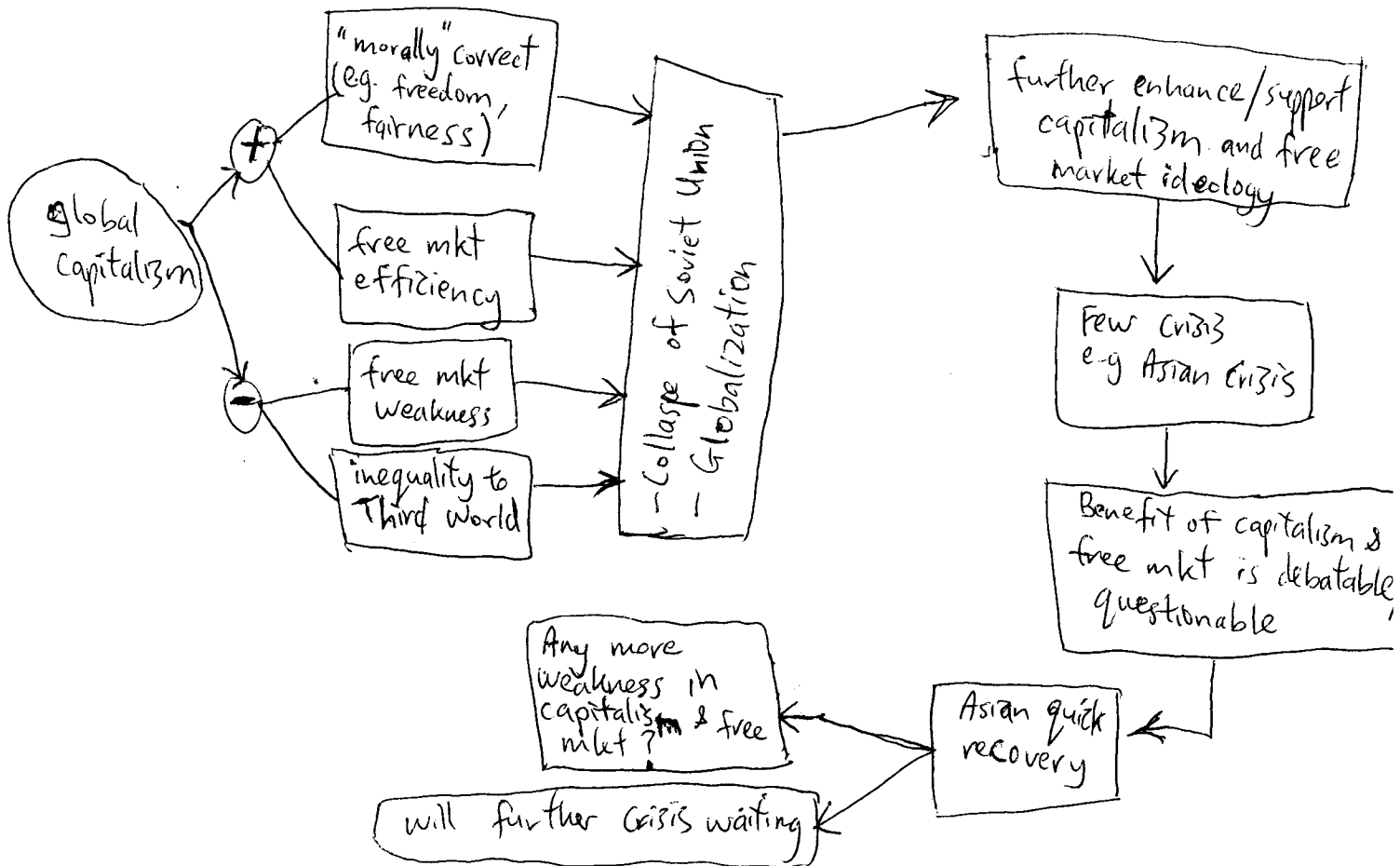
