



UNIVERSITI PUTRA MALAYSIA

**THE EAST ASIAN ECONOMIC CRISIS:
A DISCUSSION**

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ORIGINALITY OF DOCUMENT

I, Shamsulkamal bin Ibrahim, matric no. 51621, a final year student of the MBA programme at the University Putra Malaysia, Serdang, Selangor Darul Ehsan, hereby confirmed that the thesis prepared for the above programme is purely the sole effort of my goodself.



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ABSTRACT

Generally, the ASEAN and other East Asian countries are currently facing a severe economic crisis. It started with a currency crisis across the region triggered when the Thai baht had to be floated on 2 July 1997. It later developed into a stock market crisis and financial crisis, culminating in a full blown economic crisis. The possible causes underlying the crisis revolve around the attitude towards risks and debts, unhealthy practices, and rapid movement of capital with the advent of globalisation. The effects of the crisis generally touches the issues of economic growth, credit crunch, decreasing wealth, unemployment, debt burden, political and social repercussions, and ultimately, uncertainty about the future. The various governments, some with the help of the International Monetary Fund, are taking several measures to overcome the crisis, although some with questionable effectiveness. Nevertheless, looking forward, measures must also be taken to try to prevent and mitigate, even if only partially, such crisis in the future.

ABSTRAK

Secara amnya, negara-negara ASEAN dan negara-negara Asia Timur yang lain sedang berhadapan dengan krisis ekonomi yang teruk. Ia bermula dengan krisis matawang serantau yang tercetus apabila baht Thailand terpaksa diapungkan pada 2 Julai 1997. Hasilnya, krisis pasaran saham dan krisis kewangan pun menyusul tidak lama kemudiannya, yang memuncak kepada krisis ekonomi sepenuhnya. Sebab-sebab asas yang mungkin bagi krisis ini berkisar sekitar sikap terhadap risiko dan hutang, amalan-amalan tidak sihat, dan pergerakan modal yang pantas bersama datangnya globalisasi. Kesan-kesan krisis ini pada amnya menyentuh isu-isu perkembangan ekonomi, kepayahan kredit, pengurangan kekayaan, pengangguran, beban hutang, tindak-balas politik dan sosial, dan akhirnya, masa depan yang tidak menentu. Kerajaan-kerajaan yang terlibat, sesetengahnya dengan bantuan Tabung Kewangan Antarabangsa, sedang mengambil beberapa langkah-langkah untuk mengatasi krisis tersebut, tetapi keberkesanan sesetengahnya boleh dipersoalkan. Walauapapun, memandang ke hadapan, langkah-langkah mesti diambil untuk menghalang dan mengurangkan kesan, walaupun hanya sekadarnya sahaja, krisis sedemikian di masa akan datang.

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CHAPTER ONE

INTRODUCTION

A few voices, and there was very few indeed, said that it was a bubble economy and it would burst, but most people, especially in the country, seems not to hear it or at least seems not to believe it. Burst it did, and spectacularly too! Thus the downturn of the Malaysian economy started with the tailspin drop of the ringgit from around RM2.50 to around RM4.00 to the US dollar. It was quickly followed by the drop at the Malaysian stock-market, the Kuala Lumpur Stock Exchange (KLSE), with the main market index, the Composite Index, fell from a high of well above 1000 points about one and a half years ago, to below 250 points in August this year, wiping more than three quarters of the market capitalization.

Indeed, the economic crisis is not just a Malaysian crisis, but it affect most of East Asian countries. Interestingly, the crisis is still unfolding, even after more than a year. Events are still happening, and more are expected to come. The



crisis does not seem to be abating, in fact it seems to deepen. Possibly, the worst is yet to come.

It must be realized that the economic crisis that is currently besetting East Asia is a very complex one. It is actually a currency crisis, financial crisis and economic crisis rolled into one, spiced with intriguing webs of global, as well as local, political agenda.

