ASEAN's Balance of Payments, Its Post-Crisis Rebirth and the Subsequent Evolution of Sovereign Wealth Funds

By Nirvaan Verma, 2024-25
Mentor: Christian Carrillo, Head of Economics, Asia-Pacific, BlackRock

Introduction

The Association of Southeast Asian Nations (ASEAN) is an intergovernmental international organization, comprised of Indonesia, Vietnam, Laos, Brunei, Thailand, Myanmar, the Philippines, Cambodia, Singapore, and Malaysia. Many of these nations faced severe economic challenges during the Asian Financial Crisis of 1997-1998, as speculative attacks and capital flight triggered a cascade of currency crashes and economic turbulence. Historically net borrowers, many of these economies have since transformed into net savers. This paper will dive into this shift and the effects that it had on the financial environment in many of these economies, focusing specifically on Singapore, Indonesia, Thailand, and Malaysia. Specifically, this paper will analyze the interaction between these countries' balance of payment (BoP) dynamics, foreign exchange (FX) reserves, and their impact on exchange rates and bond yields, analyzing data post-1999 and examining the region with India as a control variable.

The Asian Financial Crisis - A Brief Background

The Asian Financial Crisis of 1997-1998 was a financial storm that was precipitated by an unhealthy and excessive reliance on short-term capital inflows, ballooning current account deficits, and structural weaknesses in the financial systems. The situation was worsened when speculative attacks targeted the regional currencies, beginning with the Thai baht. Speculative attacks occur when investors, in anticipation of a currency's devaluation, sell it heavily in exchange for foreign currency. This mass selling exerts severe downward pressure on the targeted currency, and this often forces central banks to intervene through selling their own foreign reserves to stabilize the exchange rate. However, when the reserves dwindled and market confidence eroded, governments were forced to abandon their original fixed exchange rate regimes.

What is a BoP Crisis?

Before the crisis, many ASEAN countries maintained fixed or tightly managed exchange rate systems, primarily pegging their currencies to the U.S. dollar. This policy was initially favored for its ability to reduce exchange rate volatility and boost investor confidence. However, fixed exchange rates hid underlying problems, such as ballooning current account deficits and limited monetary policy flexibility. If a country wants to set their exchange rate, they must relinquish control of their interest rate. This rigidity of this system made economies vulnerable to speculative attacks; once investors doubted a government's ability to defend its currency peg, they could trigger a rapid depletion of reserves, as seen during the crisis.

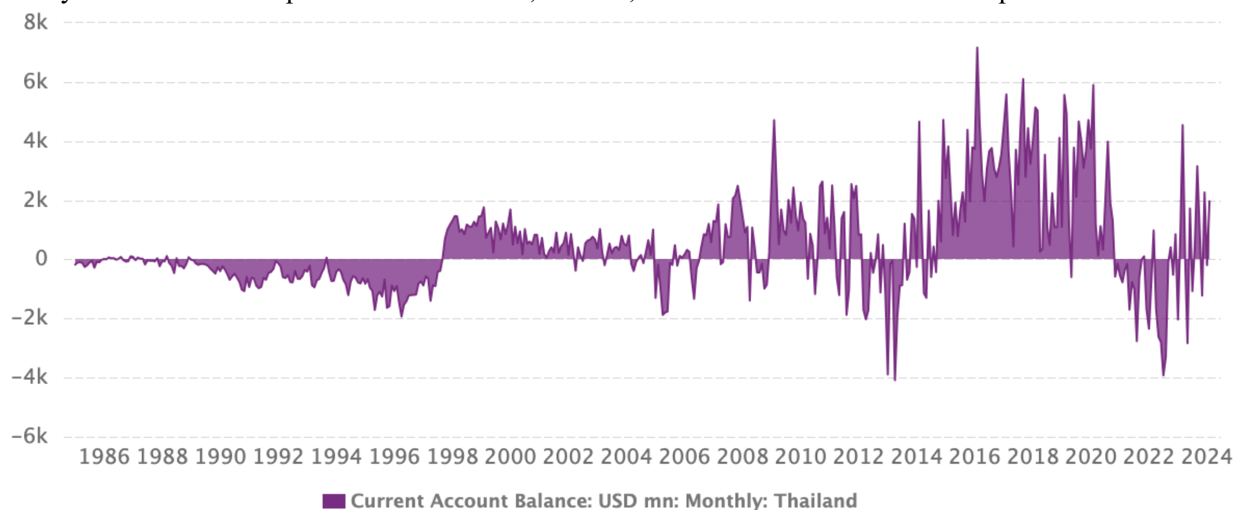
The consequences were severe. Currencies like the Thai baht, Indonesian rupiah, and Malaysian ringgit depreciated dramatically, with some losing over half their value. Since many ASEAN nations had borrowed heavily in U.S. dollars, the sharp drop in their local currencies made their debt much more expensive to repay. Local companies also faced the same problem. Believing the exchange rate was stable, they had taken out loans denominated in U.S. dollars, but when their currencies crashed, they suddenly owed much more than expected and struggled to pay back their debts. GDPs fell significantly, unemployment rose, and widespread corporate failures and bankruptcies worsened the crisis.