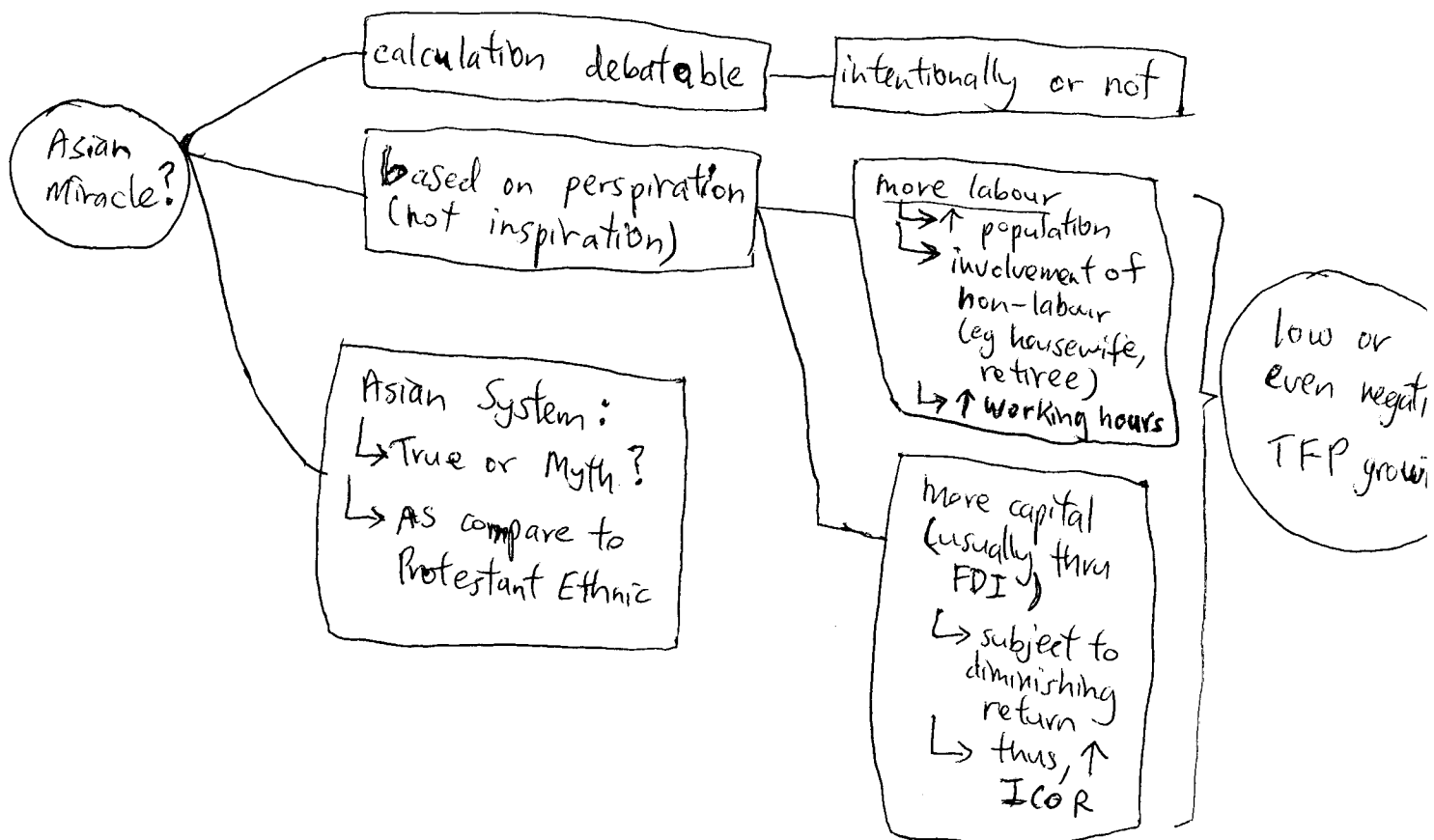


