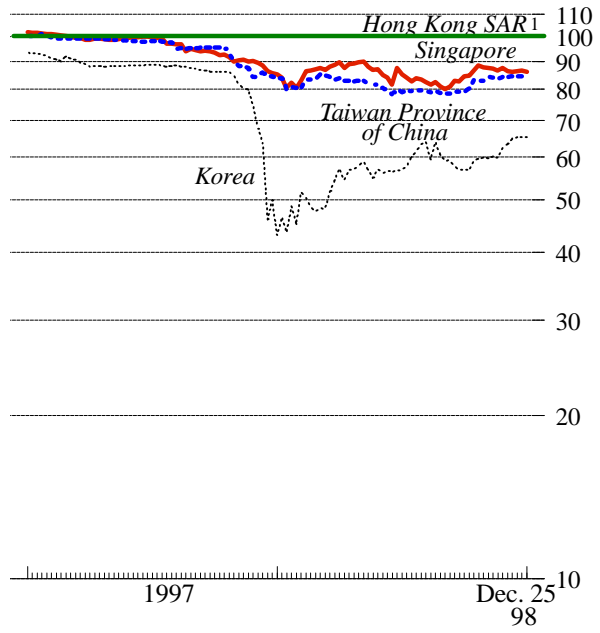
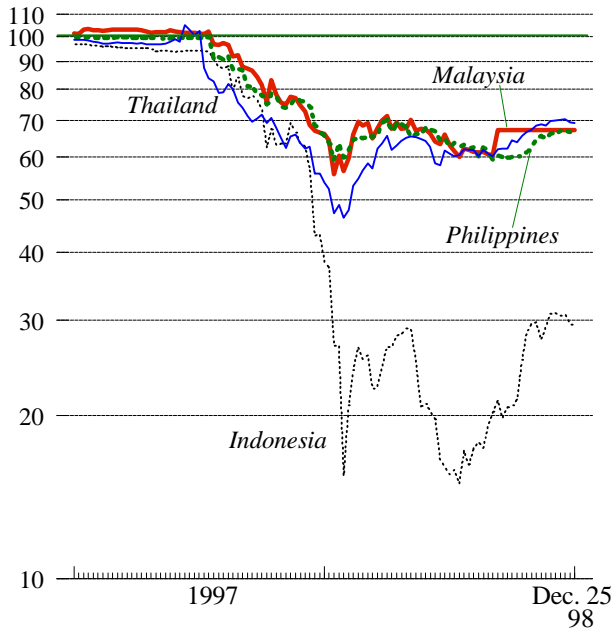


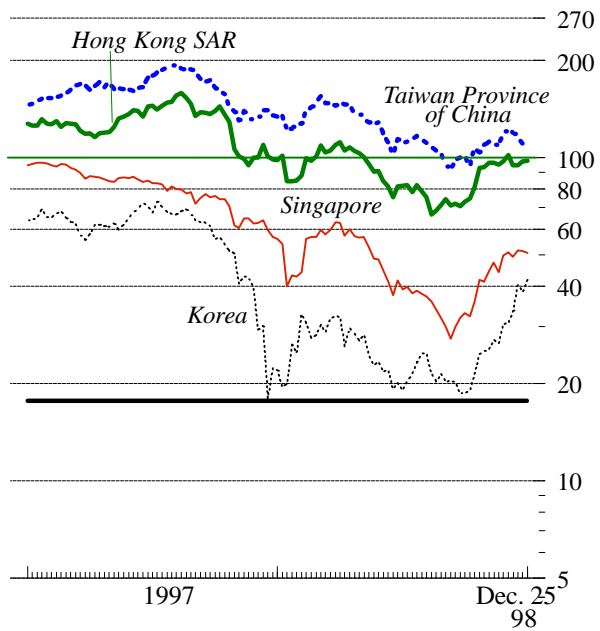
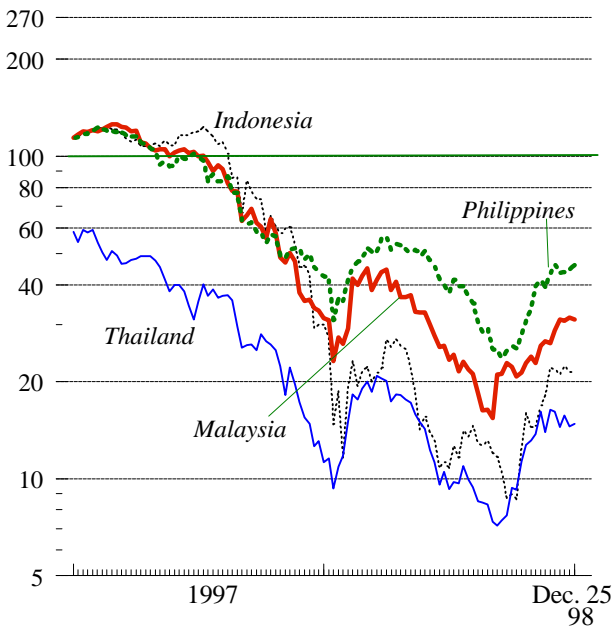
Figure 1. Selected Asian Economies: Bilateral U.S. Dollar Exchange Rates and Equity Prices

