International Monetary Funds

IMF (International monetary funds)

- a global render of last resort???
- country - lives beyond its means, appeals for external help from international development organizations such as ...

Shangri-la

- hard currency ↓, little prospect
- IMF - only place for the overextended country like Shangri-la

IMF as Financial planner

- reductions in spending
- policies to ↑ income and production
- within the constraints what’s available
Current account crises

$$Y = C + I + G + \{(EX - IM) + (EX_{FS} - IM_{FS}) + (UT_{IN} - UT_{OUT})\}$$

$$S = I + CA$$

$$S > I \iff CA > 0$$

Current Account

- How much a country spends in excess of its income
- How it saves too little relative to its investment needs

Current account deficit

- spending more than it earns
- saving too little
- living beyond its means
Current account crises

Before 1990s

- limitation on the amount of money by foreigners (stock, lending to firms)
- borrowing from abroad → hard currency for imports and govt infrastructure projects
- main reason for living beyond their means (maxing out on their credit cards)
  - govt - overspending (running large budget deficit)
  - pumping up the economy and importing foreign goods in abundance
Current account crises

IMF loans

- avoid going cold turkey on imports

This tried-and-true prescriptions on austerity helped them bring their national lifestyles within their productive capacities
Capital account crises

Capital - globally mobile than ever
Sudden withdrawals of foreign money

▶ (often) weaknesses - banking systems
▶ hard currency ↓ w/o living beyond their means

“twenty-first century crises”

▶ Electronic Herd → ↓ hard currency
  ▶ even if tight budget and money supply within prudent bounds
  ▶ Herd: start to worry bad loans and the lack of hard currency

IMF’s traditional remedy - austerity (deep budget cut...)

▶ even makes matter worse - this was the IMF’s prescription
▶ the complex banking issues that rose to the fore in Asia
  ▶ Many staffers in IMF (macroeconomists) do not know of this
more on this chapter

Stanley Fischer
  ▶ first deputy managing director (1994-2001)
    ▶ during East Asian Crisis
  ▶ MIT faculty since 1973

IMF
  ▶ headquarter: Washington
  ▶ History of IMF
    ▶ Keynes
    ▶ Bretton Woods system
    ▶ raison d’être - the fixed-rate system
  ▶ members: 183 nations
    ▶ deposit hard currency
    ▶ largest share: U.S.
Contagious currency crises

ERM crisis (1992-93)
Mexican peso crisis (late 1994)
Russian crisis (1998)

Contagions

- trade links
- capital markets
- the role of banks - transmitting disturbances across countries
Main findings of the paper

1. Japanese banks ↓↓ lending to the affected Asian countries following the Thai devaluation
   ▶ spreading the crisis to Indonesia, Malaysia, and S. Korea
2. little bilateral trade among emerging Asian economies
   ▶ indirect link via exports to a common third party
   ▶ little bilateral trade
3. contagion vulnerability indexes - doing well
4. Before and After crisis
   ▶ Pre: little evidence of systematic causality or interdependence among these five countries
   ▶ Post: greater degree of dependence on external shocks
5. Malaysia’s interest rate - uninfluenced by shocks to other interest rates in the region
   ▶ capital controls
common lender channel

Potential for contagion - the withdrawal of a common bank creditor

▶ other paper by the authors (Kaminsky and Reinhart, 2000)

Bank A → Country B (financial crisis)

▶ make up for the deterioration in the quality of loans
  ▶ ↓ lending and ↑ govt bonds
  ▶ country B: ↓ line of credit

▶ ↓ new credits to the other borrowers, refuse to roll over their existing loans

the role of banks in propagating disturbances internationally

▶ Asian Crisis of 1997
### Bank Lending to Emerging Asia, June 1997-1998

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<tbody>
<tr>
<td><strong>European banks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US$ billions</td>
<td>85,338</td>
<td>87,846</td>
<td>76,820</td>
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<td>% ∆ since June 1997</td>
<td>n.a.</td>
<td>2.9</td>
<td>-10.0</td>
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<tr>
<td><strong>Japanese banks</strong></td>
<td></td>
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<tr>
<td>US$ billions</td>
<td>97,232</td>
<td>86,651</td>
<td>74,297</td>
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<tr>
<td>% ∆ since 1997</td>
<td>n.a.</td>
<td>-10.9</td>
<td>-23.6</td>
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<td><strong>U.S. banks</strong></td>
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<tr>
<td>US$ billions</td>
<td>23,738</td>
<td>21,974</td>
<td>16,566</td>
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<td>% ∆ since June 1997</td>
<td>n.a.</td>
<td>-7.4</td>
<td>-30.2</td>
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Notes: Emerging Asia comprises Indonesia, Malaysia, the Philippines, South Korea, and Thailand.

n.a. = not applicable.
Lending to emerging Asia

Expanded markedly

- European banks
  - goal: higher profile in emerging markets, particularly S. Korea

- Japanese banks
  - slumping economy and little domestic loan demand
Distribution of lending

U.S. bank exposure to Asia: modest
- 20% of all U.S. bank lending to developing countries

Japanese banks: 4 times as much as U.S. banks
Japanese banks - most exposed to Thailand (1st country to experience a crisis)

European banks
- half of all the lending to emerging markets (S. Korea alone - 40%)

Japanese banks - quick to pull out of emerging Asia
- most exposed to Thailand

Banks
- trigger of financial contagion?
- spillovers