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THE CURRENT INTERNATIONAL FINANCIAL CRISIS: HOW MUCH IS NEW?

Steven B. Kamin*

Abstract: The paper surveys a broad array of data to compare the scope and impact of three emerging market financial crises: the debt crisis of the 1980s, the Mexican financial crisis of 1994-95, and the current international financial crisis. While certain conventional views regarding the three episodes are supported by the data examined in this paper, we find that in several respects, the current crisis is more similar to prior emerging market crisis episodes than is commonly believed.

Keywords: devaluations, financial crises

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The international financial crisis that began with the devaluation of the Thai baht in July 1997, and which continues to grip world markets as of this writing, represents the third major bout of financial disruption to sweep across the developing countries in recent decades. Compared with the debt crisis of the 1980s and with the Mexican (or so-called “Tequila”) crisis of 1994-95, the current crisis is widely considered to be distinctive in several respects. First, it appears to be the first genuinely global financial crisis to hit the emerging market economies, affecting, as it has, Asia, Russia, South Africa, and Latin America.¹ Second, it appears to be exerting a much greater impact on commodity prices, financial markets, and economic activity throughout the world—including in the industrialized countries—than was true of the prior two emerging markets crises. Finally, the current crisis, particularly as it has taken hold in Asia, appears to be more deeply rooted in financial imbalances in the private sector than in the public sector financial problems that characterized the 1980s debt crisis and the Mexican 1994-95 crisis.

This note represents a broad-brush survey of selected data to compare salient aspects of the three most recent emerging markets crises. In Section 1, we focus on the geographical scope of the crises to compare the extent of the world economy that was affected in each episode. Section 2 addresses the impact of the crises on key macroeconomic performance variables, including exchange rates, inflation, GDP, and the current account. Have these crises grown increasingly severe in their impact on affected countries, or are we merely more aware of their impact than was the case in the past? We find that, notwithstanding certain important differences between recent and previous crises, the basic characteristics of these crises were remarkably similar.

1. The Scope of Emerging Market Crises

There is a general perception that the current international financial crisis is more widespread than previous crises. However, precisely gauging the geographical scope of the different crises is less straightforward than it might appear at first glance, since different countries may be affected by financial

¹An argument also can be made for including Japan as a participant in this crisis.

crises to different degrees. Moreover, at any point in time, there are always countries experiencing difficulties for reasons entirely unrelated to international financial crises. For the purposes of this paper, we have identified—in an admittedly casual and ad hoc manner—the following countries as having been significantly affected by the three recent emerging markets crises:

1980s Debt Crisis:	Argentina, Bolivia, Brazil, Chile, Colombia, Cote D’Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia.
1994-95 Tequila Crisis:	Mexico, Argentina.
Current International Financial Crisis:	East Asia (Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand), Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela), Russia, South Africa.

For want of a more definitive list, the countries associated above with the 1980s debt crisis are those identified in 1986 by then-U.S. Treasury Secretary James Baker as being particularly affected by external indebtedness, and therefore the focus of attention under the so-called Baker Plan. The countries identified with the 1994-95 Tequila Crisis—Mexico and Argentina—are those that suffered the most pronounced pressures in financial markets and declines in output, although during that period, many other emerging market countries also either lost their access to international funding or found interest rates too costly to make it worthwhile to issue new liabilities. Finally, we have identified as current crisis countries those that have experienced or are experiencing significant balance-of-payments disruptions and/or reductions in growth.²

Based on the groups of countries identified above, Figure 1 represents a rough cut at portraying the economic weight of the economies affected by the different crises. At the broadest level and consistent with conventional beliefs, the current crisis has involved economies accounting for the greatest share of world activity—measured by GDP, exports, and US exports—while the Mexican 1994-95 crisis

²For Latin America, we have included seven of the largest economies in the region. Others have been affected as well, in particular Ecuador.

has involved the least.

Nonetheless, the scope of the 1980s debt crisis should not be minimized. The countries affected by the 1980s crisis accounted for nearly as high a share of world GDP as those in the current crisis. Because of the less open character of the Latin American economies in the 1980s, their share in world trade was much less than that of the economies affected by the current crisis, as may be seen in the second column; on the other hand, the third column shows that, as a share of U.S. trade, the Latin American countries in the 1980s were again very prominent.

An alternative means of assessing the scope of the three crises is to compare the amounts of external debt involved, insofar as a central focus of all three emerging market crises has been difficulties in servicing external debt. The first two columns of Table 1 compare the total amount of external debt owed by the affected countries, both in dollar terms and scaled by world GDP. While the dollar value of debt involved in the current crisis certainly is the highest of the three episodes, the difference is much less marked when debt is scaled by world GDP: 3.5 percent for the Baker 15 countries in 1982 compared with 3.9 percent for the countries affected by the current crisis.

The next two columns present the claims of industrial country banks on these countries as reported by the BIS. They indicate that bank loans to the countries involved in the emerging market crises, whether measured in dollars or as a share in GDP, have grown more rapidly than total external debt over the past 1 ½ decades, perhaps reflecting a fall-off in the role of official credits to these countries. Therefore, measured on the basis of bank loans, the current financial crisis appears to be broader in scope than were the preceding crises.

A more precise gauge of the exposure—and in particular, the vulnerability—of creditor banks to emerging market crises is the share of bank loans to the affected countries in the creditor banks' capital. The fifth column of Table 1 presents these data for U.S. banks. It is clear that the U.S. banking system is far less exposed to the current crisis than it was to the 1980s crisis.

On the other hand, it may well be the case that European and Japanese banks are more exposed to the current emerging markets crisis than they were to the previous two episodes. Data on European and Japanese bank capital are not available. However, the final column of Table 1 indicates that the non-U.S. share of BIS bank claims on countries affected by emerging market crises has increased substantially in the current episode compared with the 1980s crisis. Therefore, it is likely that claims on affected emerging market countries represent a much higher share of capital among European and Japanese banks than among U.S. banks.

