FRANZ R. HAHN
MARKUS MARTERBAUER
STEPHAN SCHULMEISTER
JAN STANKOVSKY

THE FINANCIAL CRISIS IN SOUTH-EAST ASIA – ITS IMPACT ON AUSTRIA

The financial crisis in South-East Asia will only marginally affect the Austrian economy. Direct trade with the region accounts for only 1½ percent of total exports and Austrian banks are barely involved. The current crisis makes a strong case for the regulation of international financial markets.

Franz R. Hahn, Markus Marterbauer, Stephan Schulmeister and Jan Stankovsky are economists at the Austrian Institute of Economic Research. Research assistance was provided by Christa Magerl, Martha Steiner and Gabriele Wellan.

According to current estimates, the crisis in the Far East could depress the growth of Austria's exports by at most 0.5 percentage point and the expansion of real GDP by 0.1 to 0.2 percentage point, even under pessimistic assumptions. To the direct effects must be added the indirect effects resulting from lower economic growth in third countries, which by general agreement will be small in the advanced economies of Europe and North America; much will depend, however, on how economic policy, particularly in the monetary sphere, reacts to the deflationary effects of the Asian crisis.

Austria's exporters, moreover, will have to cope with strong downward pressures on prices with regard to those products and on those markets where they compete directly with producers from the Far East. The engagement of Austrian banks in the crisis region seems to be rather limited.

The conclusion that the Austrian economy's marginal vulnerability in the present situation is due to its limited exposure to this region would be, however, fundamentally wrong. Over the past years, Austria's economy, by failing to take advantage of the market opportunities offered by the booming economies of South-East Asia, has "lost" more growth potential than it can expect to save this year and possibly next year.

If the turmoil in the Far East is only a temporary phenomenon, the crisis could be used as an opportunity to strengthen Austria's position in this region[1]. Such a pro-

[1] The prompt decision of the U.S. EXIM Bank to strengthen its engagement in the Far East should make it easier for Austria's policymakers to pursue such a project.

The Origins of the Crisis – "The Conventional View"

According to first assessment studies (e.g., *IMF,* 1997, *Krugman,* 1998) the following factors contributed to the financial crisis in South-East Asia (Indonesia, Korea, Malaysia, the Philippines and Thailand):

- Overheating of the economies in the four ASEAN countries (Malaysia, Indonesia, the Philippines and Thailand) as well as late and inadequate measures to curb the crisis: the overheating in the form of exuberant investments together with misallocation of resources created "bubbles" in the stock- and real-estate markets.
- The unwillingness to devalue against the dollar in the final phase of the dollar's surge against the yen and most European currencies (beginning in 1995) on the part of the four ASEAN countries contributed to the crisis. Moreover, during the same period the four ASEAN countries revalued their own currencies against the yen. This is significant because the USA is the most important trading partner of the ASEAN countries and South Korea, with Japan ranking second place.
- The sluggishness of the Japanese economy together with the yen's devaluation also slowed down the four tiger economies' potential for growth. (Japan is the region's second largest trading partner.)
- High interest rates designed to bolster the region's dollar-linked exchange rate mechanism cause problems because they facilitated excessive borrowing. Many companies, already deeply in debt, could thus move into the international market and offer excellent investment opportunities for international investors.
- European efforts to cut down on spending with the aim of meeting the Maastricht criteria, the dwindling public borrowing requirements in the USA and a disproportionate level of self-financing in the private sectors of the industrialized economies created an overabundance of liquidity on the international capital markets and thus put pressure on short and long-term interest rates. South-East Asia as well as the emerging market economies of eastern Europe seemed to offer good opportunities for investment. All the more so because many investments were backed by state guarantees and promises of public bail-outs.
- Foreign investment usually entered the financial markets of South-East Asia as short-term bank loans (mainly denominated in dollars); short-term loans with a maturity of less than a year account for 62 percent of all international loans in the region. Most of the loans went to banks (43 percent) or directly to enterprises or businesses run under state auspices (48 percent). Compared to the private sector, the indebtedness of the public sector is only marginal.
- International organizations like the IMF, the World Bank, the OECD and rating-companies were badly informed about the region's structural weaknesses in the financial and entrepreneurial sectors and consequently underestimated the well-known dangers of structural problems.

gram, backed by political acumen, might also garner psychological benefits for Austria.

On the international plane, there are two approaches to economic regulation. First of all, the creation of the Euro could provide the opportunity to stabilize the exchange rates among the three major currencies in the world. The rise in the value of the dollar since 1995 has been one of the factors triggering the present crisis.

Second, the efforts of the Basle Committee on Banking Supervision and of the IMF to strengthen the stability of the international financial system need to be intensified. Giving the BIS and the IMF additional powers of information and supervision might markedly improve the information efficiency of the global financial markets, which in the recent crisis turned out to be low.

EFFECTS OF THE CRISIS IN SOUTH-EAST ASIA ON INDUSTRIALIZED COUNTRIES

There are several channels through which the Asian crisis can effect economic growth in industrialized countries. These channels assume a substantial devaluation of the currencies in question as well as diminished domestic demand due to asset effects and the effects of a more restrictive economic policy. These measures are part of the IMF program to increase banks' liquidity. The effects will be roughly as follows:

- direct effects on foreign trade due to weak domestic demand and the devaluation of the currencies of the countries of South-East Asia,
- indirect effects on foreign trade with third countries due to a change in the competitive position brought about by changes in exchange rates,

Origins of the Crisis – "Alternative Views"

Several of the IMF's arguments have been criticized:

- The overheating of the business cycle: in most South-East Asian countries economic growth has slowed down since 1994-95; the same is true of inflation.
- The "bubbles" in the stock- and real-estate markets: between the end of 1993 and mid 1997 – that is, before the advent of the crisis – stock prices fell by 68.7 percent in Thailand, by 13.9 percent in South Korea, by 18.1 percent in Singapore and by 5.6 percent in Malaysia; they rose by 23.2 percent in Indonesia and by 27.8 percent in Hong Kong.

  "Stock market bubbles" appeared mainly in the industrialized countries: stock prices rose by 116.4 percent in the USA, by 53.4 percent in U.K., by 84.2 percent in Germany between the end of 1993 and the middle of 1997; at the same time, the capital stock of the business sector in these countries grew more slowly than in East Asia.

