Philequity Corner (January 21, 2008)
By Valentino Sy

The US can learn from the Asian Financial Crisis

During a conversation with BPI president Gigi Montinola, he pointed out that he advised one of his American bank counterparties that the US can learn from the 1997 Asian financial crisis. He said that looking back to what happened in Asia 10 years ago could provide the US with a good history lesson that may help determine how they should respond to the crisis at hand.

Similarities

The events and circumstances during the Asian financial crisis are far too similar to what has been happening in the world's largest economy, the US. Enumerated below are the similarities:

1. Both crises had their origins on easy credit. In Asia, short-term foreign capital looking for higher returns found its way into emerging Asian economies. In the US, extremely loose monetary policies in the early 2000s and the advances in securitization led to the proliferation of loans to borrowers with bad credit history (subprime lending).

2. Easy credit coupled with inadequate financial supervision led to excessive investments in real estate triggering property bubbles.

3. When both bubbles burst, it resulted in a massive non-performing loan (NPL) problem in Asia and a subprime mortgage problem in the US.

4. In an eyewink, banks in Asia could not find buyers for their NPLs and the collaterals in their portfolio. Likewise in the US, there suddenly were no buyers for their mortgages, CDOs and other financial instruments.

5. As property prices collapsed and the property market turned illiquid, there was no way of valuing the assets held by the banks as collateral. Therefore, there was also no way of knowing the extent of their losses. In the US, illiquidity of more complex structured securities was compounded by a lack of transparency about their exposure to underlying subprime loans and to uncertainty about ratings.

6. Bank share prices in both instances suffered steep declines of 50 percent and more.

7. To deal with impaired assets, most governments in Asia formed centralized asset management companies (AMCs). Because of fiscal constraints in the Philippines, private-owned AMCs known as special purpose vehicles (SPVs) were set up to address this problem. In the US today, special investment vehicles (SIVs) were established by major banks to hold assets off their balance sheets and reduce bankruptcy costs.

8. Impaired assets were sold at deep discounts, some as much as 70 to 80 percent discount to face value.

9. Banks suffered massive write down in their capital. In the US, where the capital market is more developed, the banks can write down aggressively because of their easy access to credit. In Asia, however, it was not as easy to raise capital. Most banks, like those in the Philippines, had to carry the non-performing assets in their books for several years.

10. Before, it was US investment firms and Opportunity funds (such as Lehman Brothers Southeast Asia Pte Ltd, JP Morgan International Finance Ltd., etc.) that bought Asian depressed assets. Now it is the Asian sovereign wealth funds (SWFs) like Temasek, and GIC of Singapore and CIC of China which are buying into US banks.

11. Banks became totally risk averse after the Asian crisis. Thus, the reluctance of the banks to lend became a drag to the economy. They failed to act on their primary function as financial intermediary. In the Philippines, the inter-bank market (previously a major source of funding) disappeared as questions on counter-party risk arose. The same thing is happening in the US. But the big difference now is that the Fed and other central banks are more aggressive in injecting liquidity to ease concerns.

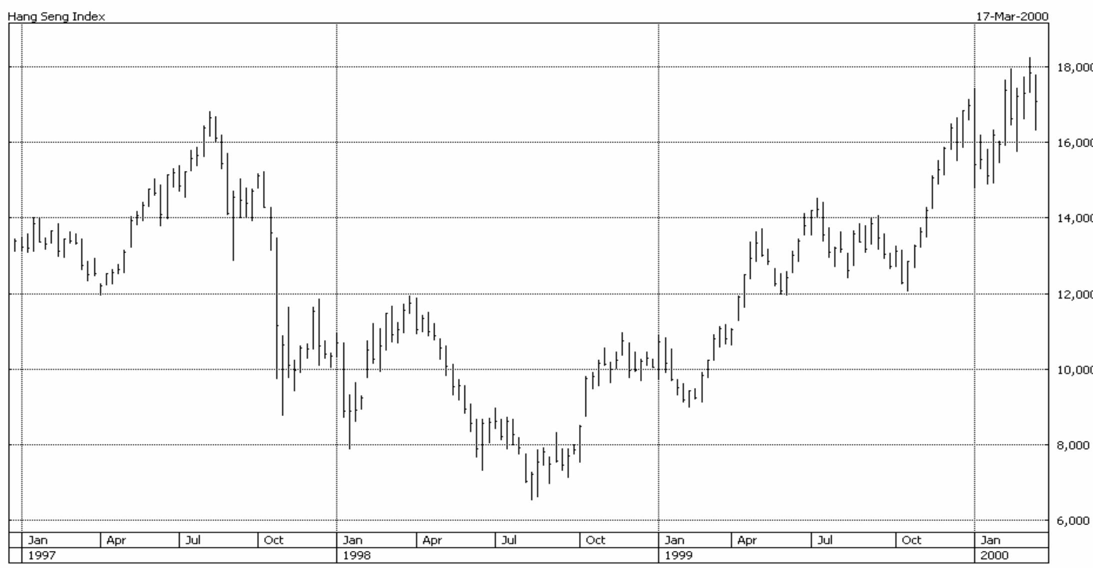
12. The problems of the banking industry in Asia quickly spread to the entire economy causing a major recession in 1997 to 1998. It is this fear of an economic contagion that has caused the massive drop in the US markets for the past three weeks.