2. Impact of Emerging Market Crises

Perhaps reflecting the fact that the current financial crisis is more widespread than previous crises, and hence is exerting a greater effect on the industrial countries, the perception has arisen that the current crisis has been more virulent in its impact on the affected economies. In this respect, however, memories of the hardships endured during previous emerging market crises may have been dimmed by the passage of time. Based on several measures of economic performance, the impact of previous crises has been at least as severe as that of the current crisis.

2.1 Exchange rates

Figure 2 compares movements in nominal exchange rates, inflation, and real exchange rates before and after the start of their respective financial crises for several key countries. The top panel indicates a surprising degree of similarity in the extent of initial nominal exchange rate depreciation experienced in each of the three emerging markets crises. Roughly half a year into their respective crises, Mexico (1982), Mexico (1995), and the East Asian economies affected most severely by the current crisis (Indonesia, Korea, Malaysia, Philippines, and Thailand) all experienced declines in nominal currency values on the order of about 40 percent.³

³The East Asia index is a GDP-weighted average of individual country exchange rates, rebased so that their value in the quarter immediately before devaluation—generally 1997 Q2—equals 100. For Korea, the index is constructed so that the quarter before the crisis is 1997 Q3, not 1997 Q2.

Notwithstanding the initial similarity in depreciations, Figure 2 indicates that subsequently, the Mexican peso in 1995 and the Asian currencies during the current crisis largely stabilized, while the Mexican peso in the early 1980s continued to depreciate. This difference may, in part, be attributable to differences in the response of domestic prices to devaluation in the different episodes. As the middle panel makes clear, inflation rates rose substantially in Mexico in 1982 and 1983, while the inflationary response to devaluation during the 1994-95 Mexican crisis and particularly during the current crisis in Asia has been much more muted.⁴ This difference in the response of prices to exchange rate changes is consistent with differences in inflationary tendencies between Asia and Latin America even before the current crisis.

The bottom panel of Figure 2 tracks the movements of multilateral real exchange rates before and after the advent of financial crises. The effect of correcting for changes in prices is to reduce the difference between Mexico in the early 1980s, on the one hand, and Mexico in 1995-96 and the Asian countries in 1997-98. Nevertheless, it is obvious that the real exchange rate for Mexico in the early 1980s recovered more gradually than it did in Mexico after 1995, probably reflecting the much slower and more tentative resolution of that earlier financial crisis.

There are no obvious reasons for why initial depreciations—both real and nominal—were so similar in the three episodes. While it is beyond the scope of this paper to explain the occurrence and severity of these financial crises, Table 2 presents some indicators of vulnerability to external shocks for selected countries (including several not represented in Figure 2). Interestingly, as shown in the first column, current account deficits were substantial and similar in all three financial crises: about four to five percent of GDP on average. On the other hand, the very rough measure of exchange rate

⁴For the East Asian aggregate, both the depreciation shown in the top panel and the inflationary response shown in the middle panel is exaggerated, to some extent, by the inclusion of Indonesia, where economic difficulties were compounded by political problems. Without Indonesia, the data for East Asia would have indicated a rebound in nominal currency values after two quarters, and a much less pronounced inflationary response to depreciation.

overvaluation shown in the middle column—deviations of real multilateral currency values from their 1980-96 averages—indicates substantial overvaluation in the Latin American economies in the 1980s, but generally appropriate alignments for the East Asian countries immediately before their recent crisis. Finally, ratios of short-term external debt to international reserves were high in all three episodes, but considerably higher on balance among the Latin American countries before the debt crisis than among the East Asian economies in 1996.

2.2 Output

While all three of the emerging market financial crises started with precipitous exchange rate devaluations, in all cases the crises led subsequently to sharp declines in economic activity. Figure 3 compares movements in the GDP growth rates of Latin America during the debt crisis of the 1980s, Mexico during its financial crisis in 1994-95, and the most affected East Asian countries during the current crisis. (Data for East Asia in 1999 and 2000 are from the February 1999 Consensus Forecasts.)

The following observations can be made.

First, the reductions in growth experienced in Mexico and Argentina in 1995 and in Asia in 1998 appear to be broadly comparable, although the decline has been more pronounced for the East Asian countries.⁵

Second, assuming that the Asian growth performance in 1999 comes close to predictions, East Asia will share with Mexico and Argentina in 1994-95 the experience of a sharp rebound after an initial sharp decline. However, Asian growth is projected to rise to a much lower level— about 0 percent— than was the case during the Tequila Crisis, suggesting that certain aspects of Asia's financial crisis may have much longer-lasting effects than was the case in Mexico and Argentina. Factors that have been cited as likely to retard the recovery of growth in Asia include the dimensions of its financial sector problems,

⁵The comparison is complicated by the fact that 1995 embraces a complete year of the financial crisis in Mexico and Argentina, whereas the Asian crisis started only mid-way through 1997. Hence, 1995 for Mexico-Argentina is best compared with 1998 (that is, year +1) for East Asia.

problems of overcapacity relative to world demand for its exports, and flagging economic activity in a key trading partner, Japan. Moreover, since a significant fraction of the trade of developing East Asian economies is with each other, this makes it more difficult for them to rely on exports as an engine of growth.

Finally, the growth rate of GDP in Latin America during the 1980s debt crisis appears to exhibit less marked upswings and downswings than in the two later episodes. While this could in part reflect differences in the nature of that crisis compared with Mexico and Argentina in 1994-95 and East Asia in 1997-98, it also reflects the fact that the Latin American countries fell into crisis at different times, with Argentina's problems starting in 1981, Chile and Mexico's in 1982, and Brazil's in 1983. In fact, the accumulated loss of GDP growth over the 1981-83 period was comparable to the losses experienced in the first full year of the latter crises. Moreover, output growth in the region remained depressed throughout the remainder of the decade.

