The impact of the financial and economic crisis in Asia on Norway's major development partners

Report submitted to the Norwegian Ministry of Foreign Affairs

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Summary*

This paper discusses the events that led to the Asian crisis, the management of the crisis and how it has affected some of Norway's most important development partners, South Africa, Mozambique, Tanzania, Zambia, Uganda, and Bangladesh. The term "The Asian crisis" encapsulates three different, but interrelated, crises, a financial crisis, a currency crisis and an economic crisis.

Four countries have been particularly adversely affected by the economic turmoil; Indonesia, Malaysia, South Korea and Thailand. All of these countries have experienced currency depreciation of at least fifty per cent, a strong reduction in the value of stocks and properties, increasing unemployment rates, and contraction of economic activity. Estimates suggest that the decrease in Gross Domestic Product in 1998 has been approximately 15 per cent for Indonesia, and between 6 and 10 per cent for Malaysia, South Korea, and Thailand. Other countries in Asia have been less severely hit by the problems, but economic growth in the region, which has been the fastest in the world for several years, has been substantially reduced.

Our analysis shows that the effect of the currency and financial crises is negligible for all development partners included in this study, except South Africa. The economic crisis in Asia, which refers to a reduction of Asian demand and economic activity, has some, but limited, implication for Norway's development partners.

The financial and currency crises in Asia led to a reduction of investors' confidence in the development of "emerging market economies," resulting in a massive withdrawal of capital. This affected South Africa, which experienced a higher risk premium in international markets. For the other countries analyzed in this study, however, the increased risk premiums in international capital markets were of relatively little importance. The main reason for this is that the countries are not integrated into the international financial markets as they mainly rely on donor money rather than financing from private sources.

The fast growing economies of Asia have been a significant driving force for the international economic and trade growth in the last decades. The reduction of economic activity in East and Southeast Asia in 1998 thus has important consequences for the international economy. One important effect is the reduction of prices in international commodity markets following the diminishing Asian demand. The net effect is, however, limited for the countries analyzed since they all benefit from the fall in the price of oil.

Our conclusion is that the turmoil in East and Southeast Asia is of relatively little importance to the countries analyzed. Their economies are more exposed to political instability, regional conflicts, weather conditions, and unsound macroeconomic management than to the effects from Asia. However, the development in Asia prior to the crisis, particularly with regard to the amount and utilization of incoming funds and the managing of exchange rates, may be an important lesson for other developing countries.

* The authors thank Stein Tønnesson for useful comments and suggestions.

1 Introduction

This report analyzes the impact of the crises in Asia on six developing countries, South Africa, Mozambique, Tanzania, Zambia, Uganda, and Bangladesh. In order to do so, we first distinguish between three crises: the currency crisis, the financial crisis, and the economic crisis. The three crises are closely related, but it is not the case that one crisis inevitably leads to the others. In South Africa, for example, the currency crisis did not trigger a financial crisis.

The countries included in this study do not have close trade and investment links to Asia, although Malaysia has recently become one of the most important sources of foreign direct investment in South Africa. Furthermore, with the exception of South Africa the countries are not integrated into the world financial markets. The currency and financial crisis therefore has had little direct effect in these countries. The economic crisis has, however, had an impact, albeit so far it has probably been small. Only if the economic crisis eventually spreads to the OECD area, will it take a significant toll on the poor countries included in the study.

On the international level the economic crisis is first and foremost felt in the world commodity markets. In addition, aid flows from Japan have declined as a result of the recession there, and aid flows from multilateral agencies and Japan are to some extent diverted to the crisis-ridden Asian economies. In late 1998 Japan launched a special aid program for the countries most heavily affected by the crisis, and some of the initial funds arranged by the International Monetary Fund (IMF) came from the coffers of the World Bank and the Asian Development Bank.

