Asian Financial Crisis: Causes and Development

- The Asian crisis plunged many of the region's economies into severe recession during 1997–98 and called for massive rescue efforts by the IMF. It abruptly put to rest the rising claim that unique Asian values had been responsible for the region's spectacular growth and distinguished it from other countries and their economic cycles and problems.
- The period of rapid growth in Asia prior to the crisis during the 1990s coincided with the expansion of global capital markets and the increasing flow of capital to developing economies. Total net private capital inflow to Asia reached a peak of US$110 billion in 1996.
- This massive capital inflow fueled economic growth but at the same time exacerbated the structural weaknesses already underlying many of the Asian economies, such as inadequate regulatory control, high corporate leverage and heavy reliance on short-term foreign debt. The continued rise in asset prices due to increasing liquidity also masked external problems which included slower export growth and a deteriorating Japanese economy.
- When banks and corporations started to fail in 1997, the abrupt change in investor and lender sentiments led to a major reversal of capital flows and triggered financial and economic crisis throughout the region. In Thailand, Indonesia and Korea, the IMF's austerity rescue programs arguably might have even exaggerated the economic downturn, and some of its policies had to be reversed.
- Economic growth resumed starting in 1999, spurred mainly by rising exports and growing global demand. Financial markets recovered in most countries, with some stock markets reaching or even surpassing the heights that they had attained prior to the crisis.
- Recovery, however, has been uneven. Thailand and Indonesia, in particular, are still saddled with high levels of nonperforming loans and need massive capital infusion. Even Korea, which had recovered remarkably, requires further restructuring of their financial and corporate sectors.
- For the region as a whole, broader issues exposed by the crisis still need to be addressed, including the need for better market regulation, greater transparency and improved corporate governance. The instability of international capital markets and its impact on developing economies also remain a concern.
- For the PRC and Hong Kong SAR, the Asian crisis has been a wake up call. While largely shielded from the crisis by capital control, the PRC faces similar needs to reform its financial and state enterprise sectors. These needs have been rendered even more urgent in view of its accession to WTO.
- The attack on Hong Kong's linked exchange rate regime has prompted the introduction of new measures to strengthen the operation of currency board system. Hong Kong had survived the crisis well, but has lagged other economies in recovering from the crisis. With domestic exports playing a diminished role, the benefits from the increase in global trade had been channeled into the provision of producer services in its re-export trade activities. Hong Kong has become a "metropolitan" economy to the PRC and the rest of Asia. To be able to provide added value and remain competitive in this new role, it will need to continuously upgrade itself as a knowledge-based producer service oriented economy.

ISBN 962–86056–1–5

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