2.3 Current accounts

Another important similarity across the three emerging market crises has been the substantial adjustment in current accounts. As indicated in the top panel of Figure 4, the affected economies in each of the crises started out with substantial current account deficits as a fraction of their GDP. As the crises proceeded, these deficits were sharply reduced, as in Mexico and Argentina in 1995, or swung into surplus, as in Latin America in the 1980s and East Asia currently.

Notwithstanding broad similarities, there also are important differences in the patterns of current account adjustment. Latin American current account deficits continued to widen in 1982 and never moved strongly into surplus. In Mexico and Argentina in 1995, on the other hand, initial current account adjustment was substantial but access to international capital markets was regained quickly enough so that the countries were not forced to run current account surpluses. Notably, East Asia currently is running very large current account surpluses in spite of sharp apparent declines in dollar export prices, in

part because these price declines have been largely offset by increasing export volumes, and also because imports have contracted substantially.

Differences in the international environment explain some of the differences in current account performance across crisis episodes. As shown in Figure 5, the debt crisis of the 1980s coincided with a deep recession in the industrial countries, high nominal and real international interest rates, and steep declines in the terms of trade. Together, these constrained the extent of current account adjustment. Conversely, international conditions during both the 1994-95 Tequila Crisis and the current international financial crisis have been more favorable for the external balance positions of the affected economies.

Returning to Figure 4, the bottom panel scales the current account balances of the affected countries by world merchandise exports in order to gauge the importance of current account adjustments to the rest of the world.⁶ As might be expected, given the limited geographical scope of the Mexican 1994-95 crisis, it led to a relatively small movement in scaled current account balances. Conversely, the current account adjustments of Latin America in the 1980s and East Asia more recently, relative to total world trade, appear to have been similar in magnitude.

This latter finding appears to contradict the view that the current emerging markets crisis is having a more significant impact on global economic activity than was the case during the debt crisis of the 1980s. Two possible explanations for this view arise. First, the industrial countries already were in a very sharp recession in the early 1980s, which may have obscured the marginal impact of the debt crisis in further lowering economic activity. Second, the dollar-value adjustment of East Asian current accounts may obscure an even larger adjustment in real terms, given the decline in their export prices.

2.4 Banking sector problems

As will be discussed further below, the recent financial crises in East Asia are believed to be

⁶The scale is very different in the two panels, since world exports are so much larger than the GDPs of the countries represented in the figure.

distinctive in that they were rooted in private financial sector problems. While problems of financial fragility may lead to currency crises in some instances, it also is true that sharp drops in currency values can lead to banking crises by boosting the local currency value of unhedged foreign-currency denominated borrowing. Leaving aside the question of whether banking sector problems led to balance-of-payments crises or vice-versa, it is a fact that, to one extent or another, banking sector problems have been a feature of all three emerging market crises. Shown below are estimates from various sources of the cost of cleaning up the banking sector in each of the three episodes; costs for the East Asian countries, as well as for Mexico, are based on projections rather than actual outlays.

Banking Sector Bailout Cost/GDP

I. Latin America 1980s:	
Argentina	13%
Chile	20%
II. Mexico 1994-5:	
	15-20%
III. East Asia 1997-98:	
Thailand	42%
Indonesia	36%
Korea	20%
Malaysia	21%

Source: Ricardo Hausmann and Liliana Rojas-Suarez, eds., Banking Crises in Latin America, 1996; Deutsche Bank Research, Global Emerging Markets, December 1998; and author's estimates.

The estimates tentatively suggest that the East Asian banking crises may have been larger in magnitude than their predecessors. Explaining why this might be true is beyond the scope of this paper. However, it is worth noting, as shown in the first column of Table 3, that the magnitude of domestic bank loans relative to GDP was much greater in East Asia than in Latin America—this certainly helps to account for the larger prospective cost of the cleanup.

The second column of Table 3 indicates that average loan growth also was higher in East Asia recently than it was among the Latin American countries in the early 1980s, although it was below that in Mexico and Argentina in 1995. It is believed that high loan growth may engender inadequate

assessments of borrower creditworthiness by banks, which in turn could lead subsequently to poor loan repayment performance and hence financial sector weakness. While there are many reasons why loan growth may be high in emerging market countries, observers have placed considerable weight on the role of deficiencies of supervision and regulation, as well as problems of moral hazard.

3. Conclusion

Our brief and statistical *tour de table* of emerging market crises confirms that the current international financial crisis is the most widespread of the recent emerging markets crises. This is true, whether measured by the GDP of the involved countries, their trade, or their external indebtedness.

Nevertheless, the uniqueness of the current crisis should not be exaggerated. First, while its geographical scope exceeds that of the debt crisis of the 1980s, it generally does not do so by a very large margin (depending upon the measure of scope employed). Second, the basic characteristics of the financial crisis—depreciating currencies, sharp declines in output, rapid adjustments in the current account, and (in many cases) banking sector difficulties—were remarkably similar in each of the three episodes. Third, the impact of the current account adjustments of the affected countries on the global economy—as measured by movements in current accounts relative to world trade—were comparable in the debt crisis of the 1980s and in the current international financial crisis.

These similarities suggest that efforts to explain the occurrence of the current emerging markets financial crisis, and its impact on the rest of the world, should not be pursued in isolation. Clearly, the current crisis holds much in common with prior crises, although undoubtedly there are important differences as well. Hence, any analysis of recent events in international financial markets will likely be much enhanced by a second look at what took place during the debt crisis of the 1980s and the Tequila Crisis of 1994-95.

