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A Tale of Two Crises

The current global economic downturn that transpired as a result of the subprime crisis in the United States, has brought about worldwide concern of a deepening economic recession. In Asia, it has also conjured memories of the 1997/1998 Asian Financial Crisis, which spawned not just economic insecurity, but also socio-political instability in the region. This edition of NTS Alert thus gives an overview of the causes and impacts of the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis, and what countries are doing to mitigate the effects of 1997/2008.

What Caused the Crises?

Common threads can be drawn from the sources of the 1997 and 2008 financial crises. This is largely due to the inability of states to effectively control a booming economy, imprudent lending and unregulated and risky financial products.

1997 Asian Financial Crisis Revisited

The 1997 Financial Crisis emerged from Thailand. Prior to the crisis, the Thai government focused on liberalizing and opening up the Thai economy to world markets. As a result, in the early 1990s, the Thai economy attracted massive volumes of capital inflow from aboard due to its accommodating economic policies, goal, healthy-looking conditions. The Thai government was also able to maintain a high interest rate, low inflation rate as well as a relatively stable nominal exchange rate In addition to this, stagflation of Japanese economy and the recession in European countries during 1990s diverted many investors' attention to Thailand.

In this edition:

By 1995, Thailand had a net capital inflow of US$ 14.239 billion, more than one hundred percent increase from its net capital inflow three years back.

With such an immense inflow of capital, domestic investment and the Thai banking sector expanded very rapidly. According to International Monetary Fund (IMF) statistics, Thailand's investment rate between 1990- 1996 was the highest in the East Asian region. Stock market prices rose by 175% in aggregate and by 395% in property sector. There also emerged more than 50 banks and non-banks financial institutions. These institutions however, lacked effective supervision by Thailand's central bank – the Bank of Thailand – which therefore allowed the institutions to provide loans more freely. Furthermore, overtime the inflow of foreign capital had for the most part been channeled to finance poorer-quality investments, such as housing. Hence, the lack of government supervision couple with attractive benefits, and the lack of transparency in corporate and fiscal accounting and the provision of financial and economic data, placed Thailand in a vulnerable position vis-à-vis international speculators.

The rosy picture of Thai economic growth was short lived. Under a fixed exchange rate system, it was the government's or central bank's responsibility to conduct policies to inject money into the economy (i.e. exchange-rate changing, exchange-rate switching, and direct control) to

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keep its exchange rate fixed as well as to maintain a fine level of the overall condition of the economy. Thailand, however, soon depleted its foreign currency reserve in attempts to inject money into the economy, which was constantly being taken out by speculative forces. As such, it decided to switch to a flexible exchange rate regime, which consequently depreciated the Thai baht was depreciated by more than 50% by the end of 1997. The Bank of Thailand suspended 58 finance companies and ultimately permanently closed 56 finance companies. This led to the loss of funds for thousands of companies.

2008 Global Financial Crisis

The origins of the current economic downturn can be traced back to the year 2000 when Dr Alan Greenspan, the then Chairman of the US Federal Reserve, lowered interest rates in a bid to accelerate the US economy's rate of growth. Interest rates were brought down to historical lows of 1%, which – similar to the lead up to the 1997 crisis – resulted in an expansion of the US economy and inflation of prices. This also meant an increase in the prices of houses. Banks took this opportunity to offer low interest rates on housing loans, as a means to give away the extra money generated from the expanding economy, and thereby make profits out of these loans. Loans on subprime housing in the US made a significant proportion of these loans.

Banks also became more creative in marketing these loans to the public. For instance, they introduced several schemes such as adjustable rate mortgages, instead of fixed rates (which would vary in relation to market interest rates), interest owning loans (whereby one would only need to pay the interest rate rather than the principle part of the loan for the first few years); and fixed rates followed by adjustable rates. This however had devastating implications later on.

A major factor contributing to the domino effect of the crisis worldwide, would be the process of securitization. In the financial world, this refers to the pooling of assets and offering them as collateral for third party investment. This is done by lending out money and thereby freeing up capital for banks. By doing so, banks are able to reap initial profits from the loans as well diversify their investments, as was the case with Citigroup.

This securitization is also related to the lack of effective government supervision over such financial transactions. Such was the case when investment bankers seek to get around the restriction of buying subprime debt, which is far more risky. This was done via the use of structured investment vehicles (SIVs) an off-balance sheet of entities separate from that of the institutions. This therefore gave investment bankers greater flexibility as to what can be done with the short term debts. Many bankers therefore issued short term debts at low interest rates, to buy back long term debt at higher interest rate. Moreover, institutions would be ranked as to how credit worthy they are. The more credit worthy a financial institution was, the greater leverage it had to issue this short term debts.

