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Spotlight

FINANCIAL MARKET CRISIS AND ECONOMY IN ASIA

Asia: Unstable markets, threatened economy

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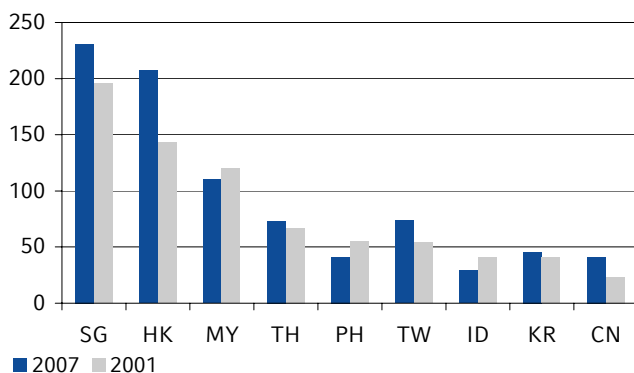
Capital flight, slumping stock markets, weakening currencies and real economic indicators which are increasingly pointing south – this is just some of the recent news from Asia. The following is a summary of the past few weeks' events.

"The financial Tsunami we now face is a global crisis. Its destructive force is much stronger and more widespread than the Asian financial crisis in 1997."

Donald Tsang, Administrative Head of the Hong Kong Special Administrative Region, October 2008

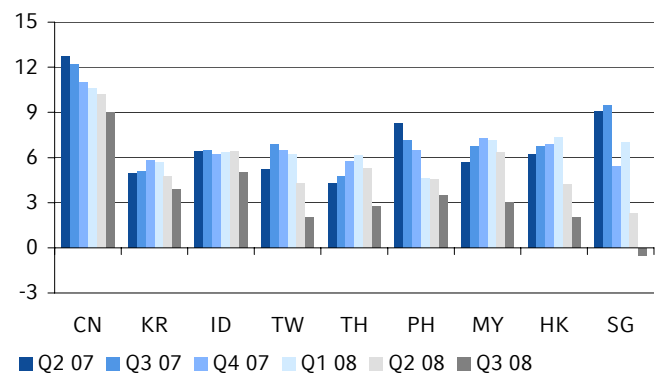
- Rapid growth, more stable state budgets, vast currency reserves, more transparent institutional setting in many places and companies which are international players. Against this background, the emerging markets in Asia have attracted many investors in recent years.
- In the global financial market crisis, the emerging markets in Asia are not the source, but merely the victims, of events. Nevertheless, investors are withdrawing, stock prices are falling, bond spreads are widening and currencies are weakening significantly.
- What has happened? Ever since the arrival of the financial markets crisis in Asia, the trends emerging for some time in the real economy, and which we have reported on several times in the past, have become clear: There can be no decoupling in a world with integrated merchandise and capital markets. Even worse, the actual extent to which the emerging markets in Asia are coupled to the rest of the world is becoming clear now.

