PACIFIC ASIAN ECONOMIES & EQUITY MARKETS:
A LONG TERM PERSPECTIVE

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THREE SCENARIOS FOR THE GLOBAL ECONOMY

I. BOUNCE BACK

Stock market collapse was a one time equity price correction

U.S. stocks are now closer to companies' liquidation value; hence prices are sustainable

Impact on real economy offset by bond market increase

U.S. legislators concur on major deficit reduction, cheering markets

Japan and West Germany continue solid growth and this results in rapid turnaround of U.S. current account deficit

U.S. growth slows from 3% to 1.5% in 1988

Slower U.S. growth facilitates turnaround of foreign deficit

U.S. dollar falls to 125 yen, facilitating decline of foreign deficit

In such conditions, U.S. stocks are likely to regain much of their lost value and other countries will follow since their economies are stronger

This scenario has relatively low probability because it contains very optimistic assumptions about U.S. budget performance and U.S. foreign deficit performance

THREE SCENARIOS FOR THE GLOBAL ECONOMY

II. MILD U.S. RECESSION/GLOBAL GROWTH CONTINUES BUT SLOWS

Real wealth effect of stock market collapse proves substantial

Shock effect of market collapse raises U.S. savings rate from 1% to 7%

Shock effect also leads to deferral of business investments

--electronic equipment purchases deferred

Already weak sectors such as garments go into substantial although temporary decline

String of market-related bankruptcies occurs in Australia, Hong Kong, U.S., with depressing effect on bank earnings

A mediocre U.S. effort to reduce government budget deficit is substantially offset by loss of revenue due to economic slowdown

--e.g., $30 billion of reduction measures offset by $25 billion of capital gains tax losses due to stock market crash

Slowdown of U.S. economy depresses Latin American export volumes & prices, causing acceleration of financial losses of Western banks

U.S. interest rates rise in response to expectations that post-collapse liquidity will eventually bring inflation; Hence U.S. bond market falls again

U.S. stocks remain depressed, but do not take another spectacular fall

Higher interest rates temporarily stabilize dollar, hindering trade adjustment

Japan, West Germany continue solid growth, hindered by U.S. slowdown, but helped by stabilization of currencies

Note: U.S. foreign deficit is unsustainable

Correction can only be achieved by some combination of:

U.S. recession
Major dollar depreciation

THREE SCENARIOS FOR THE GLOBAL ECONOMY

III. DEPRESSION

Failure of U.S. budget negotiations precipitates further collapse of U.S. stock market to 1300-1400

U.S. market collapse causes collapse in Hong Kong, Singapore

Tokyo also collapses, and MoF/investment house efforts to prop it up fail this time; Nikkei index declines rapidly to 8,000

Combined effects of stock market declines lead to collapse of several major banks and brokerage houses

COMPARATIVE MARKET PERFORMANCE IN THE RECENT CRASH

	2 Oct 1987	2 Nov 1987	% change
New York (Dow Jones Ind)	2641	2015	-24%
Tokyo (Nikkei)	26007	23359	-10%
Hong Kong (Hang Seng)	3932	2203	-44%
Singapore (Straits T)	1420	872	-39%
Malaysia (Composite)	419	273	-35%
Thailand (SET)	444	304	-32%
Manila (Composite)	836	774	-7% *
Korea	491	510	+4%
Sydney (All Ordinaries)	2241	1361	-39%

*Note: Manila had already turned down sharply after an August coup attempt.

COMPARATIVE PERFORMANCE OVER TIME

DECEMBER 1985 TO PRESENT

	31 Dec 1985	2 Nov 1987	% change
New York (Dow Jones Ind)	1547	2015	+30%
Tokyo (Nikkei)	13083	23359	+79%
Hong Kong (Hang Seng)	1752	2203	+26%
Singapore (Straits T)	620	872	+41%
Malaysia (Composite)	409	273	-33%
Thailand (SET)	135	304	+125%
Philippines	161	774	+381%
Korea	163	510	+213%
Australia	1004	1361	+36%

COMPARATIVE PERFORMANCE OVER TIME

DECEMBER 1984 TO PRESENT

	31 Dec 1984	2 Nov 1987	% change
New York (Dow Jones Ind)	1211	2015	+66%
Tokyo (Nikkei)	11543	23359	+102%
Hong Kong (Hang Seng)	1200	2203	+84%
Singapore (Straits T)	813	872	+7%
Malaysia (Composite)	511	273	-47%
Thailand (SET)	142	304	+114%
Philippines (Manila Comp)	106	774	+630%
Korea (KSE)	143	510	+257%
Australia (All Ordinaries)	726	1361	+87%

CAUSES OF FUTURE STOCK MARKET PERFORMANCE

I. Liquidity

II. Real economic growth

III. Opening of markets

PROSPECTS FOR GROWTH AND TRADE IN DIFFICULT ECONOMIC CONDITIONS: SMALL COUNTRIES OF ASIA

Center of World growth

--7% per year, 1960-1980

Center of Global Capital Markets

--Japan has over $180 billion reserves

--Taiwan has over $60 billion reserves

--Debt is generally decreasing (esp South Korea) and liquidity increasing throughout the region (Philippines the major exception)

Smaller countries are outpacing Japan

Growth rates have been much higher than Japan's for all of 1980s

Surpassed Japan's share of world trade in 1980

Difficult years of 1980s have consolidated Pacific Asian dominance

Pace of industrial transfer has accelerated

--Japanese response to high yen

Principal Third world competitors have decisively lost

--debt crisis in Latin America, Africa, E. Europe

Gain in market share of world trade during three bad years comparable to gain during 20 good years:

1960-1980: 4.3% to 6.5% or total of 2.2%

1980-1983: 6.5% to 8.2% or total of 1.7 %

Center of World Social Innovation

--Reconcile growth & distribution

--Reconcile market economy & strong government leadership

--Reconcile (partly) labor discipline & rapid wage growth

HONG KONG PROSPECTS UNDER MILD U.S. RECESSION IN 1988

Hong Kong's Growth in 1980s has ranged from low of approximately 2% (1982, when U.S. growth was -2%) to an estimated 12 % in 1987 (when U.S. growth was about 3 %)

Hong Kong's market have been diversifying rapidly, with rapid gains in China and Western Europe and spectacular gains in Japan

--accelerated market share gains likely, especially in Japan

China, Japan, EC growth prospects are favorable

China political environment highly favorable

Hong Kong would gain in competitiveness from the weakening of the U.S. dollar, which is already weak and would weaken somewhat further, even in a mild recession

Hong Kong competitiveness will gain further from the accelerated migration of manufacturing into low-wage China, an option not available to competitors

Hence the following performance would be consistent with a 1988 U.S. growth rate of 1%, including two quarters of negative growth:

GDP growth	6%
Domestic Exports growth	8%
Re-Exports growth	20%
Tourism	10%
Government construction	1-2%
Private consumption	7%

On the other hand, the wealth effects of the stock market collapse are greater in Hong Kong than elsewhere, and more widely spread

The stock market is dominated by property companies, which will experience a setback:

Property company profits	(20%)