(In U.S. dollars per currency unit; logarithmic scale; January 5, 1996 = 100)

Bilateral U.S. Dollar Exchange Rates



Equity Prices



Box 1: Commitments of the International Community and Disbursements of the IMF in Response to the Asian Crisis

(in billion U.S. dollars)

Country	Commitments				IMF Disbursements
	IMF	Multilateral ¹	Bilateral	Total	As of 1/17/99
Indonesia ²	11.2	10.0	21.1	42.3	8.8
Korea ³	21.1	14.2	23.1	58.4	19.0
Thailand	4.0	2.7	10.5	17.2	3.1
Total	36.3	26.9	54.7	117.9	30.9

1 World Bank and ADB

2 Includes augmentations since July 1998

3 Disbursements does not reflect Supplemental Reserve Facility repayments of US\$2.8 billion made by Korea in December 1998

Box 2: Thailand

The IMF-Supported Program of Economic Reform

The financial crisis first started in Thailand, with the baht coming under a series of increasingly serious speculative attacks and the markets losing confidence in the economy. On August 20, 1997, the IMF's Executive Board approved financial support for Thailand of up to SDR 2.9 billion or about US\$4 billion, equivalent to 505 percent of Thailand's quota¹, over a 34-month period.

The initial program of economic reform featured:

- financial sector restructuring, initially focusing on the identification and closure of unviable financial institutions (including 56 finance companies), intervention in the weakest banks, and the recapitalization of the banking system;
- fiscal measures equivalent to about 3 percent of GDP to correct the public sector deficit to a surplus of 1 percent of GDP in 1997/98, support the necessary improvement in the current account position, and provide for the costs of financial restructuring, including an increase in the VAT tax rate from 7 percent to 10 percent;
- a new framework for monetary policy, in line with the new managed float for the baht; and
- structural initiatives to increase efficiency, deepen the role of the private sector in the Thai economy, and reinforce its outward orientation, including civil service reform, privatization, and initiatives to attract foreign capital.

The program was modified in a Letter of Intent on November 25, 1997, in light of a larger-than-expected depreciation of the baht, a slowdown of the economy that was sharper than anticipated, and severe adverse regional economic developments. The modifications included:

- additional measures to maintain the public sector surplus at 1 percent of GDP;
- establishment of a specific timetable for implementing financial sector restructuring, including strategies for the preemptive recapitalization and strengthening of the financial system; and
- acceleration of plans to protect the weaker sectors of society.

The program was further modified in a Letter of Intent on February 24, 1998, to give clear priority to stabilizing quickly the exchange rate while limiting the magnitude and negative social impact of the larger-than-expected economic downturn, and to set the stage for Thailand's return to the international financial markets. Among the modifications were:

- accelerating financial system restructuring, including the privatization of the intervened banks;
- adjusting fiscal policy targets from a targeted public sector surplus of about 1 percent of GDP to a deficit of 2 percent of GDP in response to the weaker economic activity and larger-than-anticipated improvement in the current account, in part to finance higher social spending;
- ensuring an adequate availability of credit to the economy to help foster an economic recovery, while maintaining a tight monetary stance in support of exchange rate stability;

¹A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its share in the allocation of SDRs.

- strengthening the social safety net; and
- further deepening the role of the private sector, including initiatives to attract foreign capital.

The program was again modified in a Letter of Intent on May 26, 1998, with the main priority of minimizing any further decline of the economy and bringing about an early recovery, while preserving progress made in stabilizing the exchange rate and fostering confidence. The modified program called for:

- allowing further cautious reductions in interest rates and somewhat higher monetary growth rates, in line with recovering money demand;
- adjusting the fiscal target by increasing the public sector deficit target to 3 percent of GDP, in view of the larger current account surplus and in order to minimize any further decline of the economy;
- implementing concrete measures to strengthen the social safety net and allocating an additional 0.5 percent of GDP in the budget for this purpose;
- accelerating corporate debt restructuring by strengthening the legal and institutional framework, including through reform of the bankruptcy act, foreclosure procedures, and foreign investment restrictions, with the latter intended to increase resources for restructuring;
- continuing to focus financial sector reforms on the need for the banking system to strengthen its capital; and
- designing a strategy to strengthen the finance company sector and resolving the status of the four intervened banks to minimize the need for any future public support for these institutions.

