

Lecture Notes for Chapter 9

International Financial Markets and Institutions

Chapter 9

Currency Crises II

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Road Map

- 1 Outline: Course aims, summary of finance, international issues
- 2 Preliminaries: Conventions, notation, and basic concepts

Part A Currency markets

- 3 The spot market for foreign exchange
- 4 The forward market for foreign exchange

Part B The behaviour of exchange rates

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- 6 Aspects of the international monetary system
- 7 The behaviour of spot and forward exchange rates
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- 9 Currency crises

Part C Markets for exchange-rate derivatives and the hedging decision

- 10 The market for currency futures
- 11 The market for currency options

Part D Summary and Revision

12 Summary of international finance

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9.4 Russian Crisis

- 1995—1998, Russian borrowers (both governmental and non-governmental) has borrowed a lot of capital in international markets
- Much of this debt was in USD—repayments had to be made in USD
- Current account was between USD 15 B and USD 20 B
- But in Spring 1998, Russian export earnings began to decline
- Russian exports were mainly commodity based and global commodity prices had been in decline since the Asian Crisis
- Placed downward pressure on the rouble

- The rouble was operated on a managed float—it's USD value was kept within a certain band
- To keep the rouble within its band, the Central Bank of Russia had to sell FC and buy roubles

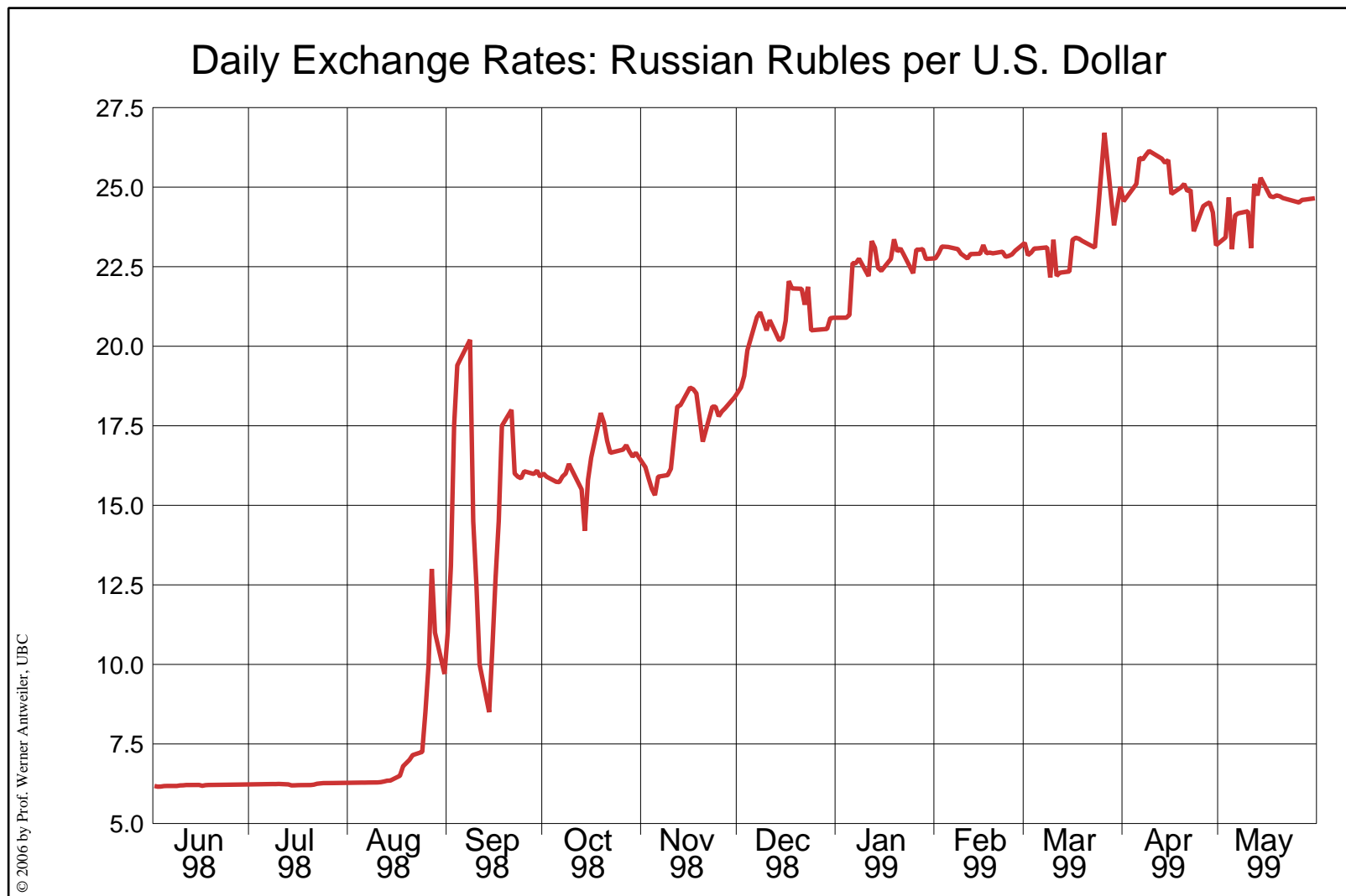
9.4.1 The August Collapse

- Friday, Aug 7, 1998, central bank announced that its hard currency reserves had fallen by USD 800 M in the last week of July to a level of USD 18.4 B on July 31
- Prime minister announced Russia would issue an additional USD 3 B in foreign bonds to help pay its rising debt—USD 1 B than had previously been scheduled
- Monday, Aug 10, Russian stocks fell more than 5% as investors feared a Renminbi devaluation—if it occurred it would increase Chinese exports at the expense of Russian exports
- Investors reduced their estimates of future current account surpluses

- There was increased concern about how Russia would pay back the USD it had borrowed
- Russia's outstanding Eurobonds due in 2001 fell in price—the yield rose by 350 bp to 23.5%
- More costly for Russia to raise money in international capital markets
- The rouble fell to 6.30 RUB/USD
- Monday, August 17, central bank announced that the rouble would be allowed to fall by 34% that year
- A lower rouble makes it much harder to repay USD denominated debt!
- The central bank postponed the payment of USD 43 B in short term domestic debt and announced a 90-day moratorium on foreign debt.

- August 18, the rouble continued to sink!





9.4.2 The Aftermath

- The rouble continued to fall until Jan-Feb 1999, when it stabilized at RUB/USD 25.0
- The government struggled to find ways of paying its USD denominated debt
- Domestic bonds issued by the Russian government—Rouble Bonds, where now in default!
- The government placed a much higher priority on servicing its USD debt