Chapter 1 : July 1, 1997 : "Is global capitalism good?"

- global capitalism
  - +
    - "morally" correct (e.g. freedom, fairness)
    - free mkt efficiency
  - −
    - free mkt weakness
    - inequality to Third World

- Collaspe of Soviet Union
- Globalization

further enhance/support capitalism and free market ideology

Few crisis e.g Asian crisis

Benefit of capitalism & free mkt is debatable, questionable

Asian quick recovery

- Any more weakness in capitalism & free mkt?
- will further crisis waiting

Chapter 2 : A Short Course in Miracle : "The truth behind Asian Miracle"

- Asian Miracle?
  - calculation debatable — intentionally or not
  - based on perspiration (not inspiration)
    - more labour
      - ↳ ↑ population
      - ↳ involvement of non-labour (eg housewife, retiree)
      - ↳ ↑ working hours
    - more capital (usually thru FDI)
      - ↳ subject to diminishing return
      - ↳ thus, ↑ ICOR
  - Asian System:
    - ↳ True or Myth?
    - ↳ As compare to Protestant Ethnic

low or even negati TFP growi

Chapter 3 : Warning Ignored : Latin America, 1995

Mexico :

cause of economic crisis ⟹ internal structural problem → corruption (leakage) → many investment but no growth → unable to service debt that finance those private investment & public spending (gov budget deficit) → confident drop → currency crisis

Timeline for Mexico :

1970s : Mexico no growth, but no crisis either

late 1970s : Oil discovery, thus trigger large loans inflow fr foreign bank

July 1982 : Mexico bond yeild < World Bank yeild (proof confident to mexico)

Aug 1982 : Mexico unable to service debt. Emergency loan & loan rescheduled by US gov & BIS.

By 1986 : Real Income per capita 10% lower than 1981
Wage 30% lower than pre-crisis
Avg inflation 70%
} 1981–1989: econ growth 1.3% below population growth

1989 : Washington Concensus adopted & economic reform (stabalized, liberalized & free trade) + Debt forgiveness (Brady Plan)

1990s : NAFTA & foreign fund inflow → strong Mexico Peso → export + import

By 1993 : Defisit reached 8% of GDP. GDP growth still too small (offset by population growth)

1994 : Peasant uprising, Mac '94 : assasination of Donald Colosio (potential success

Dec 94 : [Tequila effect] Devaluation of Peso (peso ↓ 50% due to speculatio
↳ lost confident ← devaluation not big enough
← no control over the situation (convert short term debt to tabesonos. w peso ↓, debt ↑, cause panic

1995 : GDP ↓ 7%

But Mexico was saved by US's Exchange stabilization Fund & IM

Chapter 3:

Argentina:

pre WWI: wealthy agarian nation (borrow heavily)

Agricultural price drop

debt problem

solution: Devalue Peso, Capital control, & moratorium on debt repayment

Success: Strong recovery

but lead to corruption, inefficiency discaurage enterprises & deficit spending

Shock: lost in Falklands war 1982

debt crisis & austral currency crisis

hyper inflation 300%

1989 - 1991: reform: open market, privatizati & currency board

Stabalized but: Argentina inflation = 40%. US inflation = 6% ⇒ Indicate Peso overvalue

Shock: Mexico crisis: Dec 94

reduced credit exposure by overseas fund

negative multiplier effect

bank crisis but central bank cannot become lender of last resort bcoz cannot print money

1995: crisis

Saved by World Bank US$ 12 billion

Lesson for Crisis: There were mechanisms transforming minor policy mistakes into major economic disaster.