A Letter of Intent issued on August 25, 1998 updated the macroeconomic framework to take into account economic developments through the first half of 1998. In light of a deeper than expected recession, the program was modified to incorporate a more comprehensive approach to bank and corporate restructuring, both of which were viewed as essential to fostering an economic recovery. The modified program called for:

- maintaining a 3 percent of GDP target for the public sector deficit in 1997/98, and targeting an unchanged deficit of 3 percent of GDP in 1998/99 (both targets expressed as excluding the costs of financial sector restructuring). As such, fiscal policy would be supportive of domestic demand. Against a background of interest rates that have already declined, monetary policy would continue to aim at stabilizing the exchange rate;
- implementing new initiatives to accelerate bank and corporate restructuring. Measures include plans to resolve the status of intervened banks and weak finance companies and provision of public funds for recapitalizing remaining financial institutions, with appropriate safeguards and conditions, while linking this process to progress in corporate debt restructuring. To accelerate corporate debt restructuring further, additional measures include changes in tax laws and the establishment of a Corporate Debt Restructuring Advisory Committee;
- measures to further strengthen the social safety net; and
- further opening of Thailand's economy to foreign investment through privatization and the conversion of the Alien Business Law into a new and more liberal foreign investment law.

The program was again modified in a Letter of Intent on December 1, 1998 to further facilitate a recovery of the real economy, including by providing a larger fiscal stimulus to domestic demand, maintaining a supportive monetary stance, and generating greater momentum for corporate debt restructuring. The modified program called for:

- raising the public sector deficit for 1998/99 by an additional 2 percent of GDP, for a deficit target of 5 percent of GDP. The additional fiscal measures were designed to stimulate domestic demand through well targeted investment projects and enhancements of the social safety net;
- steadfast implementation of the August 14 package on financial sector restructuring and related structural and legal reforms; and
- augmenting the voluntary, market-based strategy for corporate debt restructuring by developing an effective monitoring system, establishing credit bureaus, and reviewing options to implement a system based on incentives, penalties, and arbitration among creditors.

Chronological Highlights

1997

- | | |
|-------------|---|
| August 11 | The IMF convenes meeting of interested countries in Tokyo; total support pledged for Thailand eventually reaches about US\$17 billion. (News Brief No. 97/17) |
| August 20 | The Executive Board approves a US\$4 billion stand-by credit for Thailand, and releases a disbursement of US\$1.6 billion. (Press Release No. 97/37) |
| October 17 | The Executive Board reviews the stand-by arrangement under the emergency financing mechanism procedures. |
| November 25 | Thailand issues Letter of Intent on additional measures. |
| December 8 | The Executive Board completes the first review of the stand-by arrangement and disburses US\$810 million. (News Brief No. 97/29) |

1998

- | | |
|--------------|--|
| February 24 | Thailand issues Letter of Intent on additional measures. |
| March 4 | The Executive Board completes the second review of the stand-by arrangement and disburses US\$270 million. (News Brief No. 98/5) |
| May 26 | Thailand issues Letter of Intent on additional measures. |
| June 10 | The Executive Board completes the third review of the stand-by arrangement, disbursing US\$135 million (News Brief No. 98/19), and concludes the 1998 Article IV consultation. (Public Information Notice (PIN) No. 98/44) |
| August 25 | Thailand issues Letter of Intent on additional measures. |
| September 11 | The Executive Board completes the fourth review of the stand-by arrangement, disbursing US\$135 million. (News Brief No. 98/33) |
| December 1 | Thailand issues Letter of Intent on additional measures. |
| December 15 | The Executive Board completes the fifth review of the stand-by arrangement, disbursing US\$140 million. (News Brief No. 98/54) |

Tentative Schedule of Forthcoming Reviews

- | | |
|------------|---|
| March 1999 | Sixth review of the stand-by arrangement, with subsequent reviews semi-annually |
|------------|---|

Selected Economic Indicators

	1996	1997	1998*	1999**
			(percent change)	
Real GDP growth	5.5	-0.4	-7 to- 8	1.0
Consumer prices (Period average)	5.9	5.6	8.0	2.5 to 3.0
			(percent of GDP; a minus signifies a deficit)	
Central government balance***	1.9	-1.4	-2.4	-3.0
Current account balance	-7.9	-2.0	11.5	8.5
			(billion U.S. dollars)	
External debt	90.5	93.4	73	...

Sources: Thai authorities; and IMF staff estimates

*Estimate

**Program

***Fiscal year, which runs from October 1 to September 30.

Box 3: Indonesia

The IMF-Supported Program of Economic Reform

The shift in financial market sentiment that originated in Thailand exposed structural weaknesses in Indonesia's economy, notably the large amount of short-term foreign debt owed by the private corporate sector. On November 5, 1997 the IMF's Executive Board approved financial support of up to SDR 7.3 billion or about US\$10 billion, equivalent to 490 percent of Indonesia's quota, over the next three years.

