Lessons from Crises and Directions of East Asian Economic and Financial Cooperation

by

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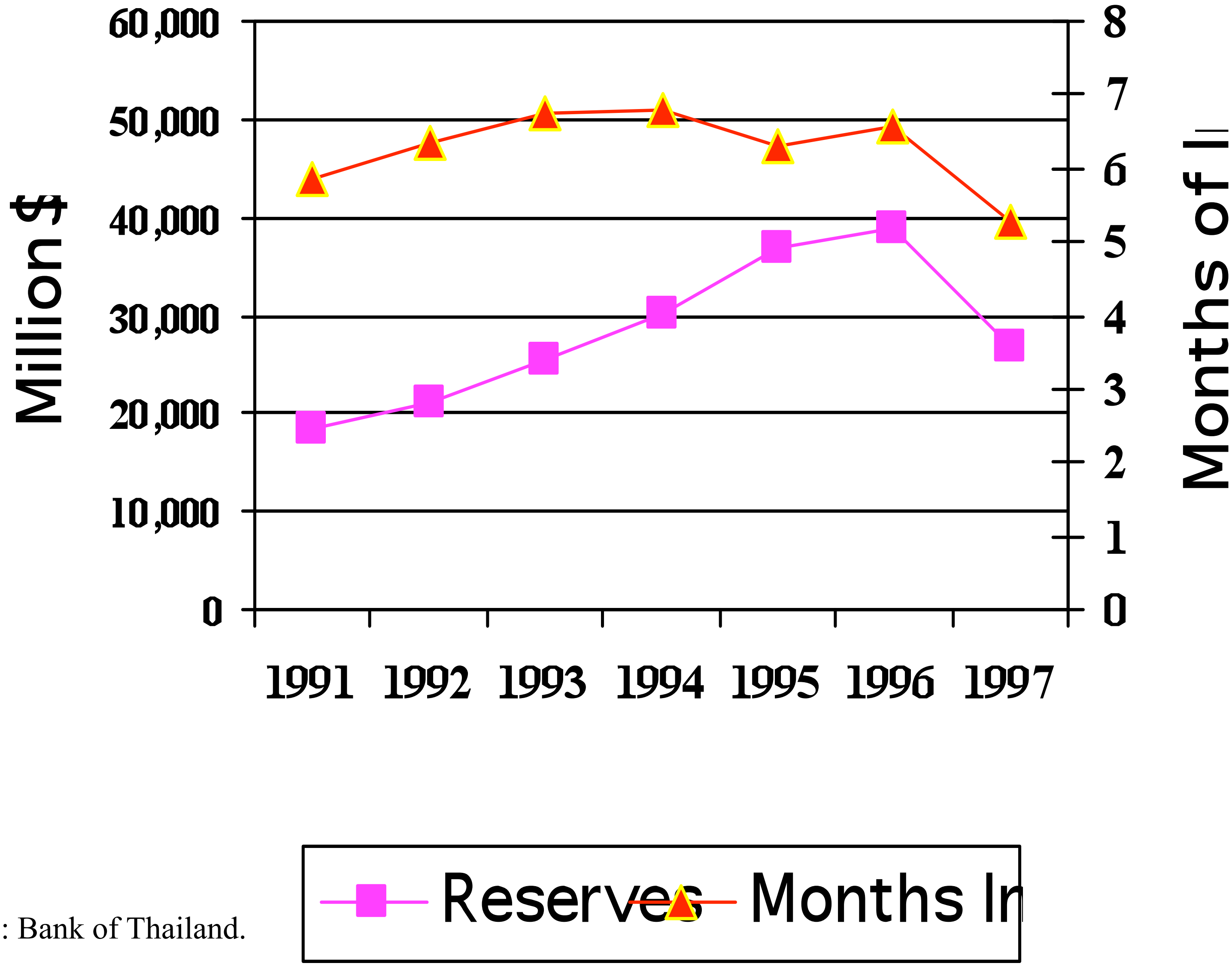
Key Lessons from 1997/98 Crisis

1997/98 East Asian Financial Crisis was an insolvency crisis in terms of foreign currencies. Public debt was not a key issue (unlike in parts of Europe today).