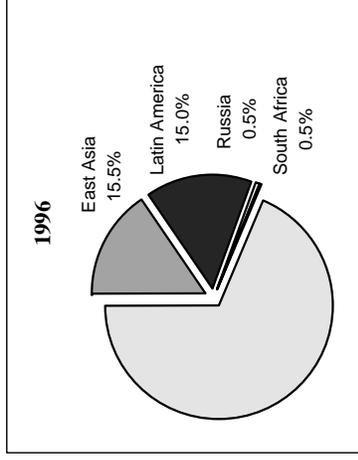
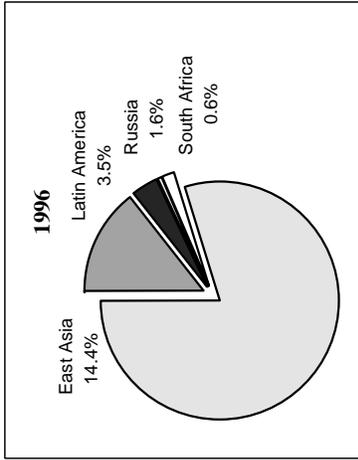
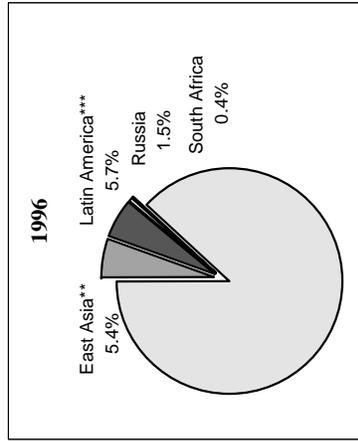
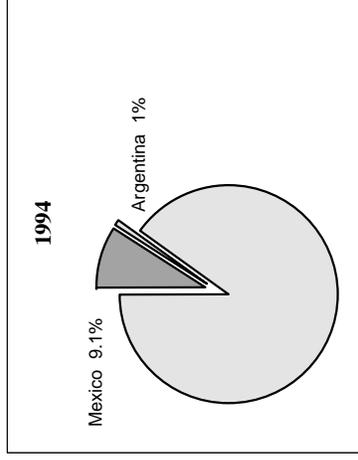
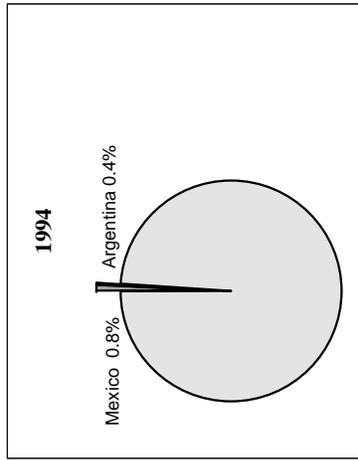
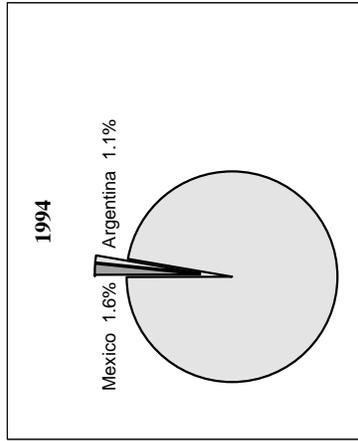
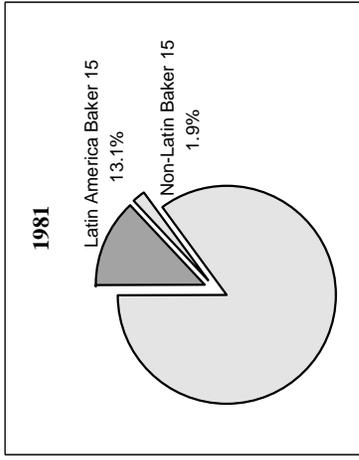
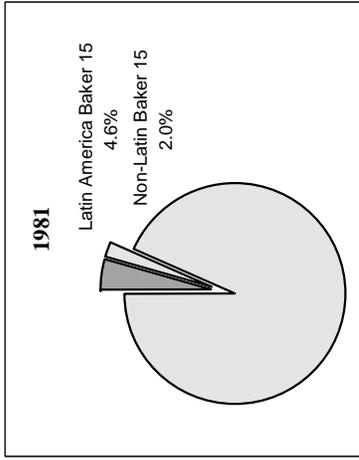
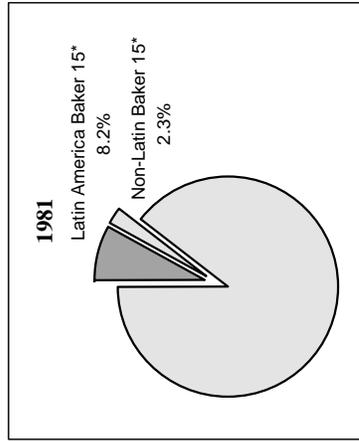
Figure 1

