Asian economies hit by US financial crisis and slowdown

Our reporters
20 March 2008

The dramatic reaction of stock markets across Asia on March 17 to the collapse to the Wall Street investment bank Bear Sterns demonstrated once again that no part of the global economy is immune from the financial turmoil that is wracking the US. Nervousness about the fallout from the escalating credit and liquidity crisis is being compounded by concerns about the impact of the US sliding into recession, particularly on China.

Japan's Nikkei 225 index dropped 3.7 percent on Monday, its third successive day of losses. The Hong Kong market fell 5.2 percent, Shanghai 3.6 percent, Mumbai 6.03 percent, Manila 3.9 percent and Jakarta 3 percent. Australian stocks dropped 2.3 percent and share values in South Korea, Taiwan and Singapore dropped a little under 2 percent.

Although the 1.38 percent fall in stock values in Thailand was smaller by comparison to other Asia exchanges, Stock Exchange of Thailand Research Institute director Kobsak Pootrakul said the sell-off was larger than during the 1997 Asian economic crisis.

"Investors are dumping their shares in the stock market, and the amounts are much larger than the deposit runs Thailand saw in 1997," he said. "The Fed has never acted like this since the 1930s or since World War II ... and we don't really know what the effect will be on the global economy."

The air of panic was echoed by South Korea's President Lee Myung Bak, who told the local media on Monday: "We are only at the beginning stages of a crisis. It's totally impossible to forecast the world economy. I think, maybe, a world economic crisis is just beginning." Lee won the presidential election last year with a grandiose "747" plan to revive the economy—7 percent annual growth, per capita income of $40,000 and South Korea as the world's 7th largest economy. The promises are now in tatters.

With the exception of Indonesia, Sri Lanka and Vietnam, markets across the region recovered somewhat on Wednesday, after the US Federal Reserve reduced interest rates by 0.75 percent, its largest cut in more than 15 years. But share values across the region have dropped sharply since the beginning of the year. The MSCI Asia Pacific Index, which covers 15 Asian countries, is still down 14 percent this year and is heading for its worst quarter since the three months through September 2001.

Share values in three large Asian economies—China, Japan and India—have plummetted by about 30 percent, 20 percent and 30 percent respectively this year. These falls outpace the decline in US shares, with the S&P 500 Index falling 13 percent since January 1.

One Tokyo trader told the *Los Angeles Times* on Tues hadn't seen such turmoil in Japan's markets since the 1997 Asian financial crisis, while a Japanese economist, Atsuo Mihara, said: "Japanese investors have completely lost confidence; they're more like jellyfish, just floating around."

Whatever the immediate ups and downs of the stock markets, the volatility highlights more fundamental problems threatening economies across the region.

All eyes are on China, which since the 1997-98 Asian financial crisis has been the main regional motor for economic growth, providing markets for raw materials, parts and, in the case of Japan, capital goods. Some commentators have speculated that China, and, to a lesser extent, India, will not be affected by the US crisis and could even pull the world economy out of recession.

This is not the official view. Premier Wen Jiabao said on Tuesday that China was "deeply worried" about the state of the US and global economies, and the continuing weakness of the US dollar. "Global economic developments cannot but have an impact on China," he warned. "2008 might be the most difficult year for China's economy, because there are uncertainties both inside and outside the country."

Wen said it was "particularly noteworthy" that China's currency had been appreciating more rapidly in recent months. "What concerns me now is the continuous depreciation of the US dollar and when the dollar will hit bottom," he commented. Any slowdown of exports to the US would impact on China's economic growth, leading to rising unemployment and social instability. Wen explained that China needed to create 10 million jobs a year for the next five years.

Like other countries throughout the region, China is being hit by soaring prices for oil, food and other commodities. Inflation in China is officially at 8.7 percent, an 11-year high and almost double Beijing's official target of 4.4 percent. As well as squeezing Chinese manufacturers, rising commodity prices are fuelling popular discontent and unrest. The price of rice—the staple food for much of Asia—hit a 34-year high on March 19 at $US708 a tonne, up almost 50 percent since January.

Sharp falls in China's financial stocks on Monday reflect concerns about underlying weaknesses in the country's financial system. In Hong Kong, the Industrial & Commercial Bank of China, the world's largest bank by market value, fell 5.5 percent and the Bank of China, the nation's third largest, dropped 4.5 percent.

China faces the prospect of a slowdown in exports not only to the US but also Europe and Japan. The European Central Bank recently projected growth across Europe of just 1.7 percent, but even this figure may be optimistic.