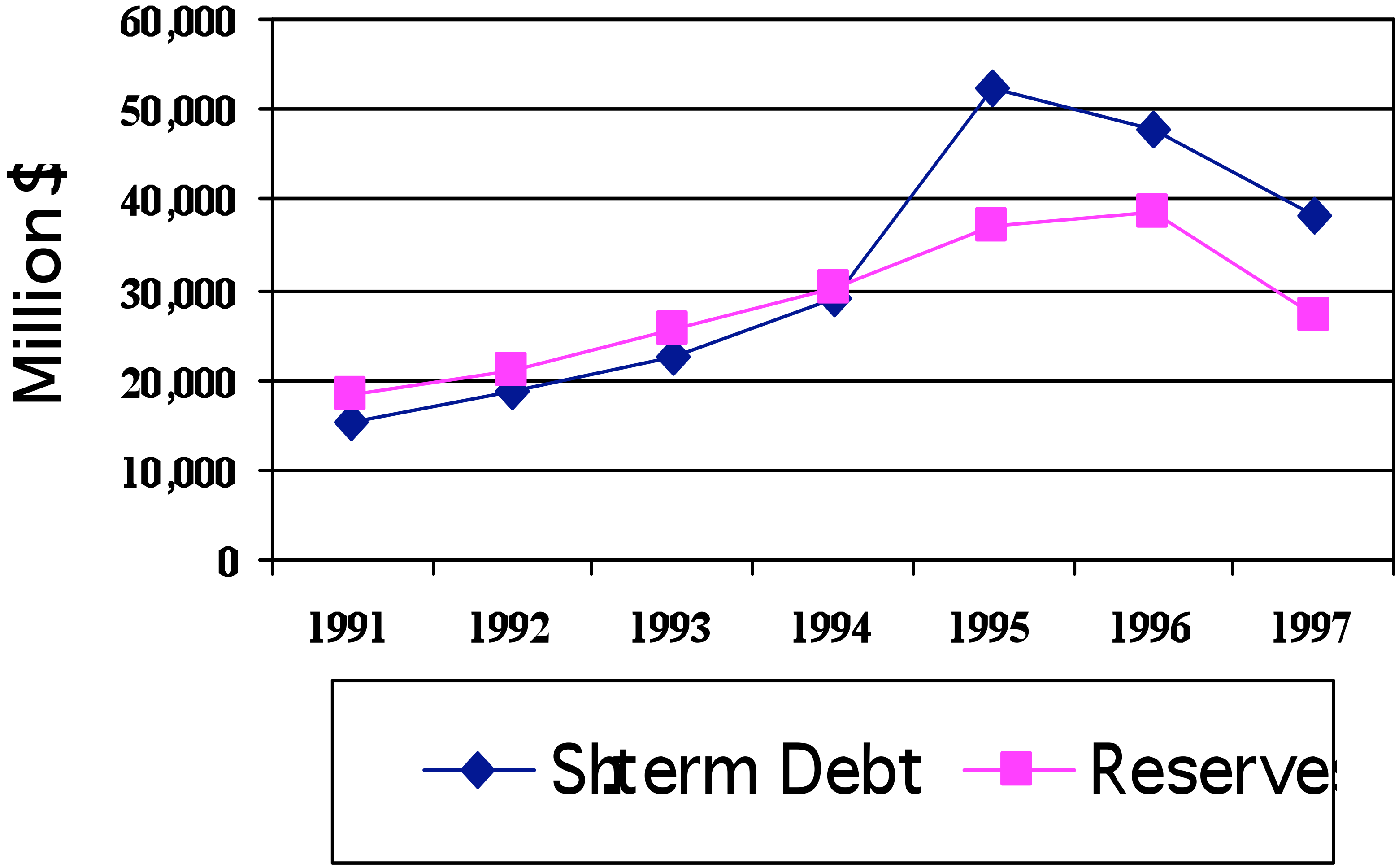
- Important lesson was that foreign reserves are needed to cover exposures to short-term debt as well as for current account transactions (need paradigm shift).

Thailand: Foreign Reserves and Months of Imports



Source: Bank of Thailand.

Thailand: Short-term Debt and Reserves



Source: Bank of Thailand.