The paper starts with an analysis of the crises in Asia. The origin of the currency crisis and how it relates to the financial and economic crises are discussed in section 2. It is emphasized that the crisis is neither unique, nor is it the result of an exogenous shock caused by international speculators, as is often claimed. Rather we posit that the crisis had been in the making for some time and was partly due to bad policy. The policy errors relate to what the governments did, but even more to the errors of omission. In particular, gainful liberalization of international capital flows requires a well diversified and developed local financial sector which is capable of managing risk, handle cash flows safely and allocate credit efficiently. It is argued that the countries that had such a financial system in place and in addition managed aggregate demand in order to avoid large, accumulated deficits on the current account escaped the crisis with the least ruptures.

The downturn that the currency crisis triggered was more serious than a correction of the built up imbalances called for. Section 3 maps out the channels through which financial and economic crises spread from one country to another. In addition it discusses the policy measures each country and multilateral institutions such as IMF and the World Bank have at their disposal in order to prevent financial crises from developing into economic crises and to limit the contagion effects. The impact on the selected developing countries in Africa and Asia is discussed in more detail in section 4. Finally section 5 concludes by drawing some lessons from the Asian crisis for development policy in the future.

2 The financial and economic crisis in Asia

The financial crisis goes back to the burst of Japan's bubble property market in the beginning of this decade, while the Asian currency crisis is usually seen as dating back to the collapse of the pegged exchange rate regime in Thailand on July 2 1997. The effect of the Thai devaluation was, however, only "the straw which broke the tigers' back". To get a full understanding of the financial and economic turmoil in the region it is necessary to take into account the development in the preceding years.

For nigh on two decades, a group of countries in East and Southeast Asia had sustained remarkably high rates of economic growth. Through a combination of high savings and investment rates, human capital accumulation, export-promoting policies and a government-initiated focus on rapid industrialization, the countries accomplished an impressive transformation of their economies. The countries are usually classified in two groups – the first generation tigers which are Hong Kong, Singapore, South Korea, and Taiwan, and the second generation tigers which are Indonesia, Malaysia, and Thailand.

2.1 The period preceding the crises

The financial crisis has been particularly severe in four of these countries; Indonesia, Malaysia, South Korea, and Thailand, although all the countries face lower economic growth in 1998 as a result of the regional turmoil. There are some important similarities between the countries which have been hardest hit by the financial crisis:[1]

- Cheap international capital, facilitated by deregulation of national banking systems and the growth of an increasingly integrated international financial sector contributed to a bubble-like development of asset-, equity- and property prices.
- International capital was partly attracted to the region by the high historical rates of return, partly pushed from industrialized countries where interest rates were low. The fixed/ managed exchange-rate regimes of the countries in Asia resulted in a misconception of the actual exchange rate risks, and some of the foreign creditors may have perceived the debt as guaranteed by the government in the various Asian countries.
- Prior to the financial crisis, the asset-, equity- and property bubble burst, resulting in an increase in non-performing loans and a sharp reduction in the value of the collateral of loans extended by financial institutions. This development is on many accounts similar to what happened in Japan and the Western world in the latter part of the 1980s.
- The crisis-ridden countries had opened the capital account on the balance of payment, but the local financial system was not prepared to handle short-term capital flows.
- Policy makers were reluctant to see the fragility of their financial systems and the need for a devaluation of their currencies in light of changing international circumstances, and thus failed to make necessary policy corrections in the period leading up to the crisis.

[1] A more comprehensive and coherent analysis of the background for the financial crisis, where the development in the individual countries is presented in more detail, can be found in Tenold (1998:16-41).