Some commentators argue that Japan is already in recession—an estimate that was reinforced by the biggest fall in five years in corporate capital spending for the last quarter of 2007.

On Monday, shares in Japanese manufacturing corporations dropped sharply. Toyota and Honda, for example, lost 5.1 percent and 4.1 percent respectively, while electronics companies Sony and Canon dropped 5.7 percent and 4.3 percent. Exporters are deeply concerned about the rising value of the yen against the US dollar. Last week, the currency slid past the 100 yen to the dollar, for the first time in 12 years and slumped to Y96 on Tuesday before recovering yesterday. Some commentators predict that the exchange rate could hit 80 yen in the next year. Sony has admitted that it loses $62 million in operating profits for every 1 yen rise against the dollar.

The share market reaction on Monday also pointed to deeper concerns about the Japanese banking system. The Topix Banks Index dropped 4 percent to 226.88, the lowest in four years. Among the victims was the Tokyo-based Shinsei Bank, which fell by 11 percent, Mitsubishi UFJ, the country's largest bank, which dropped 4.6 percent and the Sumitomo Mitsui Financial Group, the second-largest bank by market value, which dropped by 3.4 percent.

The Shinsei Bank admitted last week that it had a $US318 million exposure to the US subprime crisis and expected an extra $100 million loss in American mortgage-related markdowns in the last quarter of 2008. A bank spokesman told the local media on Monday, however, that these losses could be revised down "if the situation changes."

Indian shares were heavily affected by the sell-off on Monday. Financial stocks fell sharply, with the ICICI Bank losing 10 percent and the State Bank of India, the nation's largest, dropping 5.6 percent.

Much of the steep rise in Indian shares last year can be attributed to speculative capital seeking higher rates of return. Overseas investors bought $17.2 billion more of local shares than they sold last year, before dumping a net $3.4 billion this year, according to data provided by the Securities & Exchange Board of India show. In the past seven sessions, overseas funds sold $691 million of Indian stocks.

India is also being hit by inflation. Finance Minister P. Chidambaram admitted it was not an easy task to achieve control over inflation. During recent discussions on the budget in the Rajya Sabha (the Indian parliament's upper house), Chidambaram said prices of wheat, aluminium, steel and other items had gone up sharply. As a result, investors were taking less interest in stocks and finding safer investment in gold, minerals and oil.

While the rupee has been falling against the US dollar this year, there are concerns that this trend is changing. India's junior trade minister, Jairam Ramesh, warned this week that Asia's third-largest economy stood to lose as many as two million jobs as a rising rupee hurt exports. "In certain sectors like textiles, leather, marine products and handicrafts, there is a net decline in exports which has led to job losses," he said.

On Monday, Australia's S&P/ASX 200 Finance Index fell 4.4 percent, with Babcock & Brown, the country's second-largest investment bank, plummeting by 10 percent. National Australia Bank fell 2.9 percent, the Commonwealth Bank of Australia, the largest mortgage provider, lost 6.1 percent and Macquarie Group, the biggest investment bank, dropped 6.3 percent.

Australian treasurer Wayne Swan met with Australian Securities and Investments Commission chairman Tony D'Aloisio and Australian Prudential Regulatory Authority chairman John Laker on Monday to discuss the impact of increasing market turmoil on the Australian economy.

He admitted in parliament Tuesday that Australia was exposed to the problems crippling international financial markets and "further instances of market turbulence cannot be ruled out". Swan said the government was monitoring whether Australian banks had "adequate plans" in place to cope.

Morgan Stanley's Gerard Minck told the Australian Broadcasting Corporation's "Lateline" program the worst of the financial turmoil was "still ahead". He rejected claims that Australia had been able to "decouple" itself from the US economy. Proponents of "decoupling" theorise that Australia, China, Japan and other economies have developed to such an extent that they no longer depend on the US market for growth.

"No economy in the world is decoupled," Minck said, and warned that declining mineral exports to Chinese and Japanese would rapidly impact on Australian jobs and produce a collapse of the local housing market. He predicted a 50 percent fall in some housing prices. Last week, Australian consumer confidence experienced its sharpest fall in 50 years, plunging to the lowest level in almost 15 years after the Reserve Bank of Australia raised interest rates to a 12-year high of 7.25 percent, the fourth increase since August.

The fallout from the Bear Sterns collapse confirms the global character of the crisis that is centred in the US and points to deepening problems ahead for all the major economies in Asia.