Key Lessons from 1997/98 Crisis (2)

2. Another important lesson, stemming from bad experiences with the global crisis resolution mechanism (i.e. IMF) was that East Asia, with its large financial resources, should develop its own foreign currency liquidity support mechanism to supplement/ complement/supplant the IMF.

   In any case, most of the money in the IMF package for Thailand (US$ 17.2 billion) came from contributions by countries in the region. IMF's own contribution was only US$ 4 billion.

1997/98 Crisis Resolution Experiences

- Critics of IMF pointed to a number of areas, such as: 1) stringent fiscal and monetary policies without regard for social/political consequences; one size fits all nature; 2) ignored non-market based interventions. Malaysia and Hong Kong used these types of measures successfully; 3) full guarantee for creditors (mostly foreign) of financial institutions; and, 4) imposition of rapid structural reform measures. "Fire sale" type of policies.
- Could be seen as bailing out foreign lenders, who made imprudent lending, and then rewarding them by fire sale privatization.

1997/98 Crisis Resolution Experiences (2)

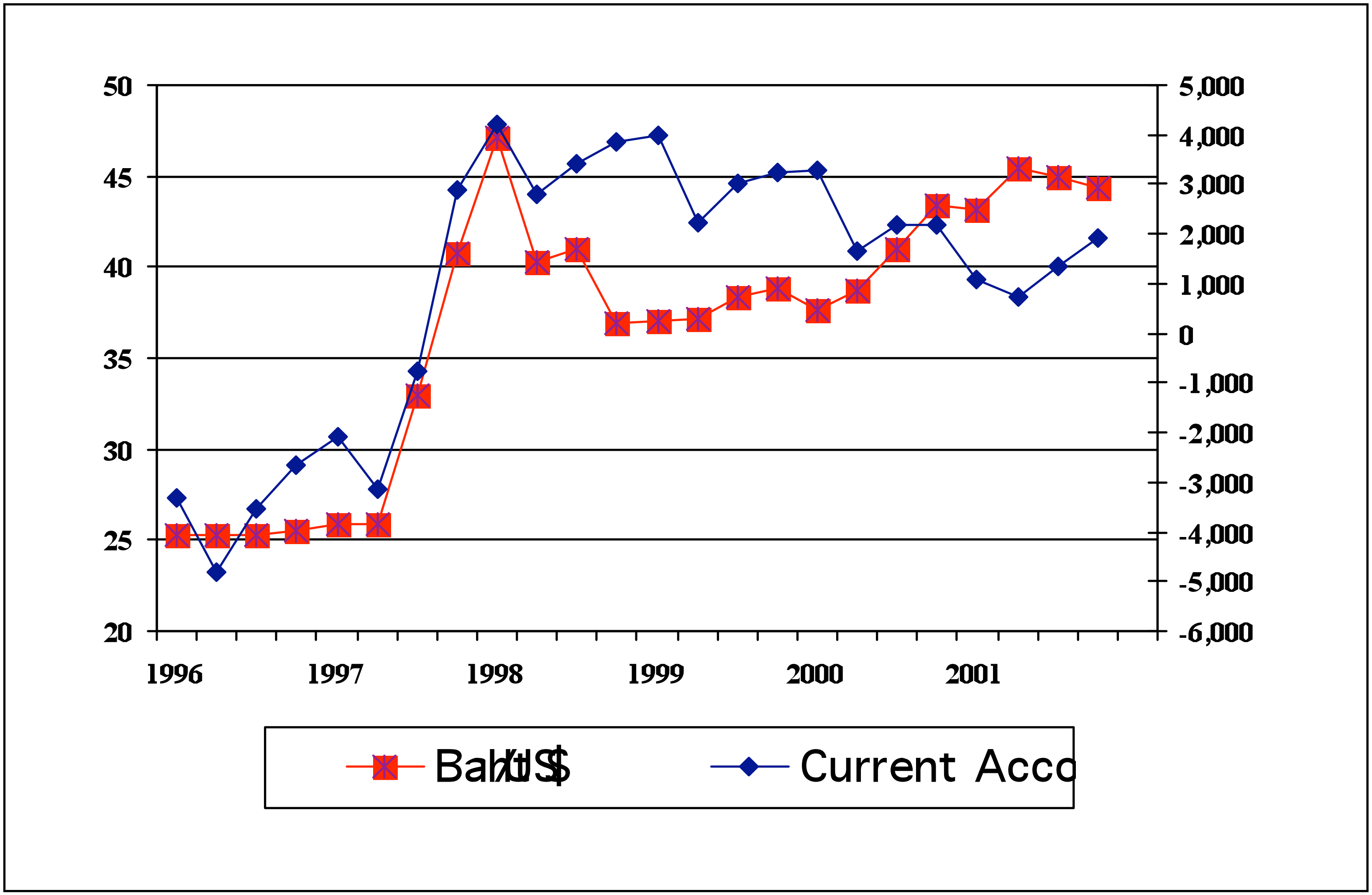
- Luckily, Thailand could exit from IMF conditionality reasonably quickly before having to implement much of the structural reform measures. Flexible exchange rate and export orientation turned around the foreign exchange situation quickly, and by mid-1999 no longer needed any more IMF drawings.
- Deep mistrust of the IMF still remains 14 years after the crisis even though one can argue that the IMF has changed a lot, with FCL etc. The IMF stigma is deep rooted in the media and the general public, so becomes a political issue.
- The Chiang Mai Initiative (CMI), aseries of bilateral swaps, was developed, still with IMF link if more than 20% used, so the IMF problem remains.

