

# IMF-related announcements and stock market returns: Evidence from financial and non-financial sectors in Indonesia, Korea, and Thailand

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## Abstract

We examine the changes in daily financial sector stock returns in Indonesia, Korea, and Thailand in response to IMF-related news during the Asian crisis and compare them with those in non-financial sectors. We find that news of both program negotiations and approval increased financial sector returns in Indonesia and Korea, whereas only program approval is associated with higher returns in the financial sector in Thailand. Sectors such as cyclical consumer goods and non-cyclical services experienced higher returns in Thailand and Indonesia, while almost all sectors enjoyed higher returns in South Korea. We interpret the empirical results based on the characteristics of corporate governance and industrial development policies in these countries.

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## 1. Introduction

This paper examines the changes in the financial and non-financial sector stock returns due to IMF-related news, such as announcements of program negotiations and approval, in Indonesia, Korea, and Thailand during the Asian crisis. Our focus on financial sector returns is motivated by the

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widely-held belief that the vulnerabilities of the financial sector in these countries contributed to the crisis. In fact, it has been argued that the financial sectors of the crisis countries seriously suffered from adverse selection problem before the crisis. The much publicized government–financial firms–corporations triangle in Indonesia, Korea, and Thailand has been pointed out as the root cause of the crisis (Harvey and Roper, 1999; Krugman, 1998; Stiglitz, 1999). We also examine the behavior of non-financial sector returns to see whether a similar response to IMF announcements took place in these sectors as well. Additionally, we interpret the impact of IMF-related news on relevant sector returns based on the corporate governance- and sector-based characteristics in these countries.

Our study can be viewed as complementary to the existing, but still limited literature on the effects of IMF-related news on financial markets. Most studies analyze such effects with respect to the bond markets. Only a handful of studies examine the response of equity returns to IMF-related news (Brealey and Kaplanis, 2004; Dong et al., 2000; Evrensel and Kutan, 2006; Hayo and Kutan, 2005; Kho and Stulz, 2000; Lau and McInish, 2003; Sarno and Taylor, 1999; Zhang, 2001). Our paper is different from the earlier studies in several respects. First, we focus on both financial and non-financial sector returns, while most studies focus on the banking sector returns. Second, most studies use an event study approach; we employ a GARCH model in order to capture the time varying volatility in stock returns. Third, the previous research implicitly assumes that Fund programs are credible such that market participants expect them to improve the efficiency in the economy in general and in the financial sector in particular. We instead interpret the changes in the financial and non-financial sector returns based on the available evidence on the corporate governance characteristics in Indonesia, Korea, and Thailand.

Our results indicate that news of program negotiations and approval increased financial sector returns in Indonesia and Korea. In Thailand, only program approval was associated with higher returns in the financial sector. The response of the non-financial sector returns to IMF-related news indicates a pattern in Indonesia and Thailand. In these countries, especially news associated with the start of negotiations and program approval increased the stock returns in cyclical consumer goods and non-cyclical services. In Korea, almost all sectors responded to IMF-related news with higher returns.

The paper is organized as follows. Section 2 defines the relevant IMF-related news and reports the results of the GARCH estimations of financial stock returns in Indonesia, Korea, and Thailand. Section 3 discusses the characteristics of these crisis countries' financial sector and interprets the empirical results regarding the financial sector returns. Section 4 examines the effects of IMF-related news on non-financial sector returns. Section 5 interprets the changes in non-financial sector returns based on the existing studies on corporate governance in Indonesia, Korea, and Thailand as well as the industrial development policies in these countries. Section 6 concludes.

## **2. Response of financial sector returns to IMF-related announcements**

In this section, we estimate the changes in the financial sector returns due to IMF-related news in Indonesia, Korea, and Thailand. In the following, we define the types of IMF-related news used in the analysis, describe our data, and present the results of the GARCH estimations.

### *2.1. IMF-related news*

We identify three dates or time periods, during which investors may form or change their expectations regarding the effects of a prospective IMF program on the stock returns: the announcement of program negotiations, the window period, and the announcement of program approval.

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