These arrangements slowly began to come apart in late 2004, when the US Federal Reserve decided to raise interest rates as it felt the US economy's pace of growth was sufficient. Unfortunately, the increase in interest rates from 1 per cent to 5.25 per cent (till January 2007) brought about a string of adverse consequences.

One immediate implication was the fact that it became much more expensive to borrow money, thereby resulting in less people being able to afford to buy a house. Those that could afford to buy a house could not afford as large a mortgage as they could when rates were low at 1 per cent. This low demand for housing therefore led to a decrease in the value of houses. This had adverse implications on sub prime borrowers who had taken out adjustable rate mortgages as many of them took loans that they could not afford. They were thus trapped in paying for a mortgage that had a greater value than that of the actual

> ***"The trouble is that the newly liberalized banks and near-banks often operate under highly distorted incentives."***
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> *- Jeffery Sachs on loans driven by 'moral hazard' incentives, Quoted in the Financial Times, 30 July 1997*

property. Those who could not pay their loans had their houses foreclosed, at a loss.

This then led to the domino effect worldwide, as these loans were mostly sold off and traded among different financial institutions from around the world. Consequently, a liquidity crisis emerged in which faith in the ability of financial institutions (including the world's leading banks) to loan out money at reasonable rates eroded rapidly. This is problematic for banks, as they rely on large short term loans from one another to cover their short term expenses. Moreover, as no one knows who has been left holding the bag with the subprime debt, the interest rates that are charged on these loans have increased dramatically. Central banks have thus stepped in, in a bid to save these banks by injecting billions of dollars into the financial system to try and keep things from locking up – which, on the surface, echoes what happened in 1997.

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Women's positive role during the financial crisis?

According to a study undertaken by a non-governmental organisation – the International Federation of Business and Professional Women (BPW International) – Thai female executives played a significant role in cushioning the adverse impacts of the 1997 crisis on their companies or organisations. Chochonok Viravan, former president of BPW International, noted that prior to the 1997 financial crisis, two thirds of women-led enterprises in BPW Thailand's survey in 1998 were not tied to foreign denominated loans. As such, their debts were less likely to double when Thai Baht depreciated.

Their response during the crisis is also significant. According to the survey, over 77 per cent of the women-led enterprise refused to lay off workers, 78 per cent refused to introduce salary cut for staffs, and 92 per cent refused to force their staffs to take a vacation leave. About 67 per cent of these enterprises sought alternative markets, 64 per cent froze increases in salaries and roughly 47 per cent of them stalled or cancelled joint ventures or financial investments.

Such decisions could perhaps be best explained by the philosophy of those managing the companies. In the case of Thailand's Kiatnakin Finance –one of the only two finance companies that were allowed to reopen in December 1997 in Thailand – they rode on the philosophy that people are the "heart of businesses" and adopted the approach to "never leave anyone behind". In the case of Toshiba Thailand, the company sought to deal with the 2nd highest expense, which is the inventory, rather than a reduction in salaries.

It therefore remains to be seen whether these successes from the 1997 crisis would be able to replay itself in the current economic downturn.

Source

Viravan, C (22 October 2007), Return on Investment when Women became Top Executives, Presentation during the Women in the World Leading the Millenium Congress, Valencia

The 'Invisible Hand' Strikes Back: Impact of the Crises on Asian states

Unlike the 1997 crisis, which was triggered off in Asia, the current financial crisis (also commonly known as the subprime crisis) originated from the United States, thereby resulting in more extensive ripple effects across the globe. Nonetheless, similarities can be drawn from the two crises in terms of what transpired after the collapse of the respective markets.

Reduced Growth, Increased Unemployment

An immediate effect of the crisis was slower economic growth, coupled with increased unemployment. Countries that were the worst hit by this in the 1997 crisis were Thailand, Indonesia and South Korea. Prior to the crisis, high growth rates in South Korea had generated a strong demand for labour, thereby ensuring an low rate of unemployment of about 2.2 per cent a year. However, once the crisis had set in, the rate of unemployment increased to 6.8 per cent in 1998 and then to 8.4 per cent in early 1999. On average, about 400,000 people were losing their jobs every 3 months, from January 1998 to March 1999. Many of these job losses were concentrated in the manufacturing and construction sectors, with workers in manual production and clerical workers being the hardest hit.