The initial program of economic reform envisaged:

- financial sector restructuring, including closing unviable institutions, merging state banks, and establishing a timetable for dealing with remaining weak institutions and improving the institutional, legal, and regulatory framework for the financial system;
- structural reforms to enhance economic efficiency and transparency, including liberalization of foreign trade and investment, dismantling of domestic monopolies, and expanding the privatization program;
- stabilizing the rupiah via the retention of a tight monetary policy and a flexible exchange rate policy; and
- fiscal measures equivalent to about 1 percent of GDP in 1997/98 and 2 percent in 1998/99, to yield a public sector surplus of 1 percent of GDP in both periods, to facilitate external adjustment and provide resources to pay for financial restructuring. The fiscal measures included cutting low priority expenditures, including postponing or rescheduling major state enterprise infrastructure projects; removing government subsidies; eliminating VAT exemptions; and adjusting administered prices, including the prices of electricity and petroleum products.

Against a background of continuing loss of confidence in the Indonesian economy and further sharp declines in the value of the rupiah, the Indonesian authorities announced a reinforcement and acceleration of the program in **the Memorandum of Economic and Financial Policies issued on January 15, 1998**. Key reinforcing measures included:

- adjustments to the 1998/99 budget that would result in a public sector deficit of about 1 percent of GDP, in order to accommodate part of the impact on the budget of the economic slowdown;
- the cancellation of 12 infrastructure projects and the revoking or discontinuation of privileges for the IPTN's airplane projects and the National Car project;
- further bank and corporate sector restructuring, including the subsequent announcement of a process to put in place a framework for creditors and debtors to deal on a voluntary, case-by-case basis with the external debt problems of Indonesian corporations; the establishment of the Indonesian Bank Restructuring Agency (IBRA); and a government guarantee on bank deposits and credits;
- limiting the monopoly of the national marketing board (BULOG) to rice, deregulating domestic trade in agricultural produce, and eliminating restrictive market arrangements; and
- measures to alleviate the suffering caused by the drought, including ensuring that adequate food supplies are available at reasonable prices.

Due to policy slippages and other developments, the rupiah failed to stabilize, inflation picked up sharply, and economic conditions deteriorated. The government issued a **Supplementary Memorandum of Economic and Financial Policies on April 10, 1998**, adapting the macroeconomic policies to the deteriorated economic situation and expanding the structural and banking reforms agreed in January. The envisaged measures included:

- a strong monetary policy to ensure stabilization of the rupiah;
- accelerated bank restructuring, with IBRA to continue its take-over or closure of weak or unviable institutions and be empowered to issue bonds to finance the restoration of financial viability to qualified institutions; the elimination of existing foreign ownership restrictions on banks; and the issuance of a new bankruptcy law;
- a comprehensive agenda of structural reforms to increase competition and efficiency in the economy, reinforcing the commitments made in January and including the further privatization of six major state enterprises and the identification of seven new enterprises for privatization in 1998/99;
- accelerated arrangements to develop a framework with foreign creditors to restore trade financing and to resolve the issues of corporate debt and interbank credit, with subsequent agreements on these issues reached on June 4, 1998 after talks between Indonesian officials and international banks;
- strengthening the social safety net through support for small and medium-sized enterprises and through public works programs; and
- enhancing the implementation and credibility of the program through daily monitoring by the Indonesian Executive Committee of the Resilience Council, in close cooperation with the IMF, the World Bank, and the ADB; substantive actions prior to approval of the program by the IMF Executive Board, and frequent program reviews by the IMF Executive Board.

The government issued a **Second Supplementary Memorandum of Economic and Financial Policies on June 24, 1998**, after the economic situation was worsened and the economic program driven off track by social disturbances and political change in May. The envisaged measures give high priority to strengthening the social safety net, comprehensively restructuring the banking system, and repairing the weakened distribution system, and include:

- increasing social expenditure to a level equivalent to 7.5 percent of GDP, with measures comprising, inter alia, the provision of food, fuel, medical, and other subsidies (which will be phased out after the economy has begun to improve); the expansion of employment-generating programs, supported by the World Bank, ADB and bilateral donors; and aid to students;
- taking measures to limit the budget deficit to 8.5 percent of GDP, a level that can be financed with foreign funds, including cuts in infrastructure projects and improvements in the efficiency of state-run operations;
- rehabilitating and strengthening the distribution system following the disruption caused by social disturbances, to ensure that there are adequate supplies of essential commodities, including the establishment of a special monitoring unit to identify potential shortages of foodstuffs or distribution bottlenecks;
- restructuring the banking system through measures to strengthen relatively sound banks partly through the infusion of new capital, while moving swiftly to recapitalize, merge, or effectively close weak banks, while maintaining the commitment to guarantee all depositors and creditors. A high-level Financial Sector Advisory Committee to advise on the coordination of actions for bank restructuring is being established;
- establishing an effective bankruptcy system, as an essential part of the corporate debt restructuring strategy envisaged by the June 4 agreement between the government and creditor banks on debt restructuring; and
- strengthening the monitoring of the economic program.