Chapter 1: July 1, 1997 : "Is global capitalism good?"

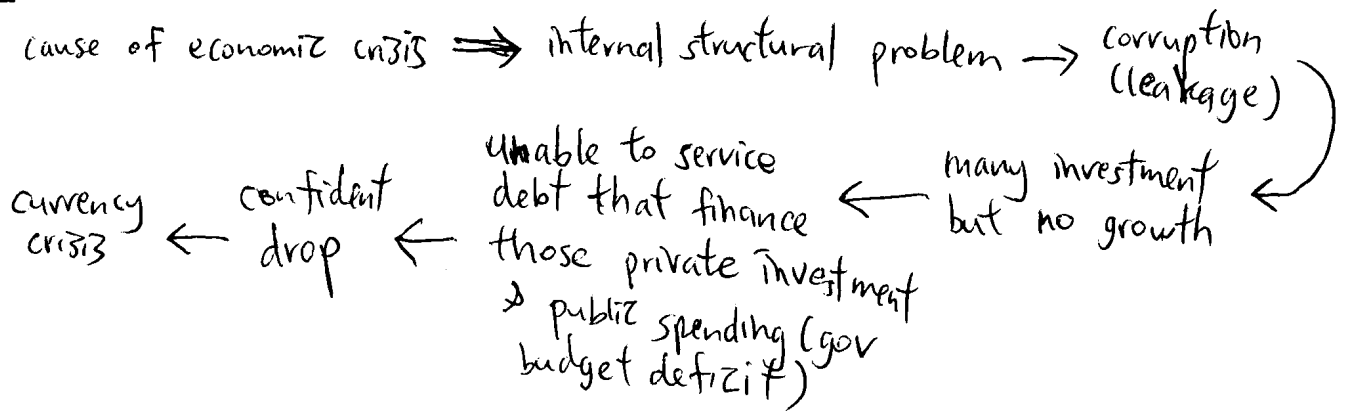


Chapter 2: A Short Course in Miracle : "The truth behind Asian Miracle"



# Chapter 3 : Warning Ignored : Latin America, 1995

## Mexico :



## 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 yield  $<$  World Bank yield (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 } 1981-1989: econ growth 1.3% below population growth  
Wage 30% lower than pre-crisis  
Avg inflation 70%

1989 : Washington Consensus <sup>adopted</sup> (stabilized, liberalized & free trade) + economic reform & Debt forgiveness (Brady Plan)

1990s : NAFTA & foreign fund inflow  $\rightarrow$  strong Mexico peso  $\rightarrow$  export + import

