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Banks, the IMF, and the Asian crisis

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Abstract

This paper examines the impact of the Asian crisis on bank stocks. In the second half of 1997, Western banks outperformed their stock markets. In contrast, East Asian bank indices incurred losses in excess of 60% in each of the crisis countries. Most of these poor performances are explained by stock market movements in the crisis countries. After taking into account these movements, currency exposures affected banks adversely only in Indonesia and the Philippines. Except for the Korean program, which affected positively bank stocks in all countries in our sample but one, IMF programs had little effect on bank values. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

For most observers, banks have been at the heart of the Asian crisis. For instance, Hamann (1999, p. 9) states that ‘‘the Asian crisis differed from previous financial crises that created a need for the IMF's assistance. It was rooted primarily in financial system vulnerabilities and other structural weaknesses.’’

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However, the reasons given for the importance of banks in this crisis differ widely across observers. For some, currency crises led to banking crises in the affected countries. With this view, banks had accumulated large currency exposures based on the belief that there was little exchange rate risk. When exchange rates collapsed, they suffered large losses on their currency exposures. For others, banks were one important contributing factor to the Asian crisis. Asian local banks are accused of making too many unsound loans and moral hazard is blamed for this behavior. Delhaise (1998, p. 35) argues that ‘‘It was generally accepted before the crisis that most banks would be rescued if they ran into trouble.’’ Western banks are blamed for first lending too much and then for contributing to the credit crunch by lending too little. For instance, Wolf states that the East Asian banking crisis was ‘‘promoted by overgenerous lending from financial institutions in advanced countries.’’[1] The IMF and governmental bailouts have been blamed for creating incentives for banks to take on too much risk, including foreign exchange (FX) rate risk.[2] As one observer puts it, ‘‘These bankers took the opportunity to make very risky, profitable loans, knowing that if the loans went bad, the IMF or the US government would bail them out.’’[3]

These various views of the Asian crisis raise important questions: Did bank shareholders get hurt because of the crisis? Did the crisis pose a threat to the banking systems in Western countries? Can exchange rate changes explain the performance of Asian banks? Did specific events in the Asian crisis affect bank shareholders? How were banks affected by the announcement of IMF programs? Did IMF programs have systemic benefits or did they help only those banks with exposures in the countries benefiting from the programs? To examine these questions, we examine the returns to bank shareholders from January 15, 1997 to July 15, 1998. Our examination uses Datastream banking indices for four Western countries (the US, France, Germany, and the UK) and for six Asian countries (Indonesia, Japan, Korea, Malaysia, Philippines, and Thailand). We also investigate the returns of the three US banks that took a lead role in the renegotiations of Korean debt, namely the Chase Manhattan Bank, Citibank, and JP Morgan.

We find that during our sample period, shareholders of East Asian banks incurred dramatic losses. For instance, an investor who had invested US$1 at the start of our sample period in Korea’s bank index would be left at the end of our sample period with 14.7 cents. An investor who had invested US$1 in Indonesia’s bank index would be left with 3.3 cents. The story is very different for the Western banks. An investor who invested US$1 at the start of our sample period in

[1] Financial Times, Wednesday, October 21, 1998, p. 14.

[2] In a recent paper, Burnside et al. (1999) develop a theoretical model where implicit guarantees make it advantageous for banks not to hedge foreign currency exposures arising from their financing.

[3] The quote is from Chung Hoon Lee, president of the Korea America Economic Association, in *Economists blame short-term loans for Asian crisis* by Louis Uchitelle, New York Times, January 8, 1999.