

'How useful is the literature on 'vulnerability indicators' in understanding Southeast Asia's 1997-98 economic crisis?'

Explain the concept of VI's.

If something goes wrong, a lot can go wrong.

Notion that apparently minor problems may conceal major problems.

Interactive problems, eg, fiscal policy, ER's, financial sector.

Need to distinguish between various crisis explanations:

(a) prelude/vulnerability indicators,

(b) the 'trigger',

(c) initial responses and spread of the crisis, and

(d) longer term adjustment and management issues.

Recall general crisis theories:

- International financial markets inherently unstable.
- Capital market devts in the 1990s.
- Domestic macro policy (fiscal, monetary; Mundell, etc).
- Domestic financial sector.
- Others - rising corruption/regime credibility, capacity to respond during a crisis; role of IFI's.

Can assign indicators to proxy the various domestic indicators.

As discussed in overhead: GDS/GDP; fiscal/GDP; inflation; CAD/GDP; debt/GDP; ST/total debt; internat reserves/months of imports; ST debt/internat reserves; NPLs; credit ratings.

Discuss briefly and illustrate rationale for choosing these series, and their reliability.

EG: CAD/GDP - could be a 'good' or 'bad' sign; NPL problems arise with ER collapse; credit ratings have mixed record.

General story:

High debt/GDP, more predisposed to a crisis.

But depends: composition; funding matter; how is foreign borrowing invested?

Financial sector crucial; regulatory/supervision quality.

A major market failure in the ratings agencies. Phils, VN rated lower, but survived the crisis!

General regime credibility and institutional quality.

Note country differences:

Eg, Thailand, exceptionally large CAD/GDP, premature financial liberalization, sudden export growth slowdown.

Malaysia: very high credit and SM capitalization/GDP; therefore less room for raising r/i to defend the currency.

Indonesia: weak financial supervision; quite high debt; political problems.

Mainly contagion, less vulnerability: Philippines, Singapore, Vietnam.
Explain and discuss.

Lessons learned, subsequent responses:

Fixed/quasi fixed ER; risky in presence of mobile capital.

How open should the capital account be? Especially ST K flows.

High quality financial sector supervision imperative.

Implications:

(a) force banks to be very conservative, high CARs, etc; (b) high quality, independent regulators; (c) encourage foreign bank presence - risk sharing and higher standards; (d) avoid govt guarantees.

Continuing search for 'predictors' of vulnerability. Any developments since late 1990s?