  Only Thailand seems to have experienced a bubble effect during the years in question, but little that is conclusive can be said as the statistics for the real estate sector are weak.
- The four ASEAN countries' reluctance to break with the dollar: the ability to compete on international markets (largely a function of the exchange rate) has not translated into a loss of market shares; rather, the growth of the region's export markets has slowed down markedly since 1994.
- The high interest rate policy: neither nominal nor real interest rates have risen in the past years in the crisis region. The relatively high interest rates match the long-term rate of growth.

Almost all tiger economies experienced a significant deterioration in the current accounts since 1993-94 and financed this deficit predominantly through dollar loans from western banks, in particular from Germany and Japan.

The most important cause of the current account deficits experienced by the economies of East Asia was the discrepancy between the rate of expansion in this region and that in Europe. As a result, this region imported more from Europe and Japan than it exported.

The current financial crisis seems to have been triggered less by the level of foreign debts (or the rate of increase) than by the fact that the debt is denominated in dollars and that in the middle of 1995 the sharpest rise in the dollar exchange rate since the early 1980s set in: by mid 1997 the dollar rose 30 percent against the DM (from 1.40 to 1.80 DM) and 35 percent against the yen (from 85 to 115 yen) in the period up to mid 1997. This cut down on the export earnings necessary to service the dollar debt held by the South-East Asian economies. This relation can be stated as follows: when the dollar exchange rate rises, the price of exports in dollars falls which in turn means that the real interest burden of debt in dollars rises. In 1995 prices of manufactured goods rose by 10.3 percent while they fell by 3.1 percent and 7.3 percent in 1996 and 1997, respectively. (In 1995, the value of the dollar had declined, but since then the world currency soared.) This means that even with stable nominal interest rates (LIBOR) real interest rates for international debt denominated in dollars rose by 17 percentage points between 1995 and 1997.

- effects of the involvement of western banks in the crisis region,
- effects on export credit insurance systems in industrialized countries,
- change in investment patterns benefiting industrialized economies,
- change in portfolio investment patterns benefiting safe havens,
- effects on expectations of investors and consumers in industrialized countries.

Austria will be affected in several ways:

- Austria's exports to the region in question will decline; this in turn will slow economic growth;
- there will be increased price competition on the domestic market as well as on the third-country markets;
- the export credit insurance system will be forced to honor its commitments which will put pressure on the federal budget.

The problems mentioned above will arise more dramatically in other countries. Problems abroad will, of course, have negative repercussions on Austrian exports and economic growth.

The crisis' immediate effect on growth in the industrialized economies will depend largely on the degree of interdependence between South-East Asia and the industrialized economies with regard to the goods, services and capital markets. The business cycle and the course of future mon-

Table 1: Distribution of international bank lending by nationality of reporting banks

		Total claims	European banks Total	European banks Austrian banks	North American banks	Japanese banks	Other banks
		Billion $	Percentage shares				
Debtors							
All countries	December 1996	991.4	54.2	2.3	15.0	17.1	13.6
	June 1997	1,054.9	55.5	2.3	14.5	16.4	13.6
Developed countries	December 1996	171.0	56.4	2.1	8.5	14.9	20.3
	June 1997	184.6	56.0	2.2	10.2	13.1	20.7
Eastern Europe	December 1996	103.0	79.5	8.4	9.3	3.9	7.3
	June 1997	116.9	79.0	7.9	10.4	3.3	7.2
Asia	December 1996	367.0	42.2	1.6	11.0	32.3	14.5
	June 1997	389.4	43.8	1.6	10.1	31.8	14.3
Latin America	December 1996	242.4	54.2	0.8	31.2	6.4	8.3
	June 1997	251.1	58.2	0.8	27.9	5.8	8.0
Middle East	December 1996	48.6	66.0	2.2	8.9	5.8	19.3
	June 1997	50.9	63.9	2.2	10.1	5.8	20.2
Africa	December 1996	50.2	74.3	4.5	8.6	6.8	10.0
	June 1997	53.1	69.3	3.7	13.0	6.4	11.3

Source: BIS.

etary policy in Europe and the USA will also play an important role in this context.

Trade relations with the region in question vary widely. Japan has particularly strong links with the tiger countries while the percentage of exports originating in the USA and Europe destined for South-East Asia is relatively low. For example, Austrian exports to the five countries hit hardest by the crisis account for only 1.5 percent of total exports. Bank loans, however, came predominantly from Japan and Europe and only sparingly from the USA.

THE INVOLVEMENT OF INTERNATIONAL BANKS IN SOUTH-EAST ASIA

According to the latest BIS statistics, Asia owes international banks $ 389 billion. The BIS calculates that Asia accounts for about one third of all international claims ($ 1,055 billion) by BIS reporting banks.

According to the latest BIS statistics (covering the period up to June 1997) Asia owes international banks $ 389 billion. The BIS calculates that Asia accounts for about one third of all international claims ($ 1,055 billion) by BIS reporting banks. However, BIS statistics underestimate the sum total of international outstanding debt and thus the total volume of credit at risk because they do not cover all bank transactions and over-the-counter financial transactions. (BIS does not account for off-balance-sheet debt, domestic loans in national currencies, derivative positions and holdings of bonds and stocks.)

Table 2: Claims of European banks on Asian countries

End of June 1997

	South Korea	Thailand	Indonesia	Malaysia	Total
	Billion $				
Europe	36.2	19.4	22.3	12.7	90.6
Germany	10.3	7.6	5.9	5.8	29.6
France	10.3	4.9	4.7	2.9	22.8
U.K.	6.2	2.8	4.1	2.0	15.1
Rest of Europe	9.3	4.2	7.6	2.0	23.1
Japan	23.8	37.5	22.9	10.4	94.6
USA	10.3	4.2	4.7	2.3	21.5
Other countries	33.1	7.6	8.2	4.3	53.2
Total	103.4	69.4	58.7	28.8	260.3
Austria	1.2	0.6	1.5	0.2	3.5
Guaranteed by the OeKB %	0.8	87.8	98.4	42.9	59.4
	Percentage shares				
Europe	35,0	28,0	38,0	44,1	34,8
Germany	10,0	11,0	10,1	20,1	11,4
France	10,0	7,1	8,0	10,1	8,8
U.K.	6,0	4,0	7,0	6,9	5,8
Rest of Europe	9,0	6,1	12,9	6,9	8,9
Japan	23,0	54,0	39,0	36,1	36,3
USA	10,0	6,1	8,0	8,0	8,3
Other countries	32,0	11,0	14,0	14,9	20,4
Total	100,0	100,0	100,0	100,0	100,0
Austria	1,2	0,9	2,5	0,7	1,3

Source: BIS, OeKB (Oesterreichische Kontrollbank).