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

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

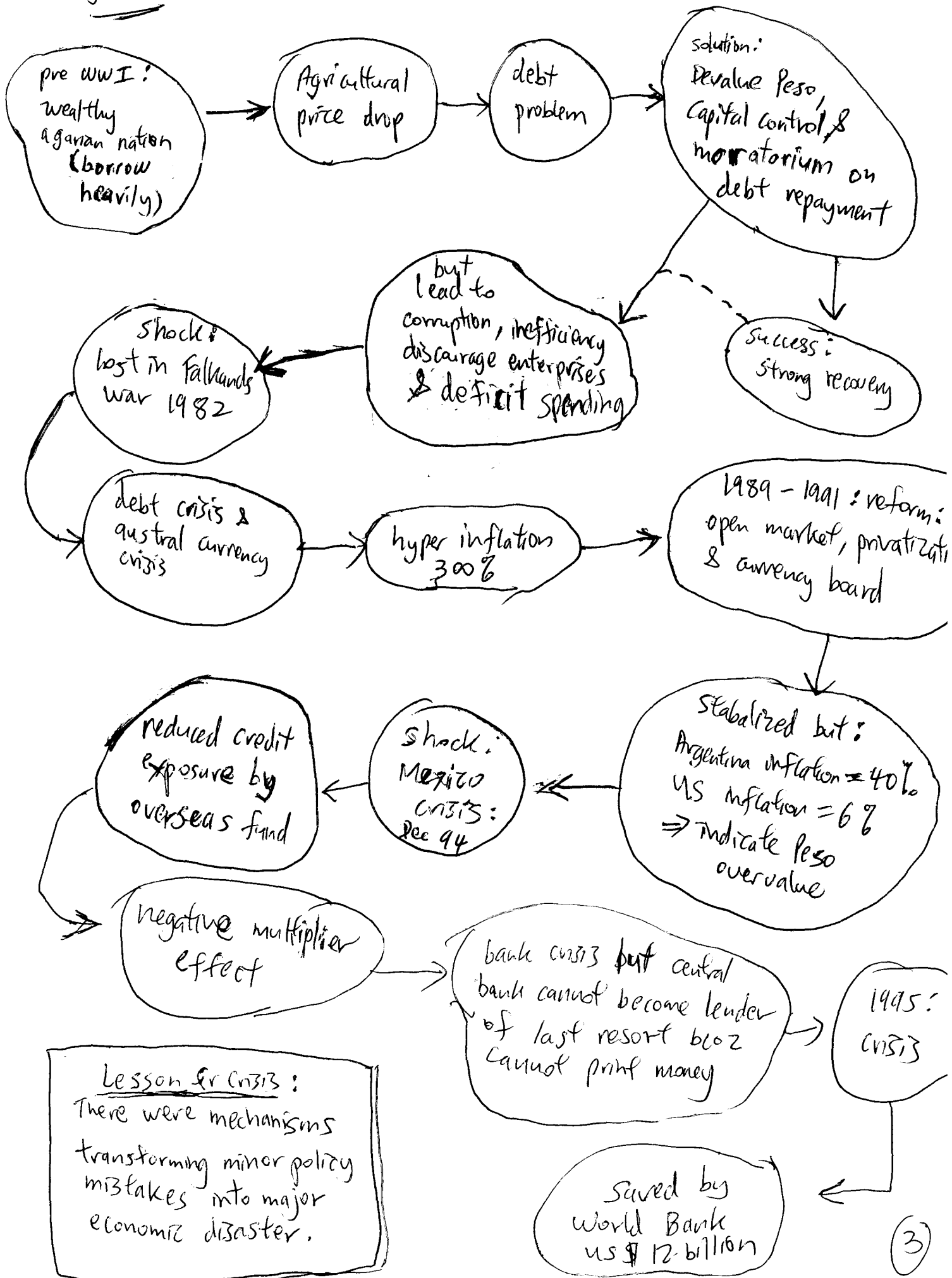
Dec 94 : [Tequila effect] Devaluation of peso (peso  $\downarrow$  50% due to speculative devaluation not big enough)  $\rightarrow$  lost confident  $\leftarrow$  no control over the situation. (convert short term debt to tabesanos, in peso  $\downarrow$ , debt  $\uparrow$ , cause panic)