The government issued a **Letter of Intent and Memorandum of Economic and Financial Policies on July 29, 1998** requesting the cancellation of the current stand-by arrangement and its replacement with a new extended arrangement, with the amount of credit available under the extended Fund facility (EFF) and its duration identical to those remaining under the stand-by credit it would replace. The government described measures to bolster the strategy for bank and corporate restructuring and improve the distribution system, especially for essential items, including:

- making progress in restructuring the banking system including agreeing a memorandum of understanding for sale of one of the six audited banks; transferring assets of the seven banks frozen in April to the asset management unit; transferring of responsibility for six state banks from the Ministry of State Enterprises to the Ministry of Finance, and announcing a program for bank recapitalization of the better banks in exchange for the preparation of business plans and infusion of capital by owners;
- officially launching the Indonesian Debt Restructuring Agency (INDRA); removing restrictions on debt-equity conversions; providing tax neutrality for mergers; streamlining procedures regarding the approval of foreign direct investment and more generally of corporate restructuring; submitting to Parliament a new arbitration law consistent with international standards, and establishing a voluntary framework to facilitate corporate restructuring; and
- improving the distribution system and the social safety net, including improving the targeting of subsidies and expanding the program initiated in July to provide rice at less than the market price to low income families.

The government issued a **Letter of Intent and Supplementary Memorandum of Economic and Financial Policies on September 11, 1998**, which dealt with aspects of the economic program that had been developed further, including:

- implementing measures to improve the food situation in terms of both availability and price, including further extending the program for providing subsidized rice to at least 7.5 million poor families and eliminating BULOG's monopoly on a number of food commodities;
- taking steps under the major bank restructuring package announced by the Government on August 21, which covers banks accounting for almost half of banking system assets; the package provides for, inter alia, completing negotiations with the former owners of large intervened banks for the repayment of Bank Indonesia liquidity support; preparing final plans for the restructuring or the recapitalization of several large banks; and completing the legal requirements for the merger of several state banks;
- establishing a framework designed to promote the voluntary restructuring of corporate debt, "The Jakarta Initiative", which complements developments associated with the newly amended bankruptcy law and the INDRA scheme; and
- enhancing further the efficiency and transparency of the newly established Special Commercial Court for bankruptcy petitions.

The government issued a **Letter of Intent and Supplementary Memorandum of Economic and Financial Policies on October 19, 1998**, which included the following additional measures:

- further advancing of banking reforms, including by announcing the key elements of the bank recapitalization program for potentially viable banks and reaching financial settlements on the repayment of liquidity support previously extended by Bank Indonesia; and

- measures to make operational the Jakarta Initiative Task Force set up to encourage the initiation of negotiations between corporate debtors and their creditors.

The government issued a **Letter of Intent and Supplementary Memorandum of Economic and Financial Policies on November 13, 1998**, specifying the following measure and commitments:

- further enhancing the social safety net, including by doubling the monthly allocation under the subsidized rice scheme and ensuring that subsidies and social safety net programs are better targeted to the poorest groups;
- increasing food security by supporting a substantial increase in 1999 rice production through programs to improve availability of seeds, fertilizer, and credit, and by increasing efficiency in rice distribution;
- improving fiscal monitoring and accountability to ensure that budgetary resources reach the intended beneficiaries, including by establishing a high-level ministerial task force and monitoring team; and
- recapitalization of a first group of banks that qualify for the recapitalization program by end-January 1999.

Chronological Highlights

1997

- October 8 The IMF announces support for Indonesia's intention to seek support from the IMF and other multilateral institutions (News Brief No. 97/19)
- November 5 The Executive Board approves a US\$10 billion stand-by credit for Indonesia and releases a disbursement of US\$3 billion (Press Release No. 97/50)

1998

- Mid-January IMF Management visit Jakarta to consult with President Suharto on an acceleration of reforms already agreed under the program, after further depreciation of the rupiah. (News Brief No. 98/2)
- January 15 Indonesia issues Memorandum of Economic and Financial policies on additional measures.
- January 26 The IMF welcomes Indonesia's plans for a comprehensive program of the rehabilitation of the banking sector and putting into place a framework for creditors and debtors to deal, on a voluntary and case-by-case basis, with the external debt problems of corporations. (News Brief No. 98/4)
- April 10 Indonesia issues a Supplementary Memorandum of Economic and Financial Policies on additional measures. (News Brief No. 98/10)
- May 4 The Executive Board completes the first review of the stand-by arrangement and disburses US\$1 billion. (News Brief No. 98/11)
- June 24 Indonesia issues a Supplementary Memorandum of Economic and Financial policies on additional measures.