Key Lessons from 1997/98 Crisis (3)

3. Another important lesson (especially for politicians) was that pre-crisis fear of devaluation (or depreciation) was misguided. With an export-oriented economy (like most East Asian economies), export can respond quickly to exchange rate changes and become a significant growth driver and a crisis from shortages of foreign exchange is best resolved through exchange rate and the export sector (also affect imports).

   Export became more important post-crisis for all East Asian economies, and led to huge accumulation of reserves. Now the fear is more about currency appreciation.

Exchange Rate and Quarterly Current Account



Source: Bank of Thailand.

Key Lessons from Global Financial Crisis

1. The global financial crisis showed that in spite of large reserves, acute foreign exchange liquidity shortages can develop quickly (this time from problems outside the region.

Adequacy of Foreign Reserves

- Need to back up short-term contingent liabilities.

	(1)	(2)	(3)	(4)	(5)
	FX Reserves (Bil. US$)	Short-term Debt (by remaining maturity)	Foreign Holdings of Stocks	Foreign Holdings of Bonds	Ratio of (1) to (2)+(3)+(4)
South Korea	201.7	191.1	111.0	27.0	61.3%
Indonesia	50.9	33.2	18.0	7.1	87.3%
Malaysia	91.3	42.4	22.3	11.8	119.3%
Philippines	39.6	14.3	11.6	0.6	149.4%
Thailand	112.3	35.1	30.7	1.7	166.4%

Source: Johanna Chua: "Asia Macro Views: Asia - Reassessing FX Reserve Adequacy," February 23, 2009, Citgroup.