Key Learnings and Takeaways

This calamity served as a wake-up call. ASEAN governments implemented large-scale reforms to effectively strengthen their financial frameworks, also reducing dependence on foreign inflows. These nations transitioned toward export-led growth and amassed significant foreign exchange reserves and implemented more flexible exchange rates. This vast transformation laid the foundation towards financial stability in the region today.

Economic Changes

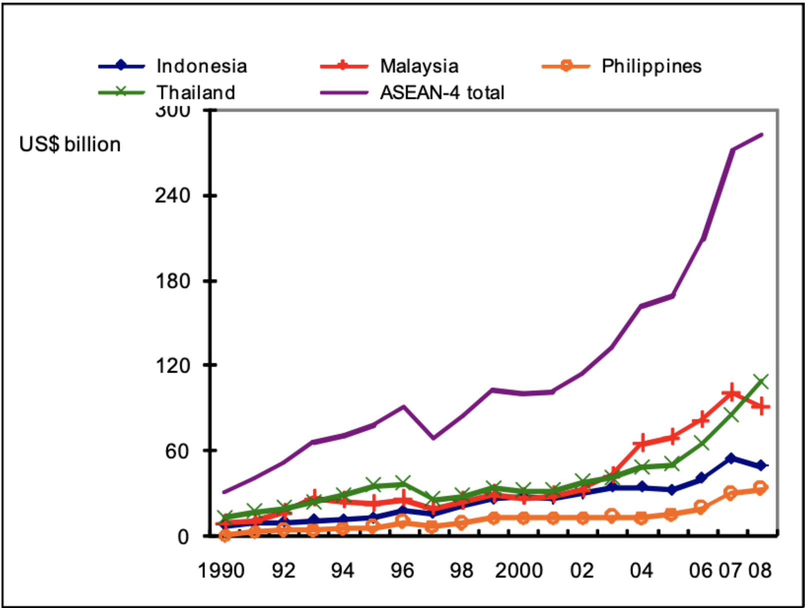
Prior to the crisis, nations like Malaysia, Thailand, and Indonesia had significant current account deficits (savings - investment) sustained by significant external borrowing to support their rapid economic expansion. For example, in 1996, Thailand ran a deficit of 8.0% of their GDP, relying heavily on short-term capital inflows (U.S. DOS). Post-crisis, they were able to complete a dramatic reversal. Many ASEAN economies, once dependent on external financing, emerged as net savers with substantial current account surpluses. By 1998, Thailand had transformed its 1996 deficit into a strong surplus of 12.5% (International Monetary Fund), while Singapore cemented its continuous position as a surplus economy, often exceeding 15% of GDP (International Monetary Fund). This overall shift was propelled by export-led growth, as weaker currencies post-crisis made ASEAN goods highly attractive on global markets. Thailand developed as a centre for the manufacturing of automobiles, while factories in Malaysia and Indonesia produced electronics, textiles, and other items at breakneck speeds.



Transition from net-borrowers to net-savers

As a result of these new export-focused economies, foreign exchange (FX) reserves expanded heavily. Singapore, once cautious with their total reserve accumulation, has since seen it skyrocket from US$68.8 billion in 1995 to US$417.9 billion in 2021 (Monetary Authority of Singapore). These reserves acted like shields, empowering central banks with the ability to stabilize currencies, manage external shocks, and help in stimulating investment.

This increase in FX reserves across the different countries, as well as an increase in domestic savings, aided with the development of domestic bond markets and a general decline in bond yields. When the demand for a particular bond increases, all else equal, its price will rise and its yield will fall. For example, Singapore's 10-year government bond yield decreased from around 4.48% in 1998 to 0.84% in 2020, falling even faster than US Treasury yields over the same period and showcasing improved investor confidence post-crisis (Monetary Authority of Singapore).



