

Different Foreign Monetary Policies during the EAFIC

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Part 1/Introduction of the EAFC

Part 1. a. Timeline of the EAFC

Thailand

July, 1997

*Gave up pegged
exchange rate system
and had to float the THB.*

*Similar to Thailand.
Indonesia Government
floated the IDR as well.*

Feb, 1998

Indonesia

Hong Kong

Aug, 1998

*It's widely known as the defence of
HKD. HK Government successfully
maintained the linked exchange rate
system and protected the security
market in HK from being attacked.*

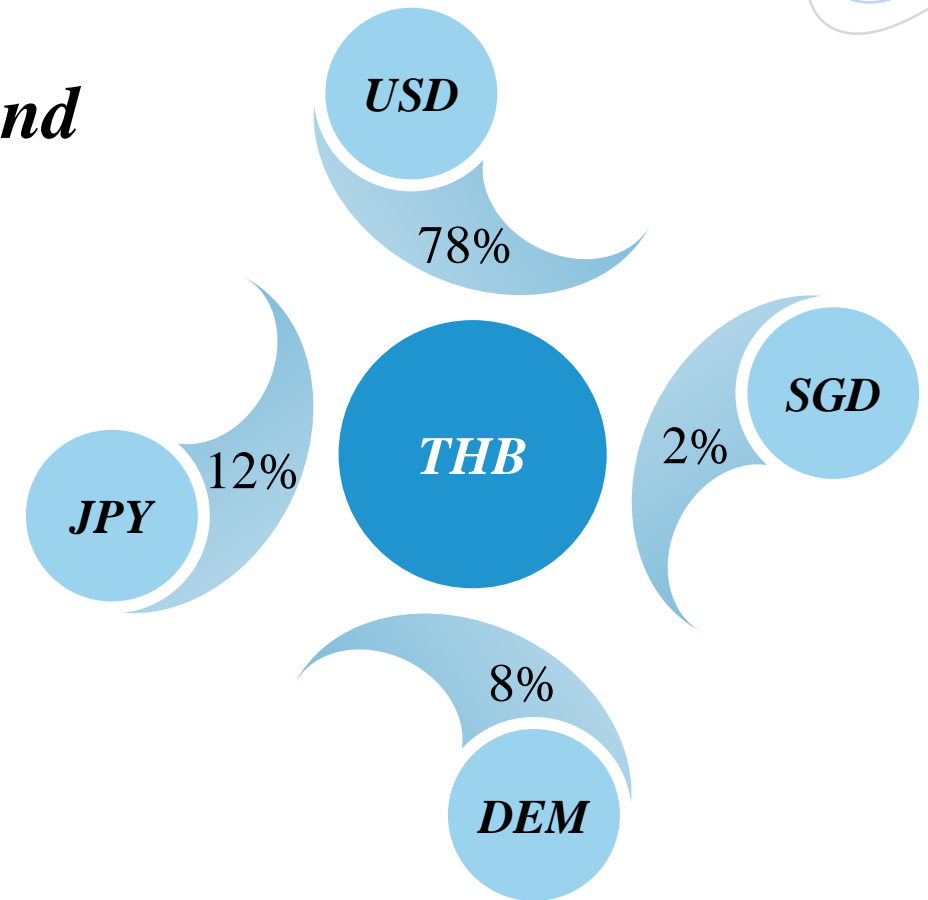
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Part 2/Introduction and Comparison of the Exchange Regimes of Thailand and HK.

Part 2. a. Pegged Exchange Rate System of Thailand

THB was pegged to a basket of currencies which were approximately made up of 78% U.S. Dollar, 12% Japanese Yen, 8% Deutsche Mark and a small part of Singapore Dollar.



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Part 2. b. Linked Exchange Rate System of Hong Kong

There is no traditional central bank to issue currency in HK. It's three commercial banks that are responsible to issue currency, which includes BANK OF CHINA, HSBC and Standard Chartered Bank.

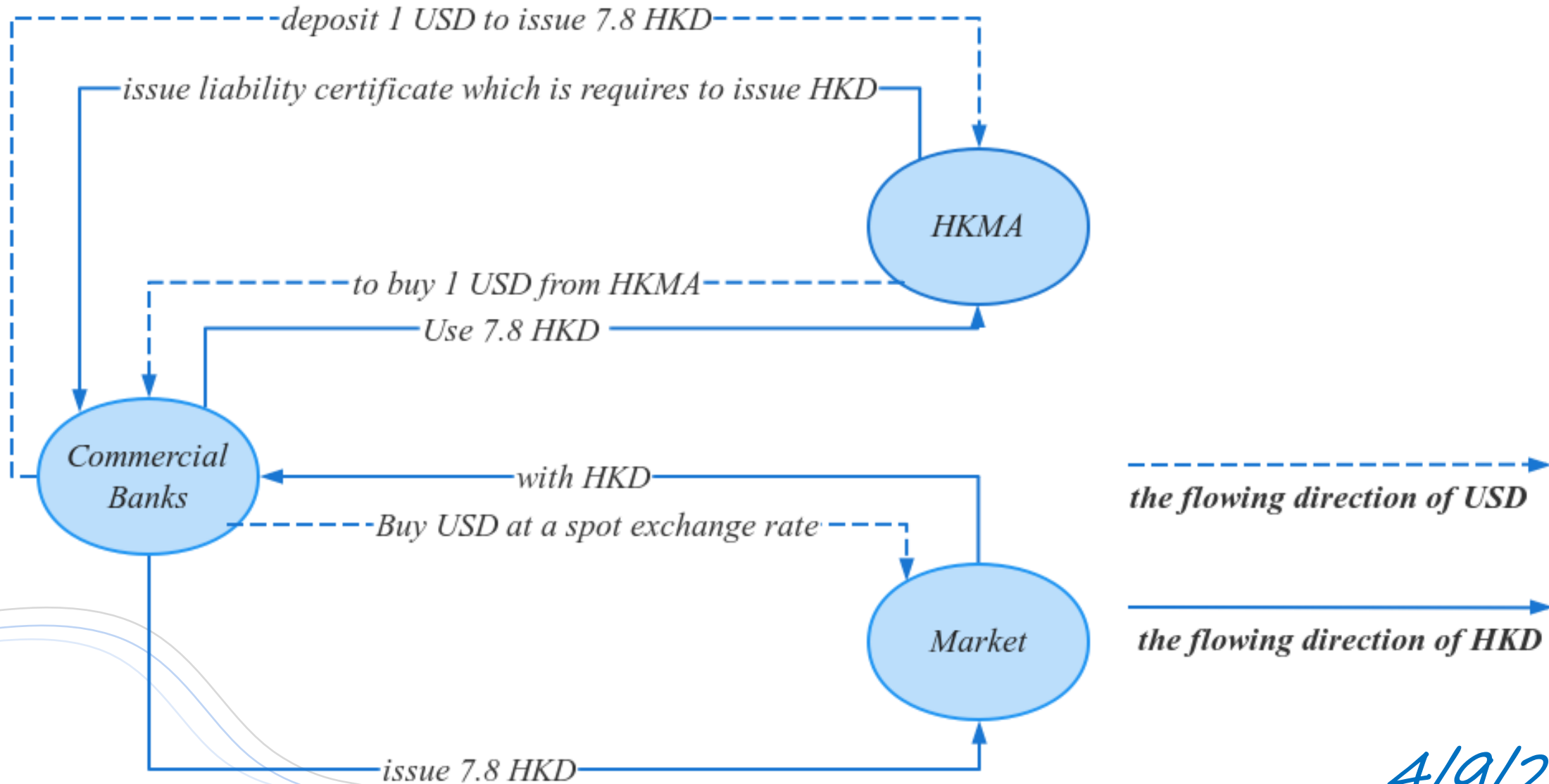
These three commercial banks need to deposit 1 USD in Hong Kong Monetary Authority to issue 7.8 HKD and can also use 7.8 HKD to buy 1 USD from HKMA. However, people can only buy USD from commercial banks at a spot exchange rate.