In Thailand, the crisis resulted in an unemployment rate of up to 5.2 per cent in 1998, with 1.2 million workers losing jobs as a result of the crisis. Women accounted for 53 per cent of the lay-offs. Underemployment among women also increased, reaching 13.7 per cent of the labour force in 1998. Real wages – purchasing power – also declined, particularly for women working in urban areas. This threatened these women's sense of economic security and, in turn, increased their vulnerability to taking up jobs that are more risky. However, such a trend is perhaps more evident among the women in blue-collar jobs, as a survey conducted on Thai women in executive positions seem to suggest otherwise (see box on "Women's positive role during the financial crisis?").

In Indonesia, unemployment increased from 4.7 per cent in 1997, to 21 per cent in 1998. Unemployment in the region also meant that migrant workers, who had lost their jobs had to return to their home countries. Indonesia had a substantial labour force working overseas and hence, many migrant workers returned from Malaysia and the Republic of Korea occurred as a result of job contraction in those countries. Reverse migration also occurred internally as seen in the case of Thailand. Unemployment in the cities resulted in a rise in urban to rural migration, thereby placing competitive pressure on available rural jobs. As such, while job losses were concentrated in construction, manufacturing and financial services; farm employment increased.

Slower growth rates have also been experienced in the current economic downturn. According to the International Monetary Fund's (IMF) latest forecast, it notes that "Emerging Asia" comprising China, India, Hong Kong, South Korea, Singapore, Taiwan, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam is projected to slow down from 9.5 percent in 2007 to 7.7 percent this year and 6.5 percent in 2009. However, if big players like China and India are excluded in the equation, then the group's growth would be reduced from 5.9 percent to 4.6 percent to 3.1 percent during the same time span.

China itself has witnessed its growth rate, falling to a single digit for the first time in five years. This is a further indication that the country is being affected by global economic gloom. In addition, the World Bank has cut its economic growth forecast for China to 7.5 percent for the year 2009 — the lowest rate since 1990 — from 9.2 percent.

With other parts of the world experiencing slower growth, there has been a reduction in demand for Asian exports. This, in turn, has led to lower production and higher unemployment amongst various export-oriented industries in Asia. In Indonesia, for instance, the Manpower and Transmigration Ministry has received reports by various companies on their plans to dismiss more than 40,000 workers due to the adverse economic conditions. The Indonesian Rattan Furniture and Craft Producers Association (AMKRI) announced that the industry may lay off up to 35,000 workers in 2009, while the Indonesian Textile Association (API) said its industry had already temporarily laid off 14,000 workers on weak export demands.

Unemployment has also been rampant in the banking sector. Banks which fail to make up for the immense losses of unpaid loans have had to resort to axing a proportion of their staff as a means of trimming costs. Leading banks such as Citigroup have already made 23,000 of its staff redundant in the UK in the past year, and plans to cut a further 14 per cent of its workforce as it struggles to come to terms with more than $20bn of losses over the last year. Citigroup becomes the latest bank to cut jobs after Goldman Sachs, JP Morgan and the Royal Bank of Scotland all launched redundancy programmes.

Asian banks have not been immune to this, as seen in the case of Singapore's DBS Group – Southeast Asia's biggest bank by assets – which is reducing its workforce by 6 percent (900 staff from its Singapore and Hong Kong Offices) to trim costs. According to CIMB-GK Research economist Song Seng Wun, this would show “Singaporeans that what the government has been warning about (job losses) is happening already." This has largely been a result of the crisis concerning Lehman brothers-linked structural products case (which will be discussed in the following section).

Undoing the Progress of Development

Another significant effect of the financial crisis was the rapid inflation of prices. In the 1997 crisis, Indonesia suffered the most in this aspect as its annual rate of inflation, calculated from the consumer price index, rose from an average 8.8 per cent during 1990-1996 to 57.6 per cent in 1998 in Indonesia. In contrast, the increase for South Korea was from 6 per cent to 7.5 per cent, while for Thailand, it was from 5 per cent to 8.1 per cent. In all three countries, wage freezes and wage reductions were implemented by many businesses.