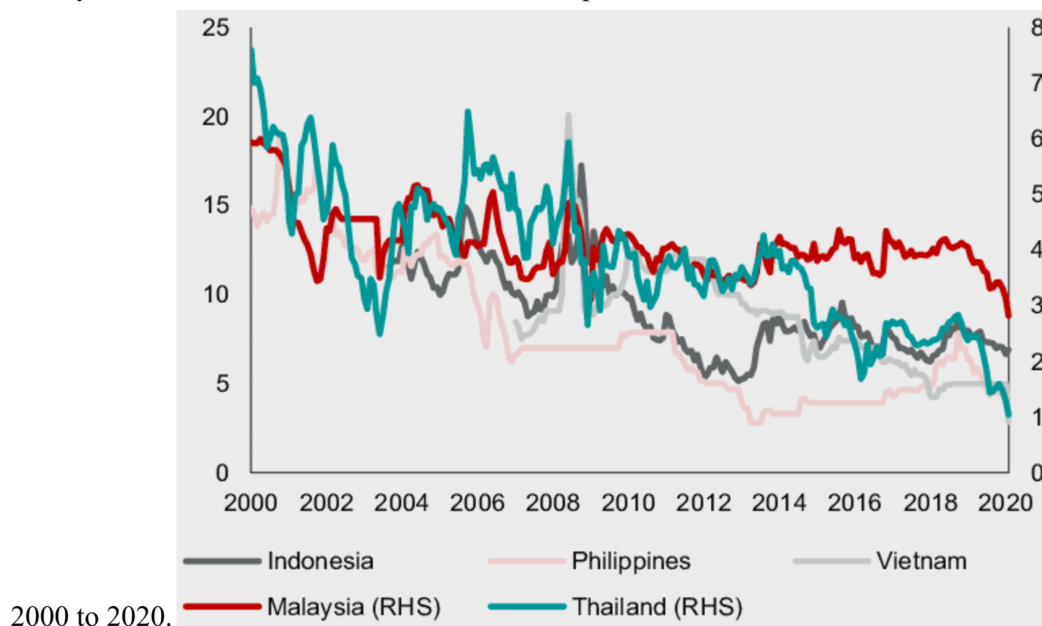
Source: Philippine Review of Economics

By 2007, ASEAN-4 nations (Indonesia, Malaysia, Philippines, and Thailand) collectively held reserves exceeding US$240 billion (Park and Estrada 7), showcasing their transition from vulnerability to financial strength. While these reserves provide a critical buffer against external shocks, they also act as a signal, showing a shift in monetary policy strategy across the region.

Singapore has adopted a unique approach, managing its exchange rate against a basket of currencies of its major trading partners (also known as the Singapore dollar nominal effective exchange rate or S$NEER). The combined index, S$NEER, is a trade-weighted exchange rate where weights are assigned to the various currencies of Singapore's major trading partners based on the importance of the trade relationships (Tee 3), helping the nation prioritize trade competitiveness and inflation control with a more stable currency. In contrast, Thailand transitioned to a managed-float exchange rate regime. Fundamentally, the Bank of Thailand allows for the baht to fluctuate within a set of defined parameters, intervening during periods of excessive volatility (Bank of Thailand). These examples go to show how to countries tailored their individual policies to match with their economic structures.

The Evolution of Bond Yields

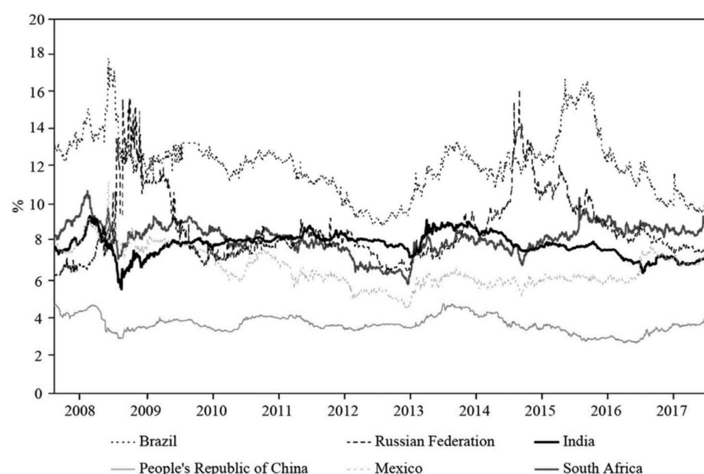
The evolution of bond yields across the ASEAN region, specifically ASEAN-4—Indonesia, Malaysia, Thailand, and Singapore—provides insight into the region's financial transformation post-1999. These trends directly reflect the impact of improving balance of payments (BoP) and the substantial accumulation of foreign exchange (FX) reserves in the economies. As the BoP shifted from deficits to surpluses after the crisis, ASEAN-4 nations also experienced significant changes in their domestic bond markets, seen primarily through declining yields. In the figure below, we see the 10-year government bond yields for each of the ASEAN-4 countries, plus Vietnam, where this effect is demonstrated from 2000 to 2020.



