



EDRC Briefing Notes
Number 8

IMPLICATIONS OF THE FINANCIAL CRISIS FOR ASIAN EXPORTS

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FOR ASIAN EXPORTS**

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March 1999

Foreword

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ASIAN EXPORTS IN THE MID-1990s

It is widely accepted that rapid export growth is one of the important contributing factors behind the so-called "Asian economic miracle". Several East and Southeast Asian economies including the People's Republic of China (PRC), sustained high export growth over long periods. Consequently, in 1997, Asia accounted for 20 percent (in US dollar value) of world exports, compared to 5.9 percent in 1970 and 8.6 percent in 1980. These percentages should be seen against the background of the fact that Asia presently accounts for only 5.95 percent of the world gross domestic product (GDP). The long-term trend came to an end in 1996, when export growth rates for several of these economies began to fall. The drop in exports led to fears about the external sector's ability to fuel economic growth.

The decline was precipitous and struck all the high-performing economies of the region. The average export growth rate for the 11 largest Asian exporters in 1995 was 21.6 percent (Table 1), peaking at 31.4 percent during the first quarter of 1995. Asian export growth had started to decelerate gradually soon thereafter, but this was not widely noticed because the average annual growth rate for 1995 remained high (see Figure 1). In 1996, the market crashed and the export growth rate dropped to 4.3 percent.

DECCELERATING EXPORT GROWTH SINCE 1996

In the first quarter of 1996, export growth fell sharply in Hong Kong, China; Indonesia; Malaysia; Taipei, China; and Thailand. Economies that recorded the steepest deceleration in their export growth in 1996 were PRC, Korea, and Malaysia. In Thailand, exports contracted. Notwithstanding the financial crisis that started in July 1997, exports from the 11 largest exporting Asian economies grew by 6.7 percent in 1997 (Table 1). Although this performance was

better than that in 1996, it was too weak to be termed a recovery in Asian exports. The 1997 economic and financial crisis, which started in Thailand with the devaluation of the Thai baht on 2 July 1997, added to this scenario. Continuing recession in Japan exacerbated regional export performance. Since a great deal of Asian exports were intraregional, the Asian crisis had a clearly discernible effect on the regional export demand. Consequently, during the first quarter of 1998, Asian export growth decelerated further to 0.4 percent, and by the second quarter it contracted by 4.2 percent (Table 1).

After two quarters of negative growth rates in 1996, PRC exports began to accelerate gradually. Their performance improved substantially in 1997. In contrast, the export growth rate for the newly industrialized economies¹ (NIEs) was a meager 3.6 percent and for the ASEAN-4² was 5.8 percent in 1997 (Table 1). This implies that export performance worsened in the NIEs in 1997, while it remained virtually at the same level, or stagnated, in the ASEAN-4 countries. Since 1996, export growth has remained slow throughout the region, except in the PRC and the Philippines where the growth rate picked up to 21.0 and 22.9 percent, respectively, in 1997.

Principal factors that caused the 1996 deceleration were (i) the large fall in world trade growth, (ii) the depreciation of the yen that adversely affected exports from the NIEs, (iii) the appreciation in the real effective exchange rate in some Asian economies, and (iv) the significant price declines for major export products. All four factors are cyclical in nature.

The fall in the world export growth rate from its cyclical peak in 1995 was the largest in the last 15 years—from 20 percent in 1995 to 4 percent in 1996 in US dollar terms. The sharp depreciation of the yen in 1995 compounded the negative impact of the slowdown in world exports on many Asian countries. Japan is a major market for Asian products as well as a competitor in third-country markets. The preceding yen appreciation had sent import growth in Japan soaring between 1992 and 1994, and the sharp depreciation had a

1. Hong Kong, China; Republic of Korea; Singapore; and Taipei, China.

2. Indonesia, Malaysia, Philippines, and Thailand.

Table 1. Annual Export Growth Rates
(percent)