A major problem in Thailand and Malaysia was the large current account deficits financed by large inflows of capital in the period before the financial crisis. A comparison of current account development in various countries in Asia reveals an interesting feature. The countries that had sustained current account deficits in the beginning of the 1990s are those countries which have been hit by the financial crisis.[2]

Table 2.1 Current account development; per cent of GDP.[3]

Country	1990	1991	1992	1993	1994	1995	1996	Avg.
Indonesia	-2,3	-1,6	-1,6	-0,7	-0,6	-1,6	...	-1,4
China	4	4,4	1,3	-2,7	1,3	0,2	0,9	1,3
Malaysia	-2	-8,9	-3,8	-4,8	-6,4	-8,6	-5,2	-5,7
Singapore	8,3	11,2	11,3	7,2	15,9	17,7	15,2	12,4
South Korea	-0,7	-2,8	-1,3	0,3	-1	-1,8	-4,8	-1,7
Taiwan	6,7	6,7	3,8	3	2,6	1,9	5,2	4,3
Thailand	-8,5	-7,7	-5,7	-5,1	-5,6	-8,2	-8	-7

2.2 *Problems in the real economy*

The negative financial development was exacerbated by real economic problems. Exporting sectors suffered from overvalued currencies following the depreciation of the Japanese yen towards the US dollar and European currencies. Since Japan was the most important competitor to the Asian tigers and the tigers had a fixed exchange rate towards the dollar, loss of competitiveness followed. Global overcapacity in important sectors such as the semiconductor and car industries further constrained export growth. Imports continued to grow unabated along with growth in domestic demand, and deteriorating trade balances resulted.

Reduced export growth fuelled speculation that some of the "tigers" were encountering structural difficulties. The apparently vanishing competitive advantage in the production of labor-intensive goods, particularly after the opening of the Chinese economy, would in time force the countries to climb up another rung on the industrial quality ladder. This transformation to exports of more advanced goods necessitated large infrastructure investments and a high degree of human capital formation. In South Korea's case, the trouble was not only fierce competition from low-cost producers. The strong depreciation of the Japanese yen led to an improvement in Japanese competitiveness as well, meaning that South Korean exports were challenged on two fronts.

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[2] The current account deficits in Indonesia and South Korea were moderate, and can not alone explain the crisis in these countries. The explanation lies partly in the way the current account deficit was financed and weaknesses in the local financial system which in turn constitute the interface between the international and local financial markets. Additionally, the economic crisis in Indonesia is closely intertwined with the country's political crisis. The problems in South Korea were amplified when international investors took a more skeptic view of the debt situation of the country's large industrial conglomerates

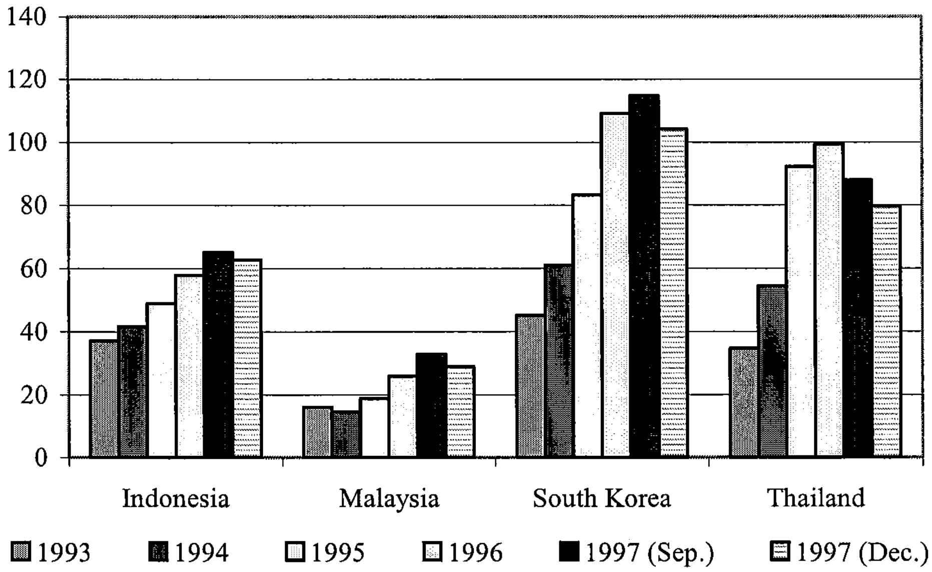
[3] Figures from IMF (1997:142-143) and, in the case of Taiwan, from Corsetti, Pesenti & Roubini (1998:103). The shaded boxes highlight negative figures. Despite the fact that the countries most severely hit by the financial crisis are the countries with the current account deficits, the size of the deficit is seemingly unrelated to the magnitude of the problems in the various countries

