Asian slump continues to deepen

Nick Beams
4 August 1998

The International Monetary Fund and the South Korean government have revised the estimate for the Korean growth rate to minus 4 percent from the figure of minus 1 percent agreed to only last May. The decision underscores the accelerating slide of the Asian economies into recession.

The latest statistics on the Korean economy show that industrial output declined 13.3 percent in June, compared to a 10.9 percent decline in May. Car production fell by 45 percent and machinery output declined 35 percent on a year on year basis. Wholesale and retail sales were down 15 percent, local machinery orders 44 percent and construction orders 46 percent. Korean banks posted losses in the first quarter amounting to one-third of their capital.

In a bid to ease the effect of the credit squeeze imposed as part of the 'restructuring' package, the IMF agreed to a lowering of interest rates and to an expansion of the budget deficit from 1.75 percent of gross domestic product to 4 percent.

But the latest measures are expected to have only a marginal impact on the Korean economy. As far as the Asian region as a whole is concerned the situation is going from bad to worse. According to estimates by the international merchant banking firm Dresdner Kleinwort Benson, the economy in Indonesia will contract by 20 percent, 11.6 percent in Thailand and 7.5 percent in South Korea this year and by 15 percent, 7 percent and 10.5 percent respectively next year.

The Malaysian government, which faces a contraction in the economy of 5 percent this year, has indicated that it expects the situation to worsen in the coming period by announcing that it will hold early elections. Mohamed Rahmat, the secretary general of the ruling National Front coalition, said the decision had been made in this 'economically difficult time' in order that the coalition could retain power in the face of 'increasingly serious external threats.'

When the crisis first erupted, the IMF predicted that the contraction would assume a V shape - a sharp downturn followed a rapid recovery. Such forecasts have been rapidly refuted. In the words of a recent report in the *International Herald Tribune*: 'More than a year after Asia's financial crisis knocked Thailand's currency into free-fall and then flattened the region's economies one by one, there is no sign of bottom to the downturn, many economists and analysts now say. While Asian economies had been widely expected to begin recovering this year, economic problems in much of Asia now seem likely to continue deepening, they say.'

In his semi-annual report to the US Congress last month, Federal Reserve chairman Alan Greenspan acknowledged that the Asian economies were still weakening with no indication of when they would begin to recover. But according to former US financial official Robert Hormats, now the deputy chairman of Goldman, Sachs International, the situation is far more serious than Greenspan indicated.

'In my view Mr Greenspan put it pretty mildly. I think things are going to get considerably worse before they improve. Everywhere in Asia growth projections are being downgraded, unemployment is rising, bankruptcies are increasing and the number of non-performing loans is rising. Virtually every major economy in Asia is experiencing falling growth, recession or depression.'

The chief Asia economist for Deutsche Bank, Kenneth Courtis, has warned that the Japanese economy is contracting at a rate of 4 to 5 percent and could only return to modest growth by the end of next year. Pointing to the wider implications he said that 'one should not underestimate the degree to which Japan's credit squeeze is asphyxiating the rest of Asia since this has now become a regional credit squeeze.'

The economic relationship between Japan and Southeast Asia is assuming the character of a vicious circle. On the one hand, the debt crisis and slump in Japan is pushing the Southeast Asian economies deeper into recession, while on the other the Asian slump is worsening the crisis of the Japanese banking system and the economy as a whole.

Japan has been one of the most important markets for Southeast exports - accounting for 17 percent of exports from the so-called Asia-5 countries (Indonesia, Korea, Thailand, Malaysia and the Philippines) and China. Exports to Japan represent 12 percent of the GDP of Malaysia and between 4 and 7 percent of the GDP of Indonesia, Thailand and South Korea.

According to IMF estimates, which have consistently underestimated the extent of the slump, the downturn in Japanese domestic demand and the fall in the value of the yen against the dollar could lower the GDP of the Asia-5 countries by almost 1 percent in 1998, while the Asian crisis is estimated to lower Japanese GDP by between 1 and 1.25 percent in 1998.

Last month the unemployment rate in Japan reached a new post-war high, increasing from 4.1 to 4.3 percent as another 710,000 workers lost their jobs. According to official figures almost 3 million are now out of work but the real jobless level is estimated to be twice or even three times that amount.

Even more significant than the statistics is the acknowledgement by government ministers and officials that they have no answers to the mounting economic problems.

The incoming Finance Minister Kiichi Miyazawa warned last week that Japan faced an 'unprecedented crisis' because the economy was no longer responding to conventional stimulus measures. His remarks were echoed by the new head of the Economic Planning Agency Taichi Sakaiya who said it would be impossible to reach the economic growth target of 1.9 percent for this financial year. Sakaiya said he had more worry than hope for the future. While there would be positive effects from the 16 trillion yen stimulus package announced last April, 'the situation is really severe and I cannot be optimistic.'

The various stimulus packages have failed because of the indebtedness of the banking system, which has resulted in the imposition of a credit squeeze across the entire economy. The official level of bank indebtedness is $550 billion, but the real figure may be much worse.

According to reports published last week in the *New York Times* and elsewhere, US officials and financial exports from private institutions estimate that the level of bad debt in the Japanese banking system may be as much as $1 trillion - almost double the official estimate.

According to the *New York Times*: 'The $1 trillion figure is being floated around during meetings at the White House, the Treasury and the Federal Reserve, and appears [to be] based on new estimates from Japan, unofficial estimates from investment bankers on both sides of the Pacific and anecdotal evidence of how Japanese banks have been performing sleight-of-hand to avoid a true accounting.

'For example, some banks are reported to be quietly lending even more money to apparently insolvent companies that have been long-time customers. The companies, in turn, are using the new loans to pay back interest on overdue loans that would otherwise be in default. As a result, the banks are able to report to authorities that their loans are being repaid - even though the new loans they are providing only deepen the problem.'

The major capitalist powers, in particular the United States, are demanding that the Japanese government undertake a 'restructuring' of the banking system by writing off the bad debts and selling off the overvalued assets they have been used to finance. But the Japanese government and financial institutions are resisting these demands because they would lead to the crippling of the Japanese economy.

Late last year when a major insolvent bank in Hokkaido was closed it set off panic withdrawals from the banking system, followed by a recession in the local economy. Even if the government were to agree to the 'restructuring' demands, the scope of the problem may prove too large. It is estimated that at least $500 billion in government funds would be needed to rescue the banks - that is more than 12 percent of GDP.

And added to the cost of the bank bailout is the crisis in the life insurance industry where bad loans of several hundred millions of dollars have been used to purchase now highly overvalued property and real estate.

See Also:
Obuchi's difficulties prompt share plunge
Political instability in Japan
[29 July 1998]
Officials discuss global economic crisis
Not a 'new economic paradigm' but old disorders
[14 July 1998]
Japan's banking crisis: the global implications
[24 June 1998]
A Marxist analysis of the Asian meltdown [50k PDF]
To read this file the free Acrobat Reader software is required