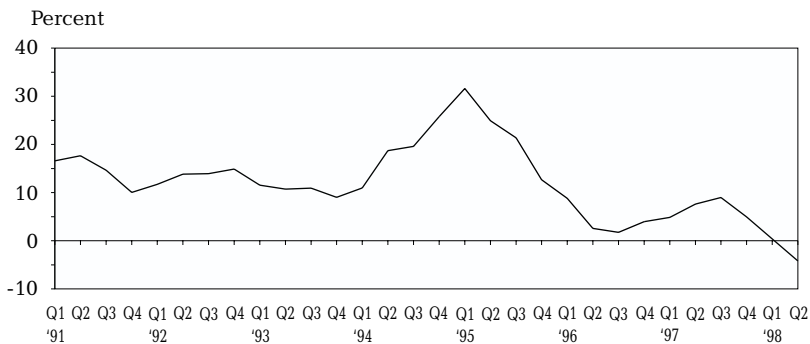
Economy	1994	1995	1996	1997	1998	
					Qtr I	Qtr II
Hong Kong, China	11.9	14.8	4.0	4.0	-0.9	-3.2
Korea	16.8	30.3	3.7	5.0	8.6	-0.5
Singapore	30.8	22.1	5.7	0.0	-6.9	-13.8
Taipei, China	9.6	20.2	3.7	5.2	-6.9	-8.1
Subgroup Average	16.2	21.0	4.3	3.6	-1.4	-5.9
Indonesia	8.8	13.4	9.7	7.3	0.9	-2.9
Malaysia	24.7	26.0	5.8	2.2	-11.3	-9.2
Philippines	20.0	31.6	16.7	22.9	23.2	10.6
Thailand	22.7	25.1	-1.3	3.2	-2.7	-6.8
Subgroup Average	19.3	23.0	5.6	5.8	-2.4	-4.6
China, People's Republic of	33.1	22.9	1.6	21.0	12.6	2.5
India	16.3	22.7	7.4	2.6	-6.1	-8.9
Pakistan	10.1	8.5	16.6	-6.5	1.1	-0.4
Average	19.2	21.6	4.3	6.7	0.4	-4.2

Sources: International Monetary Fund, *International Financial Statistics* (various issues); Central Bank of China, *Financial Statistics* (various issues).

reverse impact. Japan's imports—including those from Asia—fell sharply. In addition, due to the fall in the value of the yen, Japan's exports began to compete with those from Korea; Hong Kong, China; and Taipei, China in the markets of other developing economies. This was particularly true with Korea, whose real export growth has tended to mirror changes in the yen-dollar exchange rate, rising with appreciation of the yen and falling with its depreciation.

Although effective exchange rates were stable in the region during the early 1990s, several Asian economies began experiencing appreciation in the real effective exchange rate in mid-1995. This trend continued until the second quarter of 1997 in Indonesia, Philippines, and Thailand. This appreciation adversely affected export competitiveness in those countries. In addition, several Asian

Figure 1. Quarterly Growth Rates of Asian Exports
(exports in value terms)



Sources: IMF, *International Financial Statistics*; Central Bank of China, *Financial Statistics*; websites of Bank of Thailand and Bank Negara.

economies suffered from significant price declines in their major export lines, which in turn implied large terms of trade losses. The largest terms of trade losses were recorded by Korea and Thailand. The US experienced the sharpest fall in prices for imports from Asian countries, which dropped by 25 percent. Only the Philippines had rising unit export prices at the time of the onset of the crisis. The largest price declines occurred in the electronics industry, especially in computers, semiconductors, and telecommunications related products. Several Asian economies (Korea; Malaysia; Taipei, China) had large portions of their exports concentrated in this sector. Korea was particularly hard-hit when the 16MB DRAM chips, which accounted for a large share of Korean electronics exports, fell from a peak of \$150 per unit to \$10 between 1995 and 1997. Prices of labor-intensive manufactured goods, such as textiles and apparel, were also unsteady during 1996.

Although the sharp decline in Asian export growth in 1996 was essentially caused by the unusual confluence of adverse cyclical factors, several additional structural problems were underlying the deceleration. One of the most remarkable aspects of Asia's export performance has been the rapid shift in the composition of exports during the 1990s from resource-intensive and labor-intensive indus-

tries to more skilled and more capital-intensive industries. Between 1990 and 1996, the export structure in Asia changed dramatically. Singapore and Malaysia doubled their share of exports in high-technology products during this period. Thailand, which had started from a low base in 1990, almost tripled its share of high-technology exports. Indonesia reduced its share of resource-based exports, but was still low on the technology ladder for most exports. Thus, a noteworthy characteristic of the 1990s is the rapid transformation of the export structure of Asian exports. Both "push" and "pull" factors have contributed to the transformation: (i) competition in the labor-intensive goods market from low-cost producers such as the PRC was an important push factor; (ii) foreign direct investment from industrialized countries was the driving force behind the pull factor; and (iii) the relocation of the production bases by Japan; Korea; and Taipei, China to neighboring Asian countries in the late 1980s was another pull factor.

