

# Thailand Currency Crisis

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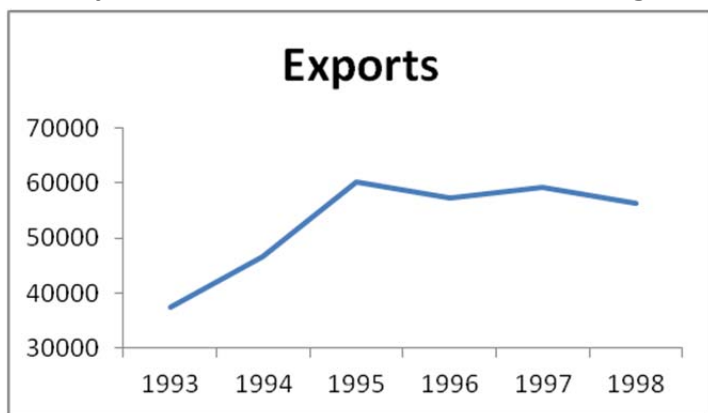
## Country Report

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**11/18/2011**

## Country Report: Thailand

This report is an analysis of some of the major economic factors that influenced Thailand during the time of the Asian financial crisis of 1998. Leading up to the crisis, Thailand's economy and financial markets were flourishing. Thailand was considered a tiger economy



meaning it underwent rapid economic growth from 1985-1996. Most of this growth came from the growth in exports. Thailand is a major exporter of rice and other

agricultural products like coconut, soybeans, and sugar cane. This sector of the economy

