



Financing decisions of firms and central bank policy

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Abstract

This paper aims to explain why unhedged foreign borrowing by South East Asian corporations rose sharply during the few years prior to the crisis despite little change in fundamentals. We show that decisions of firms and decisions of the central bank are complementary. Consequently, a small shock to fundamentals may have a large and permanent impact on the equilibrium composition of firms' borrowing.

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1. Introduction

A few years after the onset of speculative attacks against Asian currencies and the subsequent economic crisis, much remains to be understood about the reasons for the attacks and for the magnitude of the crisis. Arguably, the single most important factor aggravating the crisis has been the enormous amount of foreign currency denominated borrowing by local corporations and financial institutions prior to the crisis. Table 1 shows that foreign bank lending to Asian banks and corporations had been steadily rising prior to the crisis, constituted mostly of short term loans, and frequently exceeded the total level of the country's reserves of foreign currencies. According to IMF, external financing (including bond

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Table 1
International claims held by foreign banks—distributed by maturity and sector

	Total Outstanding	Short term ≤ 1 yr	Distribution by sector			Reserves	Short Term/ Reserves
			Banks	Public sector	Non-bank private		
	In percentage of total consolidated claims						
	In billions of US dollars		In billions of US dollars				
Indonesia							
End 1995	44.5	61.9	20.1	15.1	64.7	14.7	1.9
End 1996	55.5	61.7	21.2	12.5	66.2	19.3	1.8
Mid 1997	58.7	59.0	21.1	11.1	67.7	20.3	1.7
Malaysia							
End 1995	16.8	47.2	26.4	12.4	60.4	23.9	0.3
End 1996	22.2	50.3	29.3	9.0	61.8	27.1	0.4
Mid 1997	28.8	56.4	36.4	6.4	57.1	26.6	0.6
Thailand							
End 1995	62.8	69.4	41.0	3.6	55.2	37	1.2
End 1996	70.1	65.2	36.9	3.2	59.6	38.7	1.2
Mid 1997	69.4	65.7	37.6	2.8	59.5	31.4	1.5
Korea							
End 1995	77.5	70.0	64.4	8.0	27.6	32.7	1.7
End 1996	100.0	67.5	65.9	5.7	28.3	34.1	2.0
Mid 1997	103.4	67.9	65.1	4.2	30.6	34.1	2.1

Sources: Bank for International Settlements and Radelet and Sachs (1998).

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