European banks, especially French and German banks, are the biggest creditors in Asia. European banks hold 44 percent of claims on Asia, while U.S. banks hold only 10 percent and Japanese banks hold 32 percent. For the most part this debt is in the form of short-term loans (with maturity of less than a year) to local banks or businesses. European banks are by far the most important creditors of emerging market economies.

Korea, Thailand, Indonesia and Malaysia received $ 260 billion or two thirds of the international credit to South-East Asia. According to the BIS, European banks have loaned these countries $ 90 billion. *Standard & Poor's* (1998), however, estimates that outstanding loans to these countries amount to between $ 110 and $ 130 billion. According to *Standard & Poor's,* around 20 European banks are heavily involved in the crisis region, accounting for 80 to 85 percent of the European loans. The banks most at risk now are the Deutsche Bank (with a total engagement in the four crisis economies of DM 9 billion and reserves set aside for the Asian engagement of DM 1.4 billion), large French banks such as Crédit Lyonnais, Société Générale and Banque Nationale de Paris, banks in the Netherlands such as ABN-AMRO and ING and the three large Swiss banks. Standard & Poor's estimated that European banks could lose as much as $ 16 to $ 20 billion. 30 percent of the loans are non-performing of which 50 percent must be written off. Standard & Poor's classifies the earnings of the banks concerned as between good

Table 3: Austria's foreign trade with the Far East

	Exports				Imports				Trade balance
	Billion ATS	1989 = 100	Percentage shares		Billion ATS	1989 = 100	Percentage shares		Billion ATS
			in total exports	in GDP			in total imports	in GDP	
1989	10.0	100.0	2.34	0.60	18.0	100.0	3.49	1.07	– 7.9
1994	18.0	179.7	3.52	0.80	29.6	164.6	4.70	1.32	–11.5
1995	20.6	205.2	3.55	0.88	24.5	136.3	3.66	1.05	– 3.9
1996	20.6	205.6	3.37	0.85	26.1	145.5	3.67	1.08	– 5.5
1997	22.3	222.2	3.21	0.89	29.5	164.5	3.83	1.18	– 7.3

The figures for 1997 are based on data for 11 months.

and excellent, so that the expected loss will not impair the credit rating of these banks.

THE CYCLICAL POSITION OF THE WORLD ECONOMY

The current cyclical position of the industrialized countries will determine to a large extent what impact the crisis in the Far East will have on the world economy. If economic growth is sturdy and supported largely by domestic demands, the effects of a slowdown in export growth on the world economy will be slight. The level of economic activity will be largely unaffected only if the capital flowing from Asia to the industrialized economies can be absorbed by a lively credit demand from the business sector.

Under the cyclical aspect, Japan's economy will be hit much harder by the crisis than that of the other two economic regions of the triade. The current turmoil in South-East Asia comes at an inopportune moment for the Japanese economy: it has shown signs of a revival only recently (winter 1996-97) and economic policy has little room for maneuver to counteract the crisis' effects on Japan. Japan will not be able to absorb the surplus funds coming from the crisis region. As Austrian exports to Japan account for only 1½ percent of total exports, the effect on Austrian economic growth is negligible.

The USA is much less at risk than Japan because of its limited financial and trade involvement in the region. Moreover, the U.S. economy is in much better shape than Japan's: in 1998 the USA enters its seventh year of relatively strong economic growth. This growth is born chiefly by domestic demand, consumer as well as investment expenditures. As a result of higher exchange rates, exports are already slowing down. The slump in the Far East will further hamper exports. This will not, however, lead to a substantial setback for the U.S. economy. Furthermore, the anticipated effects of the current crisis make an interest rate cut more likely.

Since the beginning of 1997 the European Union has experienced an increase in economic activity which in some countries has already spread to domestic demand. Germany and France have shown signs of a vigorous domestic demand since winter 1997-98. But excess liquidity is absorbed only slowly given the gradual increase in demand, high profit margins and a restrictive fiscal policy. The recovery in Germany cannot yet be classified as self-sustaining. Current economic activity is far from being robust in the transition from export-driven to investment-driven growth. Although European banks are heavily involved in the crisis region, economic policy has enough room to counter the negative effects of the financial crisis in Asia. There is increasing speculation about postponement of a hike in interest rates, which would have otherwise been necessary to prepare for the European Monetary Union.

On the whole, economic growth remains strong in eastern Europe, although there are significant regional differences. The most important factor limiting growth is the cap imposed by the balance of payments. Current account deficits sometimes reach a level which requires macroeconomic intervention. There is an ample flow of short- and long-term capital to eastern Europe. The trade links between eastern Europe and South-East Asia are relatively weak. Eastern Europe will, however, have to face the stiff competition presented by the tiger economies. The South-East Asian "contagion" could also impair the flow of capital into eastern Europe. It is possible that short-term investments in eastern Europe will decline and that speculators will attack the currencies of some eastern European countries, of Russia in particular, and thus bring about a devaluation. Austria must be prepared for such a scenario, which would entail a drop in Austrian exports to this region.

For Austria, there are no comprehensive simulations which could predict the impact of the Asian crisis on the economy. Because of the weak trade links, the effects on Austrian exports will be very small, but will be examined more closely below.

