Economic instability dominates South East Asia

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While recent large falls in Asian stock markets have been attributed to rising oil prices and declines on Wall Street, some analysts are pointing to more fundamental problems that could see a repeat of the Asian financial crisis of 1997-98.

A recent article in the *Australian Financial Review*, for example, questioned optimistic predictions for economic growth by the World Bank and the Asia Development Bank and warned that the Asian economic "recovery" remains very fragile.

"In circumstances eerily similar to those played out in mid-1997," it said, "South East Asia is once again emerging as the weak link in the region's economic chain."

It noted that while the latest gross domestic product (GDP) figures from Thailand showed that the economy grew at an annual rate of 6.6 percent in the second quarter, domestic demand had "well and truly turned south."

The Thai government recently dropped its forecast growth for 2000 from 5.1 percent to 4.1 percent, the third such downward revision since the beginning of the year.

In a further indication of economic problems, the Thai composite stock exchange index has fallen by more than 40 percent since the start of the year. According to the Deutsche Bank's chief economist for Asia, Michael Spencer, most of the growth in Thailand appears to be coming from government spending and exports, neither of which is sustainable.

Thailand is not the only economy with problems. Spencer pointed out that in the Philippines the government is confronted with a blowout in its fiscal deficit, with the International Monetary Fund threatening not to release the final installment of a $314 million from a loan of $1.4 billion.

"For those who were on hand to see the Philippine debacle of 1999, the situation is beginning to evoke an eerie sense of déjà vu," he said.

The Philippines budget deficit surged to 69.78 billion pesos in the January-August period, with predictions that it will reach 80-100 billion pesos, way beyond the government's official full year target of 62.50 billion pesos.

Attacking the government's inaction, the head of Asia Pacific research at Rabobank, Andrew Fung, spelt out the implications for the Philippines financial markets if the deficit is not cut.

"The market expects that the government will be trying to rein in the deficit as we go through the remainder of the year. But we hear nothing from the government in terms of policy reforms or policy initiatives, whether on the revenue side or spending side. In the absence of any news like that, the market will continue to be very bearish on its assets."

Thailand and the Philippines have been both hard hit by rising oil prices. They import the bulk of their oil requirements and their currencies are weak in relation to the US dollar, the currency in which oil prices are set.

Salomon Smith Barney's head of country research in the Philippines, Edgardo del Rosario, commented: "The prospect of rising international crude prices does not bode well for emerging markets like the Philippines. The Philippines imports nearly all of its crude oil requirements, which in turn account for 47 percent of the country's energy mix. The Philippines thus runs the risk of increasing inflationary pressure, as well as worsening balance of payments."

According to calculations by Chase Manhattan Bank's Hong Kong-based economist Joan Zhang, a $10 increase in the price of crude will reduce Thailand's trade balance by around $2.4 billion. While inflationary pressures remained benign, the expected decline in the trade balance could add to the downward pressure on the currency at a time when capital outflows continue to be high.

According to Nomura Asia, there has been an investment outflow from Asia of $1.3 billion so far this year, with US investors alone withdrawing as much as $80 million in a single week.

The World Bank's half-yearly report on East Asia, released earlier this month, declared that the Asian economic crisis was over. But it did point to factors that could trigger a slump, including a slowdown in the US economy and continuing stagnation in Japan. Many countries, it declared, "are still suffering from a triple legacy of heavy debt, skittish investors and greater household insecurity."

"If demand should suddenly collapse, companies that can now pay their debt and are beginning to invest could quickly go under," the report warned.

Besides Thailand and the Philippines, there are concerns over the South Korean and Indonesian economies. The South Korean stock market has fallen by 45 percent this year, pushed down by fears that the massive debts in both countries are a source of financial instability.

Earlier this month the South Korean stock market plummeted by eight percent in one day following the announcement by Ford that it would not purchase the debt-burdened Daewoo Motor Company.

Ford became convinced Daewoo was not worth the $6.8 billion sale price after a close examination of its books. The South Korean government is now looking to General Motors as a buyer with predictions that Daewoo could go at a "firesale" price.

The Korean stock market index, the Kospi, hit an 18-month low after Ford's decision. But it seems that the collapse of the deal was not the only factor at work.

A banking analyst at ABN Amro, Scott Seo, pointed out that Daewoo's return to the auction block had come at a bad time for the economy. "Patchy corporate governance and slowing reform are scaring off foreign investors. Bankruptcies are anticipated among second-tier chaebols in a few months as their bonds mature. Investors are worried about a doomsday scenario."

The collapse of the Ford-Daewoo deal was described by Jim Simpson of Platinum Asset Management as a symptom of Korea's mounting economic problems.

"That's a headline deal which didn't go through," he said, " but sentiment was head down before this. There's been no real hard restructuring as a result of the Asian crisis. It's been papered over. The currencies have been falling against the US dollar and oil is denominated in US dollars and Korea is at the cutting edge of that because its heavily indebted."

The South Korean government has announced it will inject a further $45 billion into the ailing banking sector to stave off a financial crisis, taking the total cost of publicly-funded bailouts to $130 billion since late 1997.

In Indonesia, continued political turmoil is fuelling financial instability, with the stock market index at a 17-month low. As one investment banker remarked to the *Financial Times*: "We either like stable democracies or stable dictatorships. It's uncertainty we don't like."

In an article entitled "Indonesia slips further off investment map" the *Financial Times* noted that it was a truism in financial circles that Indonesia was being judged "purely on political risk and market psychology."

If international aid is withdrawn as a consequence of the government's failure to disarm militia groups in West Timor investor confidence will decline still further.

Although Indonesia, as a member of the OPEC cartel, has benefited from higher oil prices, the government is set to raise domestic fuel prices by 12 percent next month to meet conditions set down by the IMF for loans. Plans to lift prices earlier this year were postponed after a wave of protests.

Contrary to the claims of "recovery" all the indications are that the South East Asian economies, burdened with debt and under constant pressure for corporate and financial restructuring, amid stock market and currency turmoil, face a deepening economic and political crisis.