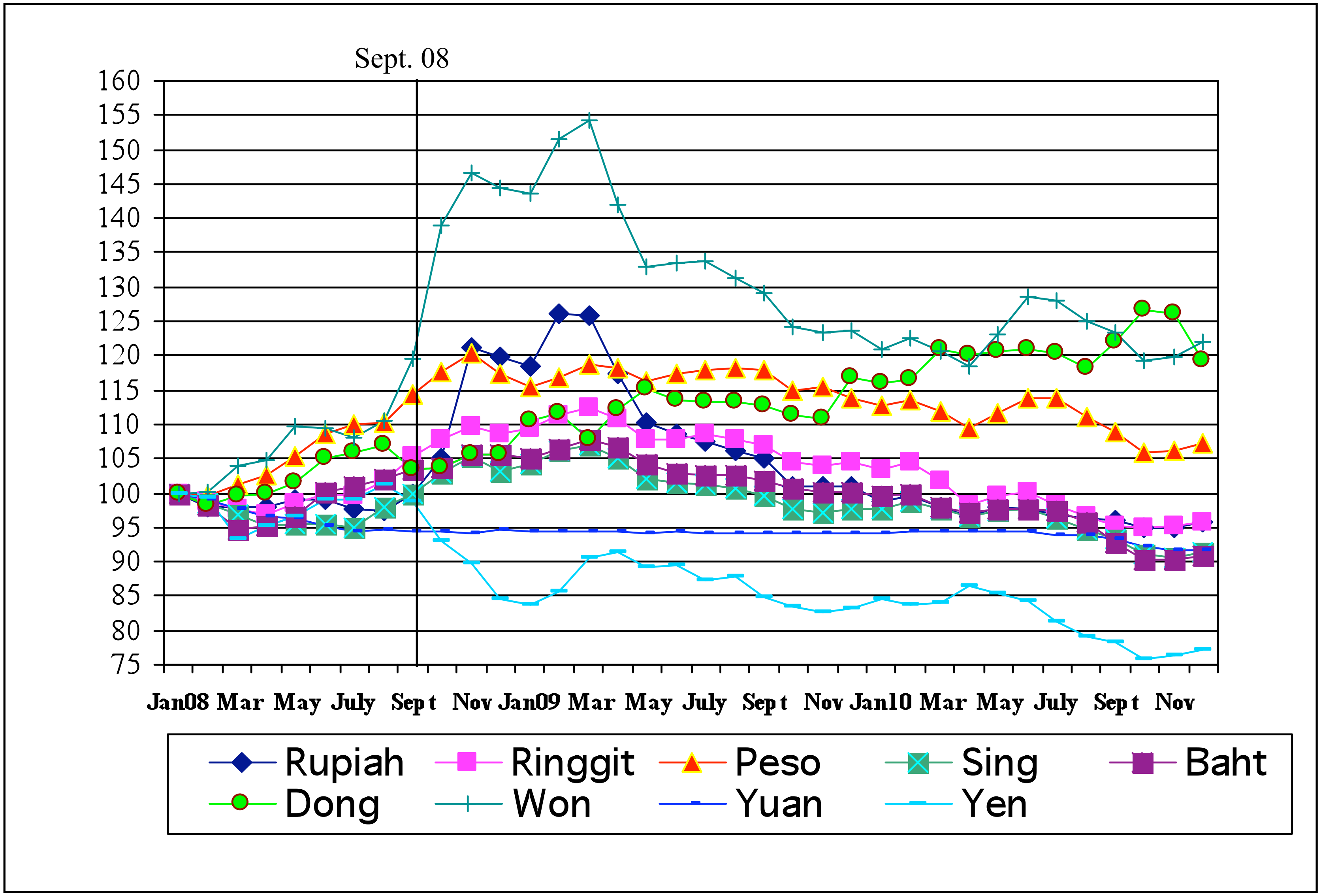
Adequacy of Foreign Reserves (2)

- Re-emphasized the lesson from 1997/98 that reserves are needed to back up all short-term capital account potential liabilities (as well as for current account transactions). Countries should be vigilant in monitoring the adequacy of foreign reserves.
- Also was an impetus to finalize the Chiang Mai Initiative Multilateralization (CMIM) for a more effective provision of liquidity support for ASEAN+3 economies.

Key Lessons from Global Financial Crisis (2)

2. Showed again that in the context of East Asia, exchange rate flexibility is crucial in quickly turning around situations of foreign exchange shortages.

Exchange Rate Indices (Jan. 2008 = 100)



Source: Bank of Thailand.

Key Lessons from Global Financial Crisis (3)

3. The large indirect impact of the global financial crisis on East Asia through the export channel emphasizes the need for East Asian economies to serious rebalance their growth drivers both domestically and regionally.

