PERIPHERAL VISIONS- A LOOK AT "OTHER" ASIA AND MEXICO
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"Forewarned, forearmed." Benjamin Franklin, "Poor Richard's Almanac" (1736)

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EYE OPENING

At the dawn of what gurus eventually label as a severe international economic or financial crisis, many prosperity partisans and nimble economists minimize impending dangers and consequences. In early stages of the terrifying troubles, declarations abound that difficulties are easily contained or merely local (regional), right? In later stages or the aftermath, hindsight wisdom emerges. Recent times- not just the misty past- offer examples. Once upon a time, during the beloved Goldilocks Era preceding the worldwide economic crisis unveiled in 2007, the US housing marketplace was destined to stay in fine shape! Oracles now declare that flames from America's treacherous subprime housing situation revealed more widespread problems and risks. Enormous difficulties from the once apparently safe European periphery of Greece, Portugal, and Ireland (and even Spain and Italy) now entwine the rest of Europe, America, and much of the rest of the world. Political domains likewise offer similar developments in outlook and rhetoric. Didn't current Middle Eastern democracy movements and regime changes in Egypt and elsewhere surprise most observers?

Most financial watchers of the global scene nowadays focus on headlines, policies, and actions from the United States, Europe, Japan, and the BRICs (Brazil, Russia, India, and especially China). Sometimes an observer offers a sideways glance at other nations, especially if their economic interest directly ties into with what's occurring in or related to that land. As petroleum obviously is important to many, Saudi Arabia captures attention and attracts analysis from various commodity, stock, interest rate, and currency watchers. Or, some commodity traders monitor currency and equity levels and trends of and political situations within key commodity producing nations. They stare not only at Saudi Arabia (and other Middle Eastern states), Brazil, and Russia, but also at Australia, Canada, Chile, and South Africa.

Compared to China and Japan, other Asian countries such as South Korea, Thailand, Indonesia, and Malaysia receive much less attention these days from those in international galleries. Yes, these four "other" Asian nations have smaller GDPs than China and Japan. Yet the Asian financial crisis of 1997-98 involved these four "other" Asian nations. Mexico, though a major trading partner of America, receives rather little mainstream press outside of immigration issues and talk of its violent drug wars. But recall Mexico's economic ("peso" devaluation) crisis of 1994-95. South Korea, Thailand, Indonesia, Malaysia, and Mexico then and now significantly interrelate- admittedly in varying fashions and degrees- with the rest of the global theater. **So paying a bit of attention these days to these five countries identifies not only risks facing them, but also their economic performance relative to other key nations such as the United States. In addition, a survey of their equities and currencies offers perspectives on other stock marketplace and foreign exchange trends, and thus on the current worldwide financial situation.**

BRAVE NEW WORLD

"What people generally referred to as the Asian financial crisis was actually a global economic crisis that began in Asia in the summer of 1997 and spread for a period of nearly two years as far as Russia and Brazil. Aftershocks were felt across emerging markets and even in the industrialized world." "In an Uncertain World" (pp212-13), by Robert Rubin, former head of Goldman Sachs and US Secretary of the Treasury

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In the interdependent world economy, and as the ongoing economic crisis displays, significant events in one pasture of the world (even an allegedly distant, peripheral, or minor corner) can ripple quite widely. Chinese and Japanese developments and risks of course play important roles for these four Asian nations. The United States obviously is crucial to Mexico. Let's summarize some specific risks, many buried in the fine print, which these other Asian nations and Mexico face.

The International Monetary Fund indicates rising inflation in Korea, Thailand, Malaysia, and Indonesia (and China; "World Economic Outlook", September 2011, Chapter 1, Figure 1.4, p6; IMF's Asia and Pacific "Regional Economic Outlook", October 2011, p2).

The Asia and Pacific "Regional Economic Outlook" ("REO")- though speaking in generalities- heralds "persistent overheating pressures" in a number of countries (p ix). "Asian banks appear to have emerged from the global financial crisis with strong balance sheets." (p12). Yet there are reasons to be alert on this front. In 2011, bank credit growth has remained rapid in many regional economies, with noteworthy loan-to-deposit ratio boosts in Indonesia and Thailand. Corporate debt issuance by Asian firms has accelerated since 2010. Also, leverage in corporate Asia rose in 2009-10, "particularly in India, Korea…." (p11; see also pp21-24). The IMF's September 2011 Global Financial Stability Report (Chapter 1, p1) warns that rapid domestic credit growth, balance sheet releveraging, and rising asset prices eventually may result in deteriorating bank asset quality in many emerging marketplaces. Though not specifically referring to the four "other" Asian nations, these comments seem to partly address them.