1.1 START OF THE EAST ASIAN ECONOMIC CRISIS

Between March and June 1997, the chaebol, Hanbo Steel collapsed. It is the first time in a decade that a major Korean chaebol went bankrupt. It was quickly followed by the bankruptcy of Sammi Steel.

At about the same time, in Thailand, Somprasong Land defaulted on some of its foreign obligations. Even the government failed to buy the bad property loans of financial institutions as promised. The baht was thus attacked. Nevertheless, the Bank of Thailand, the central bank managed to maintain the decade-long exchange rate of about 25 baht to the dollar.



However, in May 1997, the baht slid again. The government blamed speculators for the slide. Singapore was asked to help defend the currency. The intervention was a success. That was the good news, but the bad news was that Thailand largest finance company, Finance One was sunk by bad debts. By June 1997, Amnuay Viravan, the then Thailand's finance minister resigned. Yet, the Prime Minister of Thailand at the time, Chavalit Yongchaiyudh gave assurances that the baht would never be devalued. Nevertheless, the central bank suspended 16 finance companies.

Around that time, the Thailand stock-market plunged drastically for the first time in eight years. The Thai central bank had to forked out USD500 millions in that month of June to defend the baht and another USD700 millions to help struggling companies. It is interesting to note that Thailand has shown the symptoms of an ailing economy ever-since the early 1990s. Its export growth slowed due to competition from China, its labour costs spiraled upwards, its current account deficit (CAD) reached 8% of the Gross Domestic Product (GDP) and its interest rate were amazingly high at 13.75 %.

The date July 2, 1997 would be marked down in history as the watershed point when the crisis precipitated, at which there was no turning back the situation. In fact, many people considered it as the starting point of the currency crisis



that would plague East Asia, which quickly developed into a financial crisis, which in turn ignited the economic crisis of the region.

On that faithful day in July, the baht wobbled. At first, Thailand's central bank intervened, but then it suddenly withdrew, unable to withhold costly intervention such as mentioned earlier. Its officials announced a 'managed float' of the currency. It was speculated that although Thailand had USD30 billions in foreign reserves, it had only around USD1 billion available to defend the currency at its historically pegged level to the US dollar. Most of its foreign reserves purportedly were in the form of contracts. Later, the government estimated that the intervention would cost the country around USD30 billions or roughly its entire foreign reserves. Thus, the baht sunk to a record low of 28.80 to the dollar. Southeast Asia trembled.

Then, contagion effects took hold of the region. Most of the regions currencies were virtually pegged to the US dollar. The Philippines floated the peso on July 11, 1997 after raising overnight lending rates from 17% to 30%. Indonesia widened the daily upper and lower trading bands of the rupiah from 8% to 12% - nevertheless, the exchange rate remained stable at around 2,430 to the dollar. The Singapore dollar depreciated to 1.46 to the US dollar by July 17, 1997, its lowest level since February 1995. By July 24, 1997, the Malaysian ringgit hit 2.65 to the US dollar, a 38-months low, and the



Malaysian Prime Minister retaliated by bitterly attacking 'rogue speculators'. The Hong Kong dollar remained at around 7.80 to the US dollar, the official pegged rate - but later Hong Kong officials admitted that, to keep it steady, they spent USD1 billion on one unspecified day in July that year.

Later in that year, the currency crisis deepened in Indonesia, Thailand and Malaysia, and spread to Taiwan, Korea, and even Japan. It also led to stock-market plunges all over the region. It blew into a financial crisis with banks and financial houses in trouble, and then a full-blown economic crisis with stunted or even negative growths recorded, business closures and rising unemployment. Within a year, leaderships of four of the affected countries, namely Thailand, Korea, Indonesia and Japan, were changed. Social unrest and riots took place, the worst of which occurred in Indonesia in May this year which saw hundreds of buildings plundered, scores of people violated and the then President Suharto resigned after more than three decades in power.

Yet, the crisis does not seem coming to an end in the near future. In fact, the indications are that it will get worse, even possibly dragging the whole world economy with it into recession.