Table 4: The current development of Austria's foreign trade with the Far East

	Exports				Imports			
	Growth		Index	Shares in exports to the Far East	Growth		Index	Shares in imports to the Far East
	1996	1997	1997	1997	1996	1997	1997	1997
	Percentage changes from previous year		1989 = 100	Percent	Percentage changes from previous year		1989 = 100	Percent
Singapur	– 16.1	– 6.8	196.2	8.5	+ 10.9	– 0.6	96.4	5.5
Thailand	+ 46.0	– 26.1	252.3	6.4	+ 13.3	+ 21.6	148.8	5.8
Malaysia	+ 20.6	+ 9.8	242.2	4.9	+ 4.9	+ 8.8	213.2	7.2
Indonesia	+ 22.4	+ 11.8	404.4	14.2	+ 60.7	+ 3.0	400.5	5.2
Viet Nam	+113.2	+ 36.3	1,489.6	1.6	+ 29.0	+ 42.8	1,170.1	1.9
Myanmar	– 63.3	+570.3	576.7	0.4	+174.7	+ 34.5	380.0	0.1
Brunei	– 15.2	– 70.3	281.7	0.0	– 15.3	– 54.6	.	1.5
Philippines	+ 38.5	– 1.9	179.0	2.1	+ 17.8	+ 8.6	166.1	1.9
China	– 19.8	+ 10.0	179.4	17.9	+ 9.2	+ 16.1	363.1	35.3
South Korea	+ 0.8	+ 7.3	272.3	15.6	– 9.0	+ 1.3	75.3	8.7
Taiwan	+ 0.8	+ 15.0	129.8	11.1	+ 5.2	+ 11.4	128.8	18.5
Hong Kong	– 7.8	+ 28.0	245.9	17.2	– 9.4	+ 8.0	87.8	8.4
ASEAN 4[1]	+ 29.7	– 1.3	298.9	27.6	+ 20.0	+ 10.5	206.9	20.0
Far East	+ 0.2	+ 8.1	222.2	100.0	+ 6.8	+ 13.0	164.5	100.0
World	+ 5.5	+ 13.6	161.9		+ 6.7	+ 8.2	149.9	

The figures for 1997 are based on data for 11 months. – [1] Malaysia, Thailand, Indonesia, Philippines.

The crisis in East Asia will not only have negative but also positive effects:

- Austria might be able to strengthen its presence in the Far East by extending generous export credits, by supporting imports from the Far East and by favoring a liberal EU trade policy.
- Austria could make use of the existing instruments designed to support Austrian direct investment abroad (Ost-West-Fonds, internationalization programs of the ERP and the Bürges) to boost direct investment in South-East Asia.

THE IMPORTANCE OF AUSTRIAN EXPORTS TO SOUTH-EAST ASIA

In 1996, Austria exported goods worth $ 20.6 billion to South-East Asia. Exports are likely to have increased to between $ 22 and $ 25 billion in 1997, accounting for 3 to 3.5 percent of all exports, that is 0.8 to 0.9 percent of GDP[2]. A decrease in exports to the Far East by one third would reduce total Austrian exports by 1 percent. According to the WIFO macroeconomic model a reduction in exports by 1 percent would reduce real GDP by 0.3 percent and lower employment by 0.1 percent (around 3,000 jobs in the first year)[3].

Since only half of Austria's exports to the Far East go to countries affected by the crisis (see below), only half of the effects are likely to be realized. In the unlikely event that the crisis should continue and that exports should remain 1 percent below the baseline solution (no reduction as a result of the Asian crisis) for four years, GDP will fall by 0.9 percent and employment by between 0.2 and 0.3 percent.

In recent years exports to the Far East have risen at an above-average rate, but not much faster than exports (export growth between 1989 and 1997: Far East 122.2 percent, total exports 61.9 percent)[4]. Exports to the Far East stagnated in 1996, but increased by 8 percent in 1997. Exports vary by country: there was a significant increase in exports to Hong Kong, Taiwan, Indonesia and Malaysia while exports to Thailand, the Philippines and Singapore declined.

Exports to South Korea account for 15.6 percent while exports to the ASEAN 4 (Indonesia, Thailand, Malaysia and the Philippines.) account for 27.6 percent of all exports to the Far East. A little over half of Austrian exports were destined for the so-called Chinese states China, Hong Kong and Taiwan, which are less likely to be hit as strongly by the crisis. If Singapore is included, Austrian exports to the Far East are evenly divided between those countries which will be greatly affected by the crisis and those which will be less affected.

Austrian imports from the Far East account for around 3.5 to 4 percent of total imports. Imports declined significantly

[2] The export/GDP ratio is about 25 percent.

[3] These estimates are derived from the WIFO study Lehner, G., Schebeck, F., Stankovsky, J., Exportoffensive. Evaluierung des Positionspapier und Maßnahmenkatalogs der Vereinigung Österreichischer Industrieller vom Oktober 1996, commissioned by the Austrian Association of Industrialists, Vienna, 1996.

[4] All calculations in this section are in schillings.

after Austria joined the EU in 1995[5], but picked up again in 1996 and 1997. The most important trading partners are China, Taiwan, South Korea and Hong Kong. In the years up to 1994, Austria incurred a trade deficit with the Far East of $ 10 billion. The deficit decreased to $ 5 billion after 1995.

Austria mainly exports high-quality goods to the Far East. The unit value of exports to the Far East (ATS 56.9 per kg) was 2.6 times higher than the average unit value for total exports. This figure is lower than that for other European countries. Imports from the Far East have a unit value of ATS 84.9 per kg which is thus around 50 percent higher than Austrian exports to this region. Even when compared to the relatively large amount of electronic goods imported from the Far East, Austrian exports to the Far East are by and large not high-tech products.

AUSTRIA'S DIRECT INVESTMENT IN THE FAR EAST

Direct investment in the Far East is very low. Between 1992 and 1996 new investment totaled only ATS 0.8 billion. There was only one significant project in Hong Kong in 1992 and several smaller projects in 1995 and 1996 in China. For some years more Austrian investors left the market (usually by selling their assets) than entered it.

[5] The Rotterdam effect may be partially responsible for this: imports arriving via Rotterdam are partially listed as products coming from the Netherlands.

Table 5: Countries with the highest debts vis-à-vis Austrian banks

End of June 1997

	Billion $	Percentage shares
Russia	3.82	15.5
Hungary	1.55	6.3
Indonesia	1.45	5.9
China	1.42	5.8
Czech Republic	1.39	5.7
South Korea	1.21	4.9
Poland	0.95	3.9
Slovak Republic	0.95	3.8
Brasilia	0.75	3.1
Greece	0.72	2.9
Thailand	0.62	2.5
Slovenia	0.59	2.4
Total	24.60	100.0

Source: BIS.

