Asian stocks tumble after rejection of US bailout package

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All major share markets across Asia tumbled badly on Tuesday after the US House of Representatives rejected the Bush administration's $US700 billion rescue package for Wall Street. Japan's Nikkei lost 5 percent, Taiwan's main index dropped 6.7 percent and Hong Kong by 6.1 percent. There was a small rebound on Asian markets on Wednesday as investors nervously watched the ongoing debate in Washington over the bailout.

Both South Korea and Taiwan have imposed emergency measures to ban short selling--a means of profiting on falling stocks. The authorities fear such trading will drag the markets down even further. The Bank of Japan (BoJ) injected 3,000 billion yen ($28.8 billion) on Tuesday, but the move did little to ease the country's tight credit market. In total, the BoJ spent 19 trillion yen last month trying to prop up the financial system.

Major Asian banks were particularly hit hard on Tuesday. Although China's share markets were closed for the country's week-long national day holiday, the state-owned Industrial & Commercial Bank of China, the world's largest bank by capitalisation, lost 8.7 percent in Hong Kong-with a small rebound of 1.6 percent when the market closed. HSBC fell 7.7 percent on the Hong Kong market. China's leading insurer, Ping An, was hit badly by the crisis of the European bank Fortis, in which Ping An is the largest shareholder.

Japan's banking behemoth, Mitsubishi UFJ Financial, which bought a 20 percent stake in Morgan Stanley on Monday, closed 4.7 percent down. The value of its Morgan Stanley holdings had shrunk by $500 million in just one day. Nomura Holding, Japan's largest broker, which has bought the Asian operations of the failed Lehman Brothers, fell 7.3 percent.

Major Japanese electronic corporations--Sony, Canon and Nintendo--dropped by 7.1 percent, 6.1 percent and 4 percent respectively. Exporters were also hit by the rise of the yen against the US dollar. For first time in 26 years, Japan recorded a monthly trade deficit in August, with exports to the US dropping 21.8 percent compared to a year ago.

More signs of recession are emerging in Japan. Industrial production dropped 6.9 percent in August on an annualised basis-the largest fall since January 2001--and the unemployment rate rose to 4.2 percent. Consumer spending fell 4 percent, in the face of rising inflation. Toyota's share price fell 4.6 percent on Tuesday following a scaling back of its production in China amid a slowing in the Chinese auto market, the world's second largest.

In India, shares in ICIC Bank, the country's second largest, tumbled by 7.2 percent amid rumours about its shaky financial position. The share price recovered only after the Reserve Bank of India guaranteed the ICIC's deposits. Although Indian officials tried to reassure investors that the main Sensex share index in Mumbai will not go below the 12,595 mark reached on Tuesday, most analysts expect the index to drop below 11,000 in October.

Indian Prime Minister Manmohan Singh expressed fears of a global recession, saying: "If the financial crisis starts a recession in the main economies, that would compromise our exports." The US accounts for one third of India's exports, or $158 billion last year. Any downturn in the American and European economies will impact heavily on the fast growing Indian economy.

Commentators in Asia are generally pessimistic. Kim Hak-joo, an analyst with Samsung Securities, told South Korea's *Chosun Ilbo* on Wednesday: "For now, the US financial crisis seems to have stabilised, but we anticipate a ‘second shock', which entails a serious contraction in consumer spending because people have spent so much in the past." He noted that South Korean consumers had become heavily dependent on credit cards and cheap loans in recent years.

While most Asian banks claimed to have limited exposure to subprime assets, the drying up of inter-bank lending and business loans is a major problem for the entire regional economy. South Korean banks have loan-to-deposit ratios of more than 100 percent, among the highest in Asia, making them vulnerable to the credit crunch. South Korean manufacturers, which depend on dollar-denominated imports, are being hit by a declining national currency-with the won down by 29 percent against the dollar from a year ago.

The Hong Kong Monetary Authority (HKMA) had to step in to assure the public that Hong Kong banks were healthy, even as it warned of an approaching financial "typhoon". The lack of confidence was demonstrated last week, when hundreds of depositors queued outside Bank of East Asia branches to withdraw money, following an Internet rumour that the bank was holding debts of the collapsed Lehman Brothers. Small investors in Hong Kong, who lost money in Lehman Brothers, have staged protests demanding financial assistance.

Balance of financial terror

The whole region relies heavily on exports to American and European markets, making the Asian economies particularly vulnerable to the global financial turmoil. The central banks of China, Japan, Hong Kong and South Korea have used their huge foreign currency reserves accrued from exports to invest massively in US Treasury bonds and other government securities. The investments keep their currencies from rising against the US dollar, help underwrite the huge US trade deficit and thus enable the continued purchase of Asian exports.

About one fifth of US federal debts are held by China (more than $1 trillion) and Japan ($860 billion). Both countries have incurred huge losses through the weakening of the US dollar. In response to the turmoil on Wall Street, questions have been raised in Beijing and Tokyo about whether to stop buying, or even to dump, dollar-based assets--a move that would have a devastating impact on the US financial system.

According to the *Wall Street Journal* on September 29, a major reason for the bailout of the two mortgage giants, Fannie Mae and Freddie Mac, was "to assure China, which holds roughly $1 trillion in US debt, that US securities were safe". The newspaper pointed out that the $700 billion bailout would largely hinge on the continued willingness of banks in Asia and the Middle East to hold the US debts.

Former US Treasury Secretary Lawrence Summers once described the present relationship between the US and its creditors as a "balance of financial terror". China, Japan and other countries hold so much US debt that any pullout that undermined the dollar would result in huge losses on the remaining holdings. However, if confidence in the dollar began to decline, it could create a rush for the exit as everyone tried to minimise their losses, precipitating a crash of the US dollar.

At present, Beijing has decided it has too much at stake to abandon its dollar assets, as a collapse of the US and global financial system would have explosive implications for China. At the World Economic Forum in Tianjin last weekend, attended by 2,000 global CEOs, officials and economists, Chinese officials called for "international cooperation" to help the US.

Guo Shuqing, the chairman of China Construction Bank, told the conference: "What is good for the US is good for every country, including China." William Rhodes, the vice chairman of Citigroup, told reporters that Chinese financial officials were in discussion with the US Federal Reserve Board on possible measures to alleviate the crisis in Wall Street.

China's economy is slowing due to a sharp decline in exports to the US, European Union and Japan, which account for roughly half of Chinese exports. Tens of thousands of export firms have reportedly closed down. As exports slow, two other economic pillars, the property market and the auto market, are weakening. In turn, these factors have led to declines in steel and coal output, and therefore a declining demand for commodities. Despite cutting interest rates and lending rates, as well as stimulus packages and infrastructure building, many economists are worried that China will barely maintain 8 percent growth this year, with some predicting just 5-6 percent.

Any downturn in China will intensify the impact of a US slowdown throughout the Asian region, which has become increasingly integrated into manufacturing in China. The Association of South East Asian Nation (ASEAN) countries, as well as South Korea and Taiwan, export raw materials and parts to China, while Australia ships huge quantities of minerals and Japan exports capital goods to China. Any hopes that China was going to be the economic motor to counter a downturn in the world's major economies are rapidly evaporating.