1.2 INDICATORS

Broadly, at least at the moment, the world economy is in pretty good shape. For Europe, the Asian contagion is expected to shave only about 0.4% of its overall growth. Meanwhile, the United States is in its seventh year of boom although a slowdown is expected for all of 1998 after recording a strong GDP growth of 5.4% in the first quarter.

However, the scenario for East Asia is still gloomy. Indonesia is in economic ruins. The Central Bureau of Statistics said that 96 millions people or nearly half of the total population - more than the combined population of Philippines and Malaysia - will fall below the poverty line by year-end. Its economy is expected to contract by 13.4% this year and another 2.0% next year, with full recovery maybe as far as five years away. Inflation is high at an expected 65.4%. The mid-1998 exchange rate was around 15,000 rupiah to the US dollar from around rupiah 2,430 a year or so before. The Jakarta Composite index has dropped to was around 450 by mid-1998. Percentage-wise, by the middle of this year, the Indonesian currency has lost 83% of its value against the US dollar, the main stock index was shaved 35%, stock market capitalization has shrunked by a staggering 88% (USD96 billions), unemployment has increased from 14.2% to 16.8%, prime rate has shot to 65% from 18.25% and imports was reduced by 33.4% as compared to about a year before that.

Most of East Asia suffered badly this past one year, maybe not to the extent to that of Indonesia. However, as shown in the Appendix, a lot of wealth was lost and things are currently far from cozy in this region. The region is suddenly much poorer and life there is tougher.

1.3 WHAT CONSTITUTE A CRISIS

Literally, a crisis is a decisive or crucial time, stage or event. In this context, however, a crisis can be said to occur when there are major movements in the important indicators related to the situations and which normally a country was not prepared for.

If it is a currency crisis, then the normal indicator is the sharp change in the exchange rate. For a financial crisis, the indicators can be very high number of unperforming loans, sudden and large drop in stock-market index and capitalization, much tighter liquidity and a hike in interest rates. If it is an economic crisis, then the indicators can be a sharp drop in the economic growth, a sharp increase in the unemployment rate, a sharp increase in the

Consumer Price Index (CPI), a sharp decrease in consumer spending, and possibly a severe decline in the price of assets such as properties.

In the case of the current East Asian economic crisis, most of the above are present. In fact, as mentioned before, the current crisis is a currency crisis, financial crisis and economic crisis all rolled into one. If the situation is not properly managed, the unfortunate situation currently plaguing East Asian region can spiral into a very severe and long recession or even a depression that can even affect the whole world.

1.4 OTHER CRISES

The current crisis faced by the East Asian countries is not the first one in the world. There were other crises before even though most of them are more localized than the current East Asian crisis.

The most recent significant crisis was the Mexican crisis of 1994/1995. It started as currency crisis with the peso devaluated, which was followed quickly by a plunge in the Mexican stock-market. The situation sparked an



economic crisis which was also accompanied by civil unrest and the change in leadership of the country. They managed to come out of the situation with an export-led strategy but only with the help of the United States bailing them out. At the time, Mexico was fortunate that the United States was eager to form the North American Free Trade Area (NAFTA) that would include Mexico to rival the European Community (EC) trading block.

Crises are not confined to third world countries only. It had also occurred in developed economies such as the United Kingdoms' currency crisis of 1992. The 1992 UK currency crisis also illustrated that even a big, developed and mature economies can still be vulnerable to speculative attacks on their currencies. The pound sterling was hard hit then, such that the United Kingdom had to opt out of the common European Community currency system at the time.

Even the largest economy in the world, the United States' economy, is not spared from having crises. One quite recent crisis was the US Savings and Loans debacle. This crisis was very significant for its lesson that even a relatively mild financial crisis can help to initiate and exacerbate a downturn, even to the world largest economy. The 1990/1991 recession in the United States was attributed to this Savings and Loans debacle.