Corruption and "crony capitalism" are often presented as one of the main causes of the financial and economic turmoil in Asia. There is little doubt that this aspect of the economic organization has had an adverse effect on economic efficiency and income distribution. However, its role in the current turmoil tends to be overstated. There is no indication that corruption and cronyism increased in the last years, and these factors were a persistent feature of the political and economic regimes even when the countries' growth rates were twice the international average. Rather, we find that what triggered the financial and economic distress was the accumulation of foreign short-term debt in the years preceding the financial crisis. Even though crony capitalism did not trigger the crisis, it contributed to the misallocation of resources that accumulated into structural problems. Furthermore, close ties between Thai politicians and businessmen made it possible to conceal the actual economic standing of several businesses, in particular financing companies with large non-performing portfolios. This may have delayed reforms and made the financial crisis more severe.

2.3 Debt and depreciation

Against a backdrop of high economic growth and financial sector liberalization, banks and other financial institutions in Asia increased their borrowing from foreign sources dramatically. Government-initiated changes made foreign liquidity more easily accessible, and the foreign funds were to a large extent lent to local companies and individuals.

Figure 2.1 Bank and private sector foreign debt, billion dollars.[4]



Accumulation of foreign debt is not necessarily a problem. If the inflow of foreign capital is utilized in sectors which will bring future export earnings, the expected revenue increase may be used to service the foreign debt. Such sustainable deficits

[4] Based on figures depicting debt to BIS-reporting banks from Bank for International Settlements (1996 & 1998b: Table 5A).

characterized the development in several Asian countries until the beginning of the 1990s. However, from the beginning of the 1990s, it appears that the foreign capital to a larger extent funded speculative investments in assets, equity and real estate, as well as an increase in consumption. The reduction of the profitability of investments is illustrated by a sharp decrease in the inverse of the Incremental Capital/ Output Ratio (ICOR) in South Korea and Thailand in the first five years of the 1990s, compared to the last five years of the previous decade.

Table 2.2 Average ICOR (inverse).[5]

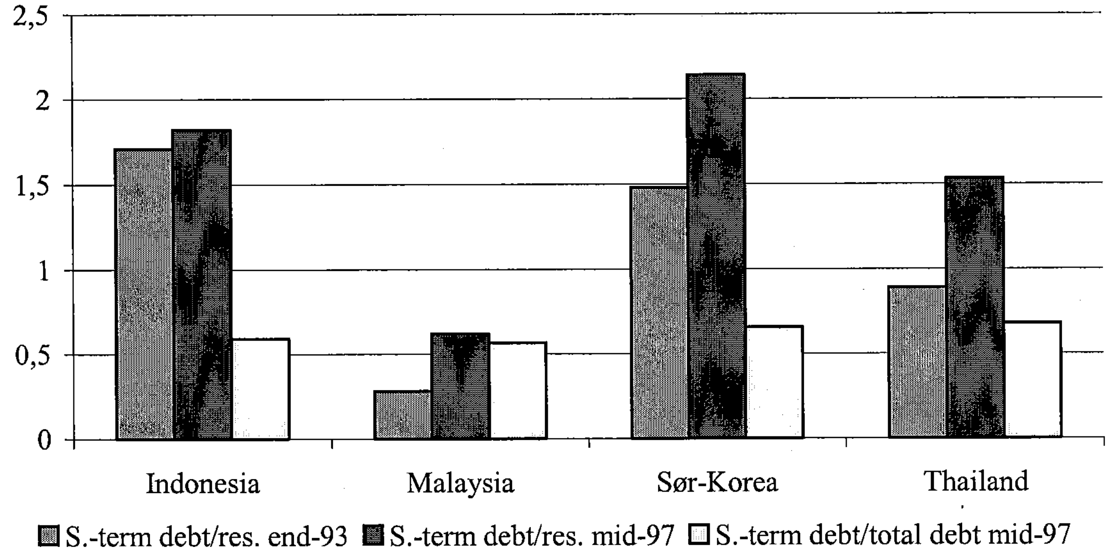
	1986-1990	1991-1996
Indonesia	19,2	22,6
Malaysia	25,1	22,1
South Korea	32,9	20,2
Thailand	32,6	19,6