accounted for 70%

of employment in

the late 1980s. The

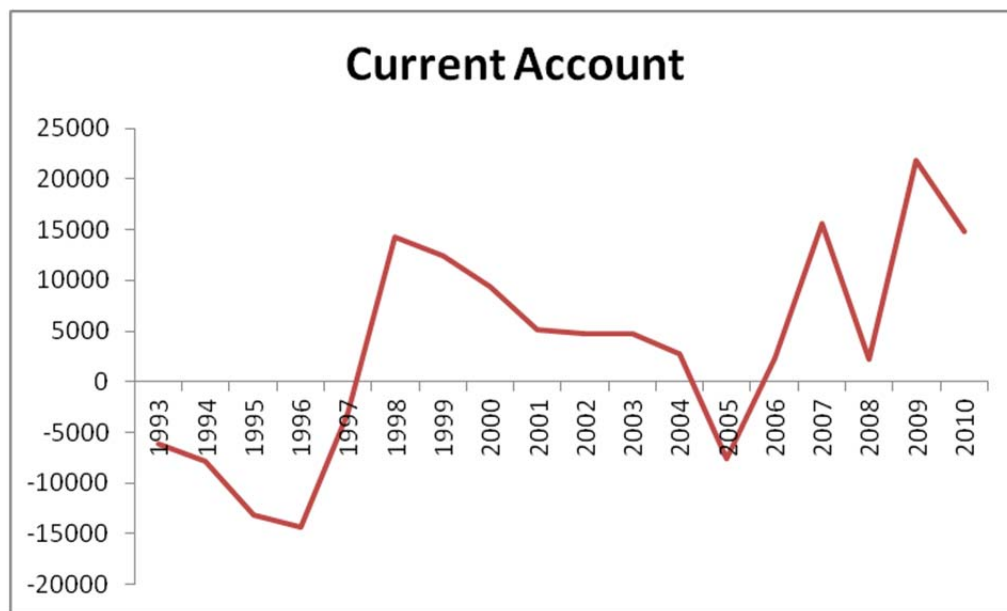
industrial sector,

though it

represented a

smaller portion of

employment, grew

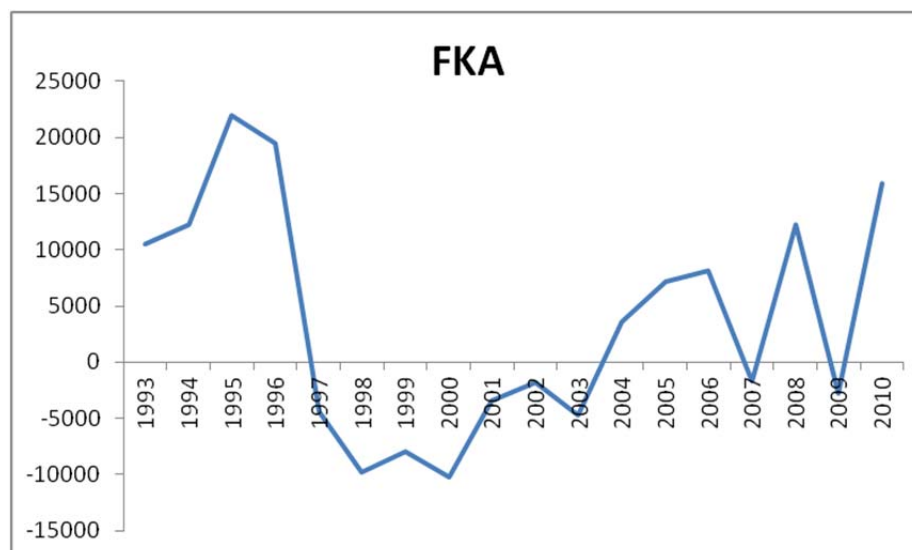


on average 3.4% from 1995-2005. Finally the manufacturing sector grew around 11% a

year in the first part of the 1990s. All of these contributed to Thailand's growth during the

pre-crisis era. Also during this era there were significant current account deficits. (Vines & Warr) These deficits were controlled by the capital account surpluses that were maintained due to private investment

inflows and external borrowing. Thailand does not release the official numbers for its capital so the financial capital account (FKA) graph only takes into account the



financial account. (Bank of Thailand) The financial account is made up of direct investment and portfolio investment mainly. Having the current account deficit at this time made Thailand a net debtor to the world but as exports began to rise, the deficit became smaller and smaller until in 1998 a current account surplus was recorded for the first time that decade.

When the currency crisis hit Thailand in the summer of 1997 it was a shock to most seeing as the economy was doing so well and most people did not foresee a problem when they were doing so well themselves. In 1997 the unemployment rate was as low as 1.5%, this almost doubled immediately when the crisis hit. Though they were not seen as a potential threat to the monetary regime at the time, there were many signs that forecasted the crisis. Corruption in the government, financial market instability, and a real estate

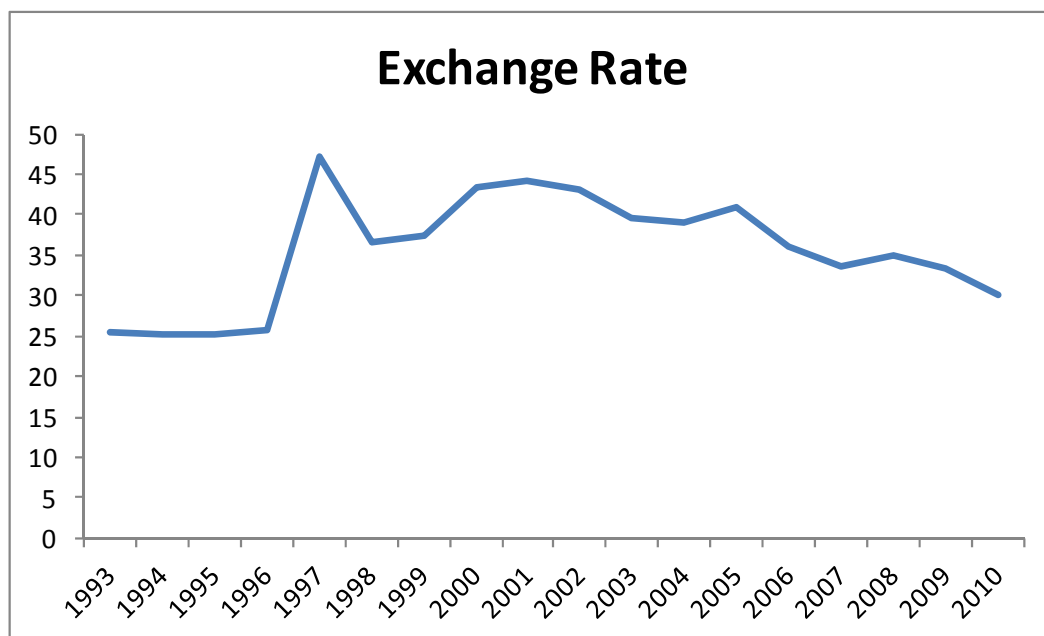
bubble were the main contributors that led to this crisis. As problems arose, the IMF eventually had to step and relieve Thailand and other Asian nations and with this help the nation eventually stabilized relative to its economic situation during this crisis.