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Part 2. b. Linked Exchange Rate System of Hong Kong

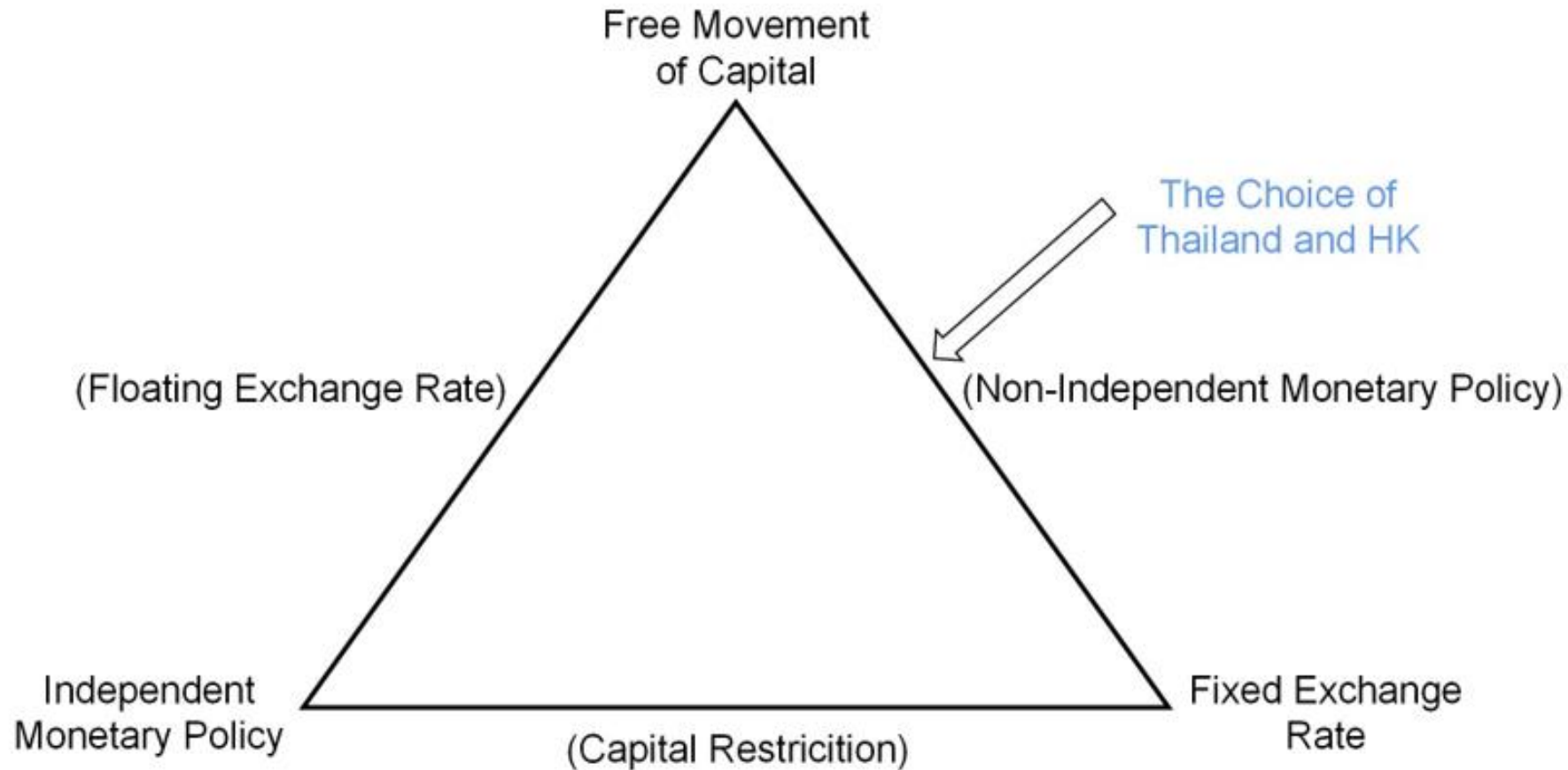


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Part 2. c. Comparison of the Exchange Regimes

Impossible Trinity Theory from Paul R. Krugman



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Part 2. c. Comparison of the Exchange Regimes

For Hong Kong,

It's distinctly that HK gives up the independent monetary policy. There is no traditional central bank in HK. HKMA, who plays part of the roles of central bank, cannot issue HKD. And when those three commercial banks issue HKD, the reserve fund is completely USD.

For Thailand,

It did have the independence to make its own monetary policy, but it could not decide the monetary policy according to the its own economic development as the THB was pegged to that special basket of foreign currencies which were mainly made up of USD.

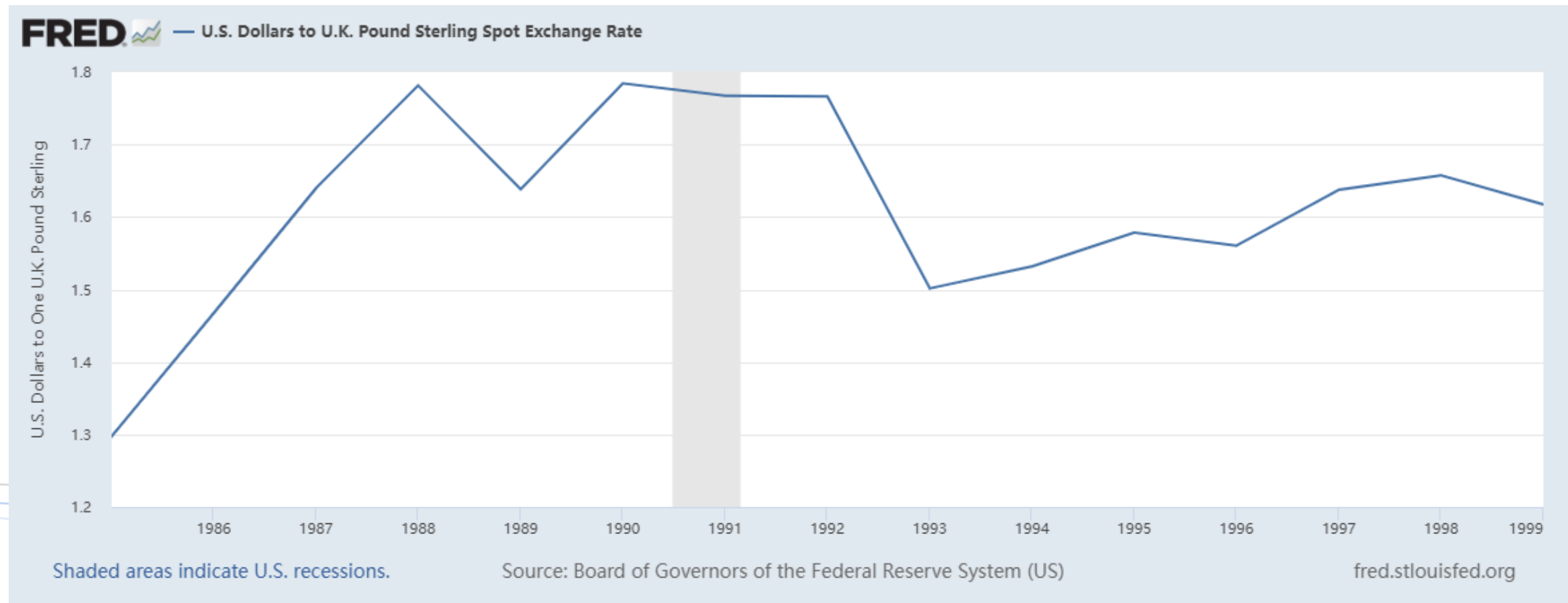
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Part 3/Analysis of the Process of the EAFC

