

# Asian financial crisis



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## Introduction

The present Asian Financial Crisis is expected to continue for next few decades for several reasons such as financial depression, recession, unemployment and a deep-cut in exchange rates bringing down the regional currency value which spreads from one region to another at a fast pace causing break down of all currencies. The initial stage of Asian Financial crisis caused much currency depression to Thailand, Malaysia, Indonesia, Philippines and finally to South Korea. The currency crisis began in Thailand (baht) which spread gradually to other Asian countries causing a break down of financial system. A great number of debates took place over the Asian Financial crisis for finding the reasons of currency crisis whether it is purely by domestic policies or by the volatility of financial system on a global perspective. A view considered by IMF and G7 is that East Asian countries are effected by domestic policies and lacking in application of economic fundamentals and no outside causes exist in currency crisis of East Asian countries. The term “ East Asian Economic Miracle” was first used by the World Bank in 1993. The crashing down of Thai currency Baht has lead to financial crisis not only in Thailand, also to East Asian countries in mid 1997.

The causes are interrelated to the issues of private sector, public sector and a failure of governments which considered a lenient view on warnings given about currency depreciation in Thailand in 1998 which dropped the GDP 4-5.5 per cent, Indonesia recorded 6.2 per cent fall in GDP, South Korea recorded 3.8% fall in GDP, Hong Kong recorded 2 per cent fall in GDP while Malaysia recorded 1.8 per cent fall in GDP.

In order to analyze what were the prominent causes for a severe effect in GDP fall of the above countries, it is required to observe and take note of international EXIM and FOREX policies that came into effect with financial liberalization between the periods 1993-1998.

There are two important markets that control the currency of a particular region. The first being foreign inflows which increase foreign accumulation of debts and secondly import policies that fluctuate on the inflation and control exchange and interest rates of a currency resulting in either fall in imports or rise in exports.

Prior to 1997 East Asian countries finance policies were liberalized enabling inflow of foreign funds into the capital account where foreign exchange was permitted with local currency for the purposes of trade and direct-investment allocating a large amount of funds inflow into the banking sector through purchase of bonds, investments in stock market and portfolio investment etc., This is apparent with Bangkok International Banking Facilities (BIBF) which was set up in 1993 collected USD 31 billion by the year 1996 and this was adopted by almost all the East Asian Countries.

What caused the fall in currencies of Thailand, Indonesia and South Korea was a sudden depreciation of respective currencies. The burden of short-term debt began to grow in volumes and heavy out flow of clearing of short-term debts gave a deep cut in foreign reserves. When foreign reserves reached a low level, IMF help was sought by Thailand, Indonesia and South Korea.

This further caused economic slow down, withdrawal of loans, sale of shares, fall of share prices and a price and demand fluctuation in banking sector and <https://assignbuster.com/asian-financial-crisis/>

real estate sector. Currency depreciation causes the following impact on respective economies.

Heavy debt service burden on banks, companies and governments who derived the benefit of grant of loans.

Fall in the value of shares, bonds, land and buildings and other real estate properties. The borrowers who pledged the above as collateral security have to face financial difficulties.

Hike in interest rates adds financial burden on companies as well as consumers who borrowed.

Higher inflation results in rise of import prices which results in currency depreciation.

Thailand as a tourist destination and as a center point for trade policies has gained a prominent place in South East Asia whereas China and Japan are the major leaders in Asia in terms of growth in economy and also in international trade. There came a devaluation of Chinese renminbi and Japanese Yen in mid 1990s which resulted in sharp decline in currency producing an adverse impact on export revenues. These events pressurized Thailand's currency Baht which collapsed in July 1997 in foreign exchange market. After the collapse of Baht, most of East Asian currencies also fell by 35-83% against USD and there were severe disruptions in banking sector and also a greater number of bankruptcies which entirely affected the economies of Malaysia, Indonesia and South Korea.

Thai Baht was introduced in the year 1897 and was fixed at an exchange of USD 1 = 20 baht. This continued until the year 1985 with a gradual decrease in Thai bath which stood at an exchange of 25: 1 until 1997

causing Asian Financial crisis. Post financial crisis, Thai baht was placed at a floating rate to a lowest rate of 56: 1 in January 1998. Finally Thai bath stabilized at 40: 1 and has been continuing at this rate. For the year 2005, inflation in Thailand reached to 3. 7 per cent which was high in a p of six years due to the reason that the government increased the price of diesel by 20 percent as the prices of oil are mounting in international trade. Central Bank of Thailand also increased interest rates from the year 2001 due to several unpredictable reasons in financial market that is causing Thai bath devaluation.

As a result of Asian Financial crisis in 1997, Thai baht devalued to an extent of 20 per cent against US dollar causing much pressure in foreign exchange market. Currency traders were buying US dollars and sell Thai baht causing currency flow out of the country. Also Thai Government was not able to maintain foreign reserves, further was losing the grip over financial stability and currency valuation. The devaluation of Thai baht reduced the prices of Thai exports which quickly spread to other Asian countries to reduce the prices on exports. Further Thailand witnesses a severe and steep rise in unemployment, bankruptcies and confusion in financial and political system. Indonesia faced much worse in collapse of its currency rupiah which was devalued to an extent of 90 percent, further failure of government when its President had to resign to delegate leadership of presidency to another candidate for restoring financial market confidence in Indonesia.

Financial assistance from IMF was provided in order to assist South East Asian countries to survive from Asian Financial crisis. In this process, South Korea was benefited with \$ 55 billion, Indonesia with \$45 billion and \$35

billion for Thailand. Financial assistance from IMF enabled Asian countries to rejuvenate its fiscal and monetary policies and also to eliminate the possibilities of further devaluation of respective currencies in South East Asia whereas the negative impacts of Asian Financial crisis still continue to grapple the above countries and it would certainly take much longer period of time to stabilize its economy at a set pace towards gradual growth. Also a collective working of Asian Development Bank along with respective regional banks with coordination from governments must allocate hedge funds, risk management, management of foreign reserves, working of interest rates, import and export policies require an excessive working in order to stop further deterioration of economy and fall in GDP.

### Conclusion

Initially, Asia was performing overwhelmingly in economy for several decades. A three-decade economic performance enabled South Korea to grow by tenfold, Thailand to grow by fivefold and Malaysia to grow by fourfold. Until the period of financial crisis, Asia invited \$100 billion capital inflows up to the year 1996 and the success of Asia was good for the other part of the world as the number of exporters increased, industrial production and meeting the demands and needs of customers around the world. The participation of Asia in international trade and business was recognized.

The origin of the crisis was well within the domestic monetary policies such as external deficits, stock market imbalances, large amounts of external borrowing and lack of portfolio management in banks. These were further manipulated by political motives lead to crash of currency in financial market. Much of the destabilization was caused to Thailand, as it was

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indicating a staggering performance of 10 percent growth every year from the year 1987-1995 with the practice of macro economic management, large amount of capital inflows were made by foreign investors on short-term to Thailand. The devaluation of Thai baht lowered foreign reserves of Thailand and in order to repay short-term debt, Thailand was compelled to seek IMF assistance which finally placed Thai baht as a floating exchange rate.

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