Lessons to be learned

With the benefit of hindsight, the Asian crisis showed how a weak banking system can damage the economy as a whole. We also know that fixing the US housing and credit crises will ultimately carry a significant price tag. But this cannot be avoided if a country is to fill in the hole in its banking system created by insolvencies and bad debts. Therefore, there is nothing gained by postponing the economic stimulus and delaying the implementation of reforms needed for economic recovery.

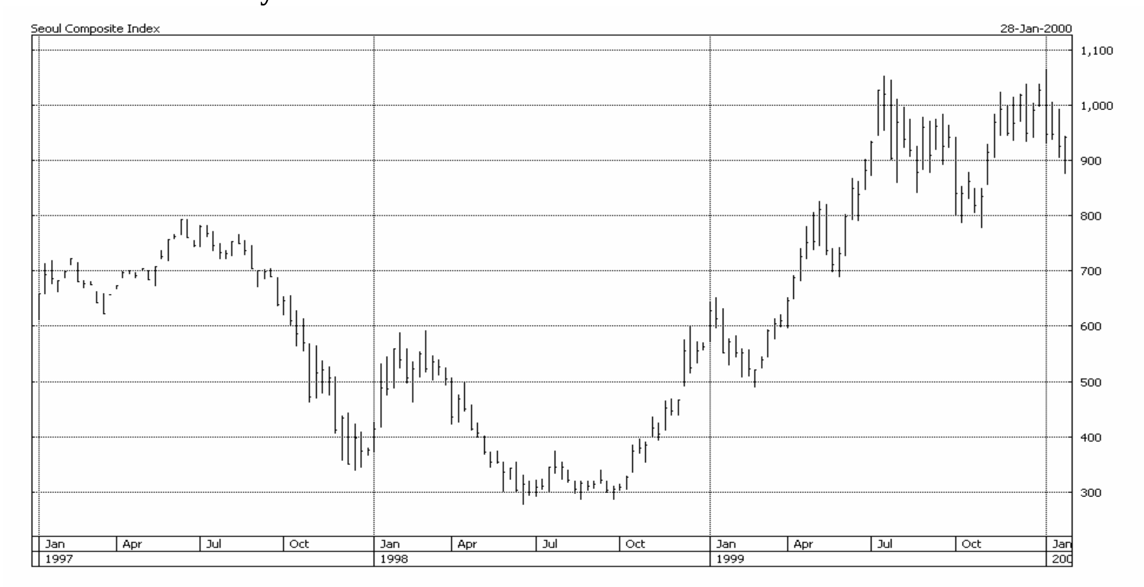
Given the lessons of the past, it also seems that markets are headed for further bouts of volatility and market turmoil. In fact, Asian markets declined for a year before bottoming out during the Asian crisis (see Hong Kong's Hang Seng index and Korea's KOSPI index below).

Hang Seng Index Weekly Chart



Source: Technistock

KOSPI Index Weekly Chart



Source: Technistock

Meanwhile, the US subprime mess started to unfold only in July 2007. It may take a few more months before all the bad news is discounted in the market. Along the way, however, there may be sharp rallies just like what happened to Asian markets in January to March 1998.

So far, the Dow Jones Industrial Average has lost almost 15 percent from its peak last year and looks extremely oversold. Who knows? A rally may be just around the corner. If the US can learn from the Asian financial crisis of 1997, the turnaround may be quicker and the bottom may be nearing.

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