Source: ResearchGate (Khor)

This relationship is driven by two main factors: First, as current account surpluses allowed for further reserve accumulation, governments became more self-sufficient and could afford reducing external borrowing. Less reliance on foreign financing lessened the benefit associated with national debt, and bond yields lowered as a result. Increased domestic savings, a byproduct of export-driven growth, increased liquidity in local markets as there was more money to be spent, also leading to increased demand for government bonds, further pushing yields lower across the region.

In comparison, these trends were more visible in ASEAN than in comparable emerging markets, such as India. In the graph below, the 10-year government bond yields for many countries are shown over a shorter time frame, and India is the highlighted line. During this period, India had periodically experienced declining bond yields, though they remained consistent over the longer term due to slower reserve accumulation, among other factors. ASEAN's unique impact of its rapid export-led growth can be seen with this contrast.



Source: ResearchGate (Akram and Das)

Regional Cooperation

The ASEAN region had a significant financial transformation post-1999 as a result of national policies but was also significantly affected by successfully coordinating regional efforts. Recognizing the interconnected nature of their individual economies, ASEAN countries implemented several processes to reduce vulnerabilities to external shocks.

One of the primary examples that can be used is the Chiang Mai Initiative Multilateralization (CMIM), established in 2010 to help address balance of payment and short-term liquidity issues in the region. With a size of over US$240 billion, the CMIM is a multilateral currency swap arrangement between the ASEAN+3 members, which includes China, Japan, and Korea; the agreement allows for these countries to access short-term liquidity during financial crisis. For example, during the COVID-19 pandemic, the CMIM acted as a safeguard to ensure stability (Monetary Authority of Singapore).

Another major program is the Asian Bond Markets Initiative (ABMI), launched in 2002 by the same ASEAN+3 countries. The ABMI was created to reduce the risk of financial crisis by developing local currency bond markets, also addressing the region's overreliance on debt from foreign currencies (Asia Regional Integration Center).

The proactive approach of ASEAN to assuring long-term economic stability is illustrated by their regional financial cooperation initiative. It not only strengthens protection against financial crises but also forges partnership ties, laying the foundation for future financial integration, which is essential for long-term, sustainable growth in an increasingly volatile global economy.

Beyond regional financial cooperation, many ASEAN nations have also adopted country-specific strategies to ensure long-term macroeconomic sustainability. One key approach is sovereign wealth funds (SWFs), which go beyond simple reserve accumulation by actively investing in key industries and global markets. These funds not only safeguard the nation's financial stability but also drive economic growth, making ASEAN more resilient and competitive.

Sovereign Wealth Funds

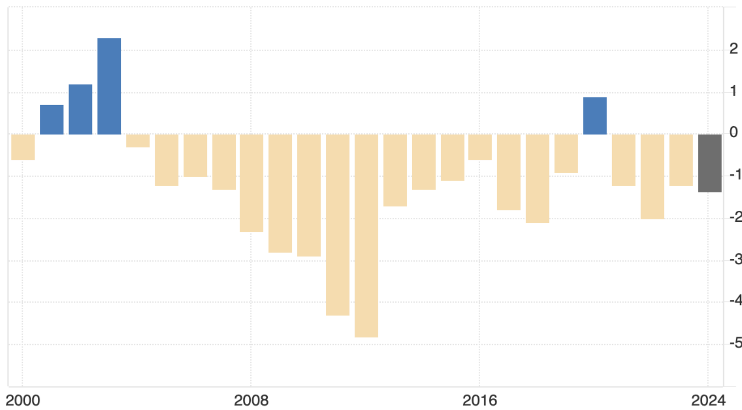
Post-crisis, many ASEAN economies had much larger foreign exchange reserves, and thus these nations were faced with the task of strategizing ways to use them to support long-term growth. Sovereign wealth funds (SWFs) arose as a solution, enabling countries like Singapore and Malaysia to utilize their reserves for investments.

