 1997	Thailand receives a $17 billion loan from the IMF and agrees to adopt tough economic measures in return.

Thai Financial Crisis: Overview

Dec. 8, 1997	56 insolvent finance companies and one commercial bank are closed. The remaining financial institutions suffer from financial panic.
Dec 31, 1997	The index of Thailand’s stock market (The SET), ultimately declines from 787 in January 1997 to a low of 337 in December of that year. Thai economy turns into recession.
1997-1998	Thai crisis spreads quickly from Thailand to other countries in the region including Malaysia, Indonesia, Philippines , South Korea and Japan. This leads to the Asian Crisis.

Map of the Asian Crisis



Causes of

Thai Financial Crisis

From the Boom…

The Causes of Economic Boom in Thailand

Since early 1990s, Thai economy had attracted massive volumes of capital inflow from aboard due to

- Its accommodating economic policies
- Healthy-looking conditions
- The recession of European Economy
- The stagflation of Japanese economy

The Causes of Economic Boom in Thailand

Thai Exchange Rate Regime before the crisis:

The exchange rate fixed to basket currency , especially US dollar. The baht had fluctuated very narrowly between 24.91-25.59 baht per dollar Thai Baht under fixed ER.ppt

To the Bust…

The Causes of Thai Financial Crisis

The obvious causes that are broadly discussed include:

- Weaknesses in domestic macro-economic fundamentals
- Weakness in the Financial System
- Financial liberalization and the volatile international capital flows
- Speculative Attacks and the Floatation of Baht
- Unstable political and social institutions

The Causes of Thai Financial Crisis

1. Weaknesses in domestic macro-economic fundamentals

Current Account Deficit

Thailand had had persistent current account deficit ranging from -5.08 to -8.10 % of GDP lowest among the other nations for most of the time in the sample

Trade Deficit before crisis.ppt

The main reasons of current account deficit as follow:

1. The real appreciation of Thai baht
2. A large increase in real wage

The Causes of Thai Financial Crisis

2.Weakness in the Financial System

2.1 Structure of the Financial System in Thailand

- Intermediaries for channeling foreign capital into domestic economy.

2.2 Asymmetric Information: Adverse Selection and Moral Hazard

- Adverse Selection: Tendency of lending money to investors ,who are high-risk seekers.
- Moral Hazard : Lending money recklessly without a prudent procedure of lending contraction and monitoring

The Causes of Thai Financial Crisis

3. Financial Liberalization and the Capital Flows

Why Thailand become attractive to a magnitude of capital inflow?

Why financial liberalization and capital inflows are key implication of the crisis?

4. Speculative Attacks and the Floatation of Baht

To defend the value of baht from speculative attack,

- Loss 4 billion dollars of the country's foreign reserve

  International Reserves during 1990-1999.ppt

- Switch exchange rate regime

  Fixed Exchange Rate to Floating Exchange Rate

  Thai Baht under fixed and floating exchange rate.ppt

The Causes of Thai Financial Crisis

5. Political Institutions and the Crisis

Politics is one of the important factors of Thai financial crisis.

- Misconducts of financial institutions.
- The delay in policy implementation.
- The unstable political regime.

