

Vulnerability Indicators to the Twin Crises:

Evidence from Thailand

Abstract

This paper aims to construct the composite index of vulnerability that represents the susceptibility to a currency and financial crisis (twin crisis) in Thailand. This index is the combination of four key early warning indicators that tend to demonstrate an abnormal behavior in the lead-up to a crisis. The four indicators include the real exchange rate misalignment, reserve adequacy ratio, financial fragility and fiscal position. RER misalignment is estimated according to the time series econometric procedure and the composite index of vulnerability is calculated by geometric average method. The advantage of this index for policymakers is the signaling and monitoring the underlying fundamentals of a country. After the 1997 crisis, the composite index shows that the state of vulnerability to a currency and financial crisis of Thailand is still at a favorable position. However, because of the contagion effect that could arise from the current global financial crisis, the government needs to monitor the state of the country's vulnerability closely, especially in terms of financial fragility and fiscal position.