External economic adjustments in the industrial countries after the crises in major emerging markets

The financial and currency crises in major emerging markets in East Asia resulted in radical changes in global current and capital account transactions in 1997 and 1998. Following the sharp fall in growth in the crisis regions and the significant depreciation of the currencies of the countries concerned, the imports of the crisis countries declined considerably. Their current accounts improved. Export growth in the industrial countries weakened in line, and the aggregate current account position deteriorated. At the same time, accentuated by the growth differential and the structural differences between the industrial countries, the existing current account divergences between the major industrial countries increased as a result. On the other hand, the financial markets of the industrial countries – notably that of the United States – which were regarded as safe havens benefited from large capital inflows. A detailed account of these adjustments in the most important industrial countries is given below.

Changes in the external economic positions of the crisis countries

Collapse of economic growth in the crisis countries ...

The financial and currency crises which spread in East Asia from the summer of 1997 resulted in sharp falls in output in the countries concerned. Particularly large falls in growth rates – of between 5 % and 14 % – were recorded for Hong Kong, Indonesia,

Current account balances of selected countries

Item	1996	1997	1998
	US $ billion		
Industrial countries	48.9	75.7	– 24.0
United States	– 129.3	– 143.5	– 220.6
Japan	65.8	94.5	120.6
Germany	– 5.6	– 1.4	– 4.2
EU	106.4	136.1	101.5
East Asian crisis countries	– 41.0	– 15.8	88.2
Hong Kong (China)	– 1.5	– 5.6	1.0
Indonesia	– 7.7	– 4.9	4.4
South Korea	– 23.0	– 8.2	40.5
Malaysia	– 4.6	– 4.8	9.2
Philippines	– 4.0	– 4.3	1.3
Singapore	14.5	15.0	17.6
Thailand	– 14.7	– 3.0	14.2
	as a percentage of GDP		
Industrial countries			
United States	– 1.7	– 1.8	– 2.6
Japan	1.4	2.2	3.2
Germany	– 0.2	– 0.1	– 0.2
EU	1.2	1.7	1.2
East Asian crisis countries			
Hong Kong (China)	– 1.0	– 3.2	0.7
Indonesia	– 3.4	– 1.8	4.0
South Korea	– 4.4	– 1.7	12.5
Malaysia	– 4.6	– 5.1	12.9
Philippines	– 4.8	– 5.3	2.0
Singapore	15.9	15.7	20.9
Thailand	– 7.9	– 2.0	12.8

Sources: IMF and Eurostat.

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Malaysia, Thailand and South Korea. However, the Philippines and Singapore, which together with the countries just mentioned form the group of seven Asian crisis countries, also had to accept substantial setbacks in their economic development. Taiwan alone was able to protect itself from the crises for the most part and recorded a respectable rate of economic growth in 1998.[1]

... and significant improvement in current account position

Together with the withdrawal of international creditors and the dramatic currency depreciations, the decline in growth rates led to a distinct downturn in imports in the crisis countries. The aggregate current account position of the seven countries improved by approximately US $ 130 billion from 1996, the year before the outbreak of the crisis, to 1998, having run a joint deficit of just over US $ 40 billion in 1996 and a surplus of just under US $ 90 billion in 1998. An improvement of approximately US $ 110 billion in the trade balance accounted for more than four-fifths of this trend. The South Korean current account alone improved by approximately US $ 65 billion, or 17 % of gross domestic product, within two years. However, the current accounts of the other crisis countries also improved significantly. Whereas in 1996 and 1997 all states with the exception of Singapore had a current account deficit, in 1998 all achieved a surplus which amounted to be-

1 With the exception of Taiwan and of Brunei, which is economically less important, the seven countries featuring in the present report are that group of countries which form the group of emerging markets in South-East Asia and which are regularly analysed in the statistics published by the Bundesbank. See, for example, Recent trends in Germany's external relations with the south-east Asian emerging economies, Monthly Report, July 1998, page 17 ff.

tween ½ % (Hong Kong) and 21 % (Singapore) of GDP.