This had major adverse implications on purchasing power and affected standards of living. Moreover, it reversed/ undid many of the countries’ progress in terms of poverty alleviation, health care and education. According to the UN's 1999 Economic and Social Survey of Asia and the Pacific, as many as seven economies in mainland Asia suffered negative growth in 1998 compared to none in 1996 and only one in 1997. Poverty increased dramatically in Indonesia from 11 to 40 per cent, in Thailand from 11 to 15 per cent and in Malaysia from under 7 per cent to 8 per cent. In Thailand estimates of drop outs from education are over 200,000 with about half range at the primary level. In Indonesia overall estimate is 25 per cent. In the case of the current economic downturn, uneven development would also be further exacerbated. For instance, China's less-developed central and western parts are likely to suffer more that its coastal regions. According to Mr Du Ying, Vice Minister of China’s National Development and Reform Commission (NDRC), fledging industrial structures, sharp drops in resource prices and a weaker capability to handle risks and social conflicts have increased western and middle regions' vulnerability.

While these adverse effects may only be visible in the long term, there are three reasons to substantiate Mr Du’s assertion. First, economies in central and western China, which are largely small in scale and resource intensive, would be slow to adapt to the changes brought along by the financial crisis. Second, since many of the manufacturers in those regions depends on exporting raw materials, their business would be adversely affected as the prices of raw materials keep on dropping in the international market. And third, the weaker economies in the central and western regions would not be able to provide enough job opportunities for migrant workers returned from bankrupt manufacturing factories in East China, and then social conflicts will arise. The central and the western regions are China’s major labor exporters

Nevertheless, despite these negative scenarios, the World Bank noted that, in addition to being the fourth-largest economy in the world, China also announced a comprehensive stimulus package, which is discussed later in this article.

Rising discontentment and anger

Social unrest as a result of the financial turmoil in 1997 is best reflected in the case of Indonesia, which ultimately led to the fall of President Suharto. With underlying factors such as President Suharto's authoritarian rule, the dominance of the military in the political sphere, widespread nepotism and corruption, historical resentment against Chinese businessmen (who were seen as 'pariah entrepreneurs'), the economic crisis served to trigger an outpouring of public discontent towards the government's failure to respond effectively to the people's economic and livelihood needs.

As mentioned earlier, high inflation had greatly reduced the real income of the Indonesians. Prices of consumer products doubled, resulting in a frenzy of stockpiling for fear of further price hikes. This was further exacerbated by the high rate of unemployment – not only because jobs from export production companies were slashed, but also because the return of migrant workers also meant greater competition for jobs within Indonesia. The combination of these factors provoked a wave of unrest among the poor, students and the burgeoning middle class, which ultimately led to President Suharto's resignation from his 30-year rule of the Indonesian state.

In juxtaposing the 1997 crisis with the current one, it is shown that rather than simply threatening the security of developing states, the effects of financial instability on developed countries are comparable, if not worse. This is because it is often assumed that developed countries, would be less susceptible to being at risk and therefore less likely to make contingency plans. What has often been disregarded in the equation are the vulnerable sections of society within a developed state. This is clearly reflected in the case of the Lehman Brothers-linked structured products in Singapore and Hong Kong, where a total of 4,700 customers had invested S$360 million the products. Many of the investors of structured products linked to Lehman Brothers are retired senior citizens, who have lodged complaints of mis-selling. Over 80% of investors in Lehman Brothers mini-bonds and Merrill Lynch Jubilee Series 3 linked-earner notes invested $50,000 with 28% having bought $10,000 or less, many of whom who have invested a substantial amount of their savings into the scheme.

Moreover, in a rare display of public discontentment, about 500 of them gathered to voice their frustrations at Speakers' Corner at Hong Lim Park. The Monetary Authority of Singapore has ensured investors that the problem will be resolved on a case-by-case basis, with investors above the age of 55 years taking priority as the 'most vulnerable' group. Several banks have also worked towards compensating some of its affected investors who have bought Lehman-linked structured products. According to Richard Stanley, CEO of the Development Bank of Singapore (DBS), it is estimated that the total customer compensation in Singapore and Hong Kong would range between S$70 and 80 million. Another bank, Hong Leong Finance, has proposed to buy back Lehman Minibond Programme notes from some of its elderly and less well-educated customers. Maybank has also contacted more than 50 per cent of vulnerable investors who have bought Lehman Minibonds, in a bid to help such customers.

In Hong Kong, the fallout has extended to the political stage, with calls for tighter regulation and for a ban on the sale of such complex investment products to retail investors. The Hong Kong Monetary Authority and the Securities Futures Commission have been criticized for failing to monitor financial institutions selling the products. The commission has pledged to investigate assertions of dishonest marketing and to examine whether there had been any systemic weakness in management controls.

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"I made a mistake in presuming that the self-interests of organisations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms," said Greenspan.