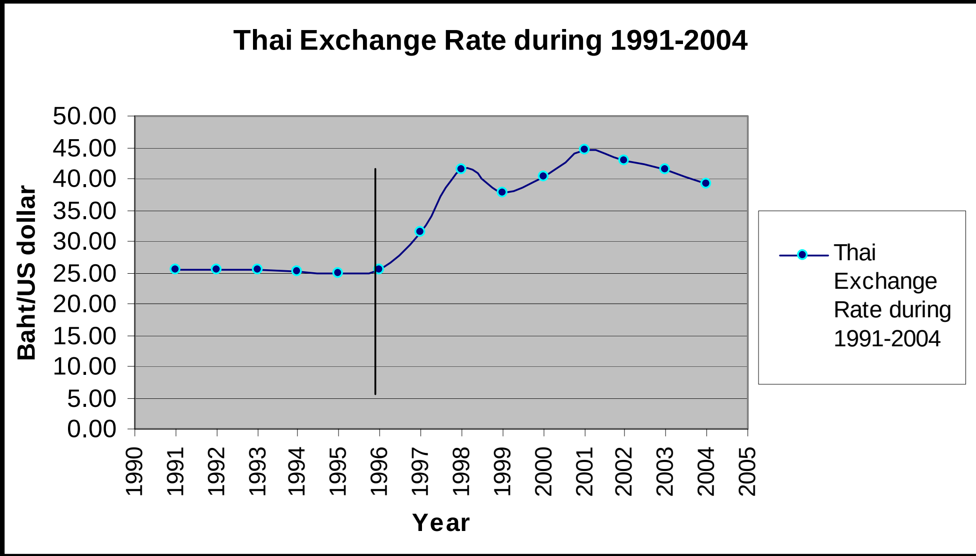
Impacts of

Thai Financial Crisis

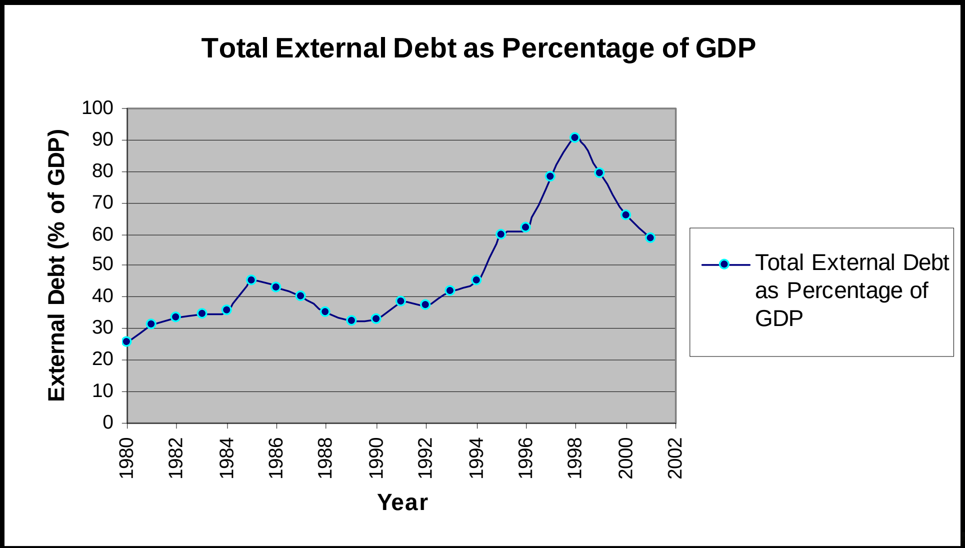
Impacts of Thai financial crisis

In Thailand:

- Highly depreciated baht because the lack of confidence in Thai economy



- Massive increase in external debt burden due to high dependency on foreign capital and deeply depreciated baht.



Impacts of Thai financial crisis

In Thailand:

- Financial institution crisis
  - Collapse of insolvent financial institutons
  - Remaining financial institutions suffering from financial panic
  - Liquidity crunch
  - Rising NPLs

<Vicious cycle>

The non performing loan as a percentage of total loans of financial system	
End 1990	9.7
End 1995	7.7
End 1996	13.0
End 1997	22.6
June 1998	35.9
October 1998	46.0
September 1999	47.0
February 2000	38.1

Impacts of Thai financial crisis

In Thailand:

- Stock Market crisis

  Portfolio investment drawn out, stock market crash (SET index goes down over 70%).

- Economic recessions

	1996	1997	1998	1999
Real GDP Growth (%)	5.9	-1.4	-10.3	4.4
GDP ($bln)	182	151	112	123
Per capita GDP ($PPP*)	6741	6580	5817	6094
Unemployment (%)	3.5	3.2	7.3	6.2
Export ($bln)	56.0	58.4	54.5	58.5
Import ($bln)	72.2	63.3	42.4	49.9
CA Balance ($bln)	-6.2	-4.9	+2.1	+8.6

C↓ -- no in Thai economy and rising unemployment rate
I ↓ -- no confidence in Thai economy and liquidity crunch
G↓ -- tight budget policy
TB↑ -- import decreases faster than export in 1998

Impacts of Thai financial crisis

In other Asian countries:

Impact of Thai financial crisis on Asian countries.doc

- Depreciation of exchange rates
- Financial institution crises
- Stock markets collapses
- Economic recessions
- Political instabilities

“The Asian Crisis”

