



# How Has the Asian Crisis

The Asian crisis was the cover theme of the June issue of *Finance & Development*, which included several articles on various aspects of this topic. It is now possible to provide a preliminary assessment of the impact of the crisis on the rest of the world. The directors of the IMF's five departments covering regions outside Asia provide brief assessments of how the Asian crisis has affected those regions during the past year.

## SUB-SAHARAN AFRICA

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**T**HE ASIAN crisis has affected sub-Saharan Africa in a number of ways, although its specific impact on economic growth and the external accounts of the region is difficult to quantify. However, combined with internal factors and other external shocks, such as the effects of El Niño and a decline in commodity prices, the crisis in Asia has led to a downward revision of the projected real GDP growth rate for sub-Saharan Africa of nearly 1/2 of 1 percent—to about 4 percent—in 1998, and an increase of some 2 percentage points in the projected external current account deficit (excluding grants) for 1998, which is estimated at 6 percent of GDP.

The decline in world commodity prices has been compounded by weakened demand in Asia and the consequent reduction in its imports, particularly of metals, fuels, and agricultural raw materials, which are important exports from sub-Saharan countries. Thus, the sharp decline in the price of copper has seriously affected Zambia; the drop in the price of gold has hurt Ghana, Mali, South Africa, and Zimbabwe; and the fall in the demand for diamonds has had a major impact on Botswana, Namibia, and South Africa. Similarly, Benin, Burkina Faso, Cameroon, Chad, Côte d'Ivoire, Mali, and Togo have experienced difficulties owing to falling cotton prices. Moreover, as a result of the considerable gains in competitiveness of the affected Asian countries, African producers are likely to face increased competition in third-country markets. This may adversely affect manufactured exports from South

Africa and textile exports from Mauritius and Zimbabwe. By contrast, the marked decline in the price of rice has benefited several African importers, particularly in West Africa and the Indian Ocean countries.

The sharp fall in world oil prices has had a negative net impact on sub-Saharan Africa, a net exporter of petroleum products. However, this conclusion masks considerable differences among countries. For the major oil-exporting countries of the region (Angola, Cameroon, the Republic of Congo, Gabon, and Nigeria), the loss in export earnings has been substantial, while the resulting reductions in the import bills of oil-importing countries may, in many cases, offset the adverse impact of declines in their earnings from commodity exports.

The contagion effects of the Asian crisis on currency and equity markets in the region have thus far been limited, partly because of the nascent stage of development of most African financial markets. Although South Africa emerged relatively unscathed from the turmoil of late 1997, pressures on its economy intensified in May and June 1998 and led to a considerable decline in the country's equity markets, a marked increase in yields on long-term bonds, and a significant depreciation of the rand, despite increases in domestic interest rates and central bank intervention in the exchange markets.

Finally, the financial difficulties facing some Asian countries may slow much-needed foreign direct investment flows to sub-Saharan Africa.

# Affected Other Regions?

## EUROPE

*Michael C. Deppler*

**T**HE IMPACT of the Asian crisis on European countries has so far been muted, reflecting their relatively limited direct trade with the countries in crisis and the strong financial positions of most, though by no means all, banks with Asian exposure. European financial markets, especially in some of the transition economies, have been buffeted sporadically, however.

Direct effects on industrial countries in fact include some favorable ones, such as terms of trade gains from lower prices for oil and raw materials, lower yields in capital markets, and downward pressure on prices owing to enhanced competition from Asia. Moreover, slowing exports to Asia have helped to prevent overheating in countries at an advanced position in the business cycle (Denmark, Finland, the Netherlands, Norway, and the United Kingdom). Elsewhere, slowing exports have coincided with strengthening domestic demand caused by lower interest rates, a pause in fiscal retrenchment, and rising business and consumer confidence. Bond markets have benefited from the flight to quality, and stock markets have reached new highs, notwithstanding occasional pullbacks. With low stock market capitalizations in most countries, large wealth effects on demand are not likely, even in the event of a significant market correction. The strengthening of the ERM (exchange rate mechanism of the European Monetary System) currencies against the Asian currencies did not cause tensions in the parity grid or in interest rate

differentials against the deutsche mark.