- July 15 The Executive Board completes the second review of the stand-by arrangement, disbursing US\$1 billion, and approves an increase in the IMF financing under the stand-by credit by US\$1.3 billion. The Fund also announces that additional multilateral and bilateral financing for the program will be made available, in part through an informal arrangement among bilateral creditors that involves debt rescheduling or the provision of new money, for total additional financing of over US\$6 billion, including the increase in IMF financing. (News Brief No. 98/25)
- July 29 Indonesia issues a Letter of Intent and Memorandum of Economic and Financial Policies on additional measures.
- August 25 The Executive Board completes the third review of the stand-by arrangement and disburses US\$1 billion. At the same time, the Board approves an extended Fund facility (EFF) for Indonesia, with the access and duration under the new arrangement the same as under the stand-by arrangement it replaces, but with a longer repayment period under EFFs, which are intended to support economic programs dealing with deep-seated structural problems. (News Brief No. 98/31)
- September 11 Indonesia issues a Letter of Intent and Supplementary Memorandum of Economic and Financial Policies.
- September 25 The Executive Board completes the first review under the extended arrangement (EFF) and disburses US\$940 million. (News Brief No. 98/36)
- October 19 Indonesia issues a Letter of Intent and Supplementary Memorandum of Economic and Financial Policies.
- November 6 The Executive Board completes the second review under the extended arrangement (EFF) and disburses US\$960 million. (News Brief No. 98/42)
- November 13 Indonesia issues a Letter of Intent and Supplementary Memorandum of Economic and Financial Policies.
- December 15 The Executive Board completes the third review under the extended arrangement (EFF) and disburses US\$957 million. (News Brief No. 98/55)

Tentative Schedule of Forthcoming Reviews

- February 1999 Bi-monthly review

Selected Economic Indicators*

	1996/97	1997/98	1998/99**	1999/2000**
			(percent change)	
Real GDP growth	8.2	2.0	-16	-2 to +1
Consumer prices (end of period)	5.2	12.9	65	17
		(percent of GDP; a minus sign signifies a deficit)		
Central government balance	1.2	-0.9	-4.5	-5.75
Current account balance	-3.3	-1.2	4.1	1.5 to 2
		(billion U.S. dollars)		
External debt	112.7	137.9	148.1	...
		(percent of GDP)		
External debt	50.5	74.7	130.1	...

Sources: Indonesian authorities; and IMF staff estimates

* Fiscal year, which runs from April 1 to March 31.

** Program

Box 4: Korea

The IMF-Supported Program of Economic Reform

Over the past several decades, Korea transformed itself into an advanced industrial economy. However, the financial system had been weakened by government interference in the economy and by close linkages between banks and conglomerates. Amid the Asian financial crisis, a loss of market confidence brought the country perilously close to depleting its foreign exchange reserves. On December 4, 1997 the IMF's Executive Board approved financing of up to SDR 15.5 billion or about US\$21 billion, equivalent to 1,939 percent of Korea's quota, over the next three years.

The initial program of economic reform assumed growth in 1998 of 2.5 percent and featured:

- comprehensive financial sector restructuring that introduced a clear and firm exit policy for financial institutions, strong market and supervisory discipline, and independence for the central bank. The operations of nine insolvent merchant banks were suspended; two large distressed commercial banks received capital injections from the government, and all commercial banks with inadequate capital were required to submit plans for recapitalization;
- fiscal measures equivalent to about 2 percent of GDP to make room for the costs of financial sector restructuring in the budget, while maintaining a prudent fiscal stance. Fiscal measures include widening the bases for corporate, income, and VAT taxes;
- efforts to dismantle the nontransparent and inefficient ties among the government, banks, and businesses, including measures to upgrade accounting, auditing, and disclosure standards, require that corporate financial statements be prepared on a consolidated basis and certified by external auditors, and phase out the system of cross guarantees within conglomerates;
- trade liberalization measures, including setting a timetable in line with WTO commitments to eliminate trade-related subsidies and the import diversification program, as well as streamlining and improving transparency of import certification procedures;
- capital account liberalization measures to open up the Korean money, bond, and equity markets to capital inflows, and to liberalize foreign direct investment;
- labor market reform to facilitate the redeployment of labor; and
- the publication and dissemination of key economic and financial data.

As described in a Letter of Intent on December 24, 1997, the program was intensified and accelerated as the financial crisis in Korea worsened and concerns about whether international banks would roll over Korean short-term external debt placed additional pressures on international reserves and the won. The revised measures, whose announcement was followed by a significant voluntary increase in rollovers and extension of claims by international bank creditors on Korean financial institutions, included:

- further monetary tightening and the abolition of the daily exchange rate band;
- speeding up the liberalization of capital and money markets, including the lifting of all capital account restrictions on foreign investors' access to the Korean bond market by December 31, 1997;
- accelerating the implementation of the comprehensive restructuring plan for the financial sector, including establishing a high-level team to negotiate with foreign creditors and reducing the recourse of Korean banks to the foreign exchange window of the central bank; and

- speeding up trade liberalization measures, including making binding under the WTO the liberalization of financial services as agreed with the OECD.

A Letter of Intent dated January 7, 1998 provided additional details of the Korean government's external financing and reserve management strategies outlined in the December 24, 1997 Letter of Intent, and further articulated the financial sector reform program.