THE ENGAGEMENT OF AUSTRIAN BANKS IN ASIA

The engagement of Austrian banks in the Asian crisis countries is relatively low. Outstanding loans amount to a little over $ 6 billion which is around 1.25 percent of the balance sheet total of Austrian banks.

The engagement of Austrian banks in the crisis countries seems to be very limited. The volume of outstanding loans totals slightly more than $ 6 billion which is

Table 6: Foreign trade between the EU and the Far East

	1994	1995	1996	From January to July 1997	1996		
	Billion $				Percentage shares		
					in world exports and imports, resp.	in extra-EU exports and imports, resp.	in EU GDP
Exports							
ASEAN	36.7	48.5	51.5	29.2	2.6	6.7	0.6
South Korea	13.0	16.4	17.9	9.1	0.9	2.4	0.2
Far East	93.8	118.8	122.1	67.5	6.1	16.0	1.4
Japan	34.5	43.3	44.8	23.9	2.2	5.9	0.5
Extra-EU	600.8	729.8	764.5	437.2	38.0	100.0	9.0
World	1,623.4	1,973.2	2,011.9	1,089.7	100.0		23.8
Imports							
ASEAN	38.7	46.1	51.8	26.9	2.8	7.1	0.6
South Korea	11.2	14.6	13.9	7.8	0.7	1.9	0.2
Far East	103.0	122.9	131.3	70.0	7.0	17.9	1.6
Japan	67.7	76.2	70.5	37.5	3.7	9.6	0.8
Extra-EU	612.8	721.3	735.0	408.2	39.0	100.0	8.7
World	1,563.4	1,864.8	1,884.7	1,018.7	100.0		22.3
Balance of Trade							
ASEAN	– 2.0	2.4	– 0.3	2.3			
South Korea	1.8	1.7	4.0	1.4			
Far East	– 9.2	– 4.1	– 9.2	– 2.4			
Japan	–33.2	–32.9	–25.7	–13.6			
Extra-EU	–12.0	8.5	29.4	29.0			

Source: OECD, WIFO. Foreign trade volume: from 1994 bis 1996: EU excluding Greece. 1997: EU excluding Greece and the Netherlands. ASEAN: Singapore, Thailand, Malaysia, Indonesia, Viet Nam, Myanmar, Brunei and the Philippines.

The Importance of Trade with the Far East for the EU

The EU exports goods worth $ 122.1 billion to the Far East (excluding Japan) which amounts to 6.1 percent of total exports or 16.0 percent of extra exports[1]. The Far East is the second most important export region, behind the USA but in front of eastern Europe (*Stankovsky,* 1996). EU exports to Japan accounted only for 2.2 percent of total exports (which amounted to $ 44.8 billion in 1996) or 5.9 percent of extra exports.

Exports to the Far East accounted for 1.4 percent of the EU's GDP in 1996. This ratio is almost twice as high as that for Austria (0.85 percent). The size of the effect of possible export losses as calculated for the Austrian economy can thus be doubled with respect to the EU.

In 1994 and 1995 EU exports to the Far East rose significantly faster than extra-exports. In 1996 and 1997 (until June) the growth rate of exports was significantly lower than that of extra-exports[2]. Exports to the Far East recorded only slightly higher growth rates than total exports in 1996 and 1997. Thus, exports to the Far East contributed only marginally to "export-led" growth in the EU.

Of all the EU countries, Germany is the most important exporter, accounting for 30 percent of EU exports to the region. U.K., France and Italy each account for 15 percent of total EU exports. Austrian exports amount to only 1.6 percent. Exports to the Far East make up almost 9 percent of total exports in Finland and more than 7 percent in Germany, the U.K., Italy and Sweden, but only 3.5 percent in Austria. When measured against extra-exports, the export shares of most countries lie between 15 and 18 percent (Austria 9 percent).

Exports to the Far East are of great economic significance for Ireland (2.9 percent of GDP), Finland (2.8 percent), Sweden and Belgium (over 2 percent). Exports from Germany, the U.K. and the Netherlands account for around 1.5 percent of GDP and for 0.8 percent of Austria's GDP. The most important markets for EU exports were Hong Kong ($ 21.9 billion or 17.9 percent of Far East exports), followed by China, South Korea and Singapore. Exports to those countries less affected by the crisis account for 56 percent of EU exports to the region.

EU imports from the region reached $ 131.3 billion in 1996; the trade deficit totaled $ 9.2 billion (in comparison: trade with Japan yielded a deficit of $ 25.7 billion). Total extra-exports created a trade surplus of $ 29.4 billion. The trade deficits of the U.K. and the Netherlands amounted to 10.7 billion and $ 6.6 billion, respectively; Austria incurred a relatively high trade deficit of $ 0.5 billion. Italy ($ 7.4 billion), Sweden ($ 3.4 billion), Finland, Belgium and Germany had a trade surplus.

[1] These figures do not include Greece. The OECD figures do not include data for Austria in 1996. The figures for Austria were taken from Austrian sources. – [2] When measured on a dollar basis, an increase of only 2.8 and 3.4 percent is recorded in 1996 and 1997; on the basis of ECU, these figures correspond to rates of +6.1 and 14.0 percent.

around 1.25 percent of the balance sheet total of Austrian banks. South Korea, Indonesia, Thailand and the Philippines account for about $ 3.8 billion, less than one sixth of total foreign lending by Austrian banks (at the end of June 1997 this amounted to $ 24.6 billion). Indonesia owes $ 1.5 billion, China $ 1.4 billion and South Korea $ 1.2 billion. Until very recently, these countries were considered highly credit worthy. Lending to the four ASEAN countries was meant to partially balance the risky credits given to countries in eastern Europe, with lending to Russia and the Czech Republic considered particularly risky. Outstanding loans total $ 9.2 billion of which $ 3.8 billion is owed by Russia, $ 1.6 billion by Hungary and $ 1.4 billion by the Czech Republic.) Almost all outstanding loans to Indonesia and Thailand are insured by the Oesterreichische Kontrollbank (loans to South Korea are not insured against payment default). Credits to Russia and the Czech Republic are only partially guaranteed. WIFO does not have data about loans extended by individual Austrian banks to this region.

