FOREX VIEW: Asian Crises Long Gone But Not Forgotten

1,151 words
2 July 2007
11:12 AM
Dow Jones Capital Markets Report
English

By Robert Flint
A DOW JONES NEWSWIRES COLUMN

NEW YORK (Dow Jones)--Ten years after the beginning of the Asian financial crises, everyone's still pondering whether it can happen again.

The float of the Thai baht on July 2, 1997, is widely considered the start of the Asian crises. No one dreamed at that time that troubles for a regional Asian currency would touch off a chain of events that would severely shake the economies of a string of neighboring countries and send ripples throughout the world.

The contagion that began in Thailand spread to Indonesia, Malaysia, South Korea, the Philippines and to a lesser degree even affected Hong Kong and Singapore. By the end of 1998, the acute phase of the crises had passed, but the effects were felt for several more years.

Ten years down the road, numerous seminars and speeches have been held to analyze the Asian crises. With hindsight, academics and government officials can point to various reasons for the turmoil - financial markets that were inadequately regulated or insufficiently developed; fixed foreign exchange rate regimes; unbalanced industrial structures; substantial short-term external debt; and heavy speculation by international and domestic investors, among others.

Accurately predicting the future, however, is beyond the ability of the very brightest.

"Investors have short memories," said John Burford, vice president and investment portfolio manager with The International Bank of Miami. "Meltdowns and bubbles can be observed but busts cannot be predicted."

The best guess seems to be that while the conditions which led to the Asian crises in the 1997-98 are unlikely to arise again, there's always the possibility that another is just around the corner, waiting for a fresh spark.

"The Asian financial crisis was not an isolated event," said **Usha Haley**, professor of international business and director of the Global Business Center at the University of New Haven, Conn.

"As the global economy is more connected than it has been for most of the last century, and financial regulations are often lax, unenforceable or changing in so many key spots, it's likely that a similar contagion will hit us sometime in the future," said Haley, author of the book, "Asian Post-Crisis Management".

Flight To Liquidity Crowds Exits

One major factor in the string of crises 10 years ago was the "flight to liquidity," said Walter Gerasimowicz, chairman and chief executive of New York-based Meditron Asset Management. He previously served as director of advisory services and chief investment strategist for high net worth investors in Lehman's Private Client Services Division.

When an event, such as the float of the Thai baht, touches off a panic, investors stampede for the exit doors all at once, Gerasimowicz explained. This "raises the price of liquidity," which tends to spread the contagion further afield as investors seek to escape to safer assets. In such circumstances, "there is potential for herd mentality," he noted.

That's a basic scenario which could rise again, although with entirely different factors igniting the rush, according to Gerasimowicz.

Some characteristics of the 1997-98 episode bore characteristics common to all crises, others were unique, said Raj Aggarwal, Dean of the College of Business Administration at the University of Akron, Ohio. In total, it was "not a one-off thing," he said.

So where does that leave investors?

It hasn't soured them on Asia. Ten years after the start of the crises, the countries affected have recovered, according to recent research from U.K. lender Halifax. Southeast Asian economies, on average, have a gross domestic product level that exceeds pre-crises levels by more than 50%, but have not fully recaptured the economic growth rates seen prior to the 1997 crises.

"By contrast, stock markets have seen better returns over the past five years than in the five years before the crisis," the Halifax note said. Southeast Asian equity markets have on average "seen a 124% rise in stock prices in the past five years compared with a 54% increase in the pre-crisis period."

Asian Currencies Still Under 1997 Levels

The same is true on the currency front. During the crises, many regional currencies depreciated sharply as investors liquidated their holdings in the region, falling by an average of 33% between June 1997 and June 1999, said Halifax. In the past five years, these currencies have appreciated an average of 20%, but are still, on average, 30% under pre-crises levels, said Halifax.

Ironically, the Thai government imposed capital controls in December 2006 to curb inflows that were driving up the value of the baht. With hot money pouring into the country, the baht had reached levels not seen for about nine years.

The currency was becoming too strong for the country's exporters and tourist industry and the Thai central bank responded with capital controls. That in turn caused a plunge of roughly 15% in Thai equity prices and wiped out $22 billion in market capitalization. That led the central bank to rescind most of the earlier-imposed controls.

It also reminded investors that while the waters in Asian financial markets are much smoother than before, they haven't calmed entirely. Undeniably, the crises heightened awareness of fundamental imbalances, which is indeed a good thing.

"The crisis did teach the Asian economies of Thailand, the Philippines, Indonesia, and South Korea especially, that pegging the exchange rate, then borrowing internationally, repaying in major currencies, and allowing the money supply to grow too fast, will not always produce positive results," said Joseph Greco, director of the Center for the Study of Emerging Markets at California State University at Fullerton.

A duplicate set of circumstances that led to the 1997-98 crisis isn't likely to occur again, but the return of massive inflows of capital are bringing new and different problems in their wake, as evidenced by Thailand's woes centering on the appreciating baht.

One factor that's become more evident is China's move to the forefront among Asian economic powers. The heavy controls the government of the People's Republic places on its currency and capital flows have to a large degree so far insulated China from the world and vice versa.

But as China opens increasingly to both the upside and downside of global markets, that protective barrier will fade. The recent worldwide reaction to booms and plunges in Chinese equity prices is clear proof of international awareness of fluctuations in China's markets.

The next bout of Asian flu could be touched off by investors sneezing in Shanghai.

(Robert Flint, a news editor in the money group, has covered currency markets for Dow Jones Newswires for the past eight years and was previously Beijing bureau chief and chief correspondent in Scandinavia.)

-Robert Flint; Dow Jones Newswires; 201-938-4408; robert.flint@dowjones.com

[07-02-07 1212ET]

1141

Document CM00000020070702e3720005m