Impacts of Thai financial crisis

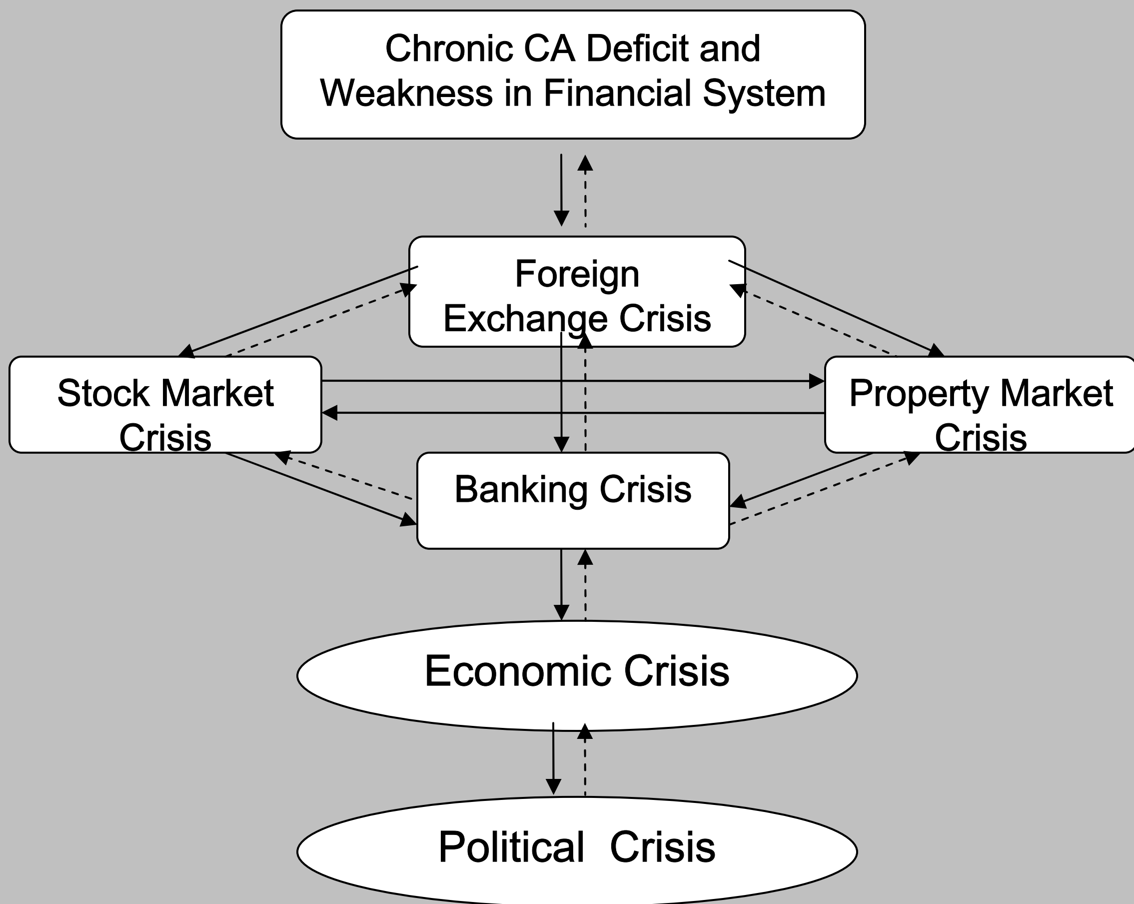
In other Asian countries:

Why Thai financial crisis becomes Asian Crisis:

- International investors' lack of confidence as they think that similar problems (chronic current account deficit and weak financial system) also occur in other countries such as Malaysia, Indonesia, Philippines and South Korea.

- For other countries with better financial structure such as Japan, Hong Kong and Singapore, they suffer because of contagious effects.

Impacts of the crisis



Recovery Strategies: IMF and Its Roles in Thai Economic Crisis

IMF Assistance to Thailand During the Crisis

Financial Support:

- IMF support = USD 4 Billion
- Bilateral and Multilateral Support

  = USD 13.2 Billion
- Total = USD 17.2 Billion

Policy Package Suggested by IMF

- implement contractionary fiscal policies
  - $\downarrow$G $\uparrow$ T
  - encourage privatization of SOEs
  - Fiscal Targeting on 1% of GDP budget surplus

This aimed to free-up resource to help financial restructuring and support the improvement of current account

- adopt new exchange rate policy to be managed float
- implement the contractionary monetary policies

  - ↑ domestic interest rate

This aimed to

- stabilize the exchange rate
- high rate of rollover the short-term foreign debt
- stop further capital outflows as well as regain the market confidence during the shock
- turn around the foreign reserve position

- adopting financial sector restructuring
  - Liquidation of 56 insolvent finance companies
  - Recapitalization of banking system
  - Issuance of Baht 500 billion in bonds to help Financial Institution Development Fund
  - Stringent rules and regulations on banking system
  - Corporate debt restructuring
  - Giving full guarantee of all depositors and creditors

Financial Sector Restructuring (cont'd)

This policy aimed to strengthen the banking system by closing possible loopholes on facilitating new credits by hurting as least people as possible

Results

- Tight Fiscal Policies
  - no fiscal stimulus on social safety net
  - arguments on privatization
  - time and administrative lag on fiscal policies
- Tight Monetary Policies
  - unable to stop capital outflows due to lack of confidence
  - should aim more to control domestic inflation

- Financial Sector Restructuring

  - stringent regulation in too short time frame creates shock in business sector → credit crunch and more NPLs creation in the economy

After 1999

The rapid spread of the Asian crisis and chronic recession bringing a larger-than-expected depreciation of the Baht, a sharp economic downturn and adverse regional economic developments–warranted revisions to the Thai program. The revisions were undertaken through a series of program reviews conducted in close consultation with the Thai authorities.