Singapore currently leads the region through two globally recognized SWFs: the Government of Singapore Investment Corporation (GIC) and Temasek Holdings. GIC manages the majority of the Government's financial assets, at about US$770 billion in assets (Ngui and Kok). They invest in a very diversified global portfolio, including 6 asset classes: developed market equities, emerging market equities, nominal bonds and cash (often the largest holding), inflation-linked bonds, real estate, and private equity (Government of Singapore Investment Corporation). It utilizes a strategy based on the long-term, ensuring steady returns while safeguarding national wealth. In parallel, Temasek Holdings manages assets worth about US$290 billion. They invest in both listed and unlisted companies worldwide; the core difference between the two SWFs is that in Temasek, the Government has no representation on the Board, and thus investment decisions are fully independent of any Government involvement or influence. GIC's Board, on the other hand, include Ministers and thus Government influence (Ministry of Finance).

Another example is with Malaysia's Khazanh Nasional Berhad, established in 1993, which follows a similar approach but with a stronger focus on domestic economic development. Khazanah has financially supported many sectors, including infrastructure, telecommunications, healthcare, and many others which contribute to Malaysia's modernization. For example, significant investments in Malaysia Airlines and many infrastructure projects have boosted the nation's overall connectivity and its competitiveness in the global market.

Comparative Analysis: ASEAN vs. Emerging Markets

A key point of comparison for ASEAN is India, which can be used as a control variable to help understand ASEAN's financial direction. Although India's foreign reserves have significantly increased after 2000, reaching over US$640 billion by the end of 2024 from the US$35.1K billion at the start of 2000 (Trading Economics), its current account deficits have remained persistent, as seen in the figure below (Trading Economics). In contrast, ASEAN-4 economies especially have consistently run surpluses, allowing for them to increase reserves without increasing external debts. This reasoning serves as one of the key explanations for why India's bond yields have remained higher: 10-year government bond yields have consistently stayed around 6-8%, compared to ASEAN-4, where nations had very low yields, going as low as 0.84%.

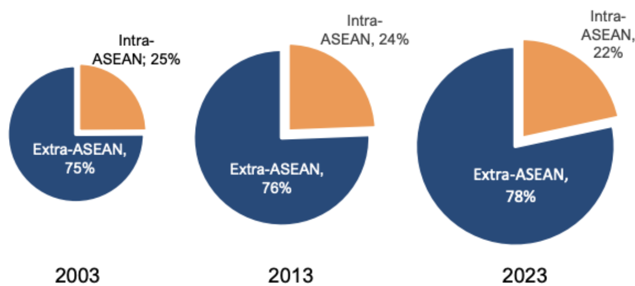


Source: Trading Economics

Export-led growth, proper reserve management, and effective strategising has allowed for ASEAN to remain relatively successful, also allowing for its bond yields to remain stable while exchange rates are managed more effectively. India and many other developing nations face repetitive external pressures, but ASEAN-4 nations have managed to create a welcoming financial environment with reduced volatility.

Future Outlook

Sustaining the financial stability that ASEAN has managed to achieve will require continued cooperation and adaptability to reduce vulnerabilities. For example, a key vulnerability is with ASEAN's high dependence on external trade. This is just an example, but this reliance could expose ASEAN to events such as external demand shocks, such as with the US-China trade war and supply chain disruptions. ASEAN has developed many financial policies and are progressing effectively, though intra-ASEAN trade still remains stagnant after so many years at about 22% (ASEAN Statistical Brief), showing gaps and opportunities for further regional integration.



Source: ASEAN Statistical Brief

Conclusion

The tremendous transition of ASEAN from net borrowers to net savers has fundamentally affected the region's financial environment and future outlook. Post-1999, these economies utilized their current account surpluses to work on stabilizing exchange rates and reduce dependence on external debt, improving their domestic bond markets in the process. Bond yields have declined across the region, showing improved investor confidence and a stronger financial environment.

Looking ahead, to maintain their financial strength, ASEAN will need to stay adaptable in order to evolve to growing needs and an ever-changing global market. By continuing to deepen regional cooperation and properly leveraging its strong reserve position, ASEAN is currently well-positioned to maintain regional stability and stay economically competitive.

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