During the period of economic growth, Thailand achieved very high investment rates and its stock market investments increased by over 175%. (IMF) The growth in investments was due in part to a growth in lending by the increasing amount of commercial banks at that time. The Bank of Thailand had little control over regulating such banks so they were free to invest in huge amount of capital without dealing with restrictions in policies. This led to the instability in the financial markets, the corruption in the government, and the real estate bubble that were all the major signs of a crisis for Thailand. Though a significant amount of excess lending took place in the private sector, the government also lent out more than it should of. A large part of the capital invested was in real-estate. Real-estate is a non-productive asset to invest in because it can only be invested domestically and results in less national volume of exports. (World Bank Group) The decline in exports leads to a weaker balance of trade and a weaker capital account. As investment grew in the non-productive sectors, it decreased in foreign direct investment which is a non-speculative type of investment that leads to real productivity in the economy. This type of investment decreased from 33.57% in 1990 to 15.90% in 1996. (IMF) The real estate bubble eventually becomes a problem as investment in the sector began to decline, dragging down the economy with it. People become less likely to pay back

their debts to financial institutions that were approaching maturity and the collapse of the financial markets began.

There had been foreseen long-run economic growth in the late 1980s and early 1990s that was now becoming subject to major speculation by foreign and domestic investors. Even if investors were willing to invest in foreign direct investment opportunities, funds were not available for them to get a loan. The financial crisis became focused around the lack of

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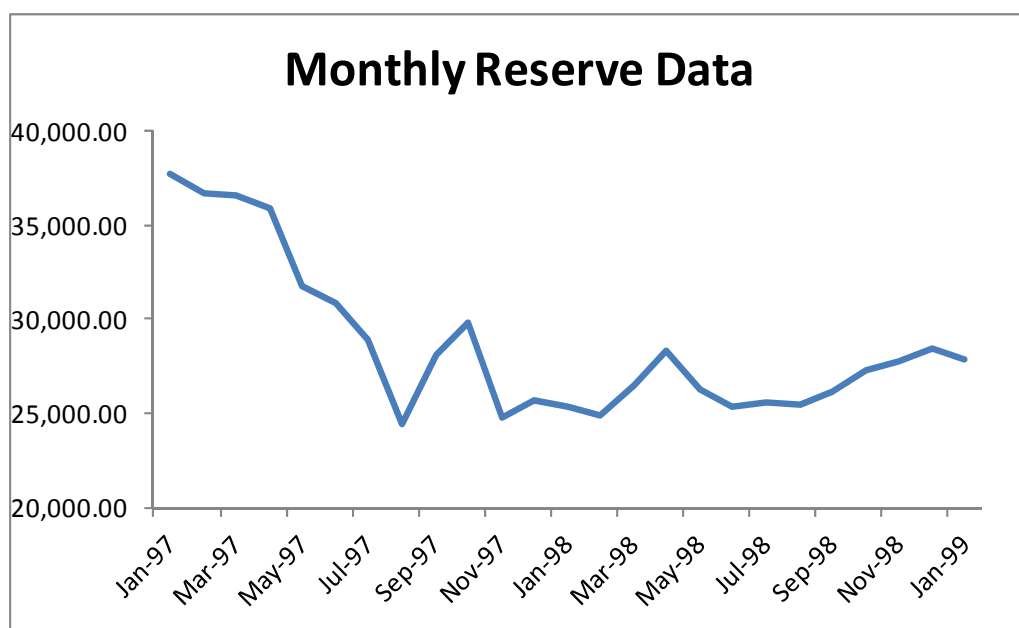


Bank of Thailand looking for some kind of solution. All that was found there was that the Bank of Thailand had already used \$28 billion of its \$30 billion in international reserves to try and defend the Baht. (Bank of Thailand) The problems caused by financial institutions were finally taking a toll on the nation's currency.