Former US Federal Reserve Chairman, Alan Greenspan, testifying on Capitol Hill regarding the global financial crisis. Source: Greenspan- I was wrong about the economy. Sort of, The Guardian (UK), 24 October 2008

Will 2008 be a repeat of 1997?

If the mitigating measures of 2008 were juxtaposed against the measures taken to address the 1997 financial crisis, it is apparent that the International Monetary Fund (IMF) and governments have reacted rapidly to provide liquidity in this ongoing crisis to prevent the meltdown of the global financial markets and a global recession. It is clear that the impact of the financial crisis remains to be seen as economists predict that the full impact will hit only in 2009. Currently, there is a lack of clarity on how deep this current crisis will be and when would we see a recovery. Nevertheless, some developments indicate hope that the 2008 crises would not be as devastating on Asia as that of 1997 namely because of a coordinated and rapid response to the crisis, greater flexibility of IMF financing, and stronger financial systems in Asia.

Rapid and coordinated response

US and Europe

In stark contrast to the slow reaction of governments and the international community in coming to the aid of beleaguered financial systems during the 1997 financial crises, governments in Europe, US, and Asia have been quick to respond to stabilize the financial situation through a blanket guarantee of bank deposits. In Europe, leaders have committed more than two trillion dollars to banks and the financial markets in a largely coordinated move to shore up the plummeting stock markets, with Germany injecting a $65 billion stimulus package.

In the US, apart from the federal bailout package for AIG, the government is in talks with US motor companies Chrysler, Ford and General Motors to work out details of a bailout package for the domestic automobile industry which is facing the threat of closure due to a sharp fall in demand for large vehicles which resulted from rising fuel prices. In addition, out-going President George Bush had convened a summit meeting of the G-20 leaders in Washington on 15 November to discuss the crises and possible changes to the financial architecture; however the meeting was generally inconclusive as President-elect Barack Obama was absent from the meeting.

<u>China</u>

Meanwhile China, the world's fastest-growing economy, announced a stimulus package to boost domestic demand and arrest the rapid slowdown in growth as a result of a slump in China's exports in the wake of the global financial crisis. Four trillion yuan ($586 billion) would be spend on upgrading transportation infrastructure; raising rural incomes via land reform; and pursuing social welfare projects aimed at providing affordable housing and advancing environmental protection. It is worth noting that this stimulus package amounts to nearly 15 percent of annual economic output over barely two years, as compared to China's response to the 1997 crises with a package worth just 1.2 percent of gross domestic product.

According to a senior State Council researcher, Li Jianwei, China's stimulus plans are aimed to guarantee at least 9 percent economic growth over the next two years and China's slowing economy would recover in the middle of next year. In addition, Zhang Xiaojing, a senior economist at the Chinese Academy of Social Sciences, predicts that the stimulus package could have an "immediate effect" on the economy by the end of 2008. Zhang also expected year-on-year economic growth of less than 9 percent in the final quarter of this year and estimated that China's GDP growth would be higher than the IMF's estimate of 8.5 percent in 2009. The impact of the financial crisis of 2008 is also likely to be far more manageable than in 1997 as China's financial situation has improved vastly partly due to the implementation of a proactive fiscal policy between 1998 and 2003 where it issued government bonds worth around 800 billion yuan to enrich state coffers. The country's foreign exchange reserves as of October 2008 stand at US$ 1.9056 trillion, according to the People's Bank of China.

ASEAN Plus Three

Further, at the regional level, the ASEAN Plus Three leaders have agreed to create an 80-billion dollar fund to combat the financial crisis at the Asia Europe Meeting (ASEM) in October after the global financial markets were shaken by news of AIG's bankruptcy. Talks on transforming the Chiang Mai Initiative that was formed in 2000 into a stronger multilateral reserve pooling mechanism had begun in 2006 but the exact details had not been decided until the ASEM when South Korea, China, Japan and the 10 members of ASEAN made a concerted effort to control the spread of the crisis in Asia. The pool of foreign exchange reserves would be created by June 2009 and be accompanied by an independent regional financial market surveillance organization. According to ASEAN Secretary General Surin Pitsuwan, while the fund is meant to enable the defense of the region's currencies, the mandate could also be widened to cover domestic liquidity problems.

The two financial centers of Asia, Singapore and Hong Kong, have also agreed on a coordinated effort to deal with the current global credit crunch. Singapore is drawing up an expansionary budget that promises to stimulate growth and create jobs. In Hong Kong, a high-level economic taskforce chaired by the chief executive is also monitoring the situation closely and coming up with its own set of economic measures. The two will coordinate the lifting of the government guarantee on bank deposits, with the earliest possible date being the end of 2010.