Chapter 4: The Future That Didn't work: Japan in the 1990s

Problem: Very low spending

reason

keiretsu, too-big-to-fail, deregulation
↓
bad loan (moral harzard)
↓
leakage & credit crunch in 1997

reason

aging population
↓
less ability to spend (not working)

solution

↑ private spending
↓
reduce IR
↓
till reach almost zero
* fail *

(liquidity trap)

need expected inflation
↓
print money
↓
Yen depreciated
↓
workable? (possible danger)

need strong commitment to be effective

- strong nasionalism (favour strong Yen)
- Expectation of higher Yen in future diminish future overseas returns
- Aging population sell & consume overseas assets

Public investment/ spending
↓
need borrowing to finance deficit
↓
End up debt amounted to 100% of GDP
* fail *

Note:

Japanese econs boom
- ↳ excellent basic education
- ↳ strategic industries development
- ↳ strong nasionalism (to excell after WW II destruction)

Chapter 5 : All Fall Down : Asia's Crash

Lesson 2

Thailand : Until early 1990s : self-financed growth

↓

After Latin America crisis & low IR in Europe : heavy inflow of foreign fund

↓

Baht appreciate → neutralize by printing money → further credit expansion

expansion of credit → further credit expansion

↓

economic boom (+ speculation)

gov sell bond (borrow Baht) to sterilize capital inflow (stop speculation) → economic boom

↓

fail : IR↑, thus encourage foreign borrowing

economic boom → wage↑ → cost↑ → Thai export less competative

economic boom → spending↑ → import↑

Yen depreciate (1995–1997) + China devalue currency (1994) → Thai export less competative

Huge trade defisit + Crony capitalism

↓

buble burst, business down, slowdown in foreign borrowing

↓

Baht depreciate (bcoz import > export but lesser capital inflow)

↓

solution?

→ Defend Baht : Buy Baht & ↑IR → Problems : will deplete limited reserve & negative effect to business

→ let the Baht depreciate → Problems : hurt government reputation & inflate dollor-dominated debt

↓

Gov undecided (thus, encourage speculation) --- Lesson 1

→ Speculators and investors barrow baht to aquire dollor

→ gov try "deceive tactic" by borrow dollor (swap) (more debt)

↓

Collaspe of Baht (private & gov dollor-debt↑)

↓

Panic & Contagion effect

→ thru good mkt link → too small impact (not conclusive)

→ thru financial mkt link → "due to grouping all emerging mkt" as one

→ thru financial mkt link → openess of financial mkt --- Lesson 2

② Openess of economy & financial mkt lead to increase vulnerability of self-fulfilling panic & contagion?

① Crisis as "punishment" for gov "sin" (e.g corruption, crony capitalism & wrong policy?

Chapter 6 : The Confident Game

Two Solutions:

(A) "Standard" economic principles ("textbook solution")

- normally referred to neo-classic and basic gov intervention

⇒ believe confidence will be gained back once economic stabilized

(B) Restore confidence (believe crisis is a self-fulfilling panic)

- influence expectation of the market (e.g investors)
- include assuming prejudices & different socioeconomic scenario make "standard" economic principles not workable in Third World / developing countries.
- should choose policies that are perceived as "good" to restore confidence. (eg: floating exchange rate, prudent budget). thus, these may include and "standard" economic policies as long as they can please investors and restore confidence
- should change / eliminate anything that being perceived as "bad" by investors. (eg cronyism, budget deficit, capital control).

⇒ believe economic stability will restore once confidence is gained

Cases:

1) Australia : choose (A) — let free exchange rate adjust by itself : success

2) Indonesia, Mexico, Thailand, S. Korea, Brazil : choose (B) — devaluation / depreciation of currency are terrible. Also practice tight (prudent) budget, ↑IR (Fail).

Chapter 7 : Hedge Fund

Nature of hedge fund is very risky :
1. they short some assets to get fund to long (buy) other assets.
2. difficult to regulate their operation
3. hedge fund not only antiapate the market but provoke it, thus causing crisis.

Case 1: European Monetary System's ERM

- "(n-1) problem" : Britain need to ↓ IR to fight recession but Germany (leader in EMS) need to ↑ IR to fight inflation after reunificat
- Quantum Fund short pound, long dollor, then provoke the mkt (Soros declaring his belief that pound will be devalue to financial newspaper
- Pound sterling left the EMS in Sept 1992, collapsed but stabaliz at 15% lower → then, British economy recovered strongly.