The other two major factors that contributed to the steep decline of the previously booming Thai economy were the fall in demand for semiconductors, a Thai major export,

and a serious appreciation of the dollar against the Thai Baht. As the dollar appreciated this began to cause a problem for Thailand who had fixed its currency based on a basket of dollar goods. Eventually the fixed exchange rate became an impossible target and the government was forced to float their exchange rate.

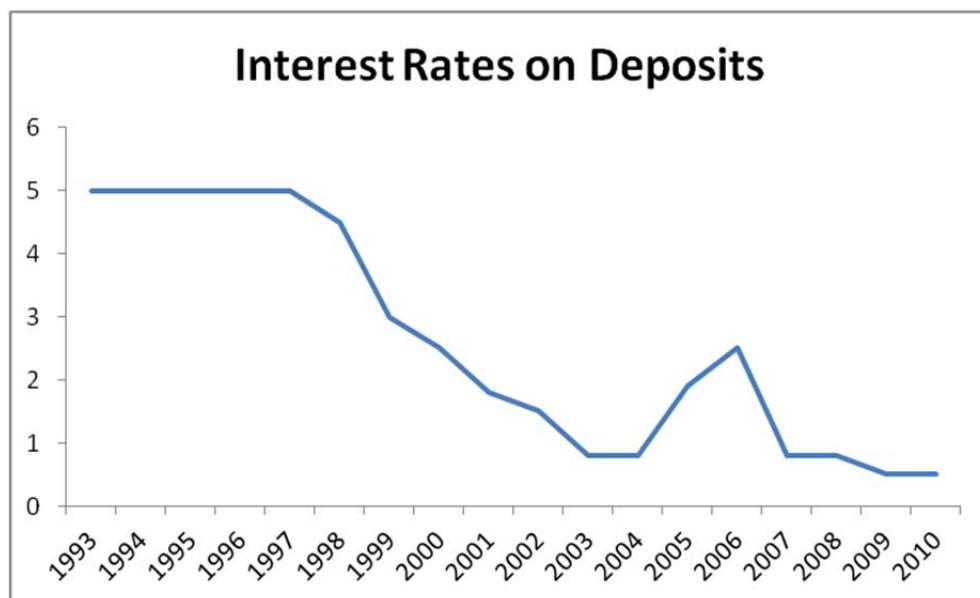
Before the crisis began in 1997, Thailand held a fixed exchange rate regime. At a fixed exchange rate a country commits to exchange foreign currency for domestic money on demand at a policy determined rate. This leaves domestic money determined by money demand. Then when money is created by the central bank after being demanded by the public, speculation of devaluation of currency evolves which in turn can lead to a loss of reserves. The series of speculative attacks led to Thailand having to float the Baht in July of 1997. The graph of the exchange rate shows an initial spike in the exchange rate as they floated the currency during the peak of the financial crisis. (World Bank Group) The value



of the Baht was on a serious decline following the floating of the exchange rate. It finally

bottomed at 48.8 baht per dollar in December of 1997.(Bank of Thailand) Floating the exchange rate was just one of the steps to getting this crisis under control. The International Monetary Fund also took drastic measures to relieve all the countries affected by the financial crisis.

