Causes and Economic Effects of the Asian Financial Crisis

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Introduction

For several decades, Asia was an economic giant that many developing countries wanted to emulate. The region was financially stable with a high level of per capita income and estimated growth of 5% – 7% per annum. Research has established that during this period, improvements in education, the market economy, and living standards were made possible (Xion, 2010, p. 15). Asian countries had high savings, government incentives for entrepreneurial activities, and high investment in human capital. In almost all Asian nations, the export industry was the core driver of the economy. It was estimated that Asia could be the new frontier in growth and development. In 1990, there was a high inflow of capital investment from Europe and Japan. As stated by Xion (2010, p. 30), things started to change in the mid-1990s, when the Asian economy started to look weak, and accumulated debts could not be paid.

Causes of the Asian Financial Crisis

However, things eventually changed in 1997, and the Asian giants started to feel the heat of the economic downturn. The financial problems started in Thailand and spread to other countries in Asia. According to Xion (2010, p. 45), the high debts accumulated by Asian countries started to overburden them, corporations became much more leveraged, and average export levels started to drop. The financial crisis was generated due to the region's financial vulnerability. It was difficult to predict the future of the region after the end of the financial liberalization of the market, which took place in Asia in 1997. Most corporations predicted that the high growth rate would not be maintained, and such perceptions scared away investors and caused the financial institutions to fall (Chowdhry & Amit, 2000, p. 15). The Asian economic crisis of 1997 affected all countries in the region, and it is one of the longest economic crises ever to occur in Asia. Therefore, it is worth studying so that its causes, effects, and the way it was resolved can be understood to address recent economic problems.

Several hypotheses have been derived to explain the cause of the Asian economic crisis of 1997. However, according to Allen and Douglas (2012, p. 24), the economic turmoil was caused by an abrupt shift in market expectation and confidence. Research has indicated that during the 1990s, European and Japanese corporations and other investors moved to Asia (Allen & Douglas, 2012, p.

12). Later, most corporations moved out, leaving most Asian countries with debts, and the move also caused a lack of confidence; therefore, it was the beginning of economic problems in Asia. The effect of the market shift, which triggered economic turmoil in Asia, negatively affected Asia's financial institutions and financial markets. Wang (2007, p. 15) noted that the interest rate increased, and per capita growth declined as well. The increase in interest rates scared away investors and, in return, reduced the number of borrowers. Research has established that the currencies and asset prices in several nations dropped by an average of 30% to 40% and much more in hard-hit countries like Thailand. Banks and other financial institutions in the Asian region experienced serious financial problems. This forced Thailand, Indonesia, and Korea to request the International Monetary Fund to help address financial market problems (Jeon, 2012, p. 12).

The interest rate abruptly increased, making it impossible for investors and other businesses to access long-term loans. Based on short-term interest theory, the increase in interest rates affects the stock market since banks and other financial institutions automatically reduce loan applications, and the default rate also increases as well. According to Rigg and Lotte (2009, p. 20), high interest rates caused several banks across Asia to become unprofitable, which in turn made banks send several employees home, resulting in a high rate of unemployment in the Asian region. It is also noted that the event changed the inflation rate and stock market of several financial institutions, and other corporations were affected, making several organizations register losses (Julian, 2000, p. 12).

Effects on Trade and Currency

It has also been reported that the export rate declined, and most Asian countries started to import goods or products from other countries. According to Corsetti (1999, p. 15), the decrease in exports and imports affects the supply of goods or products in the market. This affected the demand for products since the supply became low and demand became high. As a result of imbalanced demand and supply, the rate of inflation increased since the price of several products increased (Corsetti, 1999, p. 17). Research has also indicated that the crisis ended up forcing the devaluation of the currency in Indonesia and Thailand, compelling local businesses and foreign companies to shift to foreign currencies since it was difficult to predict the future value of the local currency in the market. Within months of the crisis, speculation was high, regional currencies were under attack, and the exchange rate was corrected quickly to ensure that the crisis did not last long. This caused the crisis to take on an international dimension, forcing reputable organizations like the IMF and the World Bank to intervene to help the region address its financial problems.

Economic Consequences and Recovery

Some analysts predicted that the financial markets of Asian nations would be affected and that the growth being realized would decline suddenly. The economic crisis increased the inflation rate and unemployment rate, while the economies of most countries shrank. For instance, the Organization for

Economic Cooperation and Development (OECD) stated that the economy of Thailand shrank by 1% by the end of 1997, and other institutions like the Industrial Finance Corporation of Thailand (IFCT) forecast indicated that the economies of most Asian countries declined by almost 5.6% (Wang, 2007, p. 23). However, some analysts believed that the economic impact on the financial market was deeper than what was being reported. According to a report by Far Eastern Economic Review dated July 22, 1999, the economy of Thailand shrank by almost 1.4%, Indonesia by 1.2%, and Korea by 1 percent. It is noted that almost all countries in the Asian region were affected (Rosengren, 2008, p. 12).

The economic crisis also resulted in a fall in market confidence, which scared away investors. As stated by Rigg and Lotte (2009, p. 15), the decline in market confidence made investors refrain from investing and start to shift to other nations in Europe and North America. This caused a low savings rate since the future of banks could not be predicted. Analysts pointed out that the scramble for the future of Asia made it impossible to invest, and therefore, it decreased the rate of investment (Rigg & Lotte, 2009, p. 45). Several financial institutions and banks closed in Thailand and Indonesia, and other companies applied for a bailout so that they could sustain their operations and fund their strategy so that they could realize growth again (Mishkin & Stanley, 2016, p. 123).

In conclusion, the Asian financial crisis negatively affected financial institutions and financial markets. The study established that a number of banks closed, and several financial institutions and firms applied for bailouts. It also increased the inflation rate and reduced per capita income and GDP of most countries in the region, such as Indonesia, Thailand, Korea, and China. In order to address the crisis, the region was bailed out by the IMF, and banks and other companies also received bailouts so that they could improve their businesses and earn profit. The Asian nations also reinvented trade amongst themselves to improve business and grow the economy as well.

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