1995 : GDP  $\downarrow$  7%

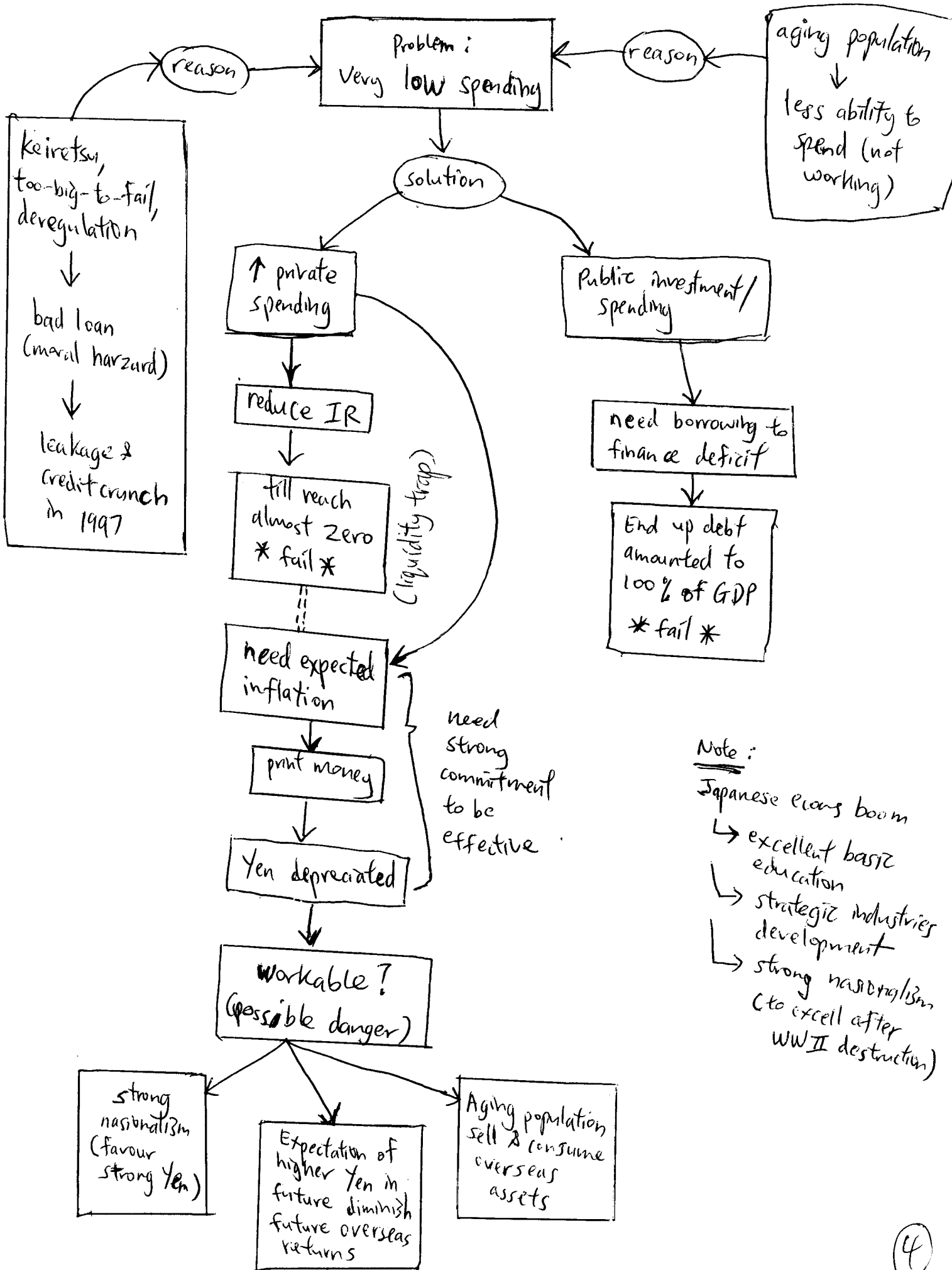
But Mexico was saved by US's Exchange stabilization Fund & IM

# Chapter 3:

## Argentina:



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



# 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

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

openness of financial mkt

"due to grouping all emerging mkt as one"

too small impact (not conclusive)

thru good mkt link

thru financial mkt link

Panic & Contagion effect

Collapse of Baht (private & gov dollar-debt ↑)

Baht appreciate

expansion of credit

neutralize by printing money

further credit expansion

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

economic boom (+ speculation)

wage ↑

spending ↑

fail: IR ↑, thus encourage foreign borrowing

cost ↑

import ↑

Thai export less competitive

Lesson 1

Gov undecided (thus, encourage speculation)

speculators and investors borrow baht to acquire dollar

gov try "deceit tactic" by borrow dollar (swap) (more debt)

Yen depreciate (1995-1997)

China devalue currency (1994)

Huge trade deficit + Crony capitalism

Problems: will deplete limited reserve & negative effect to business

Problems: hurt government reputation & inflate dollar-dominated debt

Bubble burst, business down, slowdown in foreign borrowing

Defend Baht: Buy Baht & ↑ IR

let the Baht depreciate

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

solution?