The Asian Financial Crisis caused a shortage of foreign exchange that has caused the value of the currency and equity in Thailand and other Asian

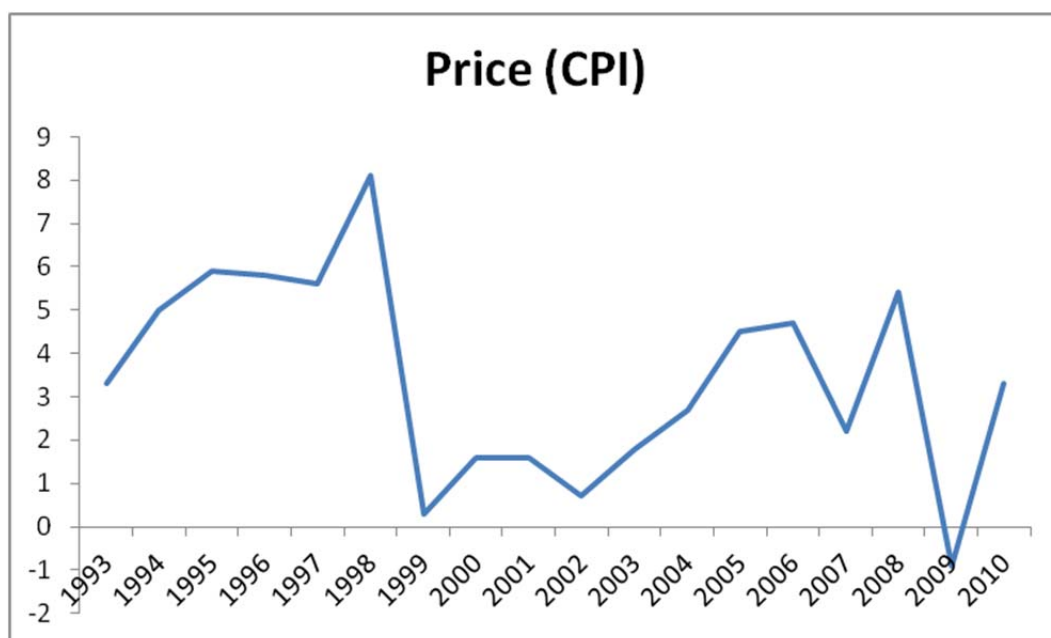


countries to decrease dramatically. Inadequately developed financial sectors and institutions developed poor mechanisms for allocating capital in Thailand's troubled economy. This in turn affected the United States and other international investors, who saw Thailand as a prosperous nation and a good investment before, in a negative manner. The Asian financial crisis was initiated by two rounds of currency depreciation that have been occurring since early summer 1997. The first round was an unforeseen drop in the value of the Thai Baht, along with the currencies of Malaysian, the Philippines, and Indonesia. The stabilization of these currencies occurred as the IMF stepped in and as each individual nation took the necessary steps toward their own stabilization. The second round of

depreciation began with downward pressures hitting the Taiwan, South Korean, Singapore, and Hong Kong. By this point a full Asian financial crisis had evolved. The graph of the monthly reserve data demonstrates the decline in reserves beginning in January 1997 and shows that they continued to decrease until the summer of that year when the crisis hit. . Interest rates almost decreased by 50% from 1997 to 1998. A decrease in interest rates was due to the increase in the money supply at this time. Though it took the Thai government almost 30 days the finally put in a request for monetary aid they finally reached out to the IMF in August. This was almost a month after Thailand switched to a floating exchange rate regime. The drop in interest rate coincided with a large jump in the exchange rate. The rapid jump in the baht/dollar exchange rate was an increase in almost 100%.

The drop in interest rate caused a significant increase in prices. Prices we slowly on the rise during Thailand's economic expansion and from 1994-1996 prices were relatively stable. With

the pressures from the decline in the financial institutions, prices rose





quickly at the beginning of 1997 until 1998. This was about a 44% increase over that one year. Following the IMF relief package prices declined quickly over that next year going from the peak of 8.1% down to .3% (measured in terms of the CPI). (Asian Development Bank)

In May 1997, Japan hints that it might raise interest rates to defend the yen. The threat never materializes, but it shifts the perceptions of global investors who begin to sell Southeast Asian currencies and begins a dramatic decrease in both currencies and local

stock

markets.