MACROECONOMIC EFFECTS OF THE CRISIS IN SOUTH-EAST ASIA – OECD AND IMF PROJECTIONS

In December 1997 the international organizations presented new forecasts which had taken into account the crisis in Asia and which are based on the information available at the beginning of December.

The International Monetary Fund reconsidered its October forecast in light of the current crisis in Asia, and revised its growth projections for the industrialized economies slightly downwards. The OECD also presented a new forecast in its December Economic Outlook: the growth forecast for

Table 7: Foreign trade between the EU and the Far East

1996

	Exports					Imports					Trade balance
	Billion $	Percentage changes from previous year	Percentage shares in world exports	Percentage shares in extra-EU exports	Percentage shares in GDP	Billion $	Percentage changes from previous year	Percentage shares in world imports	Percentage shares in extra-EU imports	Percentage shares in GDP	Billion $
Belgium-Luxembourg	6.0	– 6.5	3.7	14.5	2.1	4.8	+ 6.7	3.2	12.6	1.7	1.3
Germany	37.1	+ 0.1	7.2	16.6	1.6	36.2	– 0.7	8.1	18.2	1.5	1.0
Denmark	2.3	+14.7	4.6	13.3	1.3	2.3	+ 7.6	5.2	17.9	1.3	0.0
France	17.1	– 4.1	6.0	16.6	1.1	17.5	+ 7.1	6.3	16.9	1.1	– 0.4
U.K.	18.8	+ 8.6	7.2	16.7	1.6	29.5	+24.6	10.3	22.4	2.6	–10.7
Ireland	2.0	+56.9	4.2	13.7	2.9	3.9	+18.1	11.2	25.8	5.6	– 1.9
Italy	16.5	+ 4.9	7.0	15.8	1.4	9.0	– 8.3	4.7	12.0	0.7	7.4
Netherlands	6.8	– 2.6	4.5	17.9	1.7	13.3	+ 7.6	10.0	23.1	3.4	– 6.6
Portugal	0.3	– 1.8	1.4	7.2	0.3	1.0	–12.5	3.1	12.8	0.9	– 0.7
Spain	3.6	+ 6.1	3.6	12.3	0.6	6.9	+ 6.4	5.7	16.9	1.2	– 3.3
Finland	3.5	+ 5.3	8.6	18.7	2.8	1.6	+ 0.7	5.2	12.7	1.3	1.9
Sweden	6.1	+20.8	7.3	16.8	2.4	2.8	+ 8.2	4.3	13.9	1.1	3.4
Austria	1.9	– 4.6	3.4	9.4	0.9	2.5	+ 1.7	3.7	12.6	1.1	– 0.5
EU	122.1	+ 2.8	6.1	16.0	1.4	131.3	+ 6.9	7.0	17.9	1.5	– 9.2

Source: OECD, WIFO. EU excluding Greece.

Europe and the USA was marginally revised upwards, even after taking account of the turmoil in Asia, because of the endogenous favorable cyclical developments.

The *forecast revision of the IMF* (*IMF,* 1997) takes into consideration both recent developments in the industrialized economies (which, ceteris paribus, would have prompted an upward revision) and the new global economic conditions engendered by the Asian crisis. These developments were taken into account in the IMF macroeconomic model (MULTIMOD) in the form of new assumptions regarding exchange rates, prices of raw materials and economic policies. Given the strength of the recovery in Europe and the negative effects of the slump in Asia, the IMF expects a marginal slowdown in the growth of the European industrialized countries (by 0.1 percentage point); the Asian effect alone would dampen growth by about ¼ percentage point. Two scenarios were calculated in an alternative to the main scenario, because there is considerable uncertainty regarding the duration and extent of the crisis in Asia. The first scenario predicts an aggravation of the crisis, i.e., further outflow of foreign capital, devaluations of the Asian currencies, interest rate hikes, and a long-enduring crisis of confidence in the Asian economies. Domestic demand would contract more sharply, and the improvement in the trade accounts would be more pronounced. Under these conditions, growth would be reduced by 0.7 percent in industrialized economies in the first year and would continue for four years (see box "Downside risks of the Asian crisis").

The second alternative scenario complements the first by modeling "adequate" economic policy reactions: more generous international financial assistance to the region in

Table 8: Foreign trade between the EU and the Far East

1996

	Exports				Imports				Trade balance
	Billion $	Percentage changes from previous year	Percentage shares in world exports	Percentage shares in extra-EU exports	Billion $	Percentage changes from previous year	Percentage shares in world exports	Percentage shares in extra-EU exports	Billion $
China	18.3	– 5.7	0.9	2.4	34.5	+ 7.1	1.8	4.7	–16.2
Hong Kong	21.9	+ 4.7	1.1	2.9	13.7	+ 2.4	0.7	1.9	8.2
Taiwan	12.5	– 7.6	0.6	1.6	17.4	+ 5.4	0.9	2.4	– 4.9
Singapore	15.5	+ 8.3	0.8	2.0	14.0	+ 7.5	0.7	1.9	1.6
Thailand	10.5	– 5.2	0.5	1.4	9.6	+ 6.9	0.5	1.3	0.9
Malaysia	9.5	– 8.2	0.5	1.2	12.5	+ 11.5	0.7	1.7	– 3.1
Indonesia	8.7	+11.7	0.4	1.1	8.9	+ 10.5	0.5	1.2	– 0.2
Viet Nam	1.6	+66.0	0.1	0.2	1.9	+ 22.6	0.1	0.3	– 0.2
Myanmar	0.2	+21.4	0.0	0.0	0.1	+ 41.2	0.0	0.0	0.1
Brunei	1.3	+75.7	0.1	0.2	0.5	+123.6	0.0	0.1	0.8
Philippines	4.2	+32.8	0.2	0.6	4.4	+ 42.8	0.2	0.6	– 0.2
South Korea	17.9	+ 9.5	0.9	2.4	13.9	– 4.8	0.7	1.9	4.0
Far East	122.1	+ 2.8	6.1	16.0	131.3	+ 6.9	7.0	17.9	– 9.2

Source: OECD, WIFO. EU excluding Greece.