In a Letter of Intent on February 7, 1998, the macroeconomic framework was further revised, with lower growth of 1 percent projected for 1998 but amid the encouraging results from the strengthened economic program of an agreement with a group of foreign creditor banks on a voluntary restructuring of Korea's short-term debt on January 28, 1998 and the establishment of the Tripartite Accord between labor, business, and government concerning social issues on February 5. The additional measures included:

- targeting a fiscal deficit of around 1 percent of GDP for 1998 to accommodate the impact of weaker economic activity on the budget and to allow for higher expenditure on the social safety net;
- moving forward to implement a broader strategy of financial sector restructuring, having contained the immediate dangers of disruptions to the financial system;
- increasing the range and amounts of financial instruments available to foreign investors, increasing the access of Korean companies to foreign capital markets, and liberalizing the corporate financing market (e.g., mergers and acquisitions); and
- introducing a number of measures to improve corporate transparency, including strengthening the oversight functions of corporate boards of directors, increasing accountability to shareholders, and introducing outside directors and external audit committees.

In a Letter of Intent on May 2, 1998, the Korean authorities updated the program of economic reform in view of, on one hand, the progress made in resolving the external financing crisis and, on the other, the even weaker outlook for economic activity, with the growth forecast for 1998 revised down again, to -2.0 percent. Positive developments included the conclusion of the restructuring of US\$22 billion of Korean banks' short-term foreign debt, a successful return to international capital markets through a sovereign global bond issuance of US\$4 billion, the shifting of the current account to a substantial surplus, and an increase in usable reserves to more than US\$30 billion. The measures included:

- the accommodation of a larger fiscal deficit of about 2 percent of GDP in 1998, in light of weaker growth and through the operation of automatic stabilizers and measures to strengthen the social safety net;
- measures to strengthen and expand the social safety net, including through a widening of the coverage of unemployment insurance and increases in minimum benefit duration and levels;
- formation of an appraisal committee, including international experts, to evaluate the recapitalization plans of undercapitalized commercial banks;
- the publication by August 15, 1998 of regulations to bring Korea's prudential regulations closer to international best practices, including through strengthening compliance with existing guidelines concerning foreign exchange maturity mismatches; and
- further phased liberalization of the capital account, including loosening restrictions on foreign exchange transactions, foreign ownership of certain assets, and ceilings on foreign equity investment in nonlisted companies.

In a Letter of Intent on July 24, 1998, the Korean authorities announced a further easing of macroeconomic policies to mitigate the severity of the recession and gave further priority to financial sector and corporate restructuring. The measures in the Letter of Intent and in a subsequent revision of fiscal projections included:

- the accommodation of a larger fiscal deficit of about 5 percent of GDP in 1998, in light of a deepening of the recession and mainly through the operation of automatic stabilizers, but also reflecting emergency relief spending related to the recent floods;
- measures to bolster the social expenditure program, including through an extension of the coverage of unemployment benefits;
- the putting in place of a framework for corporate restructuring negotiated with the World Bank to, inter alia, facilitate debt workouts, minimize the use of “rescue” loans, and phase out cross guarantees;
- further progress in financial sector restructuring including progress on the implementation plans of the remaining seven of the twelve undercapitalized banks; and
- further improving capital market development through legislation that allows for the creation of mutual funds and the issuance of asset-backed securities.

In a Letter of Intent on November 13, 1998, the Korean authorities announced additional measures including:

- concentrating public investment spending in the first half of 1999 and improving the timeliness of the reporting of fiscal data to help ensure that the fiscal stimulus takes effect in a timely manner;
- further strengthening of the social safety net through an expansion of existing programs, including doubling the budgetary allocation of public works programs and the outlays for a temporary livelihood protection program and a cost of living subsidy, and further widening of the unemployment insurance system;
- steps to move forward the privatization program; and
- additional measures to support domestic demand including trade financing for small- and medium-sized enterprises.

Chronological Highlights

1997

November 21	The IMF welcomes Korea’s request for IMF assistance. (News Brief No. 97/25)
December 3	The IMF notes the successful conclusion of discussions with Korea and the pledges of support coming from the World Bank, ADB, and countries in the group of potential participants in the supplemental financing support package for Korea. (News Brief No. 97/27)
December 4	The IMF Executive Board approves a US\$21 billion stand-by credit for Korea, and releases a disbursement of US\$5.6 billion. (Press Release No. 97/55)
December 18	The IMF Executive Board concludes the first biweekly review of the stand-by arrangement and disburses US\$3.5 billion, activating the IMF’s new Supplemental Reserve Facility. (News Brief No. 97/30)

- December 24 Korea issues a Letter of Intent, concerning intensification and acceleration of its program. The IMF Managing Director announces his intention to recommend to the Executive Board a significant acceleration of the resources available to Korea, in light of Korea's Letter of Intent and in the context of the progress between Korean and international banks in dealing with Korea's external debt, and notes that the World Bank and ADB will disburse a total of US\$5 billion before the year's end and the group of potential participants in the supplemental financing support package for Korea would be prepared to disburse up to US\$8 billion. (News Brief No. 97/32)
- December 30 The Executive Board approves the request by Korea for modification of the schedule of purchases, bringing forward part of the amounts originally scheduled for February and May 1998, but without changing overall access to Fund resources, and disburses US\$2 billion to Korea.