Part 3.a. The Process of the EAFC in Thailand

The Trigger of Financial Crisis - The Appreciation of USD



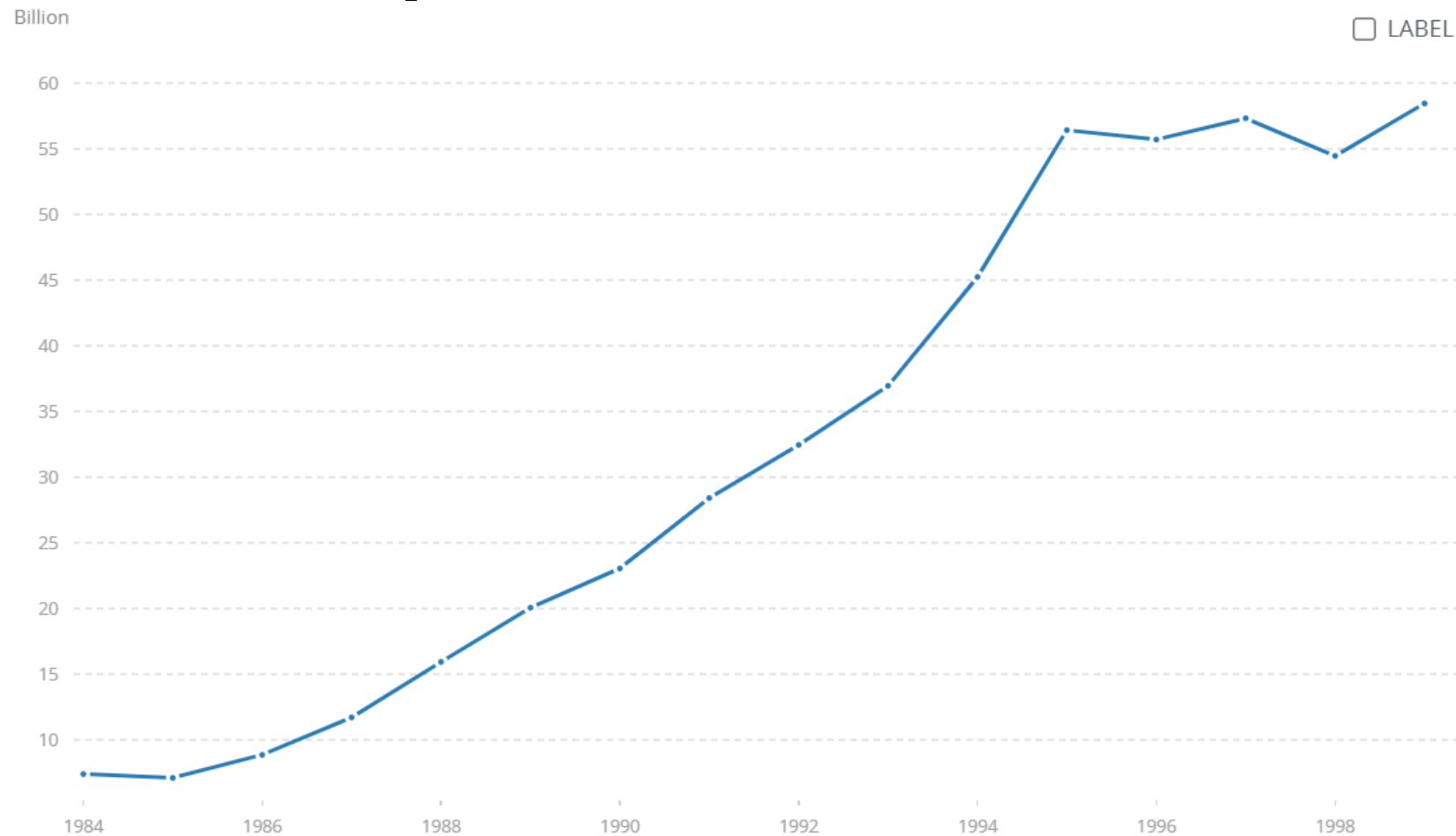
Data Source: BLS and St. Louis Fed

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Part 3.a. The Process of the EAFC in Thailand

Merchandise Export (Current USD\$) - Thailand (1985-1999)

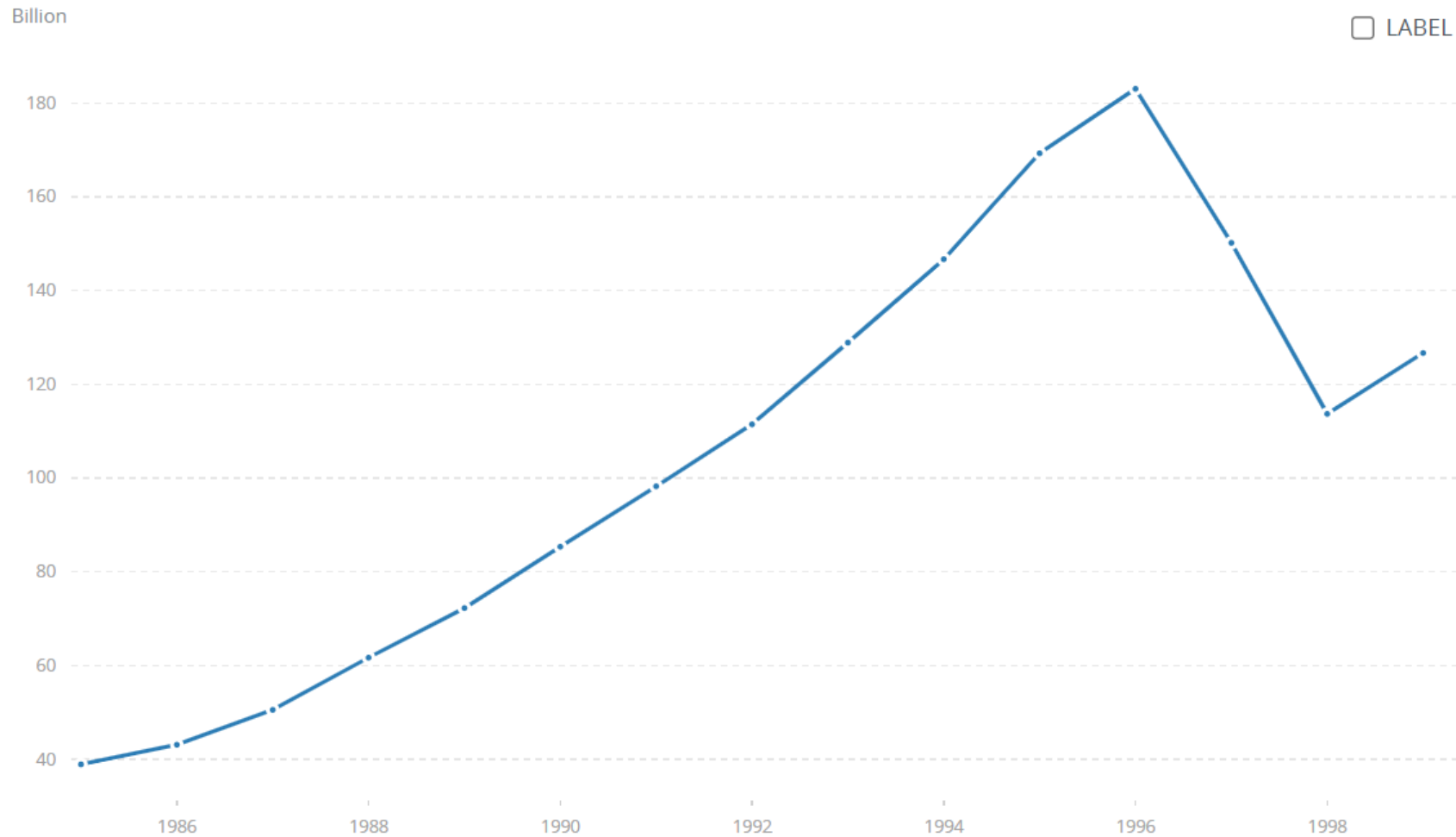


Data Source: THE WORLD BANK

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Part 3.a. The Process of the EAFC in Thailand