Emerging Market Crisis Countries

As Shares of World GDP

As Shares of World Exports

As Shares of US Exports

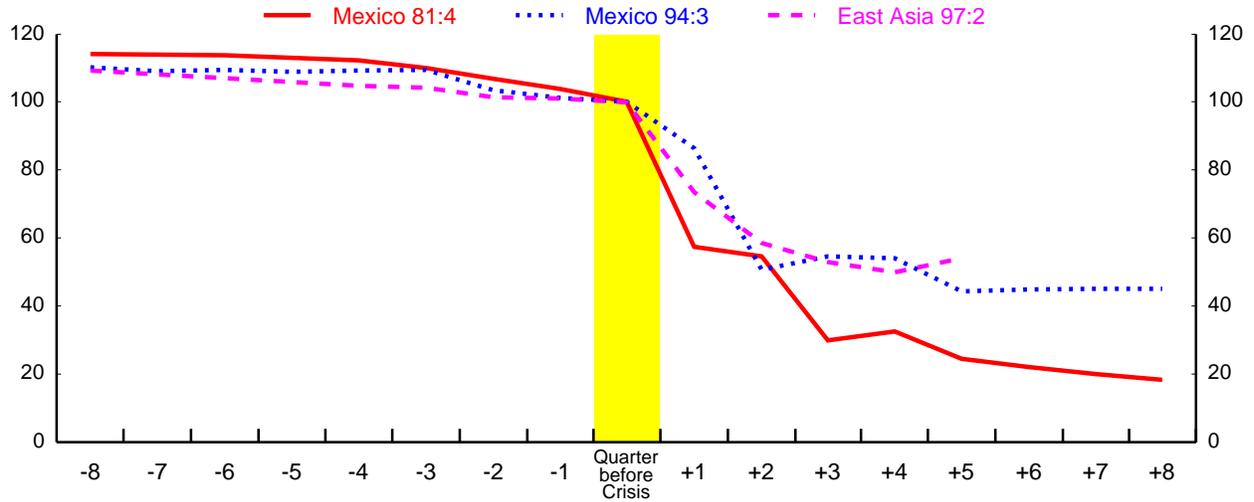


Sources: IMF International Financial Statistics and World Economic Outlook, World Bank World Development Report, and FRB Beatarex data.

