

## Don't expect a rerun of the Asian Financial Crisis

Written by Matthew Busch, PhD candidate at Melbourne Law School, University of Melbourne

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Asian currencies [hit a seven year low](#) in November, on Donald Trump's election and the potential for his policies to [spur US inflation](#) and [bond yields](#). Investors who [fanned out across emerging markets](#) in recent years are now bringing their money back to America.

The steep drops, and the seeming [inability of some central banks](#) to do much about it, has led to [worries](#) of a financial [collapse](#) crisis. Some [analysts](#) are even [drawing comparisons](#) to the currency meltdown that preceded the [1997-1998 Asian Financial Crisis](#) (AFC).

The AFC's impacts were dramatic. It [led to the sudden collapse](#) of President Suharto's regime in Indonesia and [triggered](#) the 1998 Russian bond default. Everyday economic life was upended as the five worst hit economies saw unemployment surge, inflation balloon, and investment as a share of GDP [plunge more than 10%](#).

It took five years for GDP per capita to reach parity with pre-AFC levels. Austerity was imposed to pay for large financial sector bailouts, in Indonesia the net cost of rescuing the financial sector [exceeded 40% of GDP](#).

But much has changed since 1997. China's rise means an increasingly multipolar economic order, new regional partnerships are in place, and central bankers and policymakers are less likely to repeat some prior mistakes. Even if a crisis were to materialise, it would look quite different from that of two decades ago.

## What triggered the AFC?

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The AFC began in July 1997, when Thailand gave in to speculators and [devalued the Baht](#) . Many Asian nations had long either pegged or closely tethered their currencies to the US dollar. After the baht, speculators quickly turned on the currencies of Indonesia, Malaysia, and South Korea. To

[fight the attacks](#)

on their exchange rates, central banks had to sell dollars (Thailand) or abruptly raise interest rates (Indonesia), but eventually caved - sometimes after depleting foreign exchange reserves - and allowed their currencies to fall.

The exchange rate declines wreaked havoc by driving up the cost of the money private companies had borrowed from abroad. Many were already struggling, amid an economic slowdown, with large foreign exchange borrowings and [poor investments in overheated sectors like property](#) . Once currencies floated, the companies' flight to the US Dollar put pressure on domestic banks. Financial sectors became rapidly insolvent, triggering state interventions and bailouts.

The use of fixed or managed exchange rate regimes meant central banks assumed the risks of sudden foreign exchange movements. This perceived security further prompted capital inflows and resulted in real exchange rate appreciation and asset bubbles. Hedging, an investment tool limiting the risk of exchange rate changes damaging the price of an asset, was not widespread.

Governance problems and "crony capitalism" exacerbated these issues. The Indonesian central bank governor, for example, was part of cabinet and had little power to resist instructions to pump liquidity into ailing banks. In the end, [US\\$14 billion](#) was pumped into an insolvent banking sector and state auditors later found more than [60% of the funds were misused](#) .

## A lot has changed since the AFC

It was in the reaction to the AFC that a lot of changes were made. In return for cash infusions, these countries committed to IMF supervision and extensive programmes of economic reform and liberalisation. In addition to financial sector restructuring, [the programs](#) also included "structural reforms," such as dismantled barriers to foreign investment and liberalised trade regimes.

From Indonesia, the IMF demanded dismantling of the monopolies and rent-creation schemes at the [heart of the regime](#) ; from South Korea, it demanded [large layoffs](#) and union-busting measures. In both cases a back and forth between leaders and the IMF played out in real time as the currencies continued to fall and financial sector insolvency accelerated.

Many of these countries have also built up huge [foreign exchange reserves](#) over the past decade. Banking supervision has also greatly improved, and countries like Indonesia have created genuinely independent banking supervisory agencies and monetary authorities.

Regional financial integration has also deepened, with initiatives like the Chiang Mai Agreement, a framework adopted by [members of ASEAN](#) as well as China, Japan, and South Korea, for bilateral currency swaps and repurchase agreements.

China also has expanded its role, including a web of [bilateral currency swap agreements](#) with Indonesia, Malaysia, and Thailand. These Chinese renminbi (RMB) swaps are designed to facilitate trade – the RMB is the world's second-largest trade finance currency – but swapped RMB can be converted to USD through offshore RMB trading centres and have been used to provide emergency liquidity to countries facing currency challenges (Pakistan in 2013, Argentina in 2014).

Central banks have reacted to the dollar's sudden strength by announcing currency interventions, discussing rate hikes, and pressuring banks to curb “speculative” trading. China has announced [closer scrutiny of some outbound transactions](#) and Malaysian authorities have asked banks to limit some investments

[used for offshore ringgit hedging](#)

. This has prompted

[fretting among financial analysts](#)

who recall that Malaysia imposed some capital controls - effectively preventing ringgit from being exchanged and transferred out of the country - during the AFC.

## Going forward

This is not to rule out a crisis (although markets may well [reevaluate assumptions about Trumpnomics](#) ), as the end to years of plentiful dollars will have an impact. Debt levels are higher than pre-AFC levels, and foreign currency-denominated emerging market debts have more than doubled in the last ten years.

Instead, global economic polarities are much changed because of China's emergence, weakness in Europe, and isolationism in the US. Any crisis would play out differently than in 1997/98.

Economic managers are far less in thrall to economic orthodoxies as they were in the 1990s to the “ [Washington Consensus](#) ” and are therefore likely to blaze their own trails. The IMF, which remains the global lender of last resort, has also [fine tuned its approach](#) and is far less prescriptive than after the years of heady growth during the 1990s.

Whereas Malaysia during the AFC imposed capital controls and snubbed the IMF, just across the Malacca Strait Indonesia provided free movement of capital, which allowed the mass exit of both foreign and domestic capital. Combined with efforts to provide liquidity to the banks, the absence of capital controls undermined the government's ability to carry out monetary policy. Many countries prudently used some capital controls during the global financial crisis, and as a result, some mild to moderate capital controls are likely.

A final variable is China, which despite its own currency challenges is keen to further the end of the US's sole leadership of the international financial order. The aforementioned currency swaps, though likely insufficient for seeing off a systemic, regional crisis, show its ambitions to position itself as emerging markets' [preferred economic partner](#) .

Efforts like the recent purchase of [US\\$4 billion in assets](#) from Malaysia's disgraced 1MDB further shows an opportunistic approach to emerging geostrategic events. As a result, the likes of the IMF and friends, which dictated large, condition-laden bailouts in return for AFC assistance, are no longer the sole port of call for a beleaguered economy, and any post-crisis order, much shaped by these institutions after the AFC, might end up quite different.

*Matthew Busch does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.*

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