Adjustment of IMF Policies

1. Further Comprehensive Financial and Corporate Debt Restructuring

   - encouragement of commercial bank and financial institution consolidation

   - creation of asset management corporations

   - More regulation on new bankruptcy law and foreclosure

2. Monetary Policies

- reduction of interest rate as exchange rate was relatively stable compared to the previous period

3. Fiscal Policies

- change from tight to expansionary fiscal policies

by a) Japanese Aid (Miyazawa Project)

b) Tax rate reduction

c) Oil price intervention

d) Continuing SOE privatization

5. Other government measures and private sector assistance

- Liquidity accumulation in the economy
  - Industrial Finance Corporation of Thailand (IFCT)
  - SME Bank
  - EXIM Bank
  - BoT cooperated with strong commercial banks
- Foreign Reserve Accumulation by Private Sector
  - Dollar and gold donation raised by Mahabua Monk

The Aftermath

Lessons from the crisis

- Avoid asset inflation that boosts expansion in bubble economy.
- Degree of openness and timing of financial sector liberalization.
- Management on foreign investment - Quantity VS Quality.
- External Finance Dependency VS self-reliance

Lessons from the crisis

- Central bank restructuring + tighten controls over bank and financial institutions.
- Significance roles of credibility in destine an open economy.
- Economics performance → dependency on political stability.
- Maturity and currency mismatch of foreign loans → increased country's vulnerability.

Current Situation

- In July 2003, Thailand repaid its final US$1.51bn batch of outstanding debts from US$17.2bn IMF bailout package. The repayment came two years ahead of schedule.
- Real GDP growth reached a strong 6.7% in 2003, leaded by domestic consumption and export.
- Expansionary economic policy, coupled with the expected upturn in the global economy, are expected to drive growth higher in 2004 to an average of 7.7%.
- The economy is expected to slow to a still respectable 4.9% in 2005, owing to some upward movement in interest rates and rising concern about the government's off-budge liabilities.

GDP by expenditure

Bt bln at constant 1996 prices; % change year on year in brackets

	2002a	2003a	2004b	2005b
Private consumption	1,766.9 (4.9)	1,878.7 (6.3)	2,014.6 (7.2)	2,132.1 (5.8)
Public consumption	291.7 (2.5)	295.3 (1.2)	317.5 (7.5)	350.6 (10.4)
Gross fixed investment	643.3 (6.5)	718.5 (11.7)	851.6 (18.5)	931.1 (9.3)
Exports of goods & services	2,093.5 (12.1)	2,228.5 (6.5)	2,409.5 (6.5)	2,5550.0 (5.8)
Imports of goods & services	1,610.0 (13.6)	1,728.3 (7.3)	1,900.6 (10.0)	2,038.5 (7.3)
Foreign balance	483.5(1.1)	500.2 (0.5)	511.4 (0.5)	511.4 (0.1)
GDP	3,239.0 (5.4)	3,457.4 (6.7)	3,724.6 (7.7)	3,954.3 (6.2)

Current Situation

- Household consumption is currently at an all-time high as a results of high levels of consumer confidence.
- Investment growth is recovering, primarily in the form of property development.
- Export growth will rise, but import growth is expected to grow at a faster pace.
- *current account* has recorded sizeable *surpluses*, comprises of an increased in international reserves which reached US$33.0 billion (6.5 months import cover).

Current Situation

- The ***appreciation of the baht*** with the US dollar exchange rate. (standing at BT39.3: US$1 on October 28th compared with Bt41.7: US$1 at end-June 2003).
- ***Inflationary*** pressures will remain ***low***, partly owing to a stable and strong baht.
- ***Unemployment has fallen*** continuously from 4.4% in 1998 to 2.4% in 2002.

	2002a	2003a	2004b	2005b
Consumer price inflation	0.6	1.8	2.7	2.6
Unemployment rate	2.4	2.2	1.7	1.4
Exchange rate Bt:US$	43.0	41.5	39.7	40.1

a Actual. b Economist Intelligence Unit forecasts. c Economist Intelligence Unit estimates.
d Derived using government finance and GDP data for fiscal years ending September 30th.