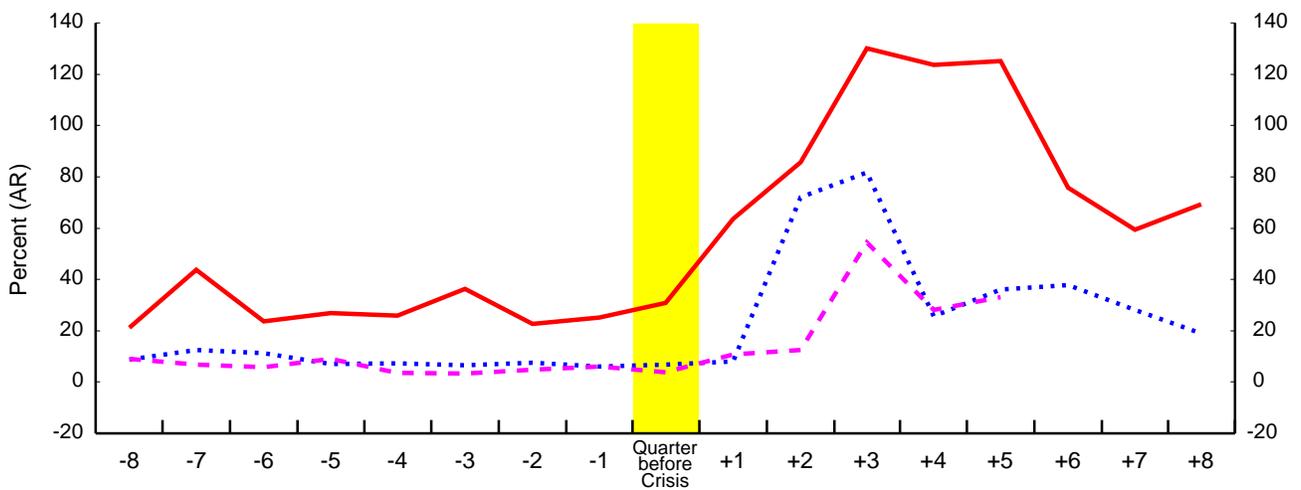
Figure 2

Impact of Emerging Market Crises on Exchange Rates and Prices

Nominal Exchange Rates Against \$US



CPI Inflation



Real Multilateral Effective Exchange Rates

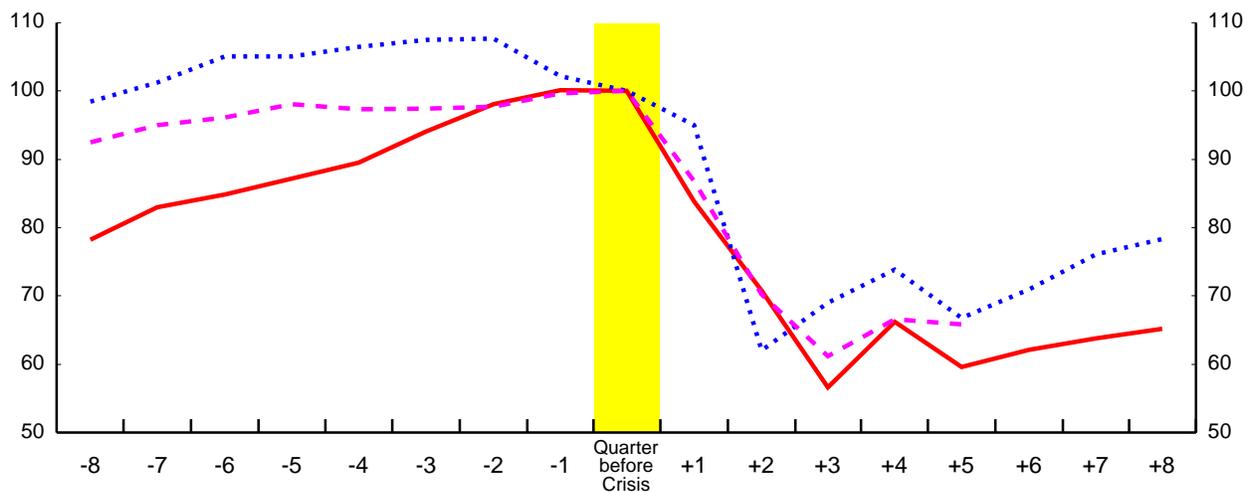
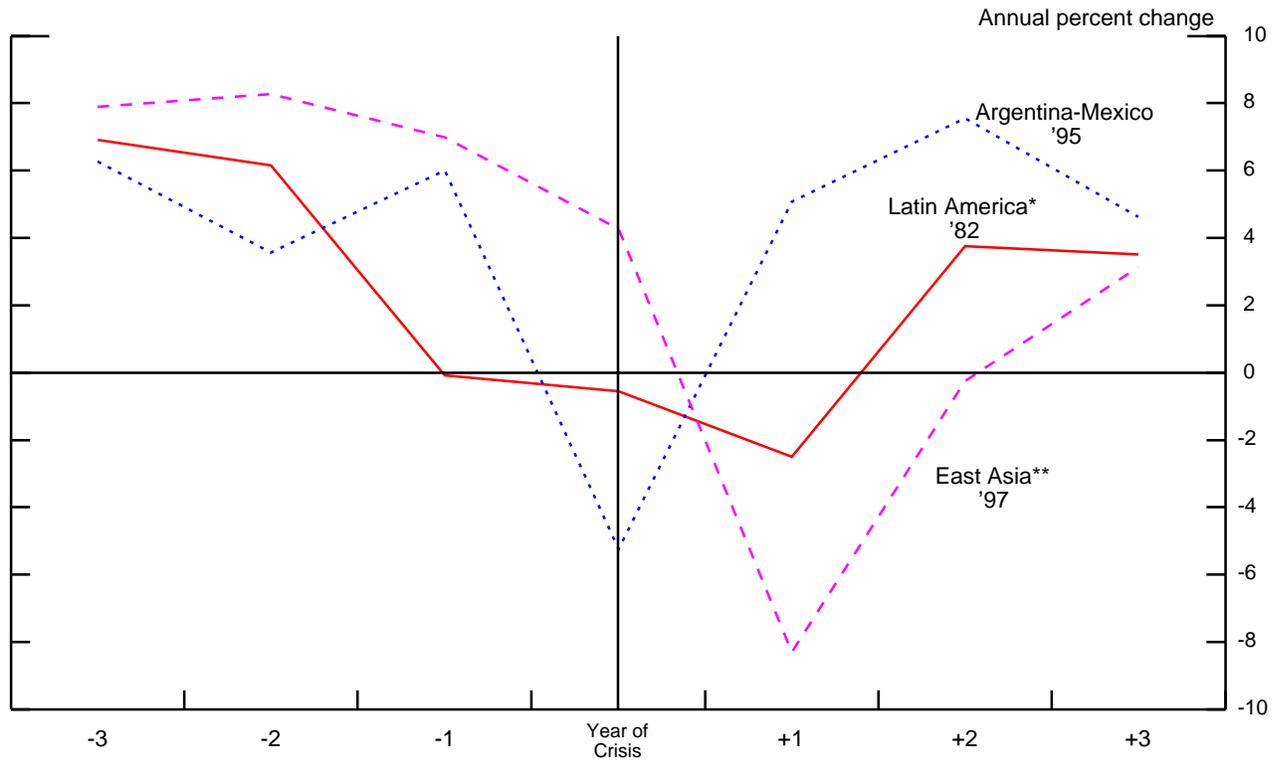