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. (e.g.: 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. (e.g. 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, ↑ IF (Fail) .

# Chapter 1: 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 anticipate the market but provoke it, thus causing crisis.

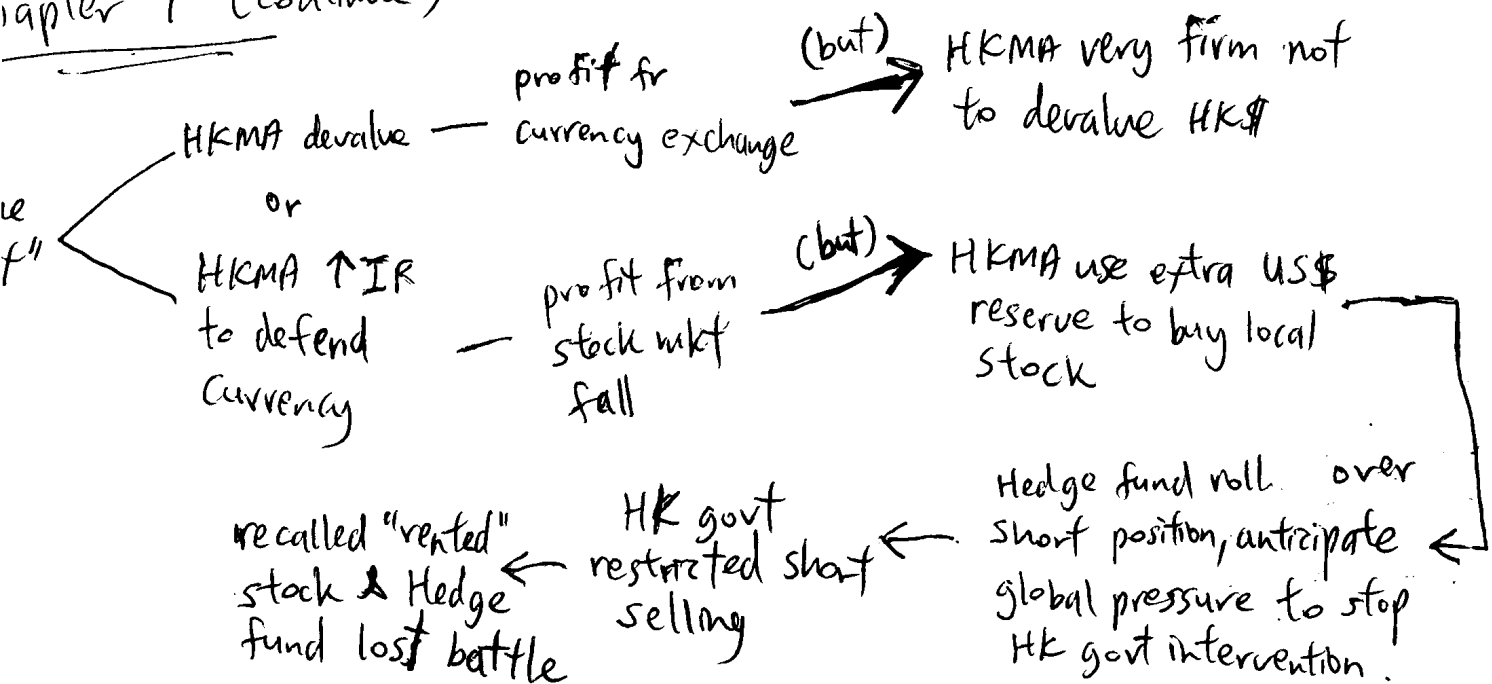
## Case 1: European Monetary System's ERM

- "Cn-1) problem": Britain need to  $\downarrow$  IR to fight recession but Germany (leader in EMS) need to  $\uparrow$  IR to fight inflation after reunification
- Quantum Fund short pound, long dollar, 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 stabilize at 15% lower  $\rightarrow$  then, British economy recovered strongly.