Degree of openness in Asia
Exports in % of GDP



Source EcoWin, Global Insight, WestLB Research

GDP growth in Asia
In % y/y



Q3 08: Forecast, except China, Korea and Singapore

Source EcoWin, WestLB Research

Capital markets in Asia – financial market crisis strikes

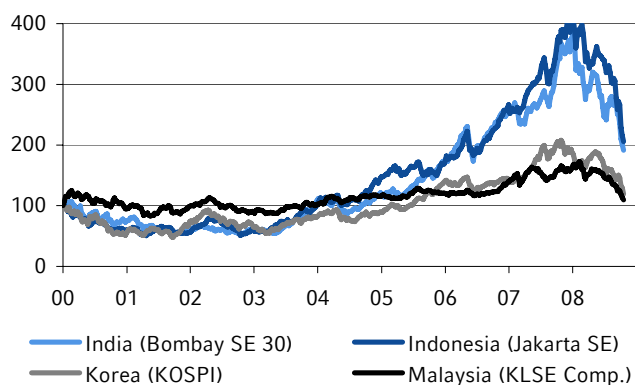
Bank run in Hong Kong

■ The fall-out of the Lehman collapse became particularly clear in Hong Kong when long queues formed in front of Bank of East Asia buildings on 24 September. Via text messages, the rumour that the bank held significantly more investments in dealings with Lehman than previously assumed and was heading towards insolvency spread like wildfire amongst customers. Within two days, concerned customers withdrew around US\$250m from their accounts. It took pacifying words from the Head of the Administration and representatives of the Hong Kong Monetary Authority plus management assurances to calm perturbed investors. Barely two weeks later, investors again gathered outside a financial institution. In this case, products based on Lehman securities had been sold to customers, in some cases using hair-raising methods and product promotion campaigns. As large numbers of these are now virtually worthless, investors' anger was vented in front of the bank's doors. This is hardly surprising as, according to media reports, around 40,000 customers in Hong Kong purchased such products, investing around HK\$20bn. Many of the investors feel that they have been poorly advised and cheated in their purchase.

Stock exchange prices in free-fall

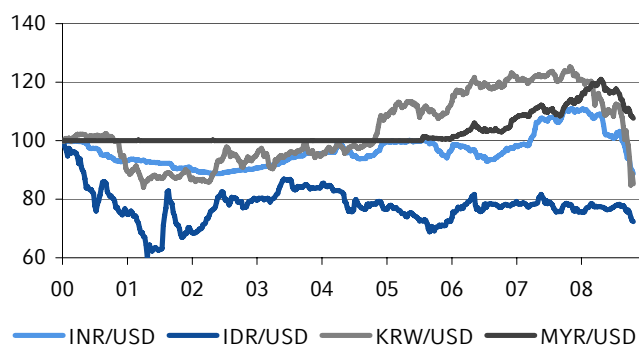
■ Shortly afterwards, during the second week of October, stock exchange prices around the world slumped. In Tokyo, prices fell more sharply in one day than at any time since 1987, and the capital exodus from Korea depressed the Korean won to the level of 1997/1998 Asian crisis. As in Tokyo, stocks in Hong Kong also suffered double-digit losses. Only Indonesia missed out on the Asian stock exchanges' rollercoaster ride, because its stock exchange simply shut its doors for almost three days and suspended trading following the day's extensive losses.

Asian stock markets
January 1, 2000 = 100



Source EcoWin, WestLB Research

Asian currencies vs. US dollar
January 1, 2000 = 100



Source EcoWin, WestLB Research

Widespread interest rate cuts

■ Central banks around the world intervened to settle the markets. The central bank in Australia surprisingly slashed interest rates by 100 basis points, more extensive than at any time during the last 16 years. This was followed by a concerted action on the part of the large central banks on Wednesday, October 8. China also joined in this action and lowered its key interest rate for the second time within two months. Immediately afterwards, further central banks in Asia emerged from the shadows and lowered interest rates in many places. These included the central banks in Korea, Hong Kong, Singapore, Taiwan and Pakistan. Only Indonesia raised interest rates. The inflation rate is still high at more than 12%. It is therefore likely to remain the only country in Asia still pursuing a

restrictive monetary policy to combat inflation. In addition, certain countries also gave assurances that deposits would be protected. In Hong Kong, an unlimited deposit guarantee was issued following unconfirmed reports that deposits would be guaranteed in Singapore. Taiwan also followed this example.

Real economy under pressure

Real estate markets are also in decline

■ However, not only the financial markets indicate that there is a storm brewing. A weak phase is also emerging on the real estate market in many Asian countries. In Singapore, house prices have fallen for the first time in four years, and are also coming under significant pressure in Hong Kong. Here, three major real estate agents have already announced that they will shed personnel and close offices. This week, on the Chinese mainland, the government stated that it would lower house purchase taxes and fees to support the weakening market.