Changes in industrial countries' current account positions

As a direct contrast to that, the current account deficit of the United States rose within two years from US $ 129 billion in 1996 to US $ 221 billion in 1998 while the Japanese current account surplus almost doubled (from US $ 66 billion to US $ 121 billion) during the same period. There was little change in the aggregate current account of the EU in that period. This may give the impression at first sight that the burden of external economic adjustment for the crises in the emerging markets of East Asia was borne by the United States alone. However, such a conclusion would be rash because a multitude of influences are reflected in the trend in current account balances. The changes cannot be interpreted as the consequences of the crises alone. In order to separate the direct and indirect effects of the crises in the emerging markets on the current accounts of the industrial countries from the other cyclical and structural factors the regional structure of the international trade in goods will be examined more closely below.

Trend in the industrial countries' bilateral trade with the crisis region in Asia

Downturn in industrial countries' trade with the crisis region

If, however, the major industrial countries' bilateral trade with the crisis region is examined, another picture emerges. In absolute terms the EU's bilateral trade balance with the emerging markets in South-East Asia showed the greatest deterioration between 1996 and 1998, at just under US $ 37 ½ billion, compared with deteriorations in the US and Japanese balance of payments of just under US $ 23 ½ billion and of US $ 25 ½ billion, respectively. However, the absolute change in the bilateral trade flows in dollar terms does not enable one to conclude definitively that this was a direct consequence of the Asian crises. Firstly, it has to be remembered that the significance of the Asian crisis countries as trading partners differed from one industrial country to another. Secondly, the dollar values of the trade balances analysed so far also reflect the exchange rate fluctuations of the industrial countries' currencies against the US dollar. For these reasons the relative changes in the industrial countries' exports to and imports from the crisis region will now be examined on the basis of data denominated in national currency.

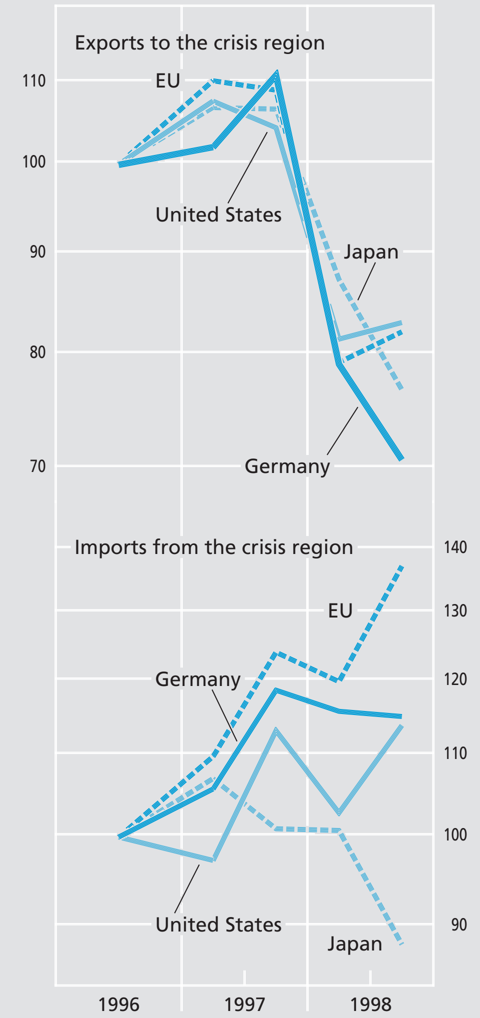
Direct effects of Asian crises on US trade

The US trade balance with the countries concerned has worsened dramatically since the outbreak of the Asian crises. Retarding effects were first noticed as early as the second half of 1997, and these became significantly more pronounced during 1998. The total value of US exports to the Asian crisis region declined by just over 17 ½ % between 1996 and 1998. As the crisis countries account for just under 13 ½ % of the United States' exports, this means that the decline in total US exports – which was due to the Asian crises – was approximately 2 ½ %.[2] However, the fall in US exports sustained as a result of the collapse of the Asian markets was more than offset by a rise in US exports to other regions.

2 The year 1996 was taken as the base year for calculating shares.

Major industrial countries' trade with East Asian crisis countries

1996 = 100, log. scale



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Exports to the European Union rose particularly sharply at 17 ½ %. This means that, despite the retarding effects of the Asian crises, total US exports grew substantially, at approximately 9 %, in 1997 and 1998.