Government initiatives have played a significant role in driving the economy

- On budget initiatives include the Village Fund and Farmers' Debt Suspension.
- Establish a "One Village, One Product" scheme in order to promote small-scale industries in rural areas.
- Off budget initiatives include the People's Bank and the Government Housing Bank's Mortgages for public servants

Fiscal Policy

- Expansionary fiscal policy as a cushion for global slowdown
- Forecasting a *balanced budget* in fiscal year 2003/04 and expect the budget deficit to ease to just 0.7% of GDP in 2004/05.b
- Policies to boost investment includes tax incentives to increase foreign investment in bonds and the creation of two equity funds to attract domestic investors.
- Thailand is scheduled to scrap all export subsidies by the end of 2005 under its WTO agreement, and import taxes will also be cut across the board.

Monetary Policy

- After the IMF program, *the central bank announced the adoption of inflation targeting in May 2000.*
- 14-day repurchase rate is lowered by 50 basis points to 1.25%.
- Given minimal inflationary pressure and the strength of the baht, interest rates are expected to remain on hold until late 2004, when Thai rates will be forced to move in line with rising international interest rates.

Trade Policy

- Aimed at export growth, including diversification of markets and higher-valued products.
- Thai export sector benefit from strong Chinese growth and regional trade (expected to average 8.4% in 2004-05).
- Promoting agricultural liberalization.

Forecast summary

	2002a	2003a	2004b	2005b
Government balance (% of GDP)	-1.5	0.3	0.6	-0.1
Exports of goods fob (US$ bn)	66.8	78.4	89.4	96.9
Imports of goods fob (US$ bn)	57.0	66.7	78.9	86.7
Current-account balance (US$ bn)	7.7	9.4	8.6	8.3
Current-account balance (% of GDP)	6.0	6.7	5.3	4.8
Real GDP growth	5.4	6.7	7.7	6.2
External debt (year-end; US$ bn)	60.1	53.7	53.2	50.1

Conclusion

Conclusion

- GDP growth alone is not enough for sustainable economic development
- Domestic financial system must be strong and consistent.
- International financial system now links every country together.
- Financial liberalization should be orderly and gradual. Government intervention may be required to overcome the market failure..
- IMF’s standard recipe cannot solve problems of every country.