Unemployment rate is rising and exports are slowing

■ For Hong Kong and Singapore, which is already technically in recession, these are clearly negative tidings. The situation in Hong Kong is being underlined for example by the continuing decline of the purchasing manager index. At 46.7 points this September, it fell to its lowest level since the SARS crisis in 2003. The employment market is also showing signs of weakness. In Hong Kong, the unemployment rate rose slightly to 3.4% in August, and the number of vacant positions fell by almost 20% in Q3 y/y. Whilst the financial sector "only" slid by 18%, the trade sector lost around 40%. The unemployment rate is still low in historic terms, but the increasingly gloomy employment market situation, negative wealth effects and inflation, which remains high at around 6%, are still likely to depress retail sales, which have been weak of late as well as private consumption. Gloom is also looming on the export front. Freight transshipments are declining due to constantly falling demand from the G3 (USA, EU, Japan). These days, fewer containers are seen in Hong Kong harbour. This situation is being further exacerbated by the fact that many banks are now more reticent about export financing. This means that mistrust amongst banks is additionally depressing trade, which is slowing down in any case.

Gloomy outlooks, including in other Asian countries

■ The outlook in other Asian countries is also gloomy. In China, economic growth has fallen significantly from an average of around 12% in 2007 to 9% y/y. The government has already announced countermeasures such as the reintroduction of export tax reimbursement. The land reform which has just recently been passed has been designed to improve resource allocation in the agricultural sector and especially to increase consumer spending among the rural population. In Malaysia, export growth of 25.4% y/y in August fell to around 11% in September while both agricultural and electronics exports came under considerable pressure. The outlook in Taiwan is similar. Here, the economy is extensively dependent on foreign trade, which is particularly oriented towards China. With declining Chinese demand for electronic input products, Taiwan's total exports fell by almost 2% y/y in September.

Exports to China and Hong Kong alone fell by more than 16% y/y. This weak export demand is also impacting on the employment market. In September, Taiwan's unemployment rate rose to 4.1% in September (after 3.9% in August).

Conclusion: Focus is being placed on boosting the economy

Inflation was yesterday

Whilst Asia was still pursuing restrictive methods to combat inflation at the start of the year, a change of course is now being implemented. Without adding numerous examples to the negative headlines outlined above, the force with which the emerging markets in Asia have been thrust into this crisis is becoming clear. The crisis is developing its effect via various channels.

Foreign trade gloomy

- Overseas demand from the G3 is likely to decline still further and will hit the most exposed countries (e.g. Taiwan, Malaysia, Singapore or SAR Hong Kong) particularly hard. Traditionally, China's domestic demand can be extensively met by domestic production. So even if the Government in Beijing succeeds in kick-starting private consumption via further measures *in the short-term* – which we consider unlikely – declining demand for Asian input and intermediate products is unlikely to be compensated by this, as final demand for these is usually found in the G3.

Private consumption weaker

- The increasingly gloomy employment market situation in many Asian countries, inflation, which is still high in many places, and negative wealth effects are likely to weaken growth in consumption. In particular, the negative wealth effects are likely to impact exposed regions such as Singapore and Hong Kong.
- The more restrictive financing conditions for companies are likely to further lower companies' willingness to invest, which is already depressed due to declining foreign demand. If access to capital is additionally hampered by increasing insolvencies and corresponding increases in loan default rates, even greater slowdown in machinery and equipment investments and growth as a whole is to be anticipated.

Combating the crisis together?

The Asian countries have adopted individual contingency programmes, deposit assurances or capital assistance measures. The fact that the regular ASEM (The Asia-Europe Meeting) is taking place in Beijing from October 24 to 25, is now a welcome opportunity for an Asian response to the crisis. Over 40 Asian and European states will be convening here, and it is hoped that this at least leads to the will to combat this crisis together. This would not only drive forth the region's integration and lessen the current effects of the crisis, but would also form the necessary foundation of trust to encourage investors to move back into Asia in the future.

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