With even more limited direct trade with Asia and continuing recovery in industrial Europe, economic growth in most of the transition economies has remained on course. Financial markets in countries without market access (Albania and the former Yugoslav Republic of Macedonia) or with balanced external and fiscal positions (Slovenia) have remained virtually unaffected. Some countries, however, have seen their yield spreads widen (Bulgaria, Hungary, and Poland). The associated increase in financing costs has been felt only where maturing debt needed to be rolled over on a substantial scale (Czech Republic). There has been some turbulence in foreign exchange and stock markets (Czech Republic, Hungary, and Poland), but the relative contributions of domestic uncertainties and contagion effects via Russia are difficult to disentangle.

In countries that experienced some tension in 1997 (for example, Turkey, owing to high inflation, and Greece, owing to continuing real exchange rate appreciation), recent actions to address the underlying causes have helped to forestall potential disturbances.

All told, European countries thus far have coped with the Asian crisis without significant problems. Indeed, the crisis perhaps ought to be viewed as a useful wake-up call that has prompted several countries to address in a timely fashion problems that might otherwise have been allowed to fester. Nonetheless, the situation still does not warrant any complacency.



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## COUNTRIES OF THE FORMER SOVIET UNION *John Odling-Smee*

**T**HE IMPACT of the Asia crisis on most countries of the former Soviet Union was widespread but relatively modest. Disturbances transmitted through capital markets were largely muted because, as a group, countries in

the region have accumulated relatively little foreign debt (with most borrowing centralized by the government) and because domestic capital markets are relatively small, with only modest linkages to international markets. The trade impact took place largely through the



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fall in oil prices, which affected primarily the oil exporters (mainly Russia). The loss of export markets in Asian countries with substantially devalued currencies has yet to be felt, but is not expected to be a major factor for most countries. Overall, the main impact has been to adversely affect access to, and increase the costs associated with, borrowing on international capital markets. Nevertheless, growth for countries of the former Soviet Union is expected to continue to rise.

However, in Russia and Ukraine, both of which had been actively borrowing on international capital markets, substantial pressures on domestic financial markets have developed as a direct result of contagion from Asia, which may have longer-term consequences for the transition process in these countries.

The authorities in Russia successfully defended the exchange rate in late October/November 1997, and again in January 1998, by raising interest rates sharply, increasing reserve requirements on foreign exchange deposits, and intervening in the foreign exchange and treasury bill markets. A new exchange rate policy, which became effective on January 1, 1998, has accommodated a larger fluctuation margin to reduce the risk of speculative attacks. Once the authorities had demonstrated their willingness to raise interest rates to defend the ruble, speculative pressures subsided, allowing rates to move to more sustainable levels. The more recent attack on the ruble, which started in mid-May 1998, was due more to internal policy weaknesses—

especially poor fiscal performance—than to a reassessment of emerging markets following the Asian crisis.

Inadequate fiscal adjustment in Ukraine led to reliance on official short-term borrowing, which heightened the country's vulnerability to adverse external developments. As the Asian crisis developed, exchange market pressures started to build toward the end of October 1997 and forced the authorities to defend the exchange rate by widening the exchange rate band and increasing both interest rates and reserve requirements. These measures, together with additional external borrowing undertaken in early 1998 to shore up reserves, were insufficient to stem speculative pressures, and the central bank consequently had to tighten monetary policy further in 1998.

The differences among the region's countries in the severity of interest rate and equity price movements illustrate the importance of sound domestic macroeconomic and structural policies in limiting their vulnerability to contagion from international financial markets. In Russia and Ukraine, weak follow-through in the implementation of structural and financial sector reforms, substantial dependence on short-term government borrowing, and (in Russia) a large fiscal deficit caused, in part, by chronically weak government revenues largely explain the intensity of the impact of the Asian crisis on them. The crisis has exposed many policy shortcomings in the region and made more apparent the need to address them urgently.