On August

20, 1997

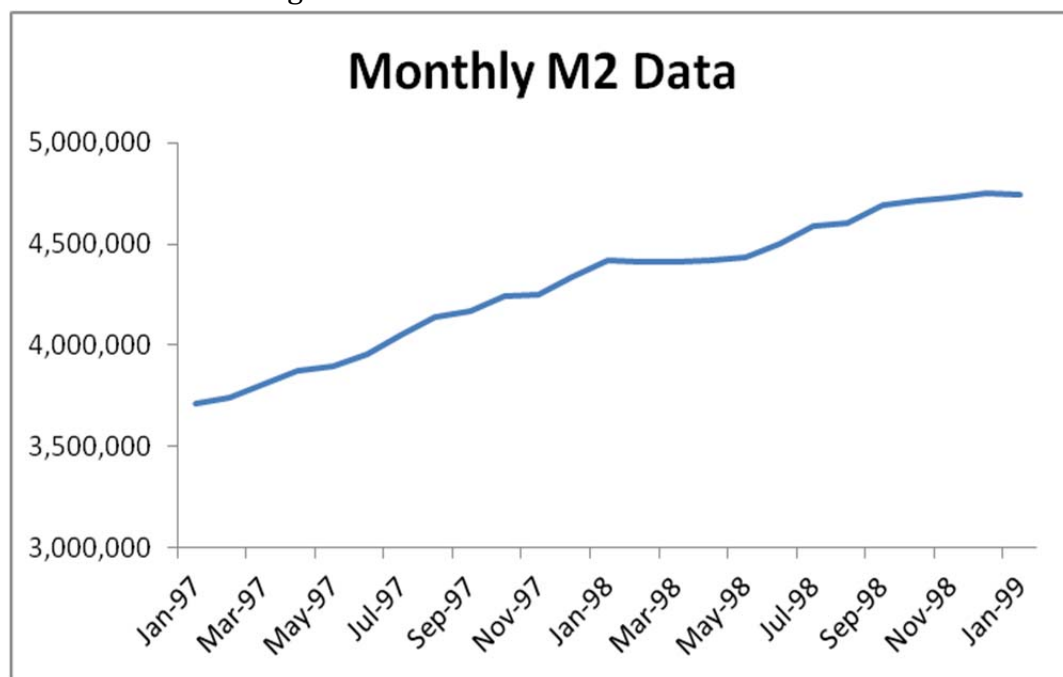
the IMF

announced

a \$17.2

billion

support



package for Thailand with \$3.9 billion from the IMF themselves. A support package is given to a country from the IMF when a request from the country experiencing financial difficulty is made. (IMF) This request is then assessed by IMF officials to determine the situation and what kind of relief is can give. If a support package is approved, the IMF usually begins with an initial loan of hard currency to the borrowing nation. For this