GDP (Current US\$) - Thailand (1985-1999)



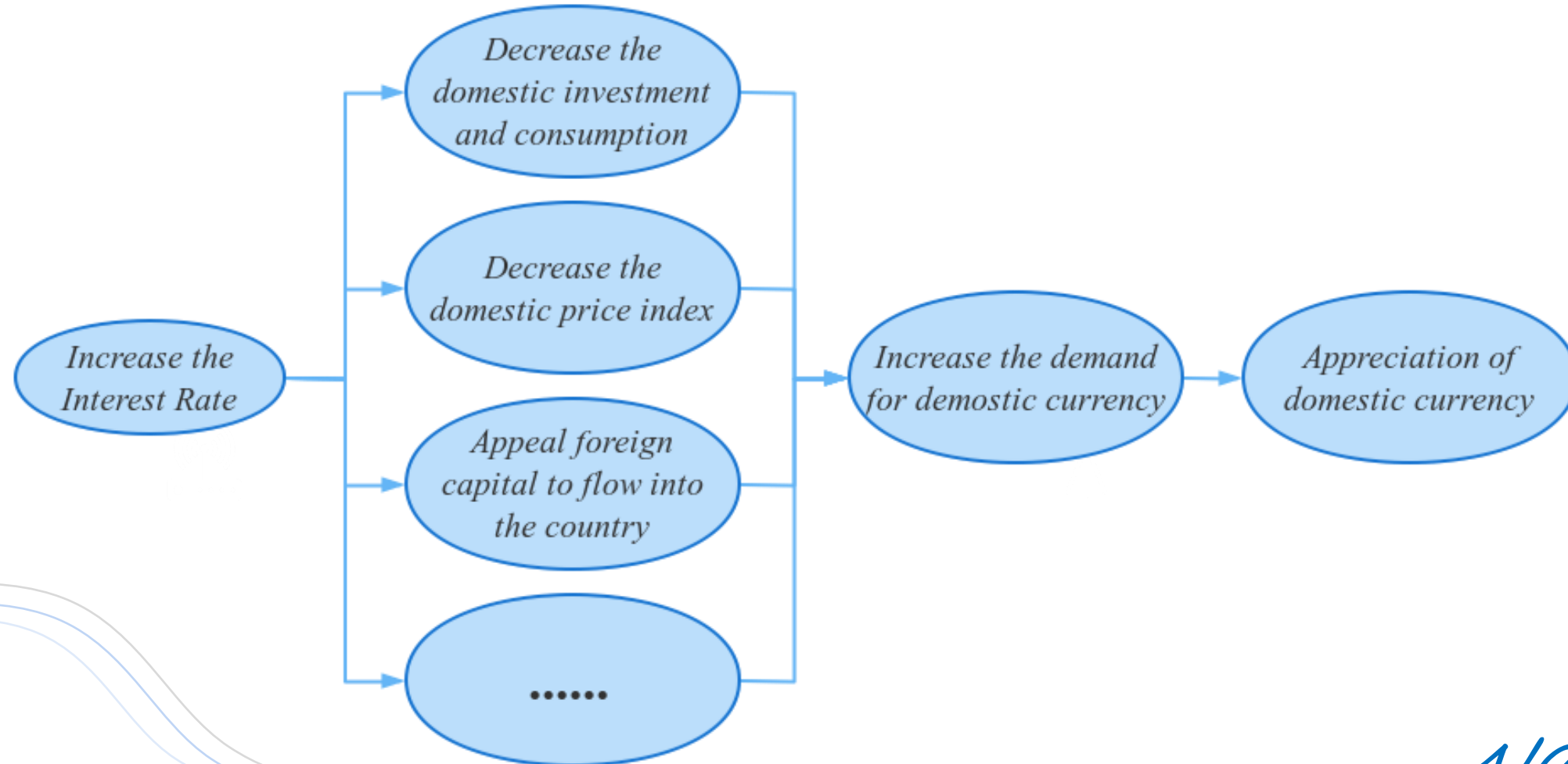
Data Source: THE WORLD BANK

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Part 3.a. The Process of the EAFC in Thailand

Increasing the Interest Rate - Poison or Cure?



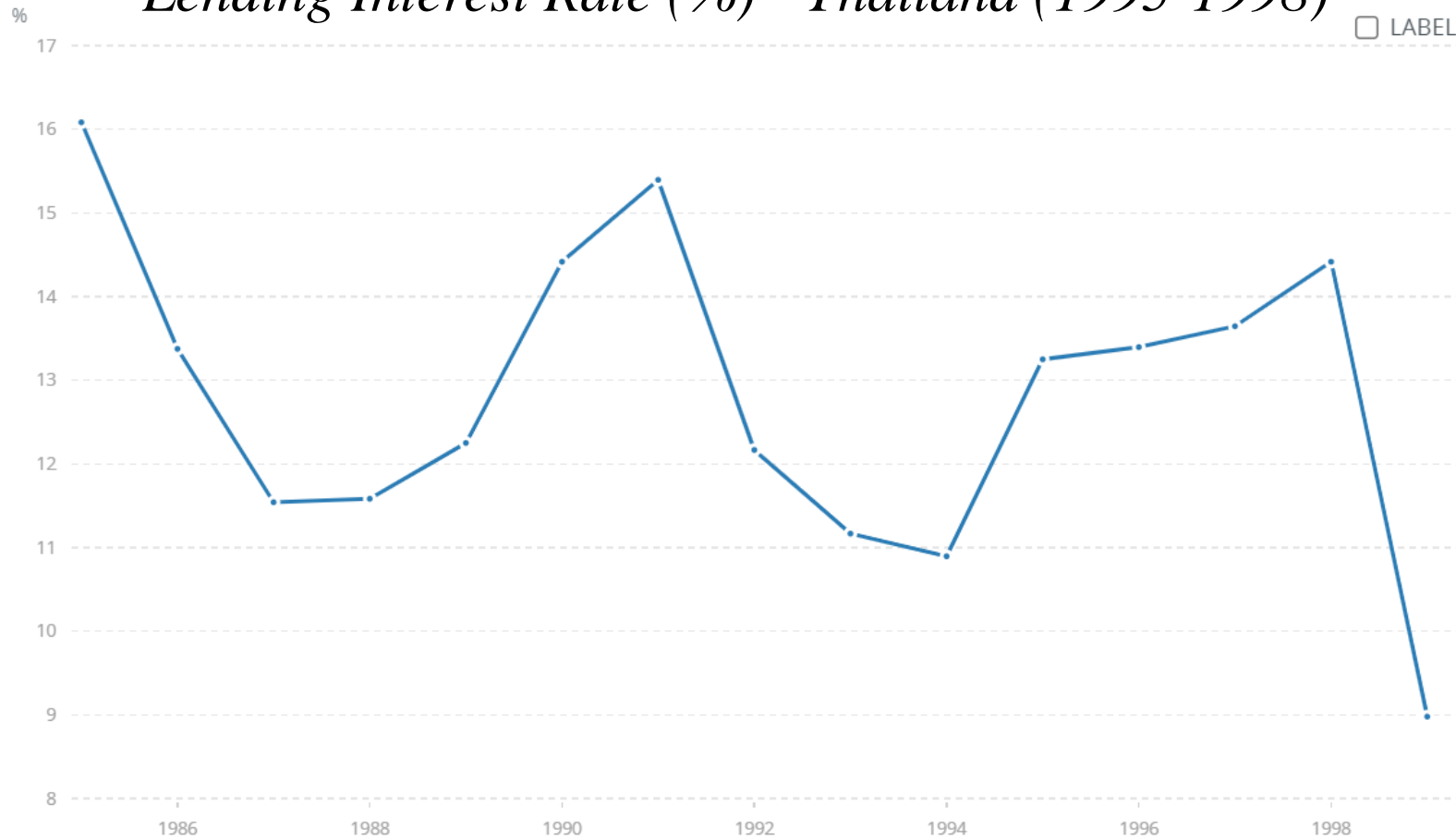
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Part 3.a. The Process of the EAFC in Thailand

