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The Impact of the Financial Crisis on Asia's Economic Growth

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Perspective

The late-2000s international financial crisis reignited interest in asset price bubble research. For some, the experience served as a reminder of how important it is to analyse asset price bubbles in our economy. Others came to the realisation that asset price bubbles are far more important than previously considered. The financial and regulatory factors that encourage "frothy" asset values, which characterise bubbles, have received a lot of attention. While it is unquestionably significant, it is not the only factor that has to be better understood. We also need a deeper knowledge of the whole life-cycle of asset price bubbles, from their beginnings to their development and spread, to their final collapse and the clean-up that follows. Researchers are increasingly realising that bubbles are not one-time, exogenous phenomena. The issue is to take a more comprehensive approach and then incorporate endogenous bubble behaviour into our policy models. Although such conduct is uncommon, it is the result of a variety of preventable issues, including a mix of financial instability, faulty legislative frameworks and bad risk management judgments.

The Asian financial crisis was a huge worldwide financial crisis that began in Asia and then spread to the rest of the globe at the end of the 1990s. The Asian financial crisis of 1997–98 started in Thailand and swiftly extended to neighbouring nations. It started as a currency crisis when Bangkok decoupled the Thai baht from the US dollar, triggering a series of devaluations and large capital outflows. The value of the Indonesian rupiah fell by 80% in the first six months, the Thai baht by more than 50%, the South Korean won by about 50% and the Malaysian ringgit by 45 percent. In the first year of the crisis, capital inflows to the most afflicted economies fell by more than $100 billion. When the Asian financial crisis expanded to the Russian and Brazilian economies, it became a global crisis, both in terms of volume and breadth.

The Asian financial crisis has a wide range of implications. Though the crisis is commonly referred to as a financial or economic crisis, the events of 1997 and 1998 may also be viewed as a governance crisis at all major political levels: national, global and regional. The Asian financial crisis, in particular, exposed the state's inability to execute its historical regulatory tasks, as well as to manage globalisation processes and demands from foreign actors. Although Malaysia's short-term capital controls were relatively effective in stemming the crisis and Prime Minister Mahathir bin Mohamad's ability to resist IMF-style reforms attracted much attention, most states' inability to resist IMF pressures and reforms drew attention to the loss of government control and general erosion of state authority. The most striking scenario was that of Indonesia, where governmental failings aided in the transformation of an economic crisis into a political crisis, leading in the demise of Suharto, who had ruled Indonesian politics for more than 30 years.

The aggregate projection methodology, on which the aforementioned estimates were based, has recognised limitations. Different economic sectors develop or decrease at different rates and employment elasticities fluctuate as well. For example, the elasticity of employment in Indonesian agriculture is quite low (and even negative), but it is very strong in construction, commerce and services. Agriculture, on the other hand, employs more people than construction, trade and services put together. As a result, the fate of the former remains critical for the Indonesian economy. As a result, considering sectoral production growth and employment elasticities to create employment estimates is critical. The lack of solid sectoral production growth predictions is a major impediment to doing so. The current author was unable to locate any similar figures in Indonesia. 11 Credit Lyonnais, on the other hand, provided a series of sectoral estimates, with the overall projection for the Indonesian economy being a 5% decline in 1998. We created an alternate set of sectoral forecasts based on the following assumptions as an alternative to this and in accordance with the within-country projection of zero GDP growth [1-5].

A short-term overshoot of inflation should be considered as part of an optimum monetary policy response, not as a policy blunder, in economies where this tail risk is large. Given other words, in the current policy environment, tight inflation targeting is not optimum. Furthermore, the model's more complex trade-offs could complicate communication for central banks with flexible inflation-targeting regimes, which have previously persuaded the public that medium-term inflation deviations from target, without observable supply or demand shocks, were a yardstick for a central bank's performance.

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