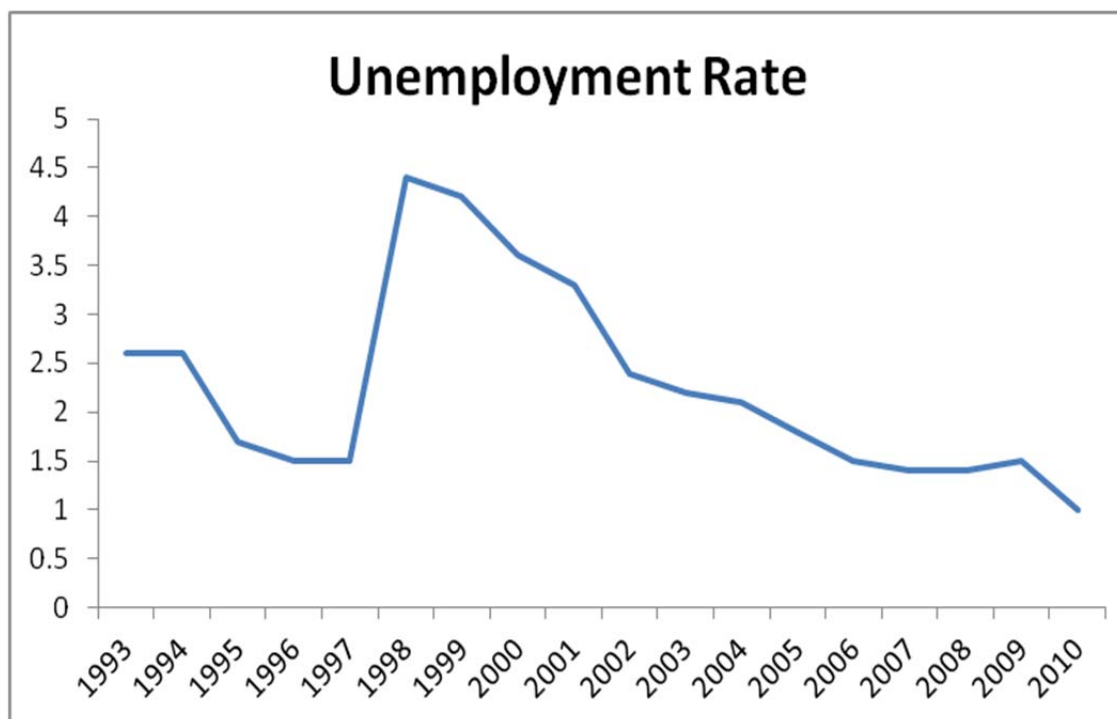
financial crisis if the financial situation continued to diminish, commitments for funds were pledged by the World Bank, Asian Development Bank and certain nations if needed. The funds borrowed by Thailand go into the central bank's, the Bank of Thailand's, foreign exchange reserves. (IMF) These reserves are used to supply foreign exchange to buyers, both domestic and international in hopes of stimulating the economy and getting Thailand back on track.

Thailand announced a package to strengthen its own financial sector on October 14, 1997. Due to the financial package granted by the IMF, during this period (1997-1998) there was a gradual increase in the Money supply (M2). The Money supply increased monthly at a more rapid pace in 1997 than it did in 1998. This increase in M2 served as the catalyst for the decreasing interest rates and the increase in the exchange rate shown on the graphs of M2, the exchange rate, and the interest rate. (Asia Development Bank)

The aftermath of the crisis and the relief period involved a significant recession in the nation of Thailand. While Thailand was booming, in the late 1980s and first half of 1990s, consumer spending was on the rise. Private consumption increased 8.4 percent from 1992-1993 and continued to increase until 1996 where it fell slightly from 7.8% to 5.8%. Then in 1997 the annual percentage change in private consumption was -1.4%. Consumers during the booming period saw long-term growth for Thailand. They invested their money in speculative assets thinking that the higher risk would offer a higher return in the long-run, not expecting a currency crisis to hit all over Asia. Not only was spending on the rise in the

private sector but government spending was also rising during the pre-crisis period. The annual change in government spending increased 12.1% in 1996. After the crisis hit in

1997, the government spending fell to -2.8% annually. The decrease in private and government spending decreased the



nation's growth of output, or GDP during the crisis period. This is how Thailand fell into a major recession. Another key indicator of the recession was the unemployment rate. After the IMF relief and Thailand's own bailout plan for themselves, the effects of unemployment continued to increase as it did during the crisis. The graph shows the major increase in unemployment from 1996 to 1998. So a decrease in overall output increased the unemployment rate by over 50% at this time. (Asian Development Bank)

Thailand eventually stabilized as the recessionary period came to a close and the once corrupt and lenient government got its balance sheet back on track. Rebalancing all the macroeconomic factors to rebuild the economy had to start at the source of the problems

for Thailand which was their financial markets and government regulation of those markets. The financial sector could not fully recover without changes to the Bank of Thailand who is supposed to act as a lender of last resort but failed to provide the necessary resources during this crisis and had to rely on the International Monetary Fund to offer a loan to the nation. As all the banks begin to work to increase their reserves and instill confidence in the banking system, investment will start to pick up once again and this will be a major factor in leading Thailand to a stabilized economy.

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