Increasing the Interest Rate - Poison or Cure?

Lending Interest Rate (%) - Thailand (1995-1998)



Data Source: THE WORLD BANK

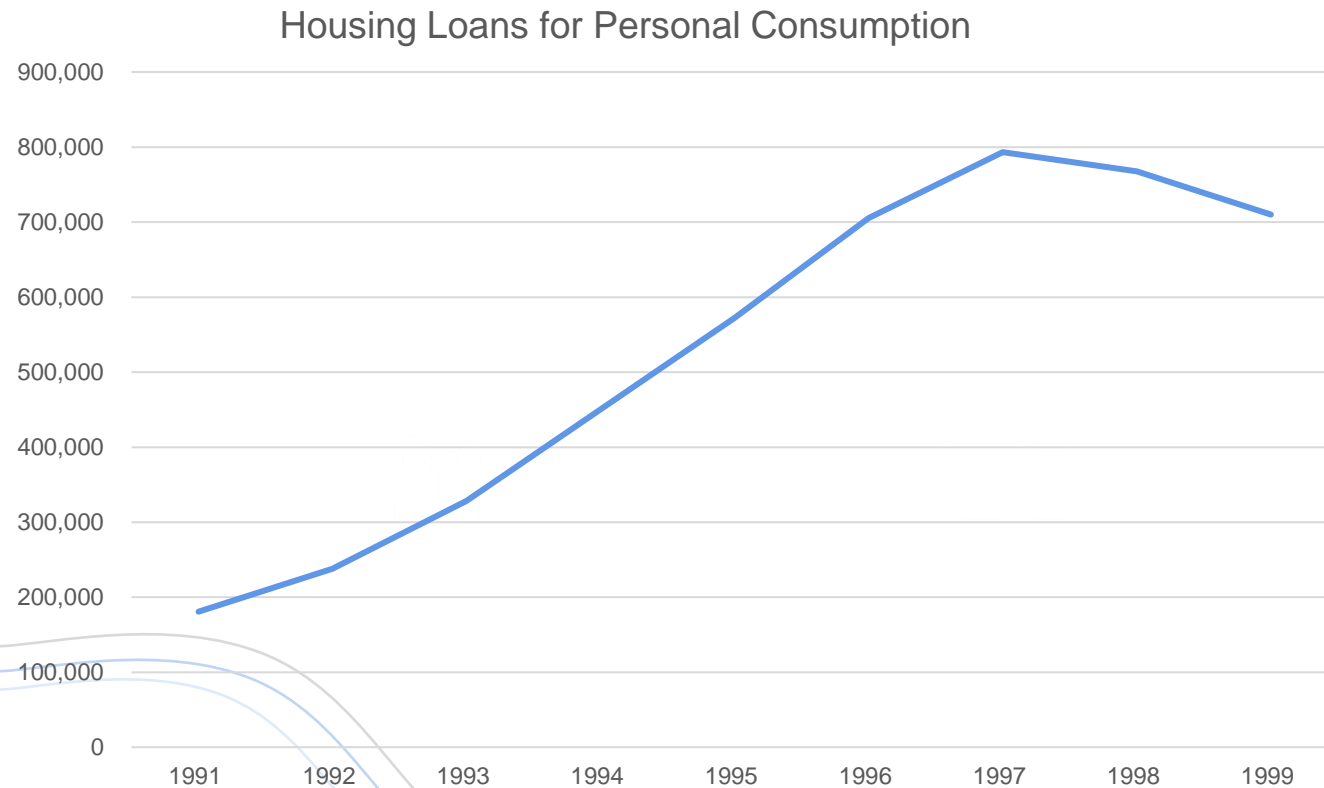
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Part 3.a. The Process of the EAFC in Thailand

Increasing the Interest Rate - Poison or Cure?