Trend in US imports from the crisis countries

During the period under review US imports from the emerging markets in South-East Asia rose by approximately 8 ½ %. This is due to the trend in the second half of 1997 in particular. In 1998 the rise in US imports from the crisis countries again declined in value. In real terms, however, the corresponding growth rates probably increased further because import prices in dollars fell discernibly as a result of the dramatic depreciation of the currencies of the crisis countries. Owing to the lack of corresponding data on volumes, however, only nominal imports can be quantified. Given that the group of countries concerned account for 12 ½ % of total US imports, they contributed about 1% to the growth in total US imports. Overall, the value of goods imported by the United States between 1996 and 1998 rose by 15 ½ %. Consequently, only a very small part of the sharp growth in US imports can be attributed to the Asian crises.

Direct effects of the Asian crises on Japanese trade

The Asian crisis countries play a far more important role in Japanese trade than they do in the case of the United States. Exports to the crisis region account for just under 31 % of total Japanese exports whereas in the case of the United States, as already mentioned, they amount to approximately 13 ½ %. The collapse of the Asian markets therefore had a much stronger impact on total Japanese exports than on US exports. Although the value of Japanese exports to these neighbouring countries fell at a similar rate to those of the United States (approximately 18 %), the greater relative importance of the Asian market for Japan than for the United States meant a 5 ½ % decline in total Japanese exports compared with a 2 ½ % decline in the case of the United States. By contrast, Japanese exports to the United States and the EU in particular rose considerably during the same period (by 27 % and 38 %, respectively). Despite the weak demand from export markets in Asia and despite the relatively large weighting of these markets, Japan's exports therefore increased by just over 15 % in 1998 compared with 1996.

Conversely, Japan's imports from the seven emerging markets in Asia fell by 5 ½ % in value between 1996 and 1998. If the share (19 ½ %) that these imports have in Japan's total imports is taken into account, this is equivalent to a total decline in imports of just over 1 %. Given the dramatic depreciation in the currencies of the crisis countries, this figure probably also reflects the lower import prices to some extent. Nevertheless, the trend in Japan's imports is in sharp contrast to that of the United States where the level of imports from the countries concerned rose appreciably. The main reasons for this are to be found in the weakness of Japanese domestic demand and in the structural problems in Japan's financial and corporate sectors that are responsible for this weak demand. Consequently, Japan's total import demand was curtailed with the result that imports in 1998 were 2 ½ % below the level in 1996. During that time the value of goods imported from the EU in particular was 4 ½ % less than in the year before the outbreak of the crises.

Germany's bilateral trade with the crisis region

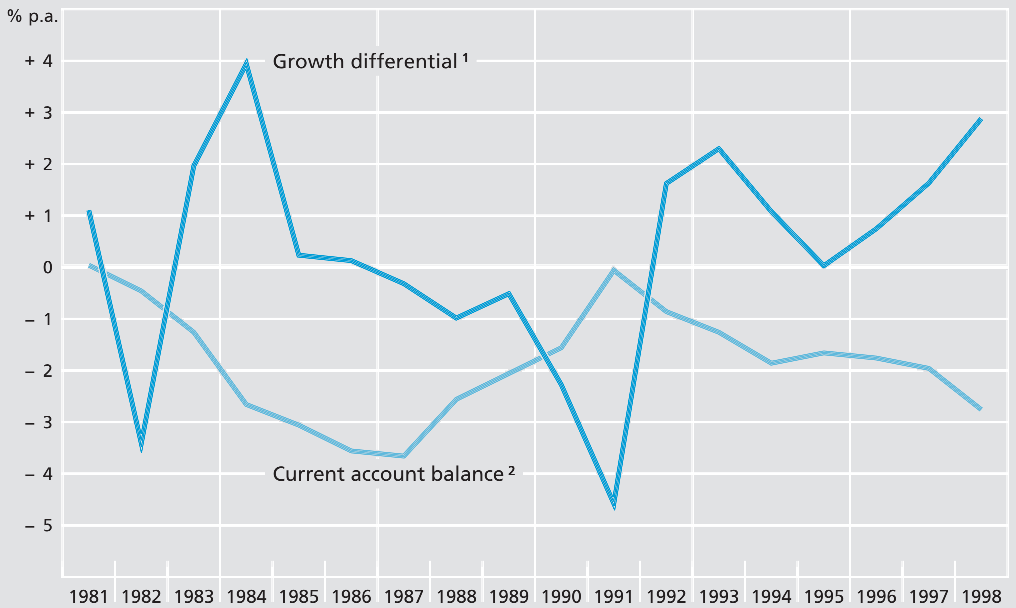
The EU countries, too, sustained significant setbacks in their trade with the Asian crisis region during 1998. Total EU exports to the emerging markets in South-East Asia declined by 19 % in 1997 and 1998 – and therefore to much the same extent as in the case of Japan and the United States. However, Germany's exports shrank even more. At 25 %, the German shortfalls in sales in the Asian markets were greater than those of the United States and Japan.