Case 2 : Hong Kong

- Economy down (Asian crisis), HK not competative due to fixed currency at HK$7.8 to US$1 (currency board system) ⇒ pressure to devalue.
- Speculators (Quantum Fund, Tiger Fund ?) short HK stocks for HK$, then change them to US$
- Provocation : ⇒ Selling HK$ in large block & regularly timed.
  ⇒ paid reporters & editors to run stories suggesting HK$ or Chinese remembi (or both) were on the verge of devaluation.
- Surprise ! ⇒ HKMA has far more US$ reserve than needed.
  ⇒ HKMA fiercely intervene in economy despite global criticism. [⇒ HK succeed to beat hedge fund](

⇒ see chart

iapter 7 (continue)

ie
f" —

HKMA devalue — profit fr currency exchange $\xrightarrow{\text{(but)}}$ HKMA very firm not to devalue HK$

or

HKMA ↑IR to defend Currency — profit from stock mkt fall $\xrightarrow{\text{(but)}}$ HKMA use extra US$ reserve to buy local stock → Hedge fund roll over short position, antizipate global pressure to stop HK govt intervention.

← HK govt restricted short selling ← recalled "rented" stock & Hedge fund lost battle

Case 3 : Russia

"Kleptocracy" → debt crisis → stabalized by US & IMF → destabalized by Soros's provoca (publizly suggest Ru devalue & establish cu board) → currency collaspe → some hedge fund loss / some hedge fund may gain

Hedge Fund's problem (further prove Hedge fund are risky to ec

- Competition among themself limited profit opportunities
- some hedge fund (eg LTCM) collaspe [LTCM saved by New Fed that persuade a group of investors to take up majority own of LTCM in return for cash injection.

On role of expectation (a "confident game"? / refer yr MA

1998 : Fed cut IR by 0.25% (deem too small, thus ca panic & possibility of recession in 1999.

oct 1998 : A surprise additional 0.25% cut (unexpect trigger positive effect.

Chapter 8: Bottoming Out?

Nature of crisis

- has silver lining behind crisis
  - will bottom, then rebound (either tempora[ry] or permenantly)
  - may benefit other sectors / other firms / other econo[mies]
- spread thru financial interconnection
  - e.g: floating exchange rate, free capital flo[w], liberalized market, international trade
    (e.g: tequila crisis, Asian crisis contagion)
    (e.g: currently, maybe war & oil price)
    subprime
  - vs financial isolation (eg: capital control in China & Malaysia)
  - ∴ will changing fr financial interconnect[ion] to isolation (control) help bottom out crisis? (Malaysia / Mahathir strategy)
- crisis causes & solutions are subject to interpretation (the confidence game)
  - eg: Peso deem not devalue enough
  - eg: Contagion effect in Asian crisis
  - eg: Brazil's 1999 crisis [Washington & IMF ask Brazil ↑ IR to defend currency ("self justification" involved??)
  - } will different course of action enable crisis to bottom out?
- may happen to any countries include developed countries like the US.

Chap 9

Depression Economics

The problem is not an economy's c[apacity] to produce (supply side) but insuf[ficient] private spending to make use of a[vailable] productiv[e] capaci[ty] side)

- A situation where there is a free lunch. If we can figure out how to get our hands on it. and put to work the unemployed resources.

Recession (crisis) → hangover theory

↳ may be view as bad to economy, but it manage to structure the economy and shake up the system.

Problem	Solve
Japan liquidity trap	≠ recover using conventional monetary policy (0% r) Japan must expand MS. → convincing savers & inves[tors] the current deflaton → modest inflaton.
US & Europe not to get into liquidity trap	inflaton ≠ too low when times are good. if crisis does strike → ↓r
Brazil	instituted capital controls to limit speculaton. Must be only one clean ch[oice] dan 4. sit somewhere in middl[e] (capital control, floating, fix[ed])
Developing country	Let market push currency dow[n] w/o ↑r

Rich: Japan; US & Europe
Poor: Brazil; Developing country

* transparency in a/c of banks & companies, closer regulation of financial risk-taking

* discourage local companies from borrowing / rely too much