As a result of these factors, by the mid-1990s, the export structure in Asia was characterized by (i) a moving out of low-skill labor-intensive exports; (ii) specialization in high-technology exports, mainly electronics; and (iii) strong intraregional links (see Demand-side Constraints, p. 8). These characteristics caused Asian economies to depend on fewer export products and on one another. The new regional export structure exposed Asian economies to greater risks of export instability, domino effect, and external shocks.

EXPECTATIONS OF ACCELERATION IN 1997

The Asian financial crisis began in Thailand and spread rapidly to the other economies. The currency crises in the NIEs and the ASEAN-4 caused instability in the currency values of these economies. Many of the resulting currency depreciations were steep. For instance, between June 1997 and August 1998 the Indonesian rupiah depreciated by 82.9 percent against the US dollar, the Malaysian ringgit by 40.9 percent, the Thai baht by 39.7 percent, the Philippine peso by 39.3 percent, the Korean won by 33.3 percent, the NT dollar by 19.6 percent, and the Singapore dollar by 18.4 percent. Conversely, the Hong Kong dollar and the

yuan, which were on a fixed exchange rate, did not depreciate. During the same period, the Indian and Pakistani rupees depreciated by 16.0 percent and 8.8 percent, respectively. The depreciation in these two currencies had only a limited link to the Asian financial and currency crisis, as they were largely caused by domestic factors.

Theoretical models generally predict that exchange rate variability, including currency depreciation, has a strong negative effect on exports. The Akhtar-Hilton (1984) model posits that increased instability in currency value will lead to a lower level of trade under the assumption that traders are risk-averse. Exchange rate variability and the resultant price uncertainty may, other things being equal, lead to a gradual reduction in the volume of trade through backward shifts in demand and supply schedules. The size of the shift will depend on exporters' and importers' perception of the risk involved, on the extent of exchange rate variation, and on the elasticities of supply and demand. Also, firm behavior depends partly on exchange rate variability because price uncertainty adversely affects procurement and output, and discourages exports as well as imports. Using pooled time-series data for 10 developing economies, Grobar (1993) provides empirical evidence of the negative relationship between changes in real exchange rate and manufactured exports. This theoretical evidence indicates that a short-term impact of currency depreciation in Asia would be a slowing down of trade in general and exports in particular.

General expectations were that, once the initial phase of uncertainty was over, such steep currency depreciations would have a significant price effect and would improve the export competitiveness of the Asian economies. Therefore, possibilities of a dramatic export revival were seen in the steep currency depreciations. The export revival in turn was seen as a vehicle of economic recovery. The regional rescue programs of the International Monetary Fund (IMF) were partly based on the assumption that the depreciations would provide an impetus to exports. Theoretically, these expectations and assumptions were reasonable. However, much to the chagrin of these economies involved, the dramatic export revivals did not ensue in 1997.

PRINCIPAL REASONS BEHIND THE FAILURE TO RECOVER IN 1997

Short-term and Long-term Elasticities

Short-term price elasticities in international trade are likely to be much smaller than long-term elasticities, as proven by the short-term and long-term effects of currency depreciation on a country's trade balance. Immediately after a currency depreciation, the trade balance generally worsens before improving later on. This is essentially because the domestic-currency prices of imports tend to rise faster than export prices soon after a depreciation, with quantities (of both imports and exports) initially not changing very much.

Since the domestic currency prices of imports rise immediately and the import content of many export lines in Asia is inordinately high,³ the immediate impact of currency depreciation is loss of competitiveness of exports. The increased input costs offset any advantage that low wages provided. In Indonesia, Malaysia, Philippines, and Thailand, exporters imported an average of 30 percent of their raw materials used in the production processes. Two of the most import-intensive export sectors in the region are electronics and auto assembly. In these two sectors, import content ranges from 60 to 90 percent of the export value. Thus, the immediate impact of currency depreciation was a loss of export competitiveness in many important export lines.