The Debt Crisis: Latin America and South-East Asia

The debt crisis in Latin America followed a development that is similar to that inherent in the current crisis in Asia: between 1980 and 1982 the recession in the industrialized countries was softened by the surge in import demand in the "tiger countries of the 1970s", such as Argentina and Brasil. As a result, the current account deficit of these countries soared. At the same time, the hike in U.S. interest rates triggered a dramatic rise in the value of the dollar and a deflation in world trade. The real interest rate for the dollar debts of Latin America jumped by 30 percentage points (from –10 to +20 percent); this set off the debt crisis of 1982. To be sure, the volume of foreign debt incurred by Latin America at the beginning of the 1980s was considerably higher than the claims on the East Asian developing countries. For this reason, the impact of the current crisis on the economies of East Asia and the world economy is expected to be less severe. While the current account deficit and consequently the foreign debts of the tiger economies are of relatively recent origin, the developing countries of Latin America had sustained high current account deficits since the beginning of the 1970s. These deficits resulted indirectly from the collapse of the system of fixed exchange rates. Permanently negative real interest rates had induced the economies of Latin America (then a growth region) to absorb the surplus capital from the oil exporting countries in the form of foreign debts. In contrast to the current situation in East Asia, a considerable part of foreign debt had been assumed by the governments of Latin America.

The length of the period during which debt was accumulated is reflected in the level of foreign debt and of the funds needed to service the debt:

- Latin America's debt ("Western Hemisphere" according to the definition of the IMF) reached 290.7 percent of its total exports in 1983; the debt service ratio was 43.2 percent (*IMF,* 1991).
- Foreign debt of the Asian developing countries totaled 107.3 percent of exports in 1997; the debt service ratio amounted to 15.7 percent (*IMF,* 1997).

question, and a more accommodating monetary policy in industrialized countries. Under these conditions, growth would be depressed by only 0.3 percentage point in the first year with no noticeable effects after two years.

The OECD-Interlink model (*OECD,* 1997) simulates the effect of the turmoil in South-East Asia on international trade between South-East Asia and the OECD countries. These simulations, however, take current nominal exchange rates and real interest rates as given, and only model a cut in imports and an expansion in exports in the crisis countries. The assumptions made with regard to the monetary variables in particular are rather unrealistic, considering the substantial changes in exchange rates, the extensive reorientation of international capital flows and the resulting changes in interest rates. According to the OECD simulation, Europe will experience a cumulated decline in output of 0.8 percentage point (relative to the baseline projections) in 1998. The OECD argues, however, that when the policy reactions in the monetary sphere are taken into account, the effects should be less than half of the simulation effects. Due to the positive developments within Europe, the OECD has revised its June 1997 forecast upward by 0.1 percentage point.

Table 9: Revision of IMF and OECD projections of economic growth

	1997		1998		1998	
	IMF	OECD	IMF	OECD	IMF	OECD
	Real GDP: percentage changes from previous year				Revision of projections in percentage points	
USA	+3.8	+3.8	+2.4	+2.7	–0.2	+0.7
Japan	+1.0	+0.5	+1.1	+1.7	–1.0	–1.2
Germany	+2.3	+2.4	+2.6	+3.0	–0.2	+0.2
EU	+2.6	+2.6	+2.7	+2.8	–0.1	+0.1

EFFECTS ON AUSTRIA'S ECONOMY AND ECONOMIC POLICY CONCLUSIONS

The current crisis in Asia seems to be of little consequence for economic activity in Austria, at least at present. Direct trade links between Austria and South-East Asia are rather weak, and Austria's major trading partners are not very seriously affected by the crisis. Moreover, Austrian banks are not heavily involved in the region.

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The latest WIFO business survey (January 1998) does not suggest that the business climate has deteriorated markedly (*Walterskirchen,* 1998). Manufacturing firms were more optimistic about order stocks and the business out-

"Downside Risks" of the Asian Crisis

Under plausible assumptions, the IMF simulations predict only a small reduction in growth in the industrialized economies (excluding Japan). The high level of bank lending to the tiger economies and the careless lending practices of the banks, however, raise the question of whether the Asian crisis might engender far-reaching changes in the portfolio of risky assets in the bank balance sheets. Such changes would in turn impair the development of the real sphere of the economy ("credit crunch"). The IMF assumes that the risk premium for all emerging market economies will rise on the international markets, and that this will entail a rise in national interest rates and a further devaluation of the currencies of the emerging market economies. The central assumption of the crisis scenario is an economic policy unwilling to accomodate the financial disturbance and an (above-average) reduction in foreign capital inflows to this region by around $ 100 billion or 2 percent of the GDP of this group of countries ("credit crunch" hypothesis). These simulations do not, however, explicitly take into account the effects of a restrictive credit allocation policy of the banks in their home countries, a stance forced on them by the need to restructure their portfolios. From a European perspective, it is important to note that European banks are the largest international creditors and that such a development would have repercussions on the emerging markets of eastern Europe and South America.

The above worst-case scenario of the IMF would have serious repercussions on the world economy. Compared to the baseline solution, GDP growth in the industrialized countries would be reduced by up to 0.75 percentage point in 1998 and 1999. In such a case, Austria's economy would be likely to experience losses of the same magnitude.

At the moment, this worst-case scenario is rather improbable. The financial measures implemented by the IMF to contain the crisis in Asia (such as the bail-out loans of $ 17.4 billion to Thailand, and of $ 42 billion to Indonesia), the measures by the Japanese government to insure sufficient liquidity in the economy (such as the purchase of preferred shares of ailing companies by the government), the debt rescheduling by large creditor banks as well as the high earnings of these banks, make such a development highly unlikely, at least for the immediate future. The return of the large capital accumulation organizations (banks, insurance companies, investment managers, investment funds, etc.) to safe-haven strategies might in the long run even have a beneficial effect on the capital markets in the developed countries (by putting downward pressure on long-term interest rates), and could facilitate the establishment of a liquid and wide capital market in the future European currency union (by rapidly introducing new diversification levels in the repo market and in the corporate securities markets).

look than in the October survey; production expectations, the indicator with the longest lead, have stabilized at a high level. The assessment of foreign orders is slightly less optimistic, however, an indication that enterprises are watching the development in Asia with apprehension.

At present it seems that the potential negative effects of the crisis in South-East Asia on economic growth in Austria will remain within the normal bounds of the forecast for 1998. The repercussions will be especially mild if economic policymakers in Europe and the USA react in a reasonable way to the turmoil in Asia. A significant cut in interest rates will go a long way to balance the negative effects of the crisis.