<u>*Flexibility of IMF financing*</u>

The IMF has announced its readiness to lend billions of dollars to support nations hit by the fallout from the global financial turmoil. IMF has reached agreement with Ukraine, Hungary and Iceland on loan deals and is holding talks with Pakistan and Belarus about possible loan programs. Extremely unpopular, IMF loans are often regarded as a last resort as countries are reminded of austere policy conditions and homogeneous reform programs imposed on borrowing countries during the Asian financial crises in 1997. Indonesia, for instance, was forced into bank closures, financial and banking restructuring and poverty levels plunged as many depositors lost their savings. These conditions imposed by IMF had harsh social repercussions and drew intense criticism due to a lack of distributive justice.

Keenly aware of such criticism, IMF Managing Director, Dominique Strauss-Kahn has recently assured that although some policy conditions will be attached to IMF loans, there will be fewer and more targeted conditions than in the past. Strauss-Kahn has told IMF staff that "conditionality has to be defined as what is needed to achieve the goals of the program...it should not attempt to fix the world". In the case of Pakistan, the IMF has acted quickly to ensure the government receives sufficient funds to deal with the immediate balance of payments crisis by approving a loan of 7.6 billion dollars over 23 months. It announced on 25 November that 3.1 billion dollars would be immediately available to Pakistan following full approval by the IMF board while the remainder would be allocated after quarterly reviews. The immediate injection of 3.1 billion dollars would go towards repaying international debts and help encourage other international financial institutions to grant loans to Pakistan. Besides the IMF's usual goal of restoring macroeconomic stability and confidence through a tightening of macroeconomic policies, it also hoped to "ensure social stability and adequate support for the poor and vulnerable in Pakistan."

Stronger financial systems in Asia

The effectiveness of IMF policies cannot be dismissed as the effect of the economic and banking restructuring is clearly visible 11 years after the financial crisis. The reforms, to a large extent, have helped countries such as Indonesia as it has been largely unaffected by the financial turmoil due to financial regulations to prevent over-reliance on 'hot money' and over-borrowing, hence limiting the country's risk exposure. Unlike in 1997, confidence has remained in the financial system and banking sector since the crisis began this year without any real fear of 'bank runs'. Since 1998, companies and banks have reduced leverage on short-term foreign borrowings, from a crisis-high of 33 percent to 8 percent in 2007, and lending is far more cautious. The business investment climate is also at healthier levels compared to before the crisis, in large part due to IMF liberalization and deregulation policies which remained endorsed by the government after Indonesia exited the IMF program.

President Susilo Bambang Yudhoyono said Indonesia's economy has kept on track as shown by continuous economic expansion for the last eight quarters and a significant improvement in debt to GDP ratio. Hence, while an economic slowdown is anticipated in Indonesia, the effects would not be vastly different from that of other export-oriented economies. In order to stave off the impact which is forecasted to hit Indonesian businessmen in the early and middle of 2009 as Indonesian exports decline sharply when the US and European economies go into recession, the government will encourage increased consumption of domestically produced raw materials and goods and reduce dependency on imports, so as to maintain a healthy balance of payments.

Further, since experiencing the Asian Financial Crises in 1997, countries in the Asia-Pacific have build up large protective buffers against the balance-of-payments shocks that had put them under much pressure in the late 1990s. Standard & Poor's Asia-Pacific Chief Economist, Subir Gokarn said that most Asia-Pacific economies will be buffered by healthy foreign exchange reserves in the fourth quarter of 2008. The build-up of reserves in Asia had been debated up until 2007, with many economists warning of potentially adverse consequences for domestic monetary stability. Now, it is evident that these handy reserves have allowed countries to avoid a potential balance-of-payments meltdown even as the flow of capital reversed sharply in the past months, as well as provide governments with the means to finance expansionary budgets in 2009.

Challenges ahead

Although Asia is likely to be better prepared for the financial crisis this time around, governments will still have to deal with the ripple effects from the world's major economies – US and Europe –

and ensure that the vulnerable people such as the poor, elderly and retirees are sufficiently protected by social safety nets, even as focus is placed on minimizing the impact of the global crisis on their domestic economies. In continuation of our analyses on the financial crises, we will follow up with a second edition that takes an in-depth look at the potential impact of the crisis on the vulnerable population in countries in Asia and flag these challenges.

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