Supply-side Bottlenecks

After the onset of the financial and currency crisis in Asia, credit became one of the biggest supply-side constraints. The banking and financial sector in the crisis-stricken Asian economies was in disarray, and this was partly responsible for the emergence of a crisis situation in these economies. A large number of banks were weighed down by massive bad debts and could not make further loans because they were unable to meet the 8 percent capital-

3. The import content of Nike shoes exported from Asia is as high as 70 percent.

adequacy ratio stipulated by the IMF.⁴ Consequently, an environment of severe credit shortage emerged in the crisis-stricken Asian economies.

Trade finance virtually dried up and so did working capital loans. This severe credit crunch hampered the ability of Asian firms to take advantage of the currency depreciations. Export orders were received but there was little liquidity available to purchase the necessary inputs, both domestic and imported. Because the banking sector in many Asian economies was in disarray, letters of credit from banks from these economies were not acceptable to foreign banks. In the initial period of economic adjustment, the financial costs also soared because interest rates in many economies soared to extremely high levels, although they have now declined substantially. High interest rates were considered a necessity by central banks in these economies as well as the IMF to stabilize currencies.

Demand-side Constraints

Intraregional trade is the single most important trade flow in Asia. It is more important than Asia's trade with the United States or other G-7 economies;⁵ indeed, more important than Asia's trade with the rest of the world. According to the 1997 annual report of the World Trade Organization, intra-Asian trade accounted for 51.9 percent of the total Asian exports (WTO 1997).⁶ The 1998 annual report puts this number at 50.7 percent (WTO 1998).⁷ The current acute recession in several Asian economies has led to weak import demand in the region. Table 2 shows that intraregional trade growth decelerated from 23.4 percent in 1995 to 4.8 percent in 1996. In 1997, there was a marginal improvement (6.4 percent). In the first quarter of 1998, intraregional trade growth registered a small (2.8 percent) deceleration again. Data for the five crisis-stricken countries (Korea, Indonesia, Malaysia, Philippines, and Thailand)

4. The 8 percent capital adequacy norm was originally determined by the Bank for International Settlements, Basle, Switzerland. It is part of the Basle accord.

5. Canada, France, Germany, Japan, Italy, United Kingdom, and United States.

6. In 1996, 37.3 percent of total PRC exports were destined for the other Asian economies while in 1997 this proportion was 35.8 percent.

7. Export volume data are available only for a few Asian economies.

indicate a drop in exports to Japan in the first quarter of 1998 of about 14 percent relative to the same period in 1997 (IMF 1998c). Over this period, Japanese domestic demand fell by 5 percent. In addition, the yen depreciated against the dollar by 10 percent, reducing the competitiveness of Asian exporters in Japanese markets.

An important fact that emerges from Table 2 is that the deceleration in intraregional trade growth was marginally steeper than that in Asian exports in general. Asia's exports to the rest of the world recovered better in 1997 and early 1998 (first quarter) than did the intraregional exports. In 1996, exports from PRC; Hong Kong, China, Indonesia, Singapore, Taipei, China; and Thailand were seriously affected by the decelerating intraregional trade. In 1997, intraregional exports from all four NIEs contracted, as did those from India, Malaysia, Thailand, and Pakistan. The two economies that began to show some improvement in intraregional exports during the first quarter of 1998 were Hong Kong, China, and Singapore.

Thus, while preponderance of trade links between Asian economies was an important factor behind the rapid regional growth, on the other hand, after July 1997, these links became a liability because they provided a perfect channel for the contagion to spread swiftly throughout Asia. Different Asian economies have different intraregional dependencies. PRC, Malaysia, and Singapore are the most dependent on intraregional trade while India, Korea, and Taipei, China are relatively less dependent on it. Thailand falls in between the two extremes. Since a significant proportion of PRC exports go to other Asian economies,⁸ the PRC's economic performance will continue to be affected by the recovery phase of the Asian crisis. Similarly, once the afflicted economies begin their recovery, Thailand will benefit more than economies such as India, Korea, and Taipei, China.

Another demand-side variable is the micro factor of export price pass-through. That is, how much of a price decline due to currency depreciation is passed on by exporting firms in the exporting country to importing firms in the importing country (Krugman 1987). Large importers who were aware of the depreciating currencies began demanding either complete pass-through in their import prices, or at least price cuts ranging between 35 and 60 percent.

