Abstract

The 1997 East Asian currency crisis has highlighted the great fragility of the economic systems of the community of East Asian countries, especially on the monetary side. In the case of the ASEAN countries, Malaysia, Indonesia and Thailand were the most significantly affected. In this respect, it is widely assumed that the source of this catastrophic economic episode was, to a large extent, due to the openness of their financial systems. In essence, these countries' financial systems were products of intense financial liberalization and deregulation, which began in the 1970s and accelerated rapidly from the 1980s onwards. Thus the last two decades have witnessed the rapid transition of the financial architecture of these countries which had governed and shaped their monetary systems. Throughout this 20 years, monetary policy had played a pivotal role in shaping the financial developments from the turbulent reccessionary era of the early and mid-1980s to the more recent currency crisis in the later part of the 1990s.

In theory, there are two dimensions to monetary policy, with the difference stemming from the control vehicle from which the policy operates through. Basically, the monetary authorities could affect output by altering the nominal money supply (which will also lead to changes in the interest rates) or alternatively, they could set the interest rates (nominal) directly to affect the economy. In essence, both methods are just as effective provided that the structural features are known with certainty. However, in developing countries like ASEAN, there is uncertainty in money demand and aggregates, given their levels of developments. This is particularly so for the monetary side which has seen significant deregulations in the last two decades. Thus given the fact that these ASEAN countries had undergone various forms of financial

liberalization and economic adjustments, the choice of an interest rate or a monetary targeting regime has been critical. In addition, the liberalization of capital account convertibility while adhering to a managed or pegged exchange rate had also further complicated the avenues for monetary policy, thus at times leaving the burden of demand management to its fiscal counterparts.

In any event, the currency crisis had underlined the potential backlash of maintaining an overly liberal financial system, thus leading to countries like Malaysia reverting to the use of capital controls and a pegged exchange rate (US dollar peg). On the other hand, the intense speculative pressures on the exchange rate meanwhile, forced both Indonesia and Thailand to abandon their previous regime of pegged and managed exchange rate respectively. In both cases, the moves enhanced the avenues of monetary policy and eventually, the economies of all three have made significant recovery. As the economies of these countries continue to evolve under uncertainty in the post-crisis period, both Thailand and Indonesia have embarked on a new type of monetary policy framework, namely inflation targeting.

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