Comparative Analysis of Economic Crises in Singapore, Thailand, Japan and South Korea in 1997-1998 and 2007-2008

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Topic and Research Question

Even though a lot of literature covers the 1997 East Asian Crisis, analyses and research papers comparing the crises in the late 1990s and the late 2000s in East Asia are scarce. This thesis is focused on an answer to the main research question: How did the economic crises in East Asia fare in comparison to the general theories of crises, especially to the crises in the 1990s and 2000s?

State of the Art


Methodology and Approach

Based on Minsky’s theory combined with research by other authors, a model based on the stages of a crisis together with some crucial indicators were selected in order to determine the basic pre-requisites of a “proper crisis”. 1: a country experiences economic conjuncture and increased credit (or broad money) creation, possibly fueled by a foreign central bank’s low-interest rate policy, especially if the country went through a period of liberalization/deregulation. 2: Companies and banks steadily increase risk, while much of the money flows to speculative investment and domestic consumption, inflating prices of goods, stocks and/or real estate. Credit growth and risk become unsustainable, and economic indicators, such as GDP growth, exports/imports or industrial/services indices, fall. 4: Some kind of wake-up call, like an accounting scandal or bankruptcy of some major company, occurs. 5: Capital outflows cause liquidity to dry up, speculators close their leveraged positions, asset prices plummet and both financial institutions and firms are unable to rollover debt. Banks drawn in non-performing loans granted against falling collateral prices. Widespread bankruptcies and an inevitable fall in aggregate demand prompted also generally deleveraging pressure on the domestic central bank, which tries to defend the falling currency (or the peg to USD) and keep the calm on the markets. As it fails, foreign reserves are depleted and a currency crisis eventually occurs, followed by a spike in inflation, lowered domestic expenditures and a growth of unemployment. Tumult in one country tends to spill over to other countries, an effect known as contagion. Governments and central banks are required to act and either use the conditional help of the IMF connected to reforms and austerity, or introduce reforms on their own and use their reserves (if adequate) to introduce measures in order to increase economic growth, employment and aggregate demand. In either case, government debt increases substantially. Empirical indicators confirming this cascade of events were compiled on year-on-year data in a time span of 1990-2002 and 2003-2014 respectively. The fundamental stage-based model combined with empirical data was used as a framework to compare the situation of the crisis-hit countries with the general theory and to study its relevance in selected countries and time periods.

Main Facts

East Asian Crisis 1997-1998

Companies and banks in Japan encountered serious balance sheet problems due to the burst of the property bubble in the early 1990s. As a result, Japan conducted a low interest rate policy in order to ease the recovery and flushed the market with cheap money which found its way to developing countries in East Asia. Thailand and South Korea, after a period of liberalization and deregulation in the early 1990s, absorbed this cheap money which, combined with poor regulatory oversight, resulted in a severe asset bubble, manifested by a rise of real estate prices and overcapacity problems in some industries. As the yen depreciated against USD (and USD-pegged currencies), some exporters experienced a competitive disadvantage, erasing already low profits. Subsequently, overleveraged banks had to write-off non-performing loans. Heavily exposed and risk-averse Japanese banks, experiencing the worsening condition of domestic companies, liquidated positions and pulled out short-term capital from the region, causing capital liquidity shortages and putting severe pressures on the banking systems and consequently the central banks. Sustained attacks of speculators depleted the reserves of central banks, causing the won and the baht to crash. The IMF was invited to help. Korea and Thailand were forced to introduce austerity and reforms, further squeezing aggregate demand. Japan encountered problems with exports to the region, putting dire pressure on the basis of the bankers and banks. Singapore was hit by contagion mainly in terms of exports and tourism, with both banking and private sector staying intact, partly due to the managed depreciation of currency and anti-cyclic reforms, partly thanks to rigorous regulatory oversight, keeping exposure to the risky countries low.

The Great Recession 2007-2008

East Asia was caught by contagion originating in the real estate and mortgage-derivatives burst in the USA. However, East Asian countries did remarkably well in comparison with most of its counterparts in Europe or Latin America. Thailand and South Korea learned their lesson from the 1997-8 crisis and introduced sweeping reforms to the banking system, financial and regulatory oversight, bankruptcy law, capital requirements, etc. But, most importantly, East Asian countries created currency denominated debt. During the phase of foreign exchange reserves, as the crisis struck, Asian countries found out that the demand for their exports in the West plummeted. Singapore went through liberalization and deregulation, a result of efforts after the 1997-8 crisis and was subsequently hit hard by both a fall in exports and financial contagion, mainly due to severe exposure to the troubled Western banks. Japan fell into deflation again and was severely hit by a fall of exports due to both a fall in demand in the West and also the strengthening of the yen as a result of the Fall of the USD/JPY cross. Many East Asian countries used huge foreign currency reserves to ensure liquidity and prop up domestic spending and/or infrastructure projects, substituting the fall in exports with an increase in domestic demand, while Japan also introduced a QE program to clear the balance sheets of banks and companies. In the meantime, China pursued a massive stimulus policy and took on the role of the main market for East Asian exporters.

References

All references can be found in the full version of the MA thesis available at http://theses.univie.ac.at.

About the Author

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