Rebalancing Regional Trade

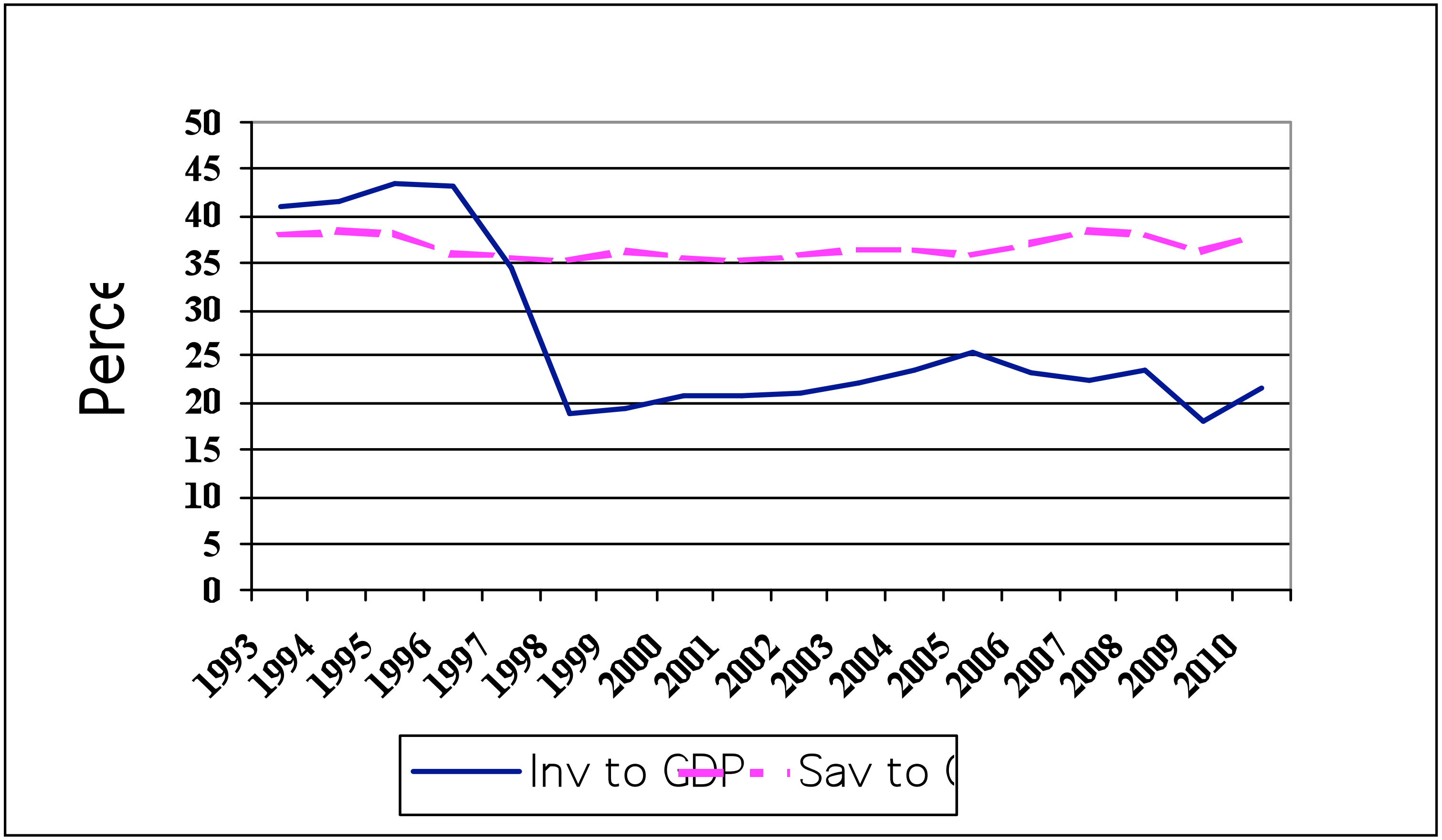
East Asia still depends a lot on outside markets for final products.

	2005-2007 Average		1994-1995 Average	
	Parts and Components	Final Products	Parts and Components	Final Products
Machinery	62.60%	38.50%	55.50%	42.90%
ICT Products	68.50%	34.40%	59.80%	36.40%
Electrical Goods	68.40%	67.40%	60.10%	58.80%
Motor Vehicles	44.00%	16.90%	42.50%	22.50%

Source: Table 4 in Athukorala and Kohpaiboon (2009). Intra-Regional Trade in East Asia: The Decoupling Fallacy, Crisis, and Policy Challenges. ADBI Working Paper No. 177, Asian Development Bank Institute, Tokyo, Japan, December 2009.

Domestic Rebalancing: Thailalnd

Real Saving and Investment to GDP.



Source: The National Economic and Social Development Board

CMIM

- CMIM provides a 90-day swap facility (local currency for US$), which could be rolled over a maximum of 7 times.
- Total size of CMIM is $120 billion.
- On decision rules, fundamental issues, such as size of pool, contributions, borrowing multiples, membership and terms of lending will be decided by consensus at the Minister of Finance level. Executive decision on lending, renewal and default will be done using two thirds majority by the Deputy-level representatives of ASEAN+3 Finance Ministries and Central Banks and Monetary Authority of Hong Kong, China.