Three aspects of the high private debt were of particular importance, and are crucial in explaining the financial crisis and the subsequent economic problems:

- The share of non-performing loans (NPL) increased markedly in the wake of the collapse of the asset and real estate bubbles. In the summer of 1998 NPLs constituted as much as 70 per cent of total loans of some Thai banks. Even though this is an extreme example, the share of NPLs increased in the other tiger economies as well. In June 1998, estimates suggest that NPLs constitute 50 per cent of total loans in Indonesia, 30 per cent in South Korea and Thailand, and 25 per cent in Malaysia.[6]
- The loans had not been secured against changes in the exchange rate. This is only a potential problem when the exchange rate is fixed relative to the currency in which the debt is denominated. However, if the national currency depreciates, the amount of local currency needed to pay the creditor increases, thus increasing the debt burden and the possibility of default.
- There was a lack of correspondence between the banks' and finance companies' borrowing and lending. They had typically borrowed short-term money abroad, and lent it to the private sector on a long-term basis. When debtors started to default, the situation became serious relatively quickly.

[5] Figures from Bank for International Settlements (1998a:35). The figures depict the inverse of ICOR, viz the growth of GDP divided by investment/GDP. A reduction implies that the economic growth associated with a given level of investments is reduced. The inverse of ICOR may thus be used as a proxy for the profitability of investments.
[6] It is, however, important to emphasize that the share of non-performing loans has increased as the financial crisis has evolved; figures from July 1997 will therefore be notably lower.

Figure 2.2 Short-term debt relative to reserves and total debt.[7]



The problems in the financial sector and the real economy led to a loss of confidence in future growth in several Asian countries, and as a result of this, their ability to defend the value of their exchange rates was questioned as well. Agents expecting a depreciation reacted by selling the currency, thus creating a currency supply increase which necessitated official intervention to keep the exchange rate at the pegged value. Thailand was the first country which fell victim to large currency sales following fears about depreciation. Joint intervention from the central banks of Thailand and Singapore was necessary to counter a speculative attack in the spring of 1997. However, this and subsequent interventions led to a strong fall in Thai reserves, making the authorities' decision to support the value of the baht even less credible. In the end the amount of foreign exchange reserves was insufficient to counter the speculation, culminating with the end of the Thai fixed exchange rate regime.

The disbanding of the Thai currency peg in July 1997 resulted in an immediate fall in the value of the baht. This had far-reaching implications, as the financial crisis and the currency crisis embodied self-reinforcing effects. When the value of the baht was reduced, the foreign currency nominated debt outstanding increased in terms of local currency. An increase in non-performing loans followed the increased debt burden in private companies. This escalation of the problems in the financial sector led to repercussions on the currency market where increased skepticism about the future development in Thailand triggered further downward pressure on the exchange rate. The Thai authorities were faced with a difficult decision in this period. Whatever they did, there was a danger that the crisis in the financial sector would escalate. They could raise local interest rates and hope that this would counter the currency outflow. The flip side of this was the risk that the share of non-performing loans denominated in local currency would increase. The authorities could alternatively lower interest rates in order to ease the position of the banks and finance companies and at the same

[7] Figures for short-term debt relative to reserves from BIS (1998a:128) and for share of total debt from (1998b). Figures for reserves do not take into account any forward contracts entered into by the central banks. In Thailand, potential losses on forward contracts implied that the real reserves were far smaller than official reserves in mid-97; some sources have suggested a "worst-case" figure of 5 billion dollar, as opposed to the official figure of 27,5 billion dollar.