Nevertheless, the overall trend in German exports in 1998 was significantly better than that of the United States and Japan. The reason is that the Asian region is a much more important export market for the United States and even more so for Japan than it is for Germany. Thus, this region's share of Germany's total exports was only 5 % in 1996 whereas, as mentioned earlier, it accounted for 13 ½ % of US exports and 31% of Japan's. The collapse of the Asian market therefore checked Germany's export growth by about 1¼ % in purely arithmetical terms, that is to say, less severely relative to the total export aggregate than in the case of the United States (2 ½ %) and Japan (5 ½ %). Much the same can be said about a comparison between US and German imports from the crisis countries. Although Germany's imports from the region grew by 16 ½ %, they accounted for less than 1% of the country's total imports during 1997 and 1998 owing to their relatively small share of the import aggregate.

EU trade with the crisis countries

The picture looks different for the EU area as a whole, however, because intra-Community trade accounts for about 60 % of the total trade of the individual EU member states. This means that after deducting intra-EU trade the share of exports going to the crisis region more then doubles, at just over 11%, and therefore comes very close to the corresponding share in US trade. At just over 2 %

US growth differential and current account balance



1 Growth differential between the United States and other industrial countries in terms of the percentage change in real US gross domestic product less the percentage change in the real gross domestic product of the other industrial countries. — **2** As a percentage of gross domestic product.

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of total EU exports to third countries, the direct retarding effect of the decline in EU exports to South-East Asia is almost as great as in the case of the United States. The simultaneous rise in EU imports from the crisis region contributes to an increase in aggregate EU imports from third countries.

Indirect effects and other influences on the trend in major industrial countries' current accounts

The indirect effects of the crises in East Asia are naturally more difficult to record and to quantify than the direct consequences for bilateral trade flows. They can be analysed only with the aid of appropriately devised model simulations, which take into account *inter alia* the interrelationships among the economies concerned. They are ultimately reflected – along with all other influences – in a corresponding deceleration in growth on all other export markets. As already stated, however, these deviations cannot be attributed solely to the consequences of the Asian crises.

US economy's higher growth rate

The increasing deficit on US current account has to be closely linked to the higher economic growth rate in the United States, which has characterised the United States' relationship with the other industrial countries for most of the nineties. In the last two years, taken together, the growth rate differential between the United States and the other industrial countries was 4½ percentage points. If average export and import rates of elasticity are taken as a basis and account is taken of these countries' share of US trade, the resultant deterioration in the US trade balance, at least in terms of its size, can be estimated to be between US $ 50 billion and US $ 60 billion.

Structural influences

Accordingly, general economic influences of this kind accounted for quite a considerable part of the growing deficit on US current account, which in the two years under review amounted to US $ 91½ billion. There are also special structural features which have been tending to have an adverse effect on the United States' external position for more than two decades. These include the deterioration in the investment income account, which has to be seen largely in connection with the rise in US net external debt as a result of the deficit on current account since the beginning of the eighties. The deficit on the US factor income account increased by US $ 29½ billion in 1997 and 1998; this is the equivalent of about one-third of the simultaneous rise in the deficit on the US current account.

Japan's trade surplus rises as a result of declining imports

As in the case of the United States, but with the opposite effect, the trend in the Japanese current account was greatly influenced during 1997 and 1998 by the changes in domestic demand and the consequent growth differential between Japan and the other industrial countries. According to rough estimates, this rather general growth-related contribution to the improvement in Japan's trade balance and current account amounts to between US $ 15 billion and US $ 20 billion; that is approximately one-half of the rise in the trade surplus and just under one-third of the rise in the surplus on current account.