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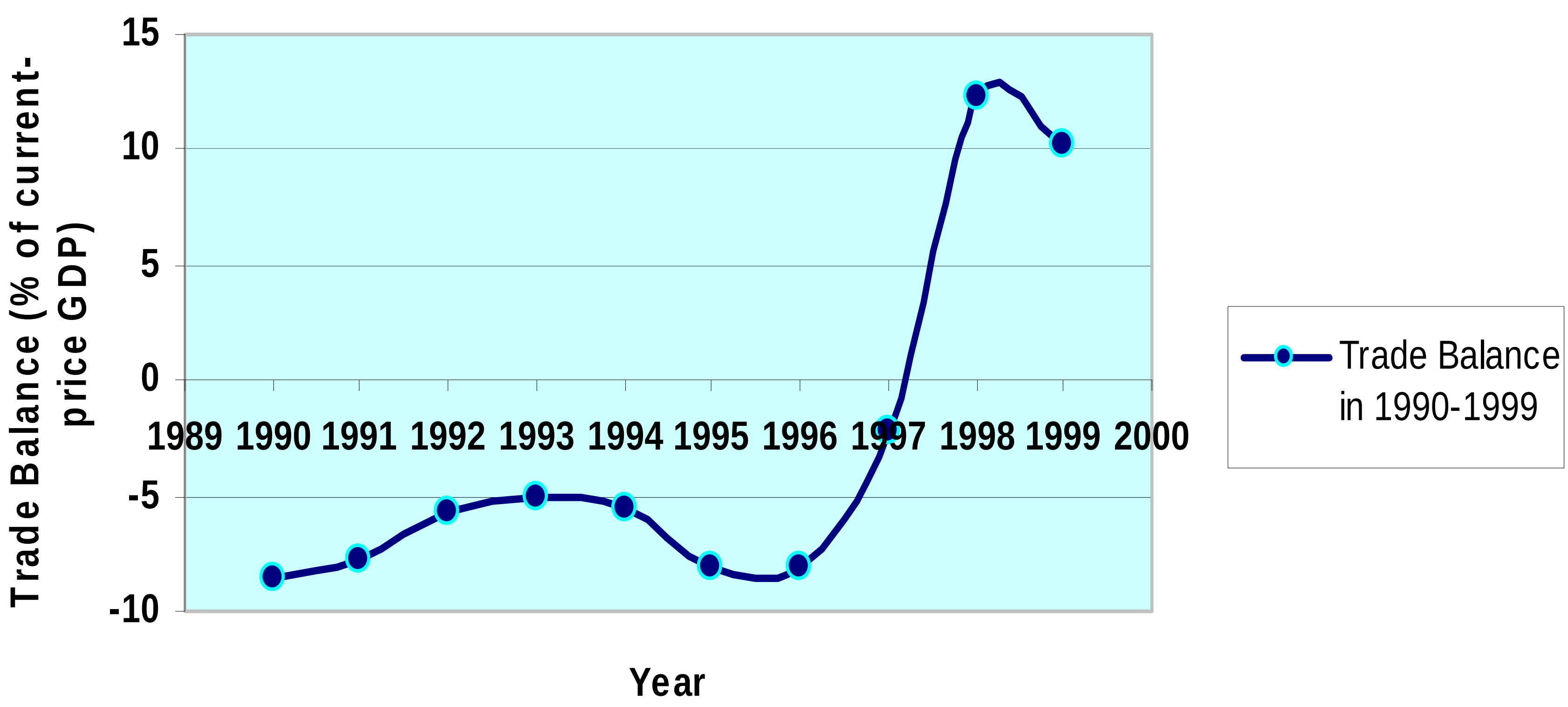
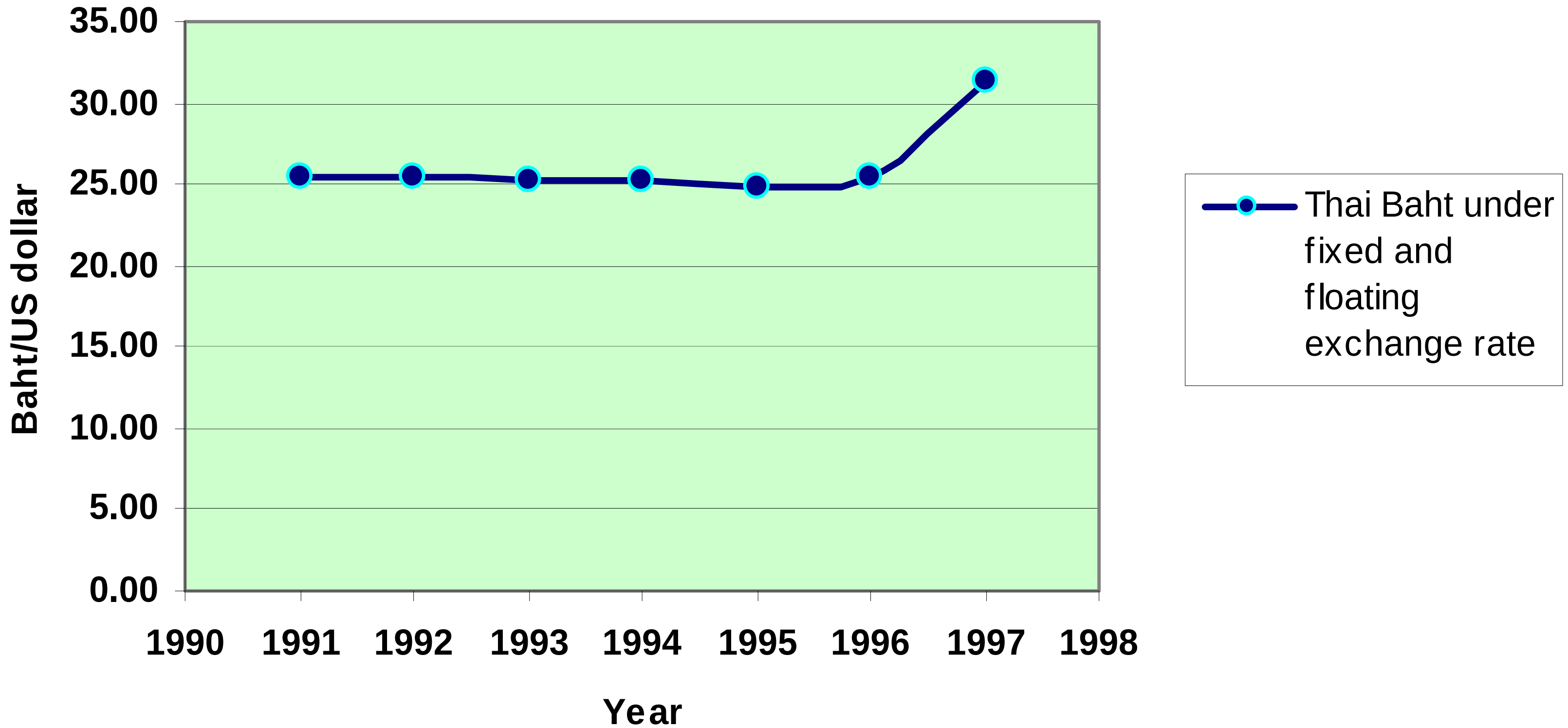
The End