time stimulate demand. The flip side of this strategy was that the currency outflow could intensify, the exchange rate could further deteriorate and the share of non-performing foreign currency denominated loans would increase. The Thai authorities vacillated between these strategies, and only when the IMF had been called to the scene, and demanded heavy interest rates increases as a condition for giving financial help, did the Thai government follow a consistent strategy.[8]

3 The contagion effect – can it be prevented?

The financial- and currency-problems in Asia in 1997 are on no account unique. Before the turmoil in Asia, the 1990s had already witnessed two major international currency-crises – the *European Monetary System*-crisis in the beginning of the decade and the *peso*-crisis, which spread from Mexico to large parts of Latin America in the middle of the decade. However, in terms of magnitude, depth and extent of contagion the Asian crises are far more dramatic than the other two.

3.1 Regional and international contagion

The change in investors' sentiment in the wake of the *peso*-crisis, which led to the diffusion of Mexico's problems to other Latin American countries, has been dubbed the *tequila*-effect. Likewise, the financial and currency problems spread from Thailand to the other countries in the region. The aptly-named *tom-yum*-effect, worked through a variety of channels, both real and psychological.[9]

There are direct economic reasons for the pressure on other Asian currencies in the wake of the collapse of the Thai fixed exchange rate regime. A depreciated Thai currency implied an increase in the country's competitiveness, and as several of the countries in East and Southeast Asia compete in the same international markets, this was expected to have an adverse effect on the other countries in the region. In addition to this, the relatively high, and increasing, share of intraregional trade meant that these countries would be adversely affected by the reduced growth of the Thai economy. Probably more important than the trade aspect, however, were the other strong economic and financial linkages among the countries of East and Southeast Asia. The industrialized Asian countries had a disproportionately large share of their investments in other countries in the region, including Thailand. They would therefore be relatively harder hit by the financial- and currency crisis in Thailand than countries outside the region. Just like capital from Asian countries had been important in creating the stock market and property bubbles, the owners of this capital would be adversely affected by the fall in asset- and currency values.

The troubles were also spread as a result of changes in market sentiment. The fact that the fast-growing Thai economy had proved to have such large hidden defects came as a surprise, and the other countries in the region were subject to closer scrutiny. This revealed that several of the other "tigers" might also have unsustainable current

[8] The International Monetary Fund and the World Bank still do not agree whether this was the correct response to the problems. World Bank economists, and others who have been skeptical of the IMF's intervention, have claimed that the high interest rates exacerbated the financial problems and resulted in an unnecessarily deep depression.

[9] This contagion is analyzed in more detail in Tenold (1998:34-40).

account deficits, overvalued currencies and declining profitability of investments. Consequently, international investors feared other instances of financial and currency crisis in the region.[10]

This negative attitude was reinforced by a change in the surveillance policies of international investors and rating agencies. Their attention changed from macroeconomic to microeconomic determinants (Wade 1998:12-13). Whereas their focus had previously been on macroeconomic indicators such as debt relative to GDP, export growth, inflation and budget deficits, in which the countries in the region largely came out positive, investors and rating agencies now started to focus on microeconomic indicators and the composition of external debt. Their view of the situation in the Asian countries was far more negative when factors such as the volume of short-term private debt relative to reserves, the currency composition of debt, and the private sectors debt/ equity-ratio were used as basis for evaluation. This led to a major loss of confidence, and a change in the international investors' sentiments towards the countries in East and Southeast Asia.

The contagion and the effects of the changes in market sentiments were amplified by some specific features of the international financial markets. Two such "psychological" aspects were of particular importance. On the one hand, there was the problem of self-fulfilling prophecies. As previously mentioned, when the agents in the financial market expected a Thai devaluation, and acted in a manner consistent with their expectations, the Central Bank had to intervene by selling foreign exchange, leading to an exhaustion of Thai reserves up to the point where a depreciation was inevitable. Thus, by expecting a breaking up of the fixed exchange-rate regimes, the agents in the international financial market managed to provoke exactly that response.[11] In addition, the exchange rate and stock market plunge exhibited a tendency of "overshooting." The fall in the value of currencies and stocks was larger than what was warranted by the general circumstances. One reason for this is that the actions of international investors can be explained by what economists call the fire-sale effect. When a shop burns, the owner is willing to sell his stock at low prices to get rid of it before the flames get it. Likewise, as investors were expecting a strong reduction of values, the fear of being "the last one out" led to overreaction. A result of this herd behavior is that actions which are individually rational have consequences which make them collectively irrational.