Table 2. Intraregional Exports and Their Growth Rates
(millions of US dollars; percent)

Economy	1994	1995	1996	1997	1998 qtr.1
Hong Kong, China	65,813 (13.8)	77,340 (17.5)	81,700 (5.6)	82,782 (1.3)	19,063 (6.1)
Korea	29,864 (17.2)	41,752 (39.8)	46,820 (12.1)	50,437 (7.7)	11,930 (2.9)
Singapore	44,438 (45.4)	54,541 (22.7)	57,442 (5.3)	56,096 (-2.3)	13,659 (2.1)
Taipei,China	42,518 (14.5)	49,903 (17.4)	51,368 (2.9)	47,253 (-8.0)	9,176 (-13.6)
NIEs	182,633 (20.9)	223,536 (22.4)	237,330 (6.2)	236,568 (-0.3)	53,827 (0.5)
PRC	46,529 (45.1)	56,341 (21.1)	53,385 (-5.2)	69,401 (30.0)	15,939 (16.6)
Indonesia	10,821 (0.8)	13,551 (25.2)	11,989 (-11.5)	17,743 (48.0)	3,126 (-28.3)
Malaysia	24,949 (25.6)	31,111 (24.7)	35,310 (13.5)	35,750 (1.2)	8,479 (-5.1)
Philippines	2,575 (13.5)	4,301 (67.0)	5,098 (18.5)	6,775 (32.9)	1,743 (24.7)
Thailand	13,710 (42.2)	17,909 (30.6)	18,171 (1.5)	19,508 (7.4)	4,225 (-19.1)
ASEAN-4	52,055 (22.5)	66,872 (28.5)	70,568 (5.5)	79,775 (13.0)	17,573 (-11.8)
India	3874 (11.5)	5065 (30.7)	7123 (40.6)	6466.4 (-9.2)	1,894 (-1.3)
Pakistan	1122 (17.0)	1360 (21.2)	1727 (27.0)	1541 (-10.8)	346 (-13.9)
Total (intra-Asia)	286,213 (24.4)	353,174 (23.4)	370,133 (4.8)	393,752 (6.4)	89,579 (2.8)
Total Asia	766,500 (18.7)	932,800 (21.7)	976,000 (4.6)	1,042,600 (6.8)	253.1 (7.7)

Notes: Figures in parentheses stand for percentage change over the previous period. Exports of Asia to Taipei,China are based on imports of Taipei,China from trading partners.

Sources: IMF (1998a, 1998b); *Direction of Trade Statistics* tape (1998); Ministry of Finance, *Monthly Statistics of Exports and Imports* (various issues).

However, the costs incurred by Asian exporters did not fall much because the costs of imported inputs rose steeply and the Asian exporters could barely afford 10 percent price cuts. Therefore, expectations of large price pass-through in importing countries were not met, which in turn affected the fresh batches of export orders in the short term.

EXPORT VOLUME GROWTH DURING 1998

In the wake of the 1996 deceleration and 1997-1998 financial crisis, first, the exporting firms and industries in the Asian economies adjusted their manufacturing policies. In response to these adjustments export volumes gradually began to rise. Second, the price elasticity of demand began to play its role and declining dollar prices (due to currency depreciations) helped raise export volumes. Since the third quarter of 1997, exports volume surged in Korea and continued to do so in 1998. During July and August, the index numbers of value were 97.1 and 94.2, respectively (1995=100), while the index numbers for volume were 166.2 and 165.0, respectively.

Likewise, in Hong Kong, China; Indonesia; and Singapore export volumes started rising in the first quarter of 1997 and continued during 1998. Since the Hong Kong dollar was not depreciated, the difference between value and volume indexes was not large: in August 1998, the two indexes were at 106.3 and 111.9, respectively. But in Indonesia and Singapore in mid-1998, the volume index was much higher than the value index. Conversely, export volumes have not risen in Taipei, China and the Philippines whereas export values have risen over the same period because of a rise in the unit prices of their exports.⁹ The unit prices of exports were in turn influenced by recovering electronics goods prices, which are a significant part of total exports from these two countries. Of the countries for which export volume data are available, the maximum volume increase has been observed for Indonesia and Korea. The rising volume trend was not noticed in Thailand until December 1997. This shows that the effect of currency depreciation was felt after a relatively long time lag. For the five crisis-stricken

Asian economies, during 1998, the index of export volume remained consistently higher than that of export value. On average, their export volume growth has been estimated at 25 percent year-on-year (World Bank 1998).