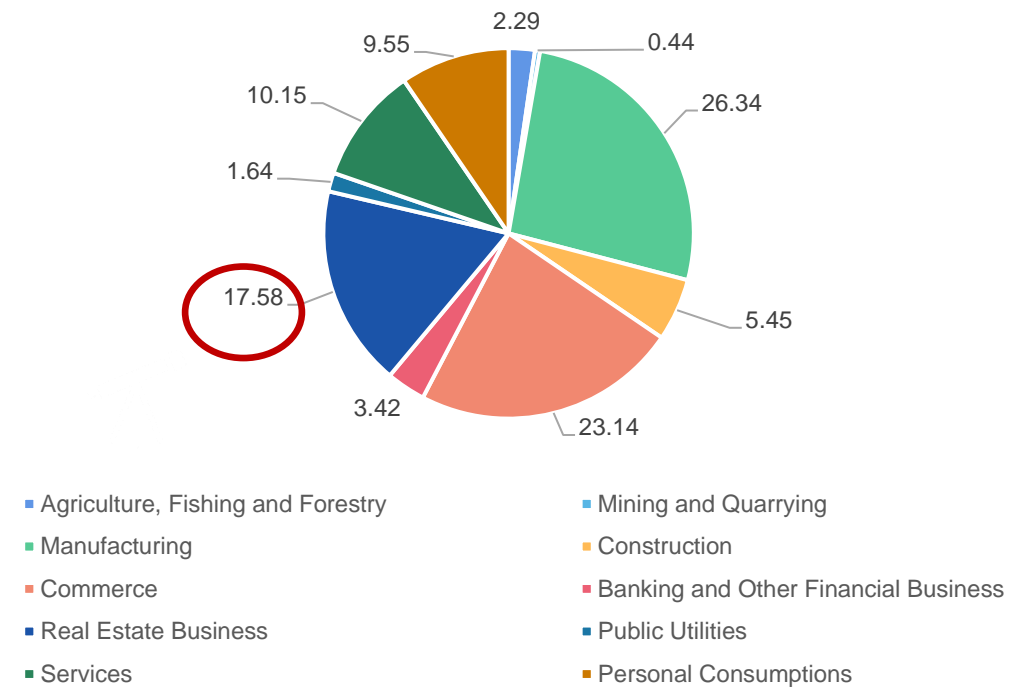
Increasing Loan in Real Estate Industry



Data Source: Bank Of Thailand

NPLs in Real Estate Industry Takes a Large Part

Gross NPLs Classified by Business Sector



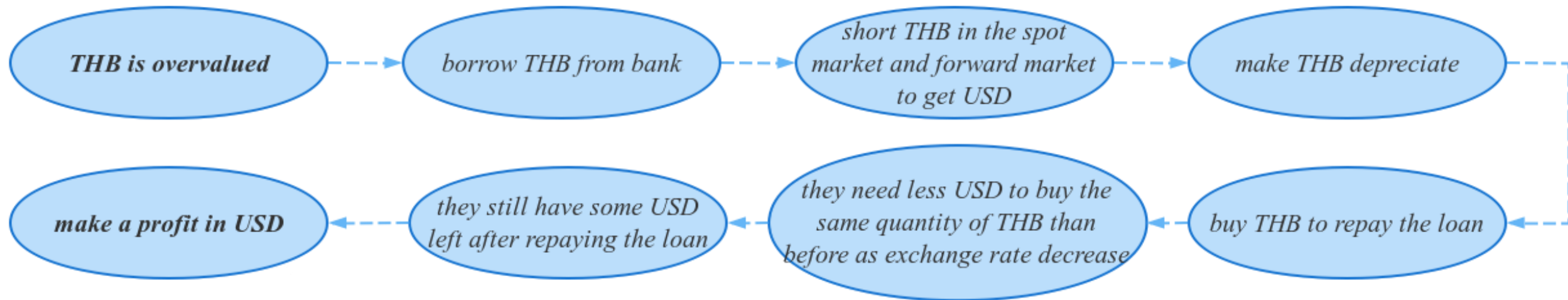
Data Source: Bank Of Thailand

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Part 3.a. The Process of the EAFIC in Thailand

How to make a profit when THB was overvalued?

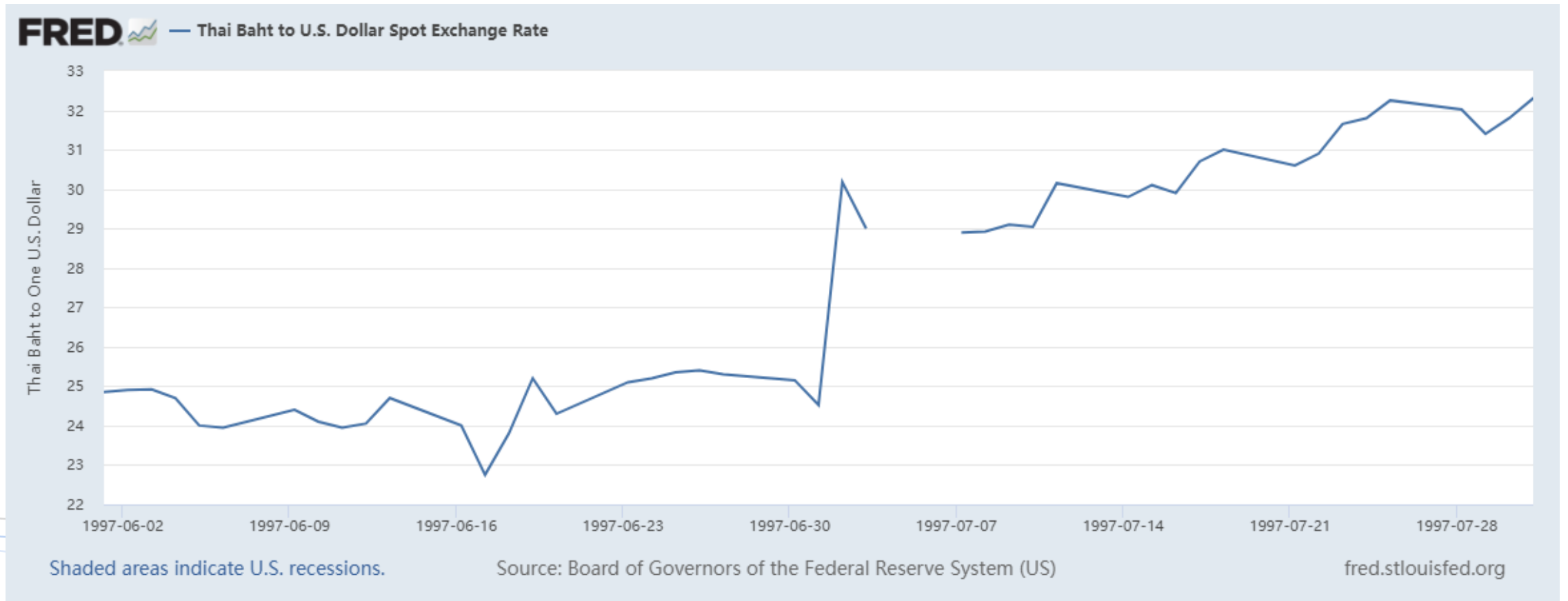


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Part 3.a. The Process of the EAFC in Thailand

Managed Floating Exchange Rate System – Compromise of Thailand Government



Data Source: BLS and St. Louis Fed

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Part 3.b. The Process of the EAFC in Hong Kong

“the Man Who Only Has One Measure”

Joseph Yam Chi Kong

He was the president of Hong Kong Monetary Authority during the EAFC.

When facing the short selling of HKD from speculative capital, the HKMA led by him usually only increased the interest rate of short-term loan to raise the cost of lending HKD from banks. And this could raise the cost of speculative capital.

As HKMA led by him usually only had this one measure to fight against speculative capital, he was called “the Man Who Only Has One Measure”.

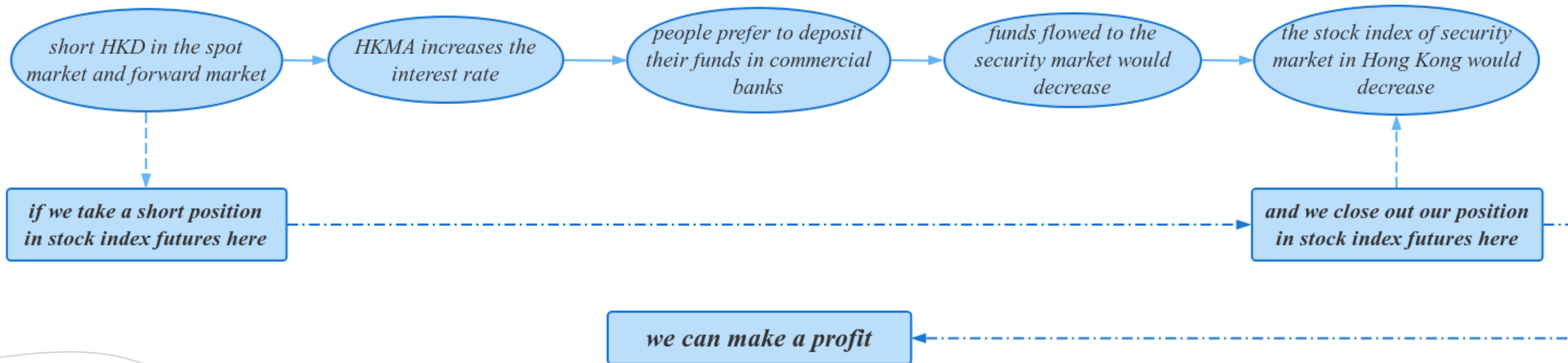


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Part 3.b. The Process of the EAFC in Hong Kong

Forex Market or Security Market – Looking One Way and Rowing Another

How the speculative capital made a profit in Hong Kong?