Contributions, Multipliers and Voting Weight

Country	Contribution (US$ Billion)		Purchasing Multiple	Voting Weight
Brunei	0.03		5.0	1.15%
Cambodia	0.12		5.0	1.22%
PRC	38.4	PRC , Excluding Hong Kong China 34.2	0.5	25.43%
		Hong Kong China 4.2	2.5	2.98%
Indonesia	4.552		2.5	4.36%
Japan	38.4		0.5	28.41%
Korea	19.2		1.0	14.77%
Lao PDR	0.03		5.0	1.15%
Malaysia	4.552		2.5	4.36%
Myanmar	0.06		5.0	1.17%
Philippines	4.552		2.5	4.36%
Singapore	4.552		2.5	4.36%
Thailand	4.552		2.5	4.36%
Viet Nam	1.00		5.0	1.84%

Source: The Joint Ministerial Statement of The 13th ASEAN+3 Finance Ministers' Meeting, Tashkent, Uzbekistan, 2 May 2010.

CMIM (2)

- CMIM is supported by the ASEAN+3 Macroeconomic Research Office (AMRO) based in Singapore. Started in April 2011. The first Director for one year is Mr. Wei Benhua, former deputy director of China's State Administration of Foreign Exchange, to be followed in the next two years, by Mr. Yoichi Nemoto, a Deputy Vice Minister of Finance for International Affairs at Japan’s Ministry of Finance.
- The Executive Committee of AMRO is the Finance and Central Bank Deputies
- AMRO is supported by an Advisory Panel of 6 economists (1 each from China, Japan and Korea and 3 from ASEAN).

CMIM (3)

- AMRO is tasked to (i) monitor, assess, and prepare quarterly reports on the macroeconomic situation and financial soundness of the ASEAN+3 Countries, (ii) assess macroeconomic and financial vulnerabilities in any of the ASEAN+3 Countries and provide assistance in timely formulation of policy recommendations to mitigate such risks should problems arise, and (iii) ensure compliance of swap requesting parties with the lending covenants under the CMIM Agreement.

Future Directions

Effectiveness of CMIM needs developments in a number of key areas.

i. The IMF link

ii. The CMIM size

iii. AMRO

The IMF Link

- IMF link needs to be modified, or countries will bypass CMIM.
- It is possible to combine a crisis prevention liquidity support facility of CMIM with a more medium term crisis resolution facility for structural imbalance problems under the CMIM.
- The IMF link can be changed from being based on a percentage of a country's swap quota (currently 20%) to one based on the number of rollovers needed (say, if more than 2 times).
- A 90 day swap facility is designed for short-term temporarily liquidity shortages, like in the Korean case during the global financial crisis, so no need for IMF involvement. However, if a country continues to have to roll over the swap, then the likelihood is that the problem is not temporary and more structural. Then, it becomes appropriate to bring in the IMF. So, for example, if a second rollover is needed (after 6 months), then the IMF should be involved.

CMIM Size

- CMIM contributions are not actually paid into a common pool but are still owned and managed by the respective country authorities.
- Opportunity cost for each country is minimal, being limited to contributions to a swap drawing, if one were to arise (though there are also possibilities for a country to opt out) and its share of financial contributions to AMRO, which will be small in the initial stages.
- Doubling size of CMIM is very feasible.
- CMIM swaps can also be supplemented by bilateral swaps (especially from China and Japan, who have very large reserves).
- The effective size of CMIM can be US$ 600-700 billion.

AMRO

- Biggest challenge is to quickly develop AMRO's capability, credibility and effectiveness to generate confidence from various parties.
- AMRO is starting from scratch and needs a lot of support. Still in the process of recruiting staff and developing its strategic directions, such as on research, the scope of surveillance and the relationships with the IMF and other organizations.
- At the same time, the regional architecture is evolving, with the ASEAN+3 Central Bank Governors joining the Finance Ministers' meeting from 2012. AMRO should evolve to become a secretariat of the Deputies and Finance Ministers and Central Bank Governors process, i.e. to be the Monetary Organization for East Asia.

Thank You for Your Attention