

Asia: this is not 1997

Despite some superficial similarities, there are really very few parallels between today's markets and the Asian financial crisis of 1997/98



Currency trader watches monitors at a foreign exchange dealing room in Seoul, South Korea

Source: Shutterstock

Things were very different (worse) in 1997 Asia

Being old enough to have been covering the Asia-Pacific region during the financial crisis in 1997/98, I can speak with some authority in saying that it was nothing like what we are experiencing today. Indeed, the Asia region as a whole was in far worse shape then than it is now.

Let's break it down.

Asian FX: A relative outperformer

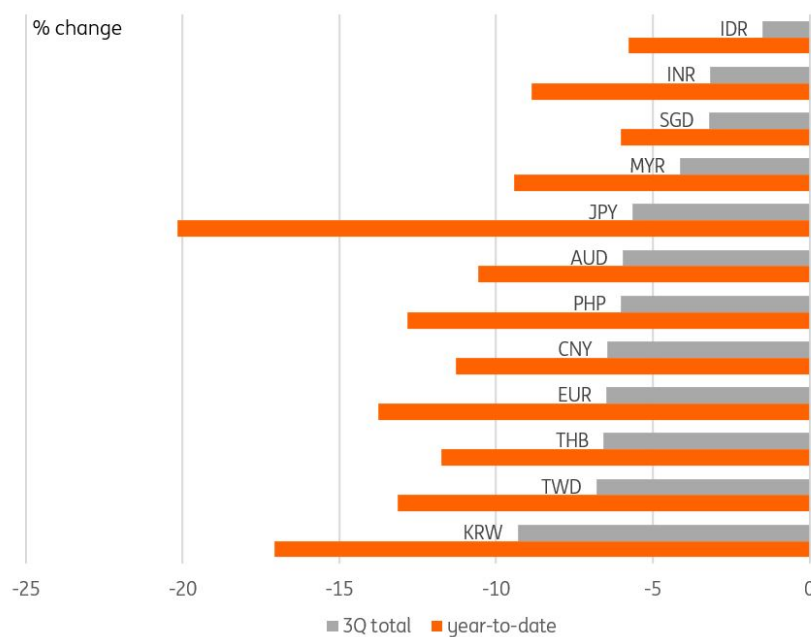
Perhaps the most important difference between now and then is in the exchange rate regimes being run by Asian economies. For the most part, these were fixed exchange rates pegged to the USD. There is a concise description of the causes and effects of the Asian financial crisis from the IMF in 1998 [here](#). In a nutshell, Asian economies back then combined high interest rates to attract capital inflows to finance investment and currencies pegged to the US dollar at favourable rates to achieve rapid export-led growth. Hot money was often channelled into unproductive property investments rather than raising the productive capital of these economies, which worsened the side effects when the bubble finally popped.

About the only similarity between then and now is what ultimately broke the currency pegs: hot money outflows attracted back to the US as the Federal Reserve raised rates to curb inflation upon emerging from recession in the mid-1990s. This caused the USD to appreciate along with Asian currencies as they were pegged, losing competitiveness. The Thai baht collapsed first, and contagion then pulled down the Philippine peso, Indonesian rupiah, and eventually the Korean won. The foreign debt that had helped finance the earlier rapid growth then became a massive debt-service headache, requiring IMF assistance and bailouts to prevent default.

So the first and rather glaring point to make is that across the region, exchange rates are not currently pegged to the USD. They may not all be the purest floats, and not all currencies are freely convertible, but they are not fixed. Nevertheless, as the chart below shows, their depreciation (year-to-date and quarter-to-date 3Q22) is for the most part not as severe as the benchmark EUR/USD, or many other G-10 currencies (British pound, Swedish krona, Norwegian krone).

Put another way, Asian currencies aren't collapsing; the USD is strengthening.

Relative Asian FX performance year and quarter-to-date (3Q22)



Source: CEIC, ING

FX reserves much fatter buffers

One of the remedies prescribed by the IMF to fix the broken Asian economies in the late 90s was that they needed to bolster themselves by accruing much bigger FX reserves. The two charts below show the extent of these reserves with reference to 1) months of import cover and 2) gross external debt (really, net external debt is the relevant metric, but gross debt serves its purpose here).

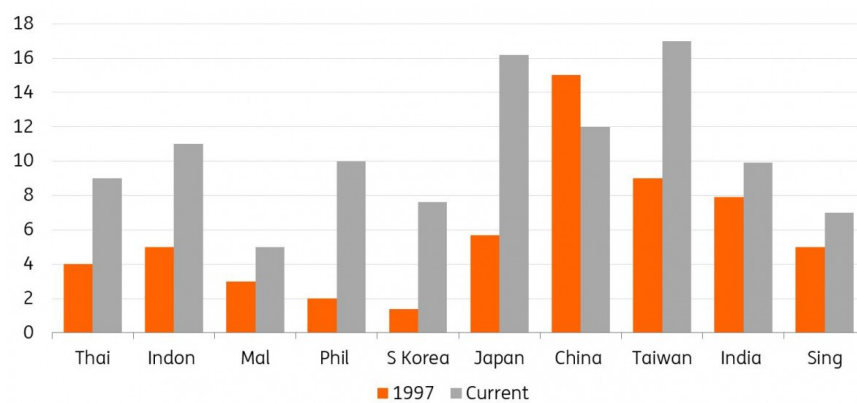
In almost all cases, export-cover is considerably better today than in 1997 or is very high anyway if not. Six months of cover is generally considered a decent buffer, so anything over that should not result in market nervousness. Malaysia is the main exception to this, and even then, import cover is

almost double what it was back in 1997. The ringgit took a different path to salvation from other Asian currencies during this period. But for the record, Bank Negara Malaysia Governor Nor Shamsiah Mohd Yunus ruled out a return to capital controls or currency pegs a [little more than a week ago](#).