Thus, export volumes have indeed responded to policy adjustments and exchange rate depreciation and provided a stimulus to demand. But this response was lagged and the surge in export volumes was more than offset by a sharp drop in the unit value of exports as well as the currency depreciation. The US import data show that the pace of decline in prices from Asian economies had accelerated—from 6 percent annually in the third quarter of 1997, to 12 percent annually in the second quarter of 1998. The fall in prices could also originate from competition in relative prices. Asian countries tend to compete more intensely with one another than with non-Asian exporters (Muscatelli and Montagna 1994) partly because of a great similarity in export structures. This means that if several Asian countries lowered their export prices simultaneously, none of them would be able to increase its market share. The final outcome would be lower export prices and slippage in terms of trade. This may be a significant factor in the crisis countries, especially in the electronics sector. At a macroeconomic level, however, rising export volumes will help prop up output and employment. This in turn could lay the foundation for an export as well as economic recovery.

PROSPECTS

To determine future prospects, let us first summarize the factors causing the dramatic decline in export growth rate in Asia. Although some structural weaknesses had existed during the 1990s, the 1996 deceleration was precipitated by cyclical factors. The 1997-1998 currency and financial crisis made it impossible for exports to recover and worsened an already bad situation. The principal negative impact of the crisis on exports was to create effective supply-side bottlenecks. By retarding intraregional trade, the crisis created demand-side constraints. The recession in Japan exacerbated the situation. However, the post-1996 deceleration in Asian export growth is not a permanent situation.

The world trade growth in 1998 was clouded to some degree by the Asian financial crisis. The World Trade Organization estimated that world trade volume would grow at 4.6 percent in 1998, or one half the 9.8 percent recorded for 1997 (WTO 1998). This in turn adversely affected the Asian export recovery endeavors during 1998. The forecast growth rate for 1999 is just 5.3 percent (OECD 1998).

Short-term Prospects

Are there realistic prospects for a short-term recovery of Asian exports? Given the sluggish growth in world trade volume and in nominal dollar terms, international capital outflow from Asia, continued strength of the dollar, recession in Japan, and the near collapse of intraregional trade, the value of Asian exports is not likely to increase rapidly in the short-term. The short-term outlook is much more difficult and laden with downside risk than was anticipated a year ago. However, two indicators are favorable. First, export volumes have started rising in several Asian economies and, second, export value rose marginally in the first quarter of 1998, providing a glimmer of hope for a recovery to start. However, these two indicators show only weak prospects for a pickup because the export data for the last two quarters of 1998 are not yet available and may well show more lagged effect of the Asian crisis on regional export performance. For instance, the preliminary export data for the PRC show zero growth for the latter half of 1998 (Harding 1998). In addition, the US and the Organization for Economic Co-operation and Development (OECD) economies have been forecast to slow down in 1999. Should this slowdown transpire, the demand stimulus that the Asian economies badly need will not be available in 1999. These factors indicate that Asian exports, at best, will stabilize in 1999.

Medium-term Prospects

The medium-term prospects of an export recovery are much better than those for the short term. Asian currencies have depreciated steeply; the yen has appreciated in the last two months of

1998 and January 1999; G-7 leaders have proposed a set of measures to strengthen the global economy; and Japan has announced a \$500 billion financial revitalization package to stimulate domestic demand. In addition, during the last Asia Pacific Economic Cooperation (APEC) summit meeting, Japan, the US, the Asian Development Bank, and the World Bank have announced stabilization packages to assist the crisis-ridden Asian economies. Macroeconomic adjustment measures undertaken by the crisis-stricken Asian economies are likely to help expand exports, albeit after a time lag. Financial sector constraints are beginning to ease and interest rates are far below their peak levels in these economies. In addition, in the medium-term, Asian economies will be able to restructure their banking and financial sectors and alleviate the supply-side bottlenecks. In fact, the affected Asian economies had made noteworthy progress at these tasks during 1998. More credit is likely to become available and trade credit to exporters will ease soon, improving medium-term prospects for exports. These domestic and international initiatives have begun creating an appropriate environment for economic stability and trade recovery in the medium term (World Bank 1998). At the end of January 1999, Standard and Poor lifted the short-term and long-term credit rating of Korea to investment grade. Also, the PRC confirmed its commitment to maintain the exchange rate of the yuan (Nomura Research Institute 1999). Underpinned by these developments, investors have recovered confidence in the securities markets. As the regional economy stabilizes by the last quarter of 1999 and world export growth picks up in 2000, Asian export growth is likely to pick up as well.

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