At the level of international policy making, the present problem can be approached in two ways:

- One problem arises from the dollar's dual role as national and international currency. As a national currency, the dollar has been undervalued against the yen and the ECU since the beginning of the 1980s; this is the most important reason for the growing U.S. share in world trade. As an international currency, however, the dollar has been overvalued since 1995 because the dollar's increase in value has also revalued dollar debts. The creation of the Euro is an opportunity to stabilize the exchange rate of the dollar, the Euro and the yen (as occurred in the EMS). This would be the first step in the direction of a world currency which could serve as a numéraire for flows and stocks of world trade. The Euro would facilitate the transition period of such an alignment since only two exchange rates would have to be fixed (dollar to Euro and dollar to yen). Moreover, the value of raw materials as well as of international financial stocks would not have to be kept track of in dollars but could be calculated in a bundle of the three most important currencies. This would discourage fluctuations in exchange rates. If a realignment were necessary, however, the price and distribution effects on the world economy would be softened.
- At the level of international policy, Austria should increase its support for those institutions, like the *Basle*

Committee on Banking Supervision (1997) and *IMF* (1998), which are trying to strengthen the stability of the international financial system by creating a supra-national agency which will solidify basic standards in the international financial system. Internationally operating banks are much more likely to be exposed to moral hazards and adverse selection than national banks. These situations threaten the efficiency and stability of the global financial systems and thus also of the world economy. The lack of information and the erroneous assessment of risks are directly proportional to the extent of a bank's international financial transactions. Misallocation by international banks, due to misinformation and erroneous risk-assessment, are among the most important causes of international financial crises.

Suggestions for reforms should not be limited to a general deregulation of the banking sector in the tiger countries[6]. The current crisis is an opportunity to reevaluate the foundation of the entire financial market, particularly where information transfer is concerned. Both the IMF and the BIS should have the authority to gather information and to monitor bank loans (for example, in core enterprises of the emerging market economies). Such authority would permit them to fulfill their jobs as international watchdog organizations more successfully.

The IMF and BIS should quickly extend the global early warning system to include not only debtors but also investors. These organizations would issue monthly reports about the term structure, the diversification and the currency basket of international claims of banks and of total liabilities of debtor countries. Such measures would insure greater transparency in the international financial markets. The IMF, the BIS and/or the World Bank could thus perform the function of an international rating agency and could influence the flow of international capital. Commercial rating agencies failed to predict the present crisis, and have thus failed in their role as an early warning system. This must, at least partially, be attributed to their close connection to debtors (*Larraín – Reisen – von Maltzan,* 1997). The failing of commercial agencies is all the more serious because most loans went to banks and businesses rather than to governments. The assessment of credit worthiness should be the strength of commercial agencies, not their weakness. The reason for their failure is probably the fact that they themselves are part of the financial world and have many of the preconceptions as the investors they advise. *Larraín – Reisen – von Maltzan* (1997) have conclusively shown that commercial rating agencies have little opportunity to receive early or more complete information about dangers in the emerging market economies. This lack of information caused commercial agencies to contribute to the boom-bust cycle, by destabilizing international capital flows and reducing the rate of return on investment. In light of the recent crisis, commercial agencies must thus be criticized very severely. Their unreliability warrants a greater presence of non-commercial organizations in the assessment of credit-worthiness and debt. The IMF or the BIS would thus be able to reduce the credit rating of countries in which there is an excessive movement of short-term capital.

In order to curtail excessive bank lending, especially in the form of short-term currency loans with insufficient collateral security, to risky emerging market economies, banks that are operating in international markets should be required to provide an above-average amount of equity.

In order to contain the real damage caused by the Asian crisis, Austrian trade policy should exploit the remaining room for maneuver. This crisis is an opportunity for Austria to increase its as yet small share of the market. The following measures should be kept in mind:

- Real or threatened *anti-dumping* measures and other restrictions on imports from Asia as considered by the EU are not in Austrian interest. Austria should campaign against such protectionist measures in the EU.
- Austria should continue to grant export guarantees for trade with the Far East. Reductions must be dealt with on an individual basis (if, for example, default risks are particularly high).
- Austrian direct investment in the Far East should be supported within the framework of existing policy instruments.

[6] The IMF supports this idea by arguing that the short-term international debt of the tiger economies is due to the incomplete nature of the local financial markets and that this was partially responsible for the current crisis. Whereas the movement of short-term capital into the areas proceeded rather smoothly, long-term investments were thwarted by too many national barriers.

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The Financial Crisis in South-East Asia: Its Impact on Austria – Summary

The crisis in the Far East could depress the growth of Austria's exports by at most 0.5 percentage point and the expansion of real GDP by 0.1 to 0.2 percentage point, even under pessimistic assumptions. To the direct effects must be added the indirect effects resulting from lower economic growth in third countries, which by general agreement will be small in the advanced economies of Europe and North America; much will depend, however, on how economic policy, particularly in the monetary sphere, reacts to the deflationary effects of the Asian crisis.

Austria's exporters, moreover, will have to cope with strong downward pressures on prices with regard to those products and on those markets where they compete directly with producers from the Far East. The engagement of Austrian banks in the crisis region seems to be rather limited.

The conclusion that the Austrian economy's marginal vulnerability in the present situation is due to its limited exposure to this region would be, however, fundamentally wrong. Over the past years, Austria's economy, by failing to take advantage of the market opportunities offered by the booming economies of South-East Asia, has "lost" more growth potential than it can expect to save this year and possibly next year.

If the turmoil in the Far East is only a temporary phenomenon, the crisis could be used as an opportunity to strengthen Austria's position in this region. Such a program, backed by political acumen, might also garner psychological benefits for Austria.

On the international plane, there are two approaches to economic regulation. First of all, the creation of the Euro could provide the opportunity to stabilize the exchange rates among the three major currencies in the world. The rise in the value of the dollar since 1995 has been one of the factors triggering the present crisis.

Second, the efforts of the Basle Committee on Banking Supervision and of the IMF to strengthen the stability of the international financial system need to be intensified. Giving the BIS and the IMF additional powers of information and supervision might markedly improve the information efficiency of the global financial markets, which in the recent crisis turned out to be low.