Accessories

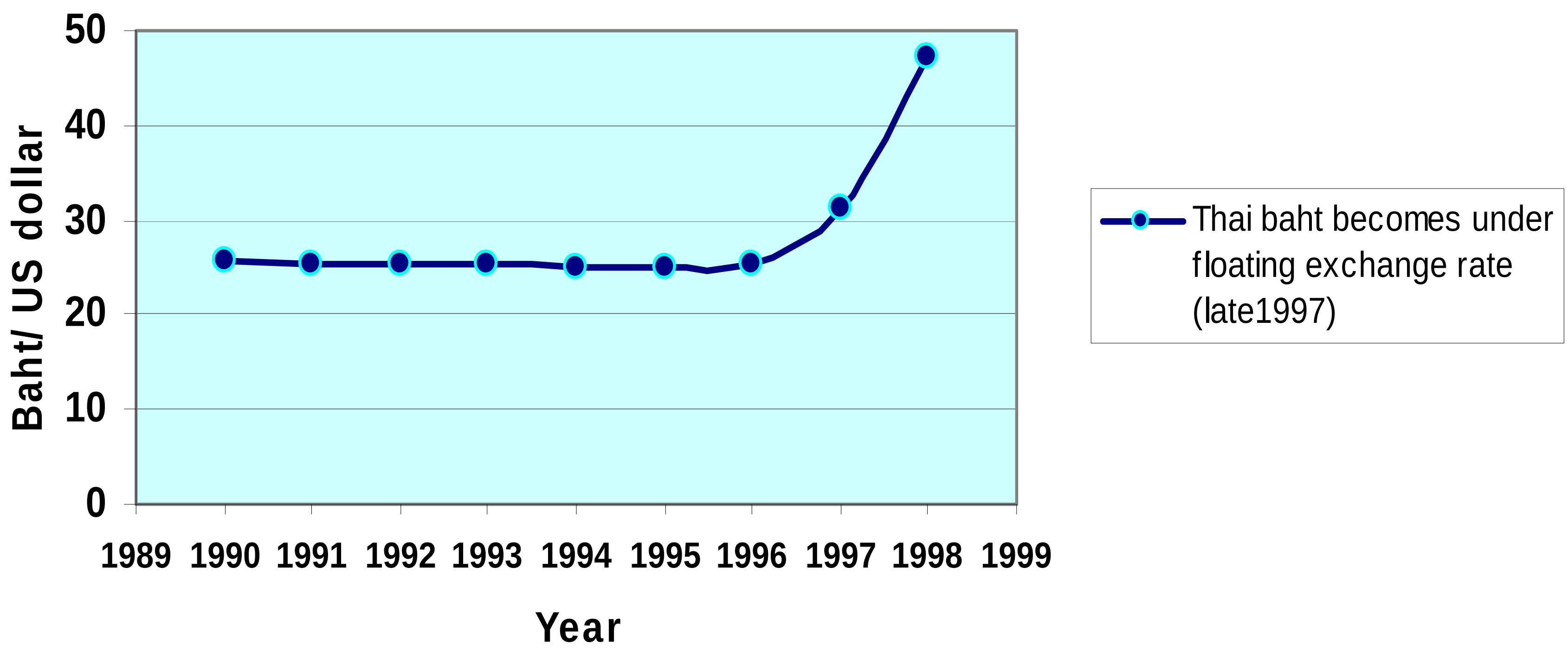
Trade Balance in 1990-1999

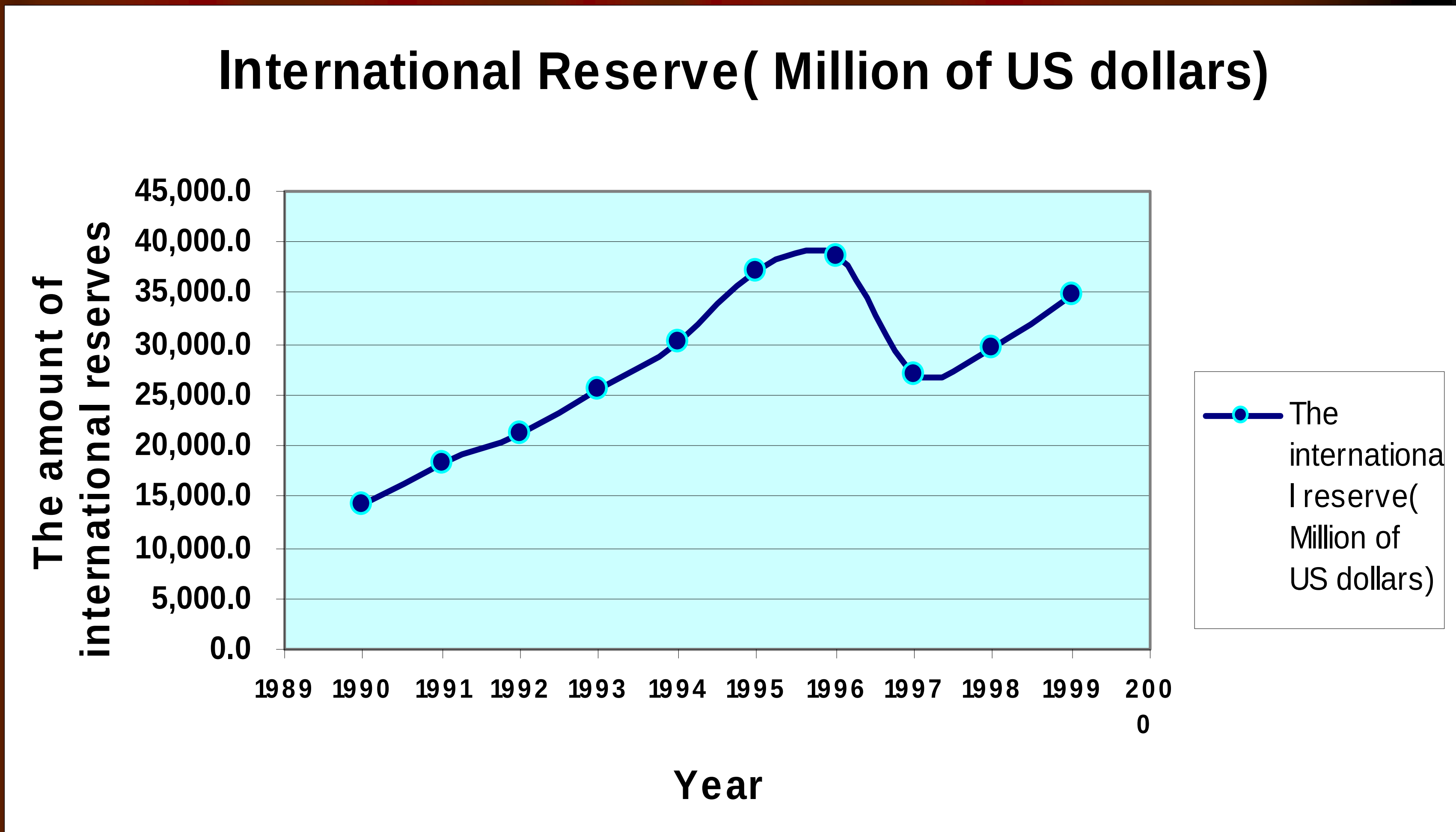


Thai Baht Under Fixed Exchange Rate



Thai Baht Under Fixed and Floating Exchange Rate




International Reserve(Million of US dollars)
The amount of international reserves
45,000.0
40,000.0
35,000.0
30,000.0
25,000.0
20,000.0
15,000.0
10,000.0
5,000.0
0.0
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
Year
The international reserve(Million of US dollars)

Depreciation of Asian Exchange Rates (per US$)

Currency	June 1997	Lowest Rate	Lowest Month	Depreciation
Indonesian Rupiah	2427.9	13,995.9	July 1998	-83%
Thai Baht	24.318	52.551	January 1998	-53%
South Korean Won	887.03	1693.65	January 1998	-47%
Malaysian Ringgit	2.5157	4.1941	January 1998	-42%
Philippine Peso	26.355	43.657	September 1998	-40%
Japanese Yen	114.32	144.59	August 1998	-21%
Taiwan Dollar	27.882	34.699	August 1998	-20%
Singapore Dollar	1.4264	1.7566	Auguest 1998	-19%

Collapse of Stock Markets

	Highest Pre-Crisis Date	LowestDate	Amount Depreciated
Kuala Lumpur Composite	25 February 1997	1 September 1998	-79%
Bangkok SET	22 January 1997	4 September 1998	-76%
Philippines SE Composite	3 February 1997	11 September 1998	-67%
Jakarta SE Composite	8 July 1997	21 September 1998	-65%
Korea SE Composite (KOSPI)	17 June 1997	16 June 1998	-65%
Straits Times Index	17 February 1997	4 September 1998	-72%
Hang Seng	7 August 1997	13 August 1998	-60%
Taiwan SE Weighted	26 August 1997	5 February 1999	-46%
Nikkei Average	16 June 1997	9 October 1998	-38%

Number of Quarters in Recession, I Q 1997-2Q 2000

Thailand	6
Japan	6
Hong Kong	5
Indonesia	5
Malaysia	5
South Korea	4
Philippines	3
Singapore	2