The contagion of the crisis may thus be explained both by economic theories and by psychological mechanisms. The turmoil spread fast. As early as three weeks after the Thai authorities had been forced to give up the peg, The Philippines, Malaysia, Indonesia, and Singapore had been forced to change their exchange rate policies. The downward pressure on the currencies of the Philippines, Malaysia and Indonesia can be explained by the fact that these tended to be lumped in the "Newly Industrializing Country"-bracket together with Thailand, and there had been a high degree of

[10] In some instances, e.g. in the case of South Korea, the problem was not necessarily "hidden defects". Rather, well-known factors, such as the conglomerates' high ratio of debt to equity, were suddenly viewed in a more negative manner.

[11] It should, however, be emphasized that there was good reason to expect that the fixed exchange rate would collapse. Otherwise speculation would not have taken this dimension, and the probability that it would succeed would have been much less. We can thus say that speculators brought about an overdue correction of the exchange, in spite of governments' reluctance to do this.

correlation in stock market fluctuations in these countries even before the crisis. Singapore's decision to go from a fixed exchange rate regime to a floating currency can be seen as an attempt to avoid having to use reserves to defend the value of the currency in light of expected speculation.

A second wave of contagion-induced speculation took place in October, when the monetary authorities of Hong Kong had to increase the discount rate to some three hundred per cent to counter the attack on the currency. The value of other Asian currencies continued to fall, but the situation became increasingly more grave in the beginning of December, when South Korea became the focus of attention. Fear about the short-term debts of South Korean companies resulted in an 80 per cent fall in the *won*/ dollar rate during a three week period. The reason for the plummeting currency was partly the regional crisis, partly specific national circumstances. The most serious problem was the extent of leverage in the huge *chaebols*. At the same time, a combination of political and economic factors caused a crash in the value of the *rupiah*, the Indonesian currency.[12] In January 1998 the Indonesian *rupiah* was traded at more than 17000 per dollar; an enormous decrease compared to the steady level of approximately 2300 which had been attained for several years, or the 3500 *rupiah* per dollar which had been recorded as late as October 1997.

As the financial crisis in Asia escalated, consequences were felt even outside the region. One effect of the financial problems of the newly industrialized countries in Asia, was increased skepticism to "emerging market economies" in general, mainly based on the fact that these countries frequently have underdeveloped financial sectors. Whereas the risk premium on emerging market debt had been reduced in previous years, the spreads on international bonds widened considerably in the latter part of 1997 (BIS 1998a:125). In June 1997 the average spread was 130 basis points, but this had increased to 375 basis points six months later.[13] The increase in risk premium was higher for Asian countries than for countries in Latin America, reflecting the loss of confidence in Asian development and illustrating Asian countries' problems of acquiring international financial resources.

In the first half of 1998 conditions in the international securities market had stabilized, but in late summer there was a deterioration of investor confidence following the financial problems in Russia and Latin America, and the difficulties of a large American hedge-fund. The main results of the loss of confidence were increased volatility, an enormous increase in the yield of emerging market securities and a market in which only the most highly rated agents were able to attract resources.[14]

[12] In the early part of the autumn the Indonesian authorities had been praised for the policies which they had introduced to tackle the crisis. However a major loss of confidence in both the government and the *rupiah* in the last part of 1997 and the beginning of 1998, amid fears of civil war and national debt default, can explain why Indonesia has become the hardest hit country. Additionally, the flight of "ethnic Chinese capital" was probably of great importance, but it is difficult to get reliable statistics which can confirm this proposition.