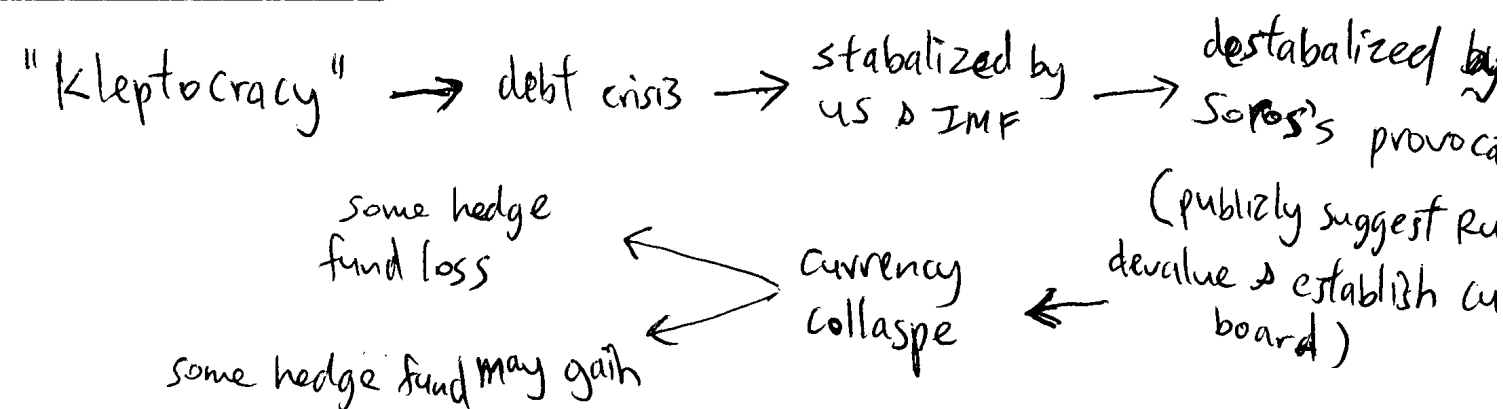
## Case 2: Hong Kong

- Economy down (Asian crisis), HK not competitive due to fixed currency at HK\$7-8 to US\$1 (currency board system)  $\Rightarrow$  pressure to devalue.
- speculators (Quantum Fund, Tiger Fund?) short HK stocks for HK\$, then change them to US\$
- Provocation:  $\Rightarrow$  Selling HK\$ in large block & regularly timed.  
 $\Rightarrow$  paid reporters & editors to run stories suggesting HK\$ or Chinese renminbi (or both) were on the verge of devaluation.
- Surprise!  $\Rightarrow$  HKMA has far more US\$ reserve than needed.  
 $\Rightarrow$  HKMA fiercely intervene in economy despite global criticism. [ $\Rightarrow$  HK succeed to beat hedge fund]
- $\Rightarrow$  see chart