US current account

US $ billion

Item	1996	1997	1998	1999 1st hf
Current account	– 129.3	– 143.5	– 220.6	– 149.9
Trade in goods	– 191.3	– 196.7	– 246.9	– 158.8
Services	87.0	91.9	82.7	39.8
Factor income	17.2	3.2	– 12.2	– 8.7
Balance on current transfers	– 42.2	– 42.0	– 44.1	– 21.6

Source: US Department of Commerce.

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Rise in investment income

Net Japanese investment income from abroad also rose in the two years under review (1997 and 1998), namely by more than one-quarter to ¥ 7,400 billion. That is equivalent to just under 20 % of the increase in the Japanese current account surplus during this period. The increase in investment income was the result of the rise in Japan's net external assets, which amounted to more than 25 % of gross domestic product at the end of 1998, and of the appreciation of the dollar, in which most of Japan's external assets are denominated.

EU current account surplus relatively stable

In contrast to the marked changes in the trade balances and current accounts of the United States and Japan, the trade balance and current account of the European Union remained relatively stable in the last two years. Expressed in ECUs, the surplus on the

Japanese current account

¥ billion

Item	1996	1997	1998	1999 1st hf
Current account	7,157.8	11,436.3	15,784.8	6,301.5
Trade in goods	9,096.7	12,310.3	15,984.3	7,016.4
Services	– 6,779.1	– 6,542.4	– 6,454.7	– 2,944.2
Factor income	5,818.0	6,739.6	7,401.1	3,104.7
Balance on current transfers	– 977.5	– 1,071.4	– 1,146.4	– 875.4

Source: Bank of Japan.

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EU current account rose (according to Eurostat) by ECU 7 billion to ECU 90½ billion between 1996 and 1998; that is equivalent to 1.2 % of the EU gross domestic product. The restraining effects of the weaker demand from the crisis regions on European trade were moderated on the whole by the fact that economic growth in the United States was faster than in the EU. From a macroeconomic point of view, at least the briskness of export business with the United States provided a certain counterweight to the downturn in demand from the crisis regions. The sluggishness in EU imports as a result of the weakness in European growth also had a stabilising effect in that sense on the EU trade balance. According to rough estimates, these (purely arithmetical) dampening cyclical influences can probably be valued at between ECU 5 billion and ECU 10 billion, or 0.1 % of GDP.

In short, it can therefore be said that the shifts in the international current account pattern following the crises in East Asia provides scant information on how the burden of adjustment within the industrial countries was distributed among the major economic blocs (the United States, Japan and Europe). The differences in growth rates between these regions, which exist regardless of the crises, and other factors, which are likewise unrelated to the crises and their consequences, are the main reasons for this.

Changes in the financial relationships between the industrial countries and the Asian crisis region

Capital exports from crisis region

As expected, the crises in Asia have left a considerable mark on the region's financial relationships with the industrial countries. After years of large and steadily increasing capital imports, notably in the form of bank credits although direct investment from the industrial countries was also involved, these sources of finance dried up as a result of the outbreak of the crises and were abruptly replaced, in part, by capital outflows. Thus, in 1997 alone there were net capital outflows from the crisis countries (excluding Hong Kong) of almost US $ 22 billion compared with net capital imports of just over US $ 72 billion in 1996. In 1998 the amount of funds withdrawn increased.

Decline in foreign bank credits

Prior to the outbreak of the Asian crises it was particularly Japanese banks, as well as German credit institutions, that had been providing the emerging markets in South-East Asia with extensive loans, which, in view of the largely short-term maturities, could be quickly reduced. Thus, Japanese and German banks had claims amounting to the equivalent of US $ 240 billion and US $ 95½ billion, respectively, in their books at the end of December 1996. By the end of 1998 these had been reduced to US $ 133 billion and US $ 79 billion, respectively. The emerging markets in South-East Asia also obtained fairly large short-term loans from US banks. The US bank claims on the crisis region had been reduced from US $ 40½ billion at the end of 1996 to US $ 22 billion by the end of December 1998.

Some increase in direct investment, by contrast

By contrast, there were actually some substantial amounts of direct investment in individual countries after the sharp depreciation of currencies and price falls on the regional stock markets had provided foreign enterprises with attractive opportunities to gain a foothold. German firms alone invested about DM 6 billion in participating interests in enterprises in the crisis countries in 1997 and 1998 compared with DM 4¼ billion in the two years earlier.