1998

- January 7 Korea issues a Letter of Intent providing additional details on measures described in the December 24, 1997 Letter of Intent.
- January 8 The IMF Executive Board concludes the second biweekly review of the stand-by arrangement and disburses US\$2 billion.
- February 7 Korea issues a Letter of Intent on additional measures.
- February 17 The Executive Board completes the first quarterly review of the stand-by arrangement and disburses US\$2 billion.
- May 2 Korea issues a Letter of Intent on additional measures.
- May 29 The Executive Board completes the second quarterly review of the stand-by arrangement and disburses US\$2 billion, and concludes the 1998 Article IV consultation. (Public Information Notice (PIN) No. 98/39)
- July 24 Korea issues a Letter of Intent on additional measures.
- August 28 The Executive Board completes the third quarterly review of the stand-by arrangement and disburses a further US\$1 billion.
- November 13 Korea issues a Letter of Intent on additional measures.
- December 9 Korea announces it will make Supplemental Reserve Facility repurchases of US\$2.8 billion during December 1998 (News Brief No. 98/48)
- December 14 The Executive Board completes the fourth quarterly review of the stand-by arrangement and disburses a further US\$1 billion. (News Brief No. 98/52)

Tentative Schedule of Forthcoming Reviews

- March 1999 Fifth quarterly review, semi-annual reviews thereafter

Selected Economic Indicators

	1996	1997	1998*	1999**
			(percent change)	
Real GDP growth	7.1	5.5	-7.0	-1.0
Consumer prices (end of period)	4.9	6.6	5.5	3.5
			(percent of GDP; a minus sign signifies a deficit)	
Central government balance	0.3	0.1	-5.0	-5.1
Current account balance	-4.7	-1.8	13.3	6.6
			(billion U.S. dollars)	
External debt	157.5	154.4	147.9	...
			(percent of GDP)	
External debt	32.5	34.9	49.7	...

Sources: Korean authorities; and IMF staff estimates

*Estimate

**Program

**Box 5: Three Major Misunderstandings
about the IMF-Supported Programs in Asia**

1. *The IMF failed to predict the financial crisis in Asia and this proves its surveillance methods don't work.*

It is true that the IMF, along with everyone else, did not foresee the scale of the financial contagion that followed the events in Thailand. The events in Thailand, however, were well-anticipated. Indeed, the IMF stressed the unsustainability of the country's policies and pressed for urgent action in a continuous dialogue with the Thai authorities during the 18 months leading up to the floating of the baht last July. However, the IMF can only advise, not force governments to take steps. Moreover, the IMF's own wish for transparency must be balanced against the facts that the Fund's ability to conduct its surveillance of members depends on its privileged access to information, and it cannot go so far in speaking out as to create the crises that it is seeking to prevent.

2. *The IMF-supported programs are structured wrong. On one hand, the programs feature austerity measures, including high interest rates, that are inappropriate. On the other hand, they overlook the private sector debt problems that were at the heart of the crisis.*

While an increase in interest rates has been a part of the countries' economic programs, the details of the programs (which are available on the IMF website) indicate that the centerpiece of each program is a set of forceful, far-reaching financial and structural reforms, not austerity measures to restore macroeconomic balance. While the longer-run recessionary effects of higher interest rates are recognized, the experiences of countries whose currencies have come under attack overwhelmingly show that temporarily raising interest rates both to make the currency more attractive to hold and to avoid a depreciation-inflation spiral has been a successful strategy.

Regarding private sector debt, the IMF is empowered by its membership to deal with sovereign governments, not directly with the diverse and dispersed private sector agents who compose the debtors and creditors of Indonesia, Korea, and Thailand, and the initial focus was on the restoration of confidence through convincing packages of policies and official financing to induce private creditors to roll over their claims on the countries voluntarily. At different stages, more direct action was also taken to involve private creditors, including the respective agreements of the Korean and the Indonesian governments with international creditor banks on the voluntary restructuring of foreign debt, and the early understanding reached between Thailand and key Japanese creditor banks on the roll-over of maturing short-term debt.

3. *The IMF bails out reckless investors, and if that weren't bad enough, in doing so it creates moral hazard and sets the stage for the next crisis.*

Most investors in Asia, whether local or international, have made substantial losses. For example, a typical foreign owner of Asian equities would have seen the value of his or her investment reduced to only one third to one quarter of what it was before the crisis. temporarily raising interest rates. Earnings reports for many of the big international banks since fourth quarter 1997 have been weakened by the Asian crisis. It is true that a byproduct of restoring stability to the financial markets is that banks with short-term claims on financial institutions may be protected from the full consequences of their actions. The IMF has been working for some time to help develop better ways at the international level of associating private sector creditors and investors with official efforts to help resolve sovereign and private sector debt problems.