Figure 3
GDP Growth



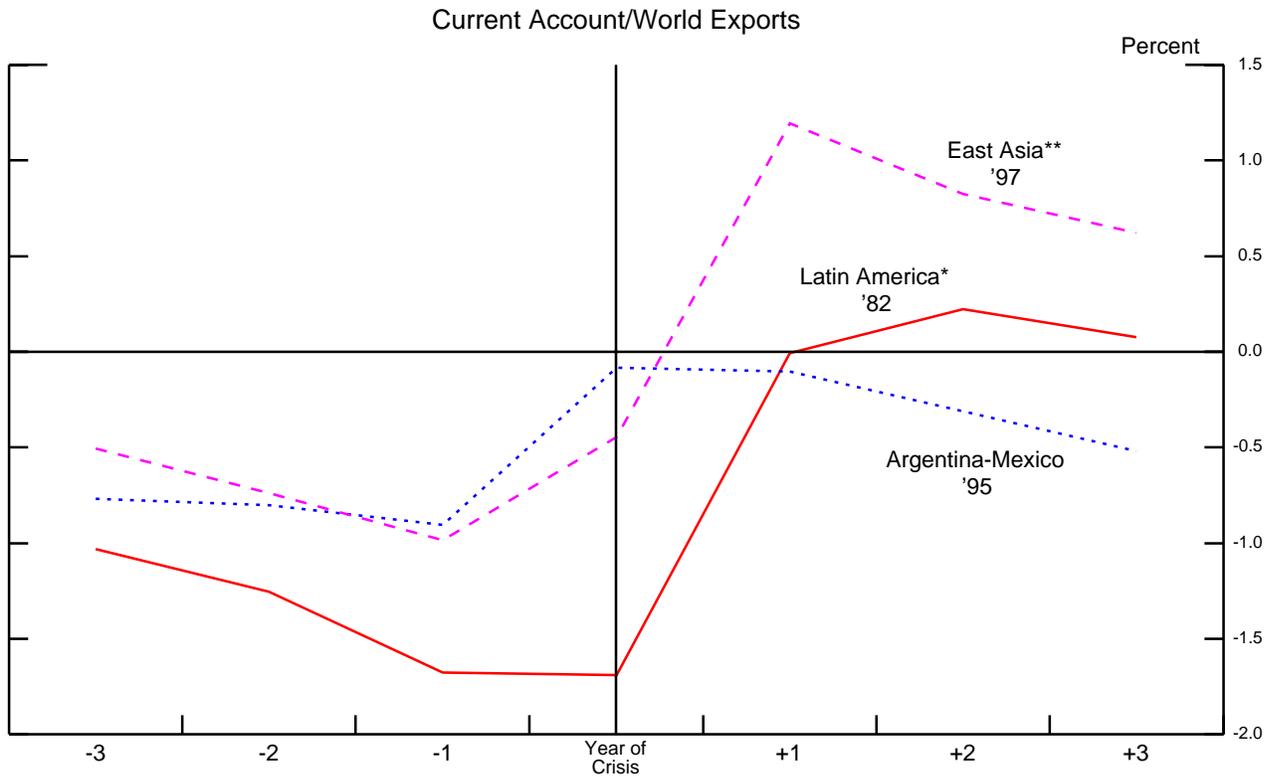
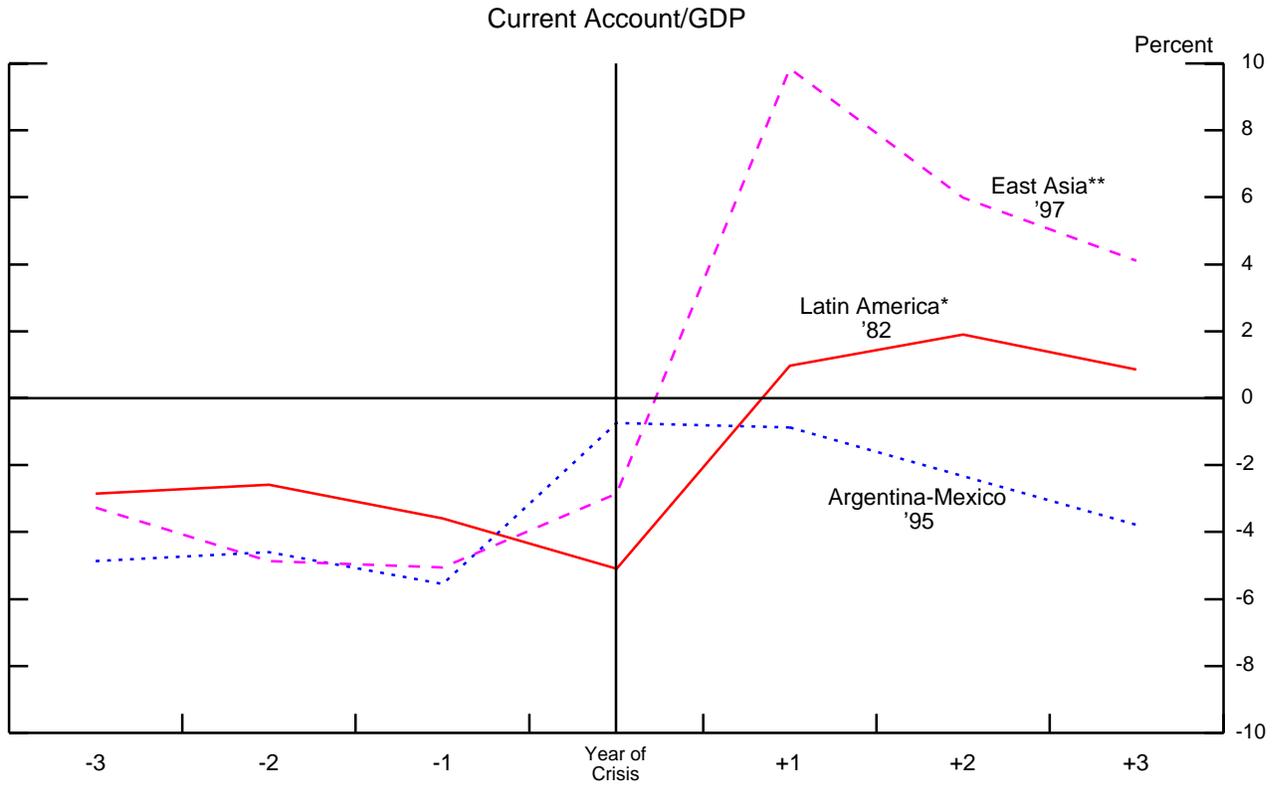
* Latin America refers to Argentina, Brazil, Chile, Mexico, and Venezuela.

** East Asia refers to Indonesia, S. Korea, Malaysia, Philippines, and Thailand.

Data for 1999 and 2000 are from the 2/99 Consensus Forecast

Figure 4

Current Account Adjustment



* Latin America refers to Argentina, Brazil, Chile, Mexico, and Venezuela.

** East Asia refers to Indonesia, S. Korea, Malaysia, Philippines, and Thailand.

1999 and 2000 figures for East Asia are from the 2/99 Consensus Forecast, world export figures assume no change in exports from 1997.