Substantial funds flow into safe havens

With the withdrawal of capital from the crisis countries there was an increase in the flow of investible funds into the financial markets of the industrial countries that were seen as safe havens. The US financial markets benefited in particular from this, but the German capital market did so, too. The banks in the United States alone received investible funds from foreign investors amounting to US $ 140 billion between the middle of 1997 and the end of 1998; that is equivalent to a rise of 75 % compared with the 18 months before the outbreak of the crises. In Germany it was mainly the securities markets that benefited from the foreign capital looking for a home. At just over DM 330 billion, the funds entering the German securities markets between mid-1997 and the end of 1998 exceeded the level prior to the outbreak of the crises by approximately 50 %. A significant decline in capital market interest rates to all-time lows and record prices on the share markets on both sides of the Atlantic were the result. However, it was first-class borrowers who benefited most from the decline in interest rates; by contrast, borrowers from the corporate sector with somewhat lower credit

EU current account

ECU billion

Item	1996	1997	1998
Current account [1]	83.8	120.0	90.5
Trade in goods	126.6	143.2	131.3
Services	15.1	19.4	13.1
Factor income	– 19.1	– 11.2	– 14.0
Balance on current transfers [1]	– 38.6	– 31.5	– 38.8

Source: Eurostat. — **1** Including capital transfers.

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Claims of banks in selected industrial countries on Asian crisis countries *

US $ billion, end-of-year figures

Item	1996	1997	1998
Total	657.4	665.4	444.4
of which			
United States	40.3	34.3	21.8
Japan	239.9	221.6	132.9
EU countries 1	278.3	300.5	229.4
of which			
Germany	95.7	99.2	78.8

Source: BIS. — * Hong Kong (China), Indonesia, Malaysia, Philippines, Singapore, South Korea and Thailand. — 1 Excluding Denmark, Ireland, Portugal and Sweden.

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ratings had to live with rising interest rate premiums owing to the greater risk awareness of investors. Nevertheless, the easing of conditions on the financial markets of the industrial countries probably provided an expansionary stimulus on the whole, and this tended, at least, to mitigate the contractionary impact of the declining export demand from the crisis countries.

However, there was a different development on the Japanese financial markets, which, as a result of the internal structural problems of Japanese business and the banking system, had long been unable to provide appropriate investment alternatives for the increased investible capital flowing into the industrial countries, especially as international credit-rating agencies had temporarily downgraded Japanese issues.

Summary and outlook

Adjustment difficulties and growth differentials as influencing factors

The pronounced shifts in the industrial countries' current and financial relationships following the currency and financial crises in South-East Asia are to a large extent a reflection of the adjustments by the crisis countries to more sustainable funding and corporate structures. A somewhat more detailed analysis of the consequent detrimental effects shows fairly clearly that these – contrary to the first impression gained from observing the changes in current accounts – were remarkably more evenly distributed over the major industrial countries. At all events, this is the conclusion one reaches if one analyses the entire two-year period and not just 1998 alone. The considerable external divergences within the group of industrial countries which arose at the same time are due mainly to the differences in the rate of economic growth. It emerges, however, that these influences will tend to become less significant again and that the detrimental effects will decline as a result of the external adjustments in the East Asian crisis countries.

Improved economic outlook in the crisis countries

At all events, the economic outlook in most of these crisis countries seems to have brightened again with the result that trade with this region might soon stimulate the industrial countries' exports again. The firming of a number of the crisis region's currencies that has been detectable since the autumn of last year is having a similar effect. While the available data on the regional breakdown of foreign trade, which, admittedly, cover the period up to the end of 1998 only, still provide no empirical proof of a trend of this kind, the initial growth stimuli are already discernible for German exports in the figures for the first six months of 1999.

Decline in growth differential between industrial countries

According to the prevailing estimate of the economic prospects, the foreseeable development trends in the industrial countries themselves will probably have a stabilising effect on the external economic position. At all events, the expected convergence of the growth paths of the major economies on both sides of the Atlantic would, if it proves to be accurate, reduce the pronounced divergences between the external positions of the industrial countries. A final point is that the apparent re-emergence of a more favourable forecast on Japanese economic growth also suggests an early correction of the external economic trends in the industrial countries. Consequently, there are several indications that the imbalanced current account structure, which arose in 1997 and 1998 as a result of the mutual reinforcement of the influences described, will tend to decline again.