Back to Asia, the bursting of the Japanese bubble economy in the 1990s, after a spectacular performance throughout the 1970s and especially in the 1980s, can also be considered as a crisis. Indeed, with the bursting of the Japanese bubble economy which left a heap of dud loans and many sick banks and companies, and the subsequent failure to address the situation other than painting a rosy front and sweeping the persisting problems under the carpet, it may and possibly is contributing to the worsening of the current East Asian economic crisis. In other words, that particular crisis is now negatively affecting the current East Asian crisis. In fact, only when the East Asian crisis hit, these problems from that lingering crisis facing the Japanese economy (when the bubble burst a few years earlier) are now very exposed all of a sudden.

Even within Southeast Asia, crisis did occurred. Back in 1985-1986, Thai banks were in a crisis. Amazingly, it was not unlike the current crisis. However, the very significant difference is that it was not so severe as the current crisis.

Malaysia had also faced it share of crises. However, these are much smaller and very localized crises. One is the cooperatives crisis which involve giving off suspicious loans which later were not recoverable by the cooperatives. The cooperatives were suddenly found to be very sick and were in dire straits.

Another, and very notorious, crisis was the one involving the Bumiputra Malaysia Finance (BMF) in the 1980s. It involved giving off suspicious and bad overseas loans. In the end, several people were murdered in the scandal, billions of ringgit was lost by the company and the nation, and the parent company, Bank Bumiputra Malaysia Berhad (BBMB), have to be rescued by the national oil company, PETRONAS. The more recent one was the crisis involving the Malaysian central bank, the Bank Negara Malaysia (BNM) in early to mid-1990s. The central bank was involved in a number of high stakes high risks speculative ventures using billions of ringgit of the countries reserves. When those ventures turned sour, these billions of ringgit when down the drain.



CHAPTER TWO

POSSIBLE CAUSES OF THE EAST ASIAN CRISIS

Crisis does not just happen. There are normally causes behind them. These causes can usually be divided into two: the directly observable causes immediate to the symptoms or the effects of the crisis, and the basic causes underlying the crisis, which is essentially the root causes that produce the observable immediate causes.

2.1 DIRECTLY OBSERVABLE / IMMEDIATE CAUSES

The immediate causes of a crisis are easily detected. Anyway, one or more of these immediate and observable causes tend to be the trigger to the crisis.

The economic crisis that currently plaguing the East Asian region started with a currency crisis. It was quickly followed by a stock market crisis, which arguably can be viewed as both an effect and a cause of the currency crisis. A short while later, other systemic effects kicked in, and a financial crisis quickly developed as a result of the currency crisis and the stock market crisis. Then, these so called systemic effects from the currency crisis, stock-market crisis and the financial crisis led to a full blown economic crisis in the region.

2.1.1 The Trigger

The immediate cause that started and opened the floodgate of the currency crisis that contributed this whole mess in East Asia is speculative attacks on the currencies of East Asian countries, beginning with Thailand's baht. On July 2, 1997, the Thailand central bank, the Bank of Thailand, after repeated attacks on the baht, finally cracked and thrown in the towel in its effort to defend the currency as the bank could no longer do so then. As mentioned earlier, it would take about USD 30 billions to defend the currency, or about the entire foreign reserves of Thailand at the time. The Thais decided to float the baht, and wallah, the baht quickly fell in its value as compared to the US dollar.



2.1.2 The Contagion Effect

The devaluation of the baht that July not only affected the competitive position of other economies in East Asia, but also occasioned a closer look, by investors and speculators alike, at the financial situation of these countries. Their collective conclusion was that most of these other countries in East Asia, especially Thailand's ASEAN neighbours, shared many of its structural problems. Thus, for the currency traders, the currencies of these countries were ripe for attacks; while for the investors, it would be wise to take their assets out of these countries. Also, in addition to other similarities, there exist a lot of intra-regional trade among these countries, which means that the situation in one country would naturally affect the other countries too. Thus, the crisis spread rapidly from Thailand to its neighbours and beyond.

2.1.3 The Systemic Effect - A Causal Analysis

Let us take a closer look at the immediate causal factors to the current economic crisis faced by East Asia. As the crisis started in Thailand, its experiences can be used as a reference case where examples can be drawn since the immediate causal factors and the prevailing conditions of Indonesia