Figure 5

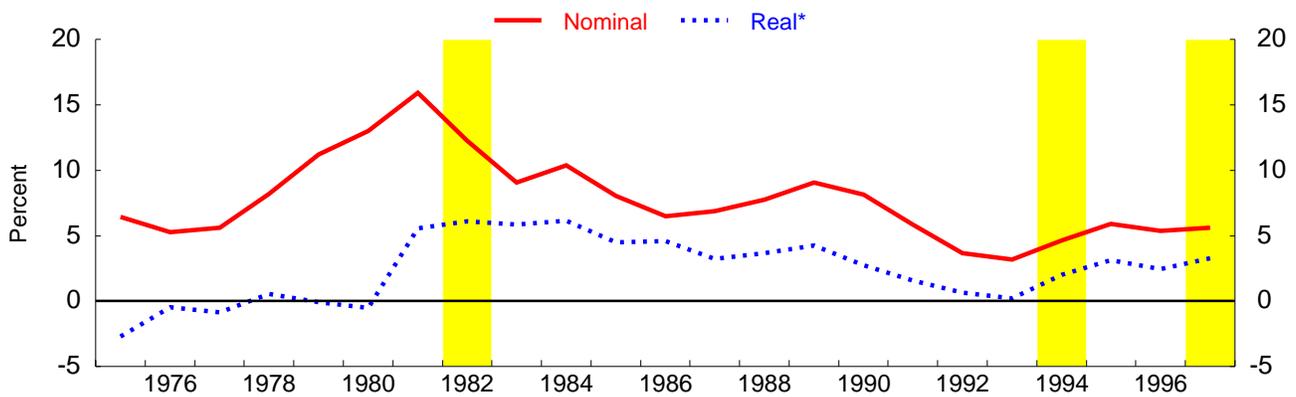
International Environment

Industrial Countries GDP Growth*



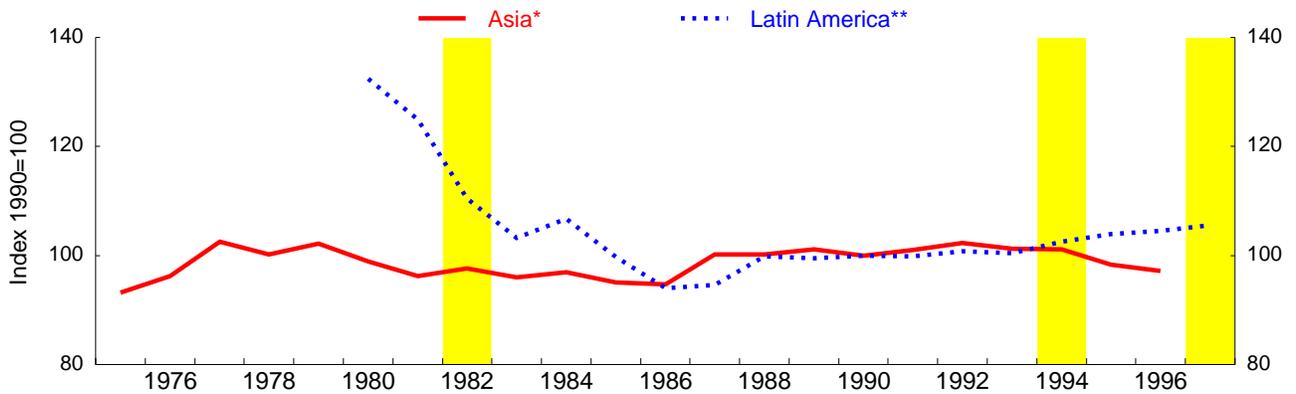
* Industrial Countries refer to the United States, Canada, Australia, Japan, New Zealand, Austria, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

3-month US Interest Rate



* Nominal interest rate less CPI inflation (annual average).

Terms of Trade



* IMF International Financial Statistics.

** Data from IADB for Argentina, Brazil, Chile, Mexico, and Venezuela; pre-1980 figures unavailable.

Table 1

	Total External Debt		BIS Bank Claims			
	\$billions	percent of world GDP	\$billions	percent of world GDP	U.S. bank claims/ U.S. bank capital (percent)	non-U.S. bank claims/ total BIS bank claims (percent)
1982						
Baker 15*						
Latin America	301.3	2.8	31.9	0.3	113.0	58.0
Non-Latin America	76.3	0.7	22.8	0.2	16.0	64.5
1994						
Argentina	77.4	0.3	35.3	0.1	4.8	72.0
Mexico	140.0	0.5	64.0	0.2	10.7	65.4
1996						
East Asia**	425.8	1.4	283.5	1.0	11.2	89.7
Latin America***	549.1	1.9	223.9	0.8	23.7	72.4
Russia	124.8	0.4	57.3	0.2	2.1	90.7
South Africa	23.6	0.1	17.0	0.1	0.8	87.8

* The Latin American Baker 15: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela. The non-Latin American

Baker 15: Cote D' Ivoire, Morocco, Nigeria, Philippines, and Yugoslavia.

** East Asia: Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

*** Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.

Sources:

Total external debt: World Bank World Debt Tables and Global Development Indicators, IMF World Economic Outlook.

BIS bank claims: BIS databases. Country Exposure Lending Survey for US bank capital data and for total claims of US banks in 1982.

Table 2

	Current Account/GDP (percent)	Real Exchange Rate (percent of long-term avg.)	Short-Term External Debt/ Reserves (percent)
1981			
Argentina	-2.8	131.3	974.9
Brazil	-4.6	104.4	375.5
Chile	-14.5	142.5	110.5
Mexico	-6.5	151.1	686.7
Venezuela	6.0	137.6	272.6
<i>Average</i>	<i>-4.5</i>	<i>133.4</i>	<i>484.0</i>
1993			
Argentina	-3.0	95.6	72.3
Mexico	-5.8	111.2	230.1
<i>Average</i>	<i>-4.4</i>	<i>103.4</i>	<i>151.2</i>
1996			
Indonesia	-3.4	86.0	226.2
Korea	-4.7	91.4	300.2
Malaysia	-4.6	95.5	41.6
Philippines	-4.8	110.0	125.7
Thailand	-8.0	100.4	102.5
<i>Average</i>	<i>-5.1</i>	<i>96.7</i>	<i>159.2</i>

Sources:

Current account, GDP and Reserves: FRB databases and IMF International Financial Statistics.

Short-term debt: World Bank World Debt Tables for 1981; J.P. Morgan for 1993 and 1996.

Real exchange rates: J.P. Morgan.

Table 3

	Bank Loans/GDP (percent)	Bank Loans/GDP (3-year percent change)
1981		
Argentina	10.7	17.6
Brazil	9.9	-19.0
Chile	46.4	128.1
Mexico	15.6	3.3
Venezuela	26.5	-21.1
<i>Average</i>	<i>21.8</i>	<i>21.8</i>
1994		
Argentina	18.2	60.1
Mexico	23.5	93.6
<i>Average</i>	<i>20.8</i>	<i>76.9</i>
1996		
Indonesia	54.5	14.7
Korea	58.7	14.5
Malaysia	93.1	26.9
Philippines	48.8	89.0
Thailand	99.3	25.1
<i>Average</i>	<i>70.9</i>	<i>34.0</i>

Sources:
FBR databases and IMF International Financial Statistics.