The REO warns of risks for the Asia-Pacific region if American and European financial systemic distress increases (Box 4.1, p34). More specifically, it stresses: "A worsening of the financial turbulence in the euro area poses an <u>extreme</u> downside risk for Asia." (p6; emphasis supplied). Regarding Asia in general, it warns of repatriation of liquidity by European banks. This could occur via selling assets, not rolling over existing loans, or cutting credit lines. (p8). The Financial Times reports that European banks "would rather sell assets than raise expensive new capital to meet compulsory demands from the European Union for higher capital ratios" (10/13/11, p4).

The IMF remarks that since 2009, investors from advanced economies have built up "substantial" positions in Asian marketplaces, "including Indonesia and other sovereign debt markets". Suppose there is a "sudden liquidation of these positions". (REO, p6). Large foreign investment positions in Korea are noted by the IMF in its Asia Pacific Department Press Briefing (9/24/11). The World Economic Outlook (Statistical Appendix, Table A13, p202) indicates private financial flows to developing Asia blossomed from about $80 billion in 2008 to over $320bb this year.

Regarding Asia in general, the IMF also considers a loss in market liquidity in key derivatives, and high leverage in currency derivatives (REO, p8).

South Korea's household debt of 125 percent of household disposable income is high. Also, though corporate funding conditions on balance allegedly are good, they are not favorable for medium size enterprises. This partly reflects weakness in the construction and real estate sector (IMF's Article IV Consultation with Korea, 8/4/11, p2).

Thailand has suffered several rounds of political instability in recent years. However, the July 2011 election outcome arguably offers hope for greater calm. Currently, "some of Thailand's worst flooding in half a century bears down on Bangkok" (NYTimes, 10/14/11, pA4). For South Korea, the risk of escalation with North Korea remains an especially important ongoing issue.

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According to the International Monetary Fund's Article IV Consultation (8/8/11), Mexico has strong fundamentals and sound fiscal and monetary policies (p4). The banking system in general seems fine (pp10, 18). There's only moderate leverage in the corporate and household sectors. Household debt is relatively low, at 20 percent of disposable income (p6).

What risks nevertheless confront Mexico? A severe downturn in the United States is one. According to the IMF's Article IV Consultation, 80 percent of Mexico's non-oil exports go to the US (8/8/11, p21). A sharp fall in petroleum prices is another. Also, despite the strength of Mexico's banking system, a severe worsening of the European sovereign/banking crisis would have noteworthy consequences. Large losses to international banks would force a few European banks to deleverage to restore their capital asset ratios (assuming no recapitalization). "In this context, Latin America would be among the regions most affected, with significant foreign bank credit reductions in Chile (2 ½ percent of GDP), Brazil (1 ½ percent), and Mexico (1 ¼ percent)." (IMF, Western Hemisphere "Regional Economic Outlook", Box 2.1, p38).

Mexico's holds its Presidential election in July 2012. So far, drug-related violence has not significantly endangered its economy.

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Though South Korea, Thailand, Indonesia, Malaysia, and Mexico are bound up with and face noteworthy risks from the world economy (and note the analysis in the "Risky Business" section below), the preceding review suggests that they are in relatively good shape. The overall good news for them (their relatively strong position compared to many nations) also appears from an admittedly brief scan of some key variables such as GDP. The following table compares their indicators with those from the United States. One could add other factors and evidence to the list, or quarrel regarding their relevance and implications.

Picture a nation with a large current budget deficit and looming long-term ones. Imagine that nation has engaged in a vigorous massive money printing festival. Suppose it has kept its policy interest rates very low (and arguably artificially so, relative to even modest inflation), thus acting to benefit debtors at the expense of creditors. Assume that country also has had and probably will continue to have a noteworthy current account deficit. It has encouraged the depreciation of its currency relative to its long run average. Pretend that it also has a volatile and fractured political environment, with contending parties unable to easily agree on many difficult issues. Is this some developing, emerging, or third world nation? History hints that it might be. However, this description also seems to resemble the United States these days.