## MIDDLE EAST AND NORTH AFRICA

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**O**VER THE PAST YEAR, the Middle East and North Africa have been affected by a number of external shocks. It is difficult to disentangle the impact of the Asian crisis from those of such shocks as the decline in oil prices, the nuclear tests in India and Pakistan, and other regional security problems.

With these caveats, the direct impact of the crisis on the region's financial markets appears to have been limited so far. It may have contributed to the weakening of stock markets that began in the second half of 1997, the increase in risk premiums on debt issued

by some countries, and probable losses on Arab investments in Asia. Most important, but more indirectly, the crisis contributed to the sharp decline in oil prices, which has had dramatic implications for macroeconomic balances in many oil-exporting Arab countries and—via its impact on remittances and trade, and on foreign investment—also for other countries in the region.

A number of influences may have limited the spread of the financial crisis. First, on the whole, countries in the Middle East and North Africa have in recent years maintained fairly solid macroeconomic positions.

Second, most of these countries have little short-term foreign debt, in part because of capital controls (most countries of the eastern Mediterranean and North Africa), or are in a creditor position (Gulf Cooperation Council countries). Finally, because growth in the region has been much weaker than in Asia in recent decades, and despite real estate booms in a few countries, the risks related to overheating and perhaps overinvestment, such as those associated with the spectacular growth in Asia, were far less prevalent.

At the same time, many countries in the Middle East and North Africa face vulnerabilities similar to those of the Asian crisis countries, such as overly rigid exchange rate pegs,

weaknesses in prudential regulation and supervision of financial systems (including Islamic banking), an excessive direct or indirect role of the public sector, and insufficient transparency. A growing consensus among regional policymakers that these issues need to be addressed may be the most positive impact of the Asian crisis. The resulting reforms should also reflect the lessons from Asia's growth performance over the last 30 years: to achieve higher growth, education needs to be strengthened; investment and saving rates need to be increased; trade, including intraregional trade, needs to be liberalized; and a properly sequenced opening of countries' capital accounts needs to be pursued.

## WESTERN HEMISPHERE

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**T**HE COUNTRIES of the Western Hemisphere confronted the Asian crisis under conditions of generally strong economic performance; during 1997, real GDP was growing at a healthy pace and inflation was low or declining in the United States and most of the countries in Latin America and the Caribbean. The region is weathering the effects of the crisis relatively well, although policymakers have had to adapt policies to rapidly changing circumstances. In the United States and Canada, domestic demand is strong, and the crisis has served essentially to reduce the need for monetary actions to slow the economy. The United States has benefited from a flight to quality of capital flows, and long-term interest rates have declined while the U.S. dollar has appreciated. The Canadian dollar has come under intermittent downward pressure, but underlying confidence in the government's policies remains strong. Relative strength in North America with growth projected at about 3 percent in both the United States and Canada in 1998 augurs well for the developing countries of the Western Hemisphere because close to 50 percent of their trade—or more than four times the share of their trade with Asia—is with North America.

Although so far the Asian crisis has not been as disruptive to the region as the Mexican crisis was, it has had significant

spillover effects in developing countries of the region. Capital inflows slowed considerably starting in November 1997, and stock and bond prices in the major Latin American markets dropped sharply in November and have resumed their decline more recently. For the most part, the policy response to the Asian crisis in the emerging Latin American economies was prompt and decisive: interest rates were raised significantly in some cases, and fiscal policy has generally been restrained. Nevertheless, the fiscal and external current account deficits in the region are likely to widen somewhat in 1998 relative to 1997 because of declining terms of trade (in particular, the drop in the world prices of oil and other key commodities, which has been exacerbated by the Asian crisis), reduced export revenues, and additional expenditures made for relief and repairs in several countries owing to damage related to El Niño. In light of the substantial drop in prices of commodity exports and the higher average interest rates associated with the crisis, the staff of the IMF projects that output growth in the region will slow from about 5 percent in 1997 to about 3 percent in 1998, while the external current account deficit will increase from 3.3 percent of GDP in 1997 to about 4 percent of GDP in 1998. The substantial progress that has been made in reducing inflation in recent years is expected to be maintained. **F&D**



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