20 Years after the Asian Currency Crisis: Asian Economies Having Higher Risk Tolerance, while Increasing Debt Burden should be Watched

AKI FUKUCHI
ECONOMIC RESEARCH OFFICE

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The Bank of Tokyo-Mitsubishi UFJ, Ltd.
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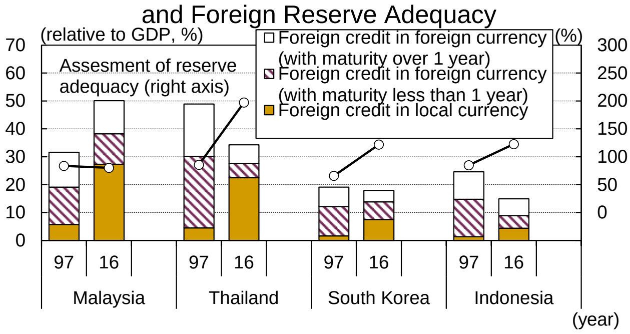
2017 marks 20 years after the Asian currency crisis, which started in July 1997 with the plunge of the Thai baht. In the current global financial markets after the US presidential election last November, the trend for higher interest rates in the US and a stronger US dollar continued, which triggered a short-term sharp fall in major Asian currencies. However, their currencies have remained overall stable since the beginning of the year. The factors behind the stability in those Asian currencies include the recovering economy in the region and their stronger economic fundamentals than before thanks to progress in economic reforms and political stability. Many Asian economies have had a current account surplus or reduced its deficit, compared to 20 years ago. As a result, their dependence on foreign debt has been reduced and their foreign exchange reserves have increased. The proportion of short-term debt with maturities less than one year or foreign currency-denominated debt in the total amount of outstanding borrowings from foreign banks has decreased after the Asian currency crisis. This suggests that improvement has been made on the issue of "mismatches in currencies and maturities", that is to say that local banks borrow short-term funds in foreign currency from foreign banks and they provide long-term loans to local companies in the local currency (see chart 1). In addition, the currency system of Asian economies has been improving as demonstrated by a shift to a floating exchange rate system as well as expansion of currency swap agreements, called the Chiang Mai Initiative, as a safety net. Asian economies are highly likely to avoid the tail risk of a currency crisis, although several risk factors still remain that could make financial markets volatile, such as interest rate hikes in the US or geopolitical risks.

The risk of an unexpected currency crisis is lowered, while continuing downward pressure from excessive accumulation of household debt in some Asian economies is recognized as a new problem in the region. Looking at the debt-to-GDP ratio by sector, the household debt ratio continues to rise as household borrowing has increased especially by means of home mortgages on the back of prolonged low interest rates and governments' stimulus economic measures. In particular, the household debt ratio in South Korea rose to 93% (as of end of 2016), exceeding that of Japan (63%) and the US (80%) (see chart 2). Looking at the bad debt provision ratios and capital adequacy ratios of financial institutions in Asian economies, the financial sector in the region remains overall healthy. However, it should be watched that rising debt burden, especially in South Korea, could rein in the pace of its private consumption growth for the time being.

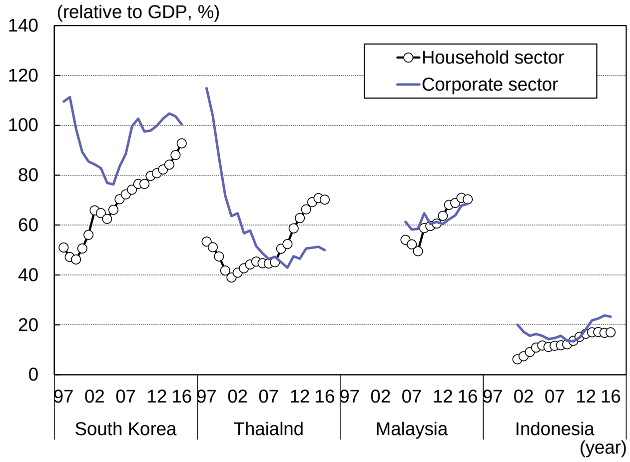
Chart 1: Total Amount of Outstanding Foreign Credit and Foreign Reserve Adequacy



Note: 1) *Assesment of reserve adequacy* in 1997 refers to the adequate level of foreign reserves as of 1997 for Thailand, 1998 for South Korea and 2001 for the remaining countries.
2) The IMF's ARA (assessment of reserve adequacy) index is calculated as below. Foreign exchange reserves above 100 to 150% of the IMF's index are regarded as an appropriate level of reserves.
ARA =5% × export amount + 5% × broad money
+ 30% ×short-term foreign debt outstanding
+ 15% ×other foreign debt outstanding (such as mid-to-long term foreign debts)

Source: IMF, BIS and BTMU Economic Research Office

Chart 2: Debt-to-GDP Ratio by Sector



Source: BIS, BTMU Economic Research Office

For further details, please contact the Economic Research Office, Bank of Tokyo-Mitsubishi UFJ

Chief Manager, Yasuhiro Ishimaru Tel: +81-(0)3-3240-3204

Written by Aki Fukuchi <aki_fukuchi@mufg.jp>