FINANCIAL LITERACY
FOR YOUTHS

1997 Asian Financial Crisis

1997 Asian Financial Crisis

Early 1990s saw economic boom across East and South East Asia where countries like South Korea, Singapore, Taiwan and Hong Kong experienced rapid growth and was often referred as the Asian Tiger Economies. They maintained remarkably high growth rates (over 7%) from 1960s-1990s due to rapid industrialization. Apart from these, other Asian countries like Malaysia and Thailand experienced over 8% from mid 80s to 90s. Much credited to reforms and proper economic decisions of governments in the early 80s.

It all came to an end in July 1997 when the region was hit by one of the worst economic meltdowns in decades. A collapse of the Thai Baht caused a domino effect in the region causing their currencies to come under attack followed by a rapid depreciation. In mid May 1997, the Thai baht was hit by massive speculative attacks and since the currency was pegged the Central Bank had to deplete its reserve to defend the Baht. Although the government was reluctant to lift the USD-Baht peg, it lacked the foreign reserve required to support it and had no choice but to float the currency. On 2nd July 1997, Thai government had no choice but to allow the exchange rate to be set by the market. Baht faced a depreciation of about 20% and caused a chain reaction of events that led to a region wide crisis.

Within a week Central Banks in the region had to start intervening to defend their respective currencies. The then Prime Minister of Malaysia, Dr Mahathir Mohammed imposed strict financial regulations hoping to curb the outflow of capital and pegged the Ringgit to 3.80 against the U.S dollar after the ringgit had depreciated from 2.50 to 4.57 within 7 months resulting in a loss of value of over 50%.

South Korea being one of the countries affected the most experienced a 7% drop in Seoul Stock Exchange, the single biggest fall. Its credit rating saw a downgrade from A1 to B2 by Moody's within few months that led to further crash in the stock market. Major automobile companies were either dissolved or acquisitioned due to the crisis.

What really caused the crisis?

There are many theories that claim to be the cause of the crisis. For Thailand, it is said that the Thai economy developed into an economic bubble fuelled by hot money. More and more was required as the size of the bubble grew. The same type of situation happened in Malaysia, and Indonesia, which had the added complication of what was called "crony capitalism". [1] As the US economy began to recover in 1990s the US Federal Reserve Bank Chairman Alan Greenspan began to raise interest rates to avoid inflation.

The rise in interest rates made United States a more viable investment destination compared to South East Asia which was attraction hot money through high short-term interest rates. The flow of money into US raised U.S dollar causing South East Asian exports to become comparatively more expensive and lose its edge in global market. Less competitive exports led to a deteriorating current account positon in most countries exposing them to a balance of payment crisis.

IMF to the rescue?

The severity of the collapse need urgent action from outside in order to rescue the economies. Countries badly affected were in serious risk of defaulting on their loans and that was not an option one could visualize considering some of them were the among the richest countries in the world. International Monetary Fund (IMF) created a series of bailout or commonly known as rescue packages for the affected countries to avoid defaulting on their loans while tying them to reforms in spanning from banking to financial system.

IMF as usual put multiple conditions on their rescue package and gave it in tranches after judging the compliance of individual countries to criteria set by IMF. It called on crisis-struck nations to cut down on government expenditure and reduce budget deficit. They also advised governments against rescuing insolvent financial institutions and raise interest rates. This was to bring back the confidence on the economy of each country and to protect their currency value. Apart from these, IMF wanted their funds to be administered rationally and no favoured party be allowed to benefit unfairly. This was particularly a hard step for some of the affected countries as their economy was dependant on a form of “crony capitalism” hat seemed to have worked for the past decade but was hindering future growth due to inefficiencies within those firms.

"IMF agreed to provide Indonesia with a $40-billion-dollar bailout package and in return had to close down 16 insolvent financial institutions and a wide range of structural reforms." [2] South Korea on the other received the biggest ever bailout package of $57 billion amid much domestic criticism. Other affected countries too received much smaller bailout packages and agreed to many domestic policy reforms.

The economic crisis also left many countries politically different than it was prior to the crisis. Most notable was the resignation of Prime Minister of Thailand and of President Suharto of Indonesia after over 3 decades of rule. There were also some renewed anti-western sentiments among the masses particularly towards the IMF and George Soros.

References

Hughes, Helen. Crony Capitalism and the East Asian Currency Financial 'Crises'. *Policy*. Spring 1999.

Timeline of The Crash | The Crash | FRONTLINE | PBS. (2016). *Pbs.org*. Retrieved 16 October 2016, from http://www.pbs.org/wgbh/pages/frontline/shows/crash/etc/cron.html