The United States is not a developing, emerging, or third world nation. And its policies and actions intertwine with those of the rest of the world. Indeed, we all know that Europe has severe problems, and Japan and even China are not devoid of troubles. The United States today is not a mirror image of the endangered Asian nations or Mexico during the mid-1990s Asian and Mexican crises period.

However, America's economic and political behavior and policies has helped to "create a situation for itself" that echoes the earlier crises in Asia and Mexico. Ironically, whereas

once America helped to rescue the economic world, it now helps to endanger it. As an indication of this, compare the current and near-term United States situation with that of four Asian financial crisis nations and Mexico.

NATION	**Growth in Real GDP (pc)**		**General Govt Balance (pc of GDP)**		**General Govt Gross Debt (pc GDP)**		**Current Account (pc GDP)**	
	2011	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**
United States	1.5	1.8	-9.6	-7.9	100.0	105.0	-3.1	-2.1
South Korea	4.0	4.4	2.1	2.4	32.0	30.0	1.5	1.4
Thailand	3.5	4.8	-2.6	-2.9	43.0	43.5	4.8	2.5
Indonesia	6.4	6.3	-1.6	-1.3	25.2	24.0	.2	-.4
Malaysia	5.2	5.1	-5.1	-4.9	55.1	55.9	11.3	10.8
Mexico	3.8	3.6	-3.2	-2.8	42.9	43.6	-1.0	-.9

["Pc" equals percent or percentage. "Govt" means government. The "-" sign in the general government balance as a percentage of GDP column indicates a budget deficit. The general government sector includes central, state, and local governments. A minus sign in the current account column represents a deficit. Statistics are from various International Monetary Fund Reports from September/October 2011: World Economic Outlook, Fiscal Monitor, and Regional Economic Outlooks (Asia and Pacific, Western Hemisphere).

Euro area GDP growth is forecast at 1.6pc for 2011 and 1.1pc for 2012, its fiscal balance -4.2pc of GDP in 2011 and -3.2pc in 2012. The IMF forecasts a small current account surplus for the Euro area in 2011 of .1pc, with that in 2012 .4pc.]

RISKY BUSINESS

"From the enemy's character, from his institutions, the state of his affairs and his general situation, each side, using the *laws of probability*, forms an estimate of its opponent's likely course and acts accordingly." Carl von Clausewitz, "On War" (Book One, chapter 1; author's emphasis)

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In the recent worldwide economic crisis era, the S+P 500's major high was 10/11/07 at 1576, with its final top at 1440 on 5/19/08. Asian stock marketplaces, as did Mexico's, tumbled alongside American and European ones.

In the table below, compare the timing of the 2008/2009 lows and the 2011 highs of South Korea, Thailand, Malaysia, Indonesia, and Mexico. Though the four Asian nations have their differences, the timing of the important trend changes is quite close. And even Latin America's Mexico moved alongside them. The moves of these five nations tend to confirm (reflect) each other.

Moreover, although the S+P 500's major low in March 2009 followed that of South Korea, Mexico, and the other three nations by about four months (yet note the second low in March 2009 low in three of them), **the major overall trend changes in the S+P 500 finds strong parallels in the bull and bear moves of those five countries**. Traders should closely watch these stock marketplace relationships.

NATIONAL STOCK INDEX	**2008/2009 Major Low (date)**	**2011 Key High**
US: S+P 500	667 (3/6/09)	1371 (5/2/11); note 1357 (7/7/11)+1347 (7/21/11)
South Korea	892 (10/27/08); 993 (3/3/09)	2231 (4/27/11); 2193 (7/8/11)
Thailand	380 (11/26/08); 409 (3/3/09)	1114 (4/21/11); 1148 (8/1/11)
Indonesia	1089 (10/28/08)	4196 (8/2/11)
Malaysia	801 (10/28/08)	1597 (7/11/11)
Mexico	16480 (10/27/08); 16757 (3/3/09)	38875 (1/3/11); 38091 (4/6/11); 36918 (7/4/11)

Was Mexico's pinnacle in 2011 really much earlier than that in America? Not in a view of the overall picture. The initial high in the S+P 500 at 1344 on 2/18/11 was fairly close in time to Mexico's January peak.

All these moves from 2008/09 valleys were explosive. The S+P 500 doubled its low (2.1 times) as did Malaysia. South Korea's high spiked 2.5 times relative to its bottom, with Mexico's up 2.4 times. Thailand's leaped 3.0 times versus its low. Indonesia headed the pack, soaring 3.8 times relative to its 2008 floor.