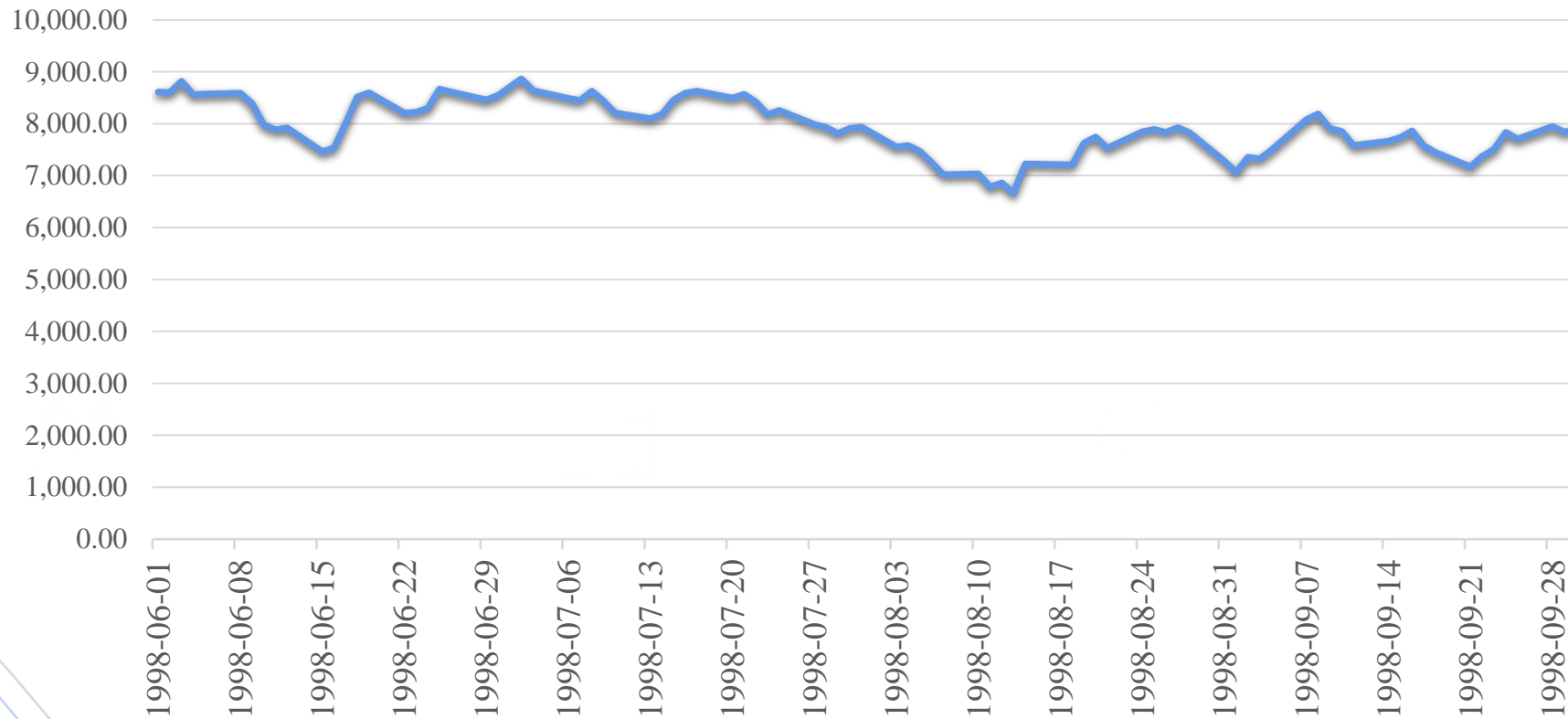


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Part 3.b. The Process of the EAFC in Hong Kong

Forex Market or Security Market – Looking One Way and Rowing Another

Daily Hang Seng Index

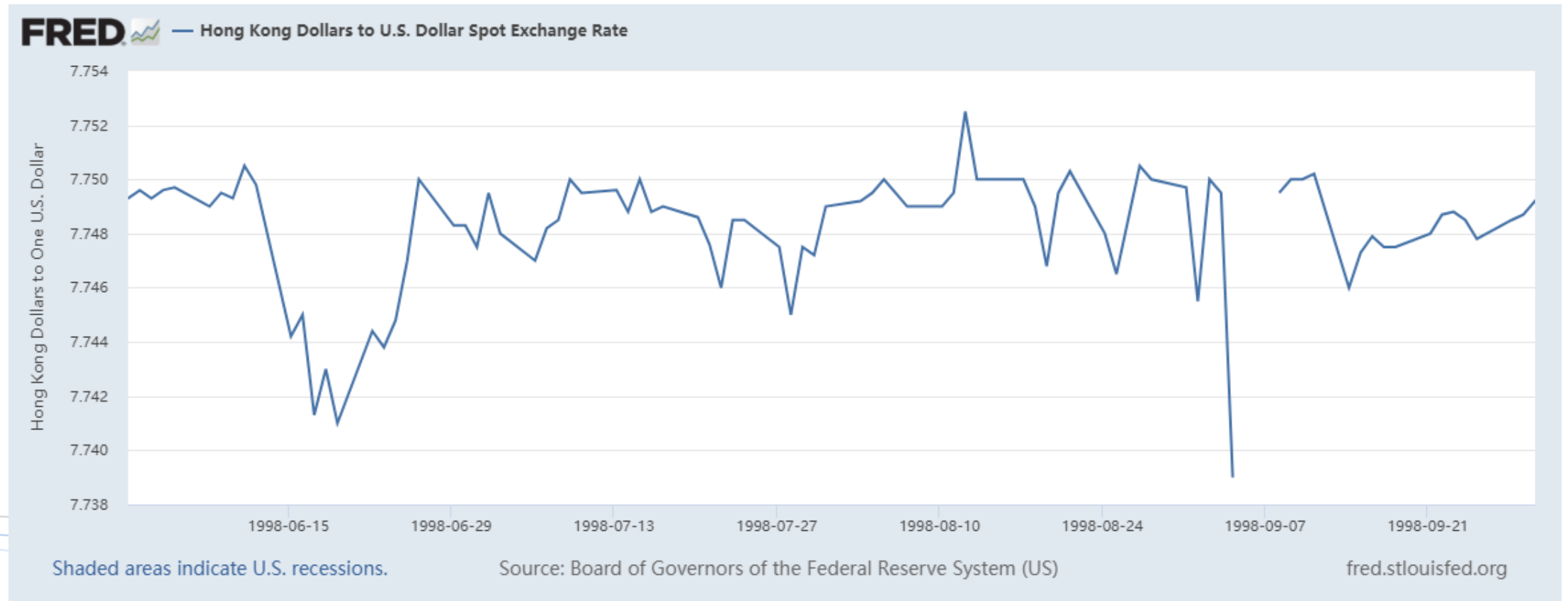


Data Source: Choice - Financial Terminal

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Part 3.b. The Process of the EAFC in Hong Kong

Forex Market or Security Market – Two Major Battlefields against Speculative Capital



Data Source: BLS and St. Louis Fed

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Part 4. Analysis of the Crisis: Based on the Fixed Exchange Rate System

Nominal Anchor Approach:

A pegged exchange rate system implemented to control inflation

- +: Preferred by many developing countries
Promise greater credibility through fixed exchange rates*
- : Easily evolve into a rigid exchange rate system
Produce an internal crisis tendency*

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Implementation of the exchange rate regime plan

Country	Plan Execution Start Date	Exchange Rate Arrangement	Inflation Rate of 12-month			Whether it end in a currency crisis
			At the beginning of the plan	The third year of plan implementation	Year of 1998	
Mexico	1987.12	Fixed Rate, Crawling Peg	143.7	29.9	18.6	Yes (1994.12)
Poland	1990.01	Fixed Rate, Crawling Peg	639.6	39.8	8.6	No
Uruguay	1990.12	Crawling Peg	129.8	52.9	8.6	No
Nicaragua	1991.03	Fixed Rate, Crawling Peg	20234.3	3.4	--	No
Argentina	1991.04	Currency Board	267	4.3	0.7	No
Estonia	1992.06	Currency Board	1085.7	29.2	4.4	No
Croatia	1993.10	Asymmetric Fixed Rate, Manage Floating	1869.5	4	5.3	No
Lithuania	1994.04	Currency Board	188.8	8.4	2.4	No
Brazil	1994.07	Fixed Rate, Crawling Peg	4922.6	6.1	0.4	Yes (1999.01)
Russia	1995.07	Crawling Peg	226	5.5	66.8	Yes (1998.08)
Bulgaria	1997.07	Currency Board	1471	--	3.2	No

Resource: Reinhart, Rogoff. *Exchange rate system in the process of world economic integration*, 2004.