## Chapter 7 (continue)



## Case 3: Russia



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

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

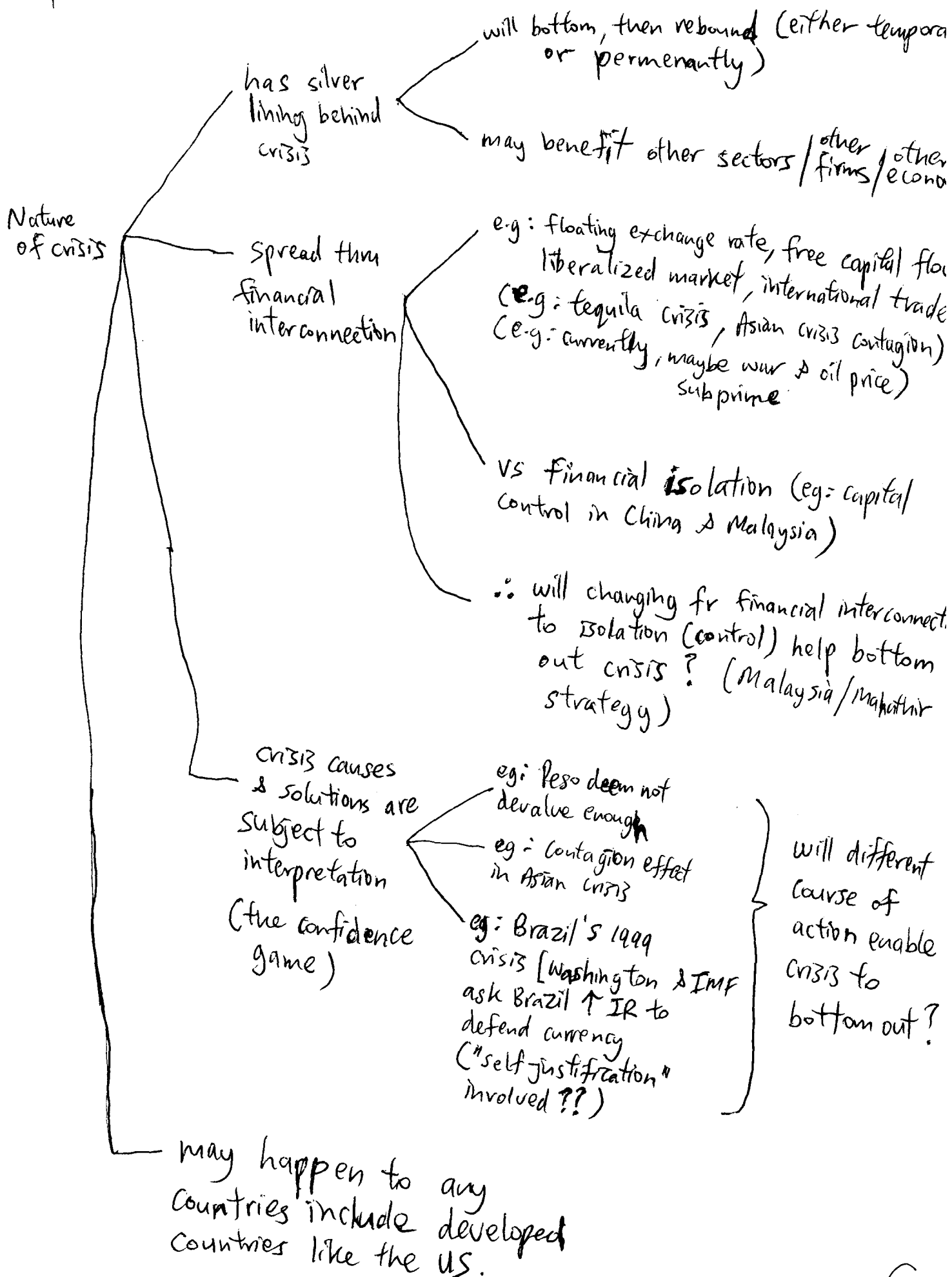
## On role of expectation (a "confident game"? refer yr MA)

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?



# Chap 9

## Depression Economics

- 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.

The problem is not an economy's (to produce (supply side) but insufficient private spending to make use of a productive capacity (demand side))

Recession (crisis) → hangover theory

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

### Problem

Japan liquidity trap

→

### Solve

≠ recover using conventional monetary policy (0% r)

Japan must expand MS.

→ convincing savers → moves the current deflation → modest inflation.

US & Europe not to get into liquidity trap

→

inflation ≠ too low when times are good.

if crisis does strike → ↓ r

Rich

Poor

Brazil

→

instituted capital controls to limit speculation.

Must be only one clear choice don't sit somewhere in middle (capital control, floating, fix)

Developing country

→

Let market push currency down w/o ↑ r

\* transparency in a/c of banks & companies, closer regulator of financial risk taking

\* discourage local companies from borrowing/rely too much