What about recent moves after the sharp downturn from 2011 plateaus? South Korea's recent trough was 1644 on 9/26/11 (a 26.3pc fall from its peak). Indonesia's also was on 9/26/11, at 3218 (23.3pc drop), as was Malaysia's to 1311 (17.9pc). Thailand's low since its top, 844, was a little later, on 10/4/11 (26.5pc). Mexico reached its 31560 bottom (18.8pc fall) earlier, on 8/8/11 (an 18.8pc slide), but it commenced a second rally from around 32260 on 10/4/11. These assorted late September/early October 2011 lows are right around the S+P 500's 10/4/11 low at 1075 (21.6pc slump from 5/2/11).

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China stock watchers should recollect not only that its 10/16/07 stock marketplace peak at about 6125 (Shanghai Composite) was almost the same day as the S+P 500's. China's benchmark hit the ground on 10/28/08 at 1665, around when Mexico and the four Asian nations in the table touched bottom. Remark upon the continued erosion in Chinese stocks not only from its 7/18/11 interim top near 2830; compare that date with the start of July/early August 2011 declines in the other marketplaces in the table. However, remember that unlike these other four Asian nations, Mexico, and the US, Chinese equities did not keep going skyward into 2011. China's July 2011 interim high was significantly under the 8/4/09 bull move high of 3478 (which was way beneath the October 2007 pinnacle), as well as below the 3187 elevation of 11/11/10.

Another China viewpoint- China's recent low around 2319 (10/12/11) grazed its prior noteworthy depth at just under 2320 on 7/2/10. The domestic investment arm of China's sovereign wealth fund announced on 10/10/11 that it would purchase shares in the largest state-owned banks to restore confidence in them (Financial Times, 10/12/11, p22).

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The broad real trade-weighted dollar is reported as a monthly average (1973=100). The nominal trade-weighted dollar has daily data.

US DOLLAR
(Broad Real Trade **<u>2009 Major High:</u>** 96.8 (March 2009)
<u>Weighted; "TWD")</u> **<u>2011 Key Low</u>**: 80.5 (July 2011); initial low probably early May 2011, based on the broad nominal trade-weighted dollar

The nominal trade-weighted dollar lows of 2011 were 5/2/11's 93.9 and 7/26/11's 93.7.

South Korea, Thailand, Indonesia, Malaysia, and Mexico have a range of trading partners. Their relative weights within the broad real TWD vary, with many quite a small percentage. Mexico represents 11.45pc of the TWD. South Korea captures 3.86pc (compare China's 19.76pc and Japan's 7.80pc), with Malaysia having 1.84pc, Thailand 1.45pc, and Indonesia 1.11pc.

Despite differences in their economies and trade weights within the TWD, on a cross rate basis against the US dollar, all five currencies rallied substantially against the dollar since early 2009. Moreover, the four Asian currencies attained their recent highs around the same date. South Korea's pinnacle was 7/27/11 around 1048 (initial low 1065 on 5/2/11), Thailand's on 7/26/11 at 29.63 (29.81 on 5/2/11). Compare Malaysia's top on 7/27/11 at 2.934 (2.960 on 5/2/11) and Indonesia's on 8/2/11 at 8458. Mexico's high versus the dollar was 5/2/11 at 11.48, the same day as the initial lows of South Korea, Thailand, and Malaysia. It made a second top 7/7/11 at 11.53.

The late 2008/early 2009 lows in the S+P 500 and the five stock playgrounds in the table above occurred alongside a (relatively) strong dollar. These equity marketplaces reached their 2011 heights around the time of a weak dollar.

Did the dollar rally and reach any cross rate highs versus South Korea and these other nations around the time of the S+P 500 low at 1075 on 10/4/11? Yes. South Korea's recent bottom against the dollar was about 1208 on 10/4/11, Thailand's 31.34 on 10/3/11, and Malaysia's 3.22 on 10/4/11. Even Indonesia's low on 9/22/11 around 9365 and Mexico's 14.14 on 9/23/11 were not long before the S+P 500's low. The nominal trade-weighted dollar achieved its recent high at about 101.3 (a climb of about 8.1pc from its July 2011 low) on 10/4/11 (data available through 10/7/11; the broad real TWD's September average was 82.7).

Thus the hymn "strong US dollar equals weak stocks, weak dollar equals strong stocks" continues to be widely sung.