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Internal Conflict:

*the Immaturity of Emerging Markets
& the Rigidity of Fixed Exchange Rate
System*

Overvaluation of Local Currency

Over-borrowing Syndrome

Risk Exposure of Banks and Financial institutions

	External Liabilities/M2			External Liabilities/Assets		
	1990	1994	1996	1990	1992-1996	1996
Thailand	6.1	25.1	32.8	265	519	775
Indonesia	1.2	7	3.2	108	193	143
Korea	4.4	8.3	14.1	140	149	174

*Borrowing of Domestic Banks from International Banks (1995-2002)
(Lending as a percentage of total domestic bank credit to the private sector, %)*

	1995	1996	1997	1998	1999	2000
Thailand	46	44	50	27	18	17
Indonesia	19	18	30	29	52	58
Korea	25	30	45	21	16	13

Corporate Debt Structure (1996)

	Domestic debt		Foreign debt	
	Short-term	Long-term	Short-term	Long-term
Thailand	29.6	12.3	32	26.1
Indonesia	20.5	19.6	31.4	28.5
Korea	29.4	17	27.7	25.8

Resource:

Goldstein Morris, Turner Philip, Controlling Currency Mismatches in Emerging Markets.

Eichengreen, B & Hausmann, R. Exchange Rate and Financial Fragility [R].NBER Working Paper 7418, 1999.

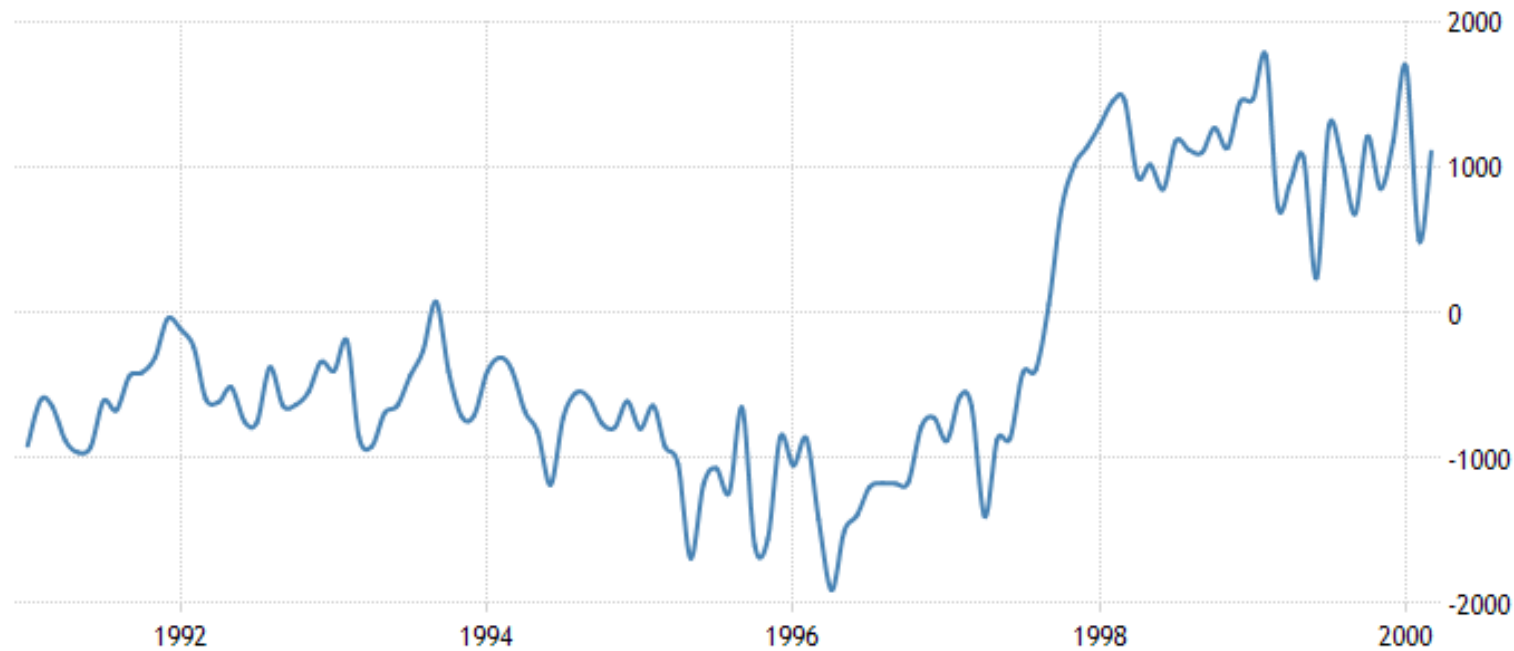


Part 5.a. Policy Evaluation in Thailand

Reason for Crisis:

1. Overdraft high growth of economy and inflation of non-performing assets

Thailand Current Amount Balance (Unit: Million USD)



Source: Bank of Thailand & Tradingeconomics.com

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Part 5.a. Policy Evaluation in Thailand

Reason for Crisis:

2. Inadequate regulatory system and inappropriate foreign exchange policies

① To attract foreign investment, the exchange rate was kept fixed while financial liberalization was expanded.

② The deregulation of the capital market provided conditions to speculate on the Thai baht.

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Part 5.a. Policy Evaluation in Thailand

Policy:

Economic reforms supervised by IMF

- ① Strong regulation frameworks for banks and other financial institution*
- ② Keeping interest rates high and cutting government spending.*

Opinions:

- ① Rapid recovery from the crisis.*
- ② Government cut harmed the recovery and surged the public debt burden.*

Final Solution: Thaksinomics

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Part 5.b. Policy Evaluation in Hong Kong

Reason:

- ① Market bubbles caused by rapid economic growth*
- ② The automatic adjustment mechanism of failed due to speculation*
- ③ Negative impact on the stock market under high interest rate*

Policy:

Purchase excessive HKD and stocks to stabilize exchange rate and Hang Seng Index.

Pros and Cons:

Stabilization on the financial and currency market.

Expectation on profit reduction and downturn in output, resulting in deflation and unemployment in the short-term.

Solution:

- ① An easy monetary policy for recovery.*
- ② Technical improvement of financial system*

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Part 5.c. Lessons we learnt

- ① Rational assessment of national conditions and selection of the most fitted exchange rate system.*
- ② Adequate level of debt and sufficient foreign exchange reserves*
- ③ A solid financial regulatory system.*

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Part 5.c. Limitations and Further Research Area

- ① Overemphasized on public sector*
- ② Lack of dynamic analysis between the monetary data*
- ③ Need more advanced statistical research methods*

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Thanks for listening!

Thanks for the guidance of Professor David Schabes.

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