[13] For comparison the difference between Norwegian and German interest rate in early December 1998 was 425 basis points.

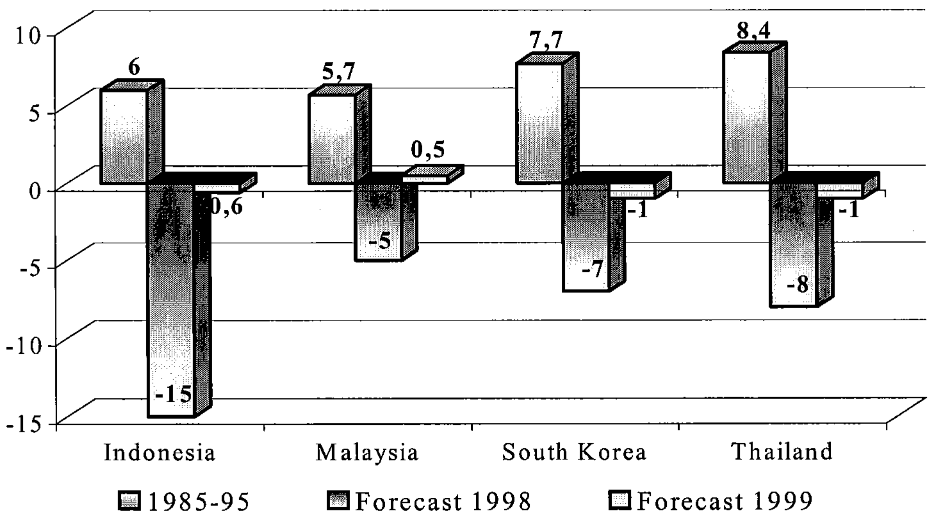
[14] Emerging markets issuances declined by more than 50 per cent, and the spread on some bonds, eg dollar-denominated Russian bonds, increased to more than 6000 points, an all-time-high for an emerging market instrument. Asian, and particularly Latin American bonds, were subject to a multiplication of spreads as well, and the average spread on emerging market papers reached the same level as that recorded at the height of the Mexican *peso*-crisis.

This flight to quality can be seen as a result of international investors' changed perception of the risk inherent in emerging market bonds, and a wish to reduce the portfolio risk which had increased following the turmoil in Asia. Even though the problems of Eastern European and Latin American countries had a very important national dimension, there is little doubt that the outcome has been amplified by the negative experiences in Asia.

3.2 *From financial crisis to economic crisis*

The financial and currency crises have had dire consequences for economic activity, particularly in the countries which have been hardest hit by depreciation and financial sector problems. Whereas economic growth in Thailand and South Korea was among the highest in the world during the period 1990-1996, it is expected that these economies will contract some 7 to 8 per cent in 1998. Perspectives are looking even bleaker for Indonesia where contraction was running at 14 percent in the 4th quarter of 1998. Malaysia, which has chosen to manage without technical and financial assistance from the IMF and in September 1998 introduced exchange controls, has not fared any better than its neighbors. Output contracted by 8.6 percent in the third quarter of 1998 compared to the same quarter the year before.[15]

Figure 3.1. Annual economic growth, 1985-1999.[16]



The financial and currency situation influences the economic activity in a variety of ways. The fall in the value of the local currencies, together with plummeting asset and property values, has resulted in a strong reduction of real income and wealth in East and Southeast Asia. An important effect of this is that consumption and investments have been reduced, which again has hampered aggregate demand and economic activity. This reduction has been exacerbated by a strong outflow of foreign capital.

[15] Source of these figures is The Economist 13.-19. February 1999, which reports the most recent official statistics.

[16] Forecasts are average estimates based on mid-1998 data from the World Bank, the International Monetary Fund, and Goldman Sachs. Compared to the most recent figures, the forecasts seem to be on the optimistic side for Indonesia and Malaysia and perhaps on the pessimistic side for Thailand.