The second chart shows reserves as a ratio to gross external debt. Like import cover, reserves relative to external debt are now much more substantial. Where they remain low (Japan, Singapore), the gross debt position is negligible anyway, and the net position is a substantial surplus, so it is irrelevant.

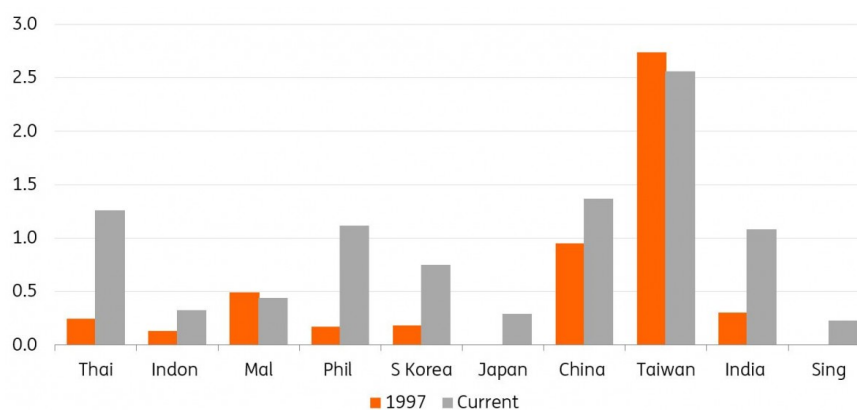
The only caveat we would make to this discussion that hints that everything is fine is that although the levels look comfortable, they have been declining. Central banks across the region have recently started intervening to limit the amount of currency depreciation, or at least to smooth its volatility. Reserves have been dropping, and the value of imports is rising due to inflation, so this is definitely a space worth watching. It isn't all good.

Import cover (months)



Source: CEIC, ING

Reserves to external debt ratio



Source: World Bank, ING

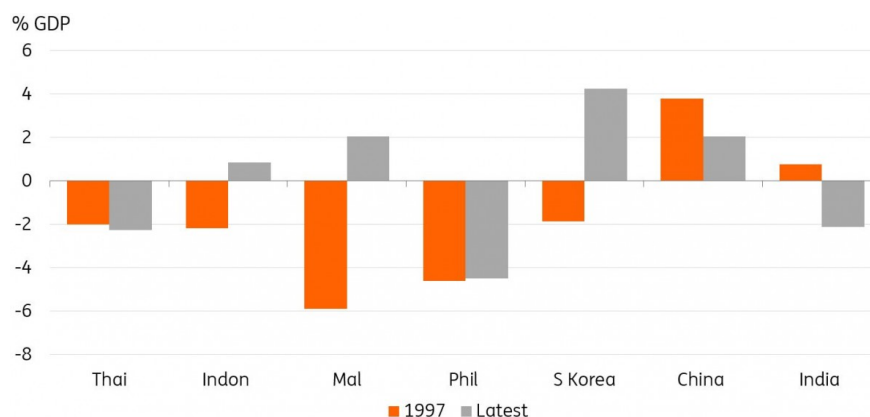
Current accounts good, but not as good as they were

The other thing that isn't quite as good now as it was before Covid and before Russia invaded Ukraine is Asia's current account environment. Of course, this is the main way to replenish

depleted FX reserves. China used to account for a large proportion of Asia's inbound tourism, but as its zero Covid policies effectively keep these flows close to zero, tourism centres like Thailand have been hit extremely hard. As a result, their current account surplus has been turned into a deficit.

Secondly, most of Asia is a net importer of energy (exceptions are Malaysia and Indonesia, as well as Australia). So, with natural gas prices spiking on increased competition with Europe for available non-Russian LNG, much of Asia has seen long-standing trade surpluses turn into deficits. Fortunately, large net investment income inflows mean that current accounts have held up better than trade balances.

Current accounts in Asia still strong



Source: CEIC, ING

On balance, things still look OK

We wouldn't want to finish this note by hinting that everything is fine in Asia. It isn't. Growth is slowing as inflation bites on spending power, and increasing policy rates are beginning to raise debt service burdens. China's lacklustre activity and European demand weakness are weighing on regional export strength, and a US recession is likely before too long. On top of this, there is also a downturn in the important semiconductor sector.

However, while all of this probably implies further currency weakness ahead, this is the safety valve that means a more abrupt break should be avoided. Never say never, but we don't see this ending like in 1997.

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