Philequity Corner (July 10, 2017)
By Wilson Sy

Asian financial crisis – 20 years after

July 1997 is the month that shocked Asia and brought the region down to its knees. Last week, I was interviewed by ANC TV to discuss my recollection of our country's experiences during those turbulent times. In this article, we revisit the events that transpired during the Asian financial crisis while also outlining the lessons that we learned from that painful episode. In addition, we shall also explain how our economy has strengthened since 1997.

Champagne toasting marks peak of PSEi in 1997

In early 1997, when I was Chairman of the PSE, I invited then Finance Secretary Bobby de Ocampo to the stock exchange trading floor to celebrate the PSEi's new all-time high. The mood was jovial as we toasted champagne. Little did we know that we had just witnessed the market peak at that time. A few weeks after, the crisis in Thailand began to unfold.

Trouble in Thailand

The Asian financial crisis started in Thailand. Back then, the Thai baht and other Asian currencies were pegged to the US dollar. The baht was targeted by speculators, which forced the Bank of Thailand to defend the currency. In doing so, Thailand's forex reserves were drained, thereby compelling the government to lift the peg and shift to a floating exchange rate. This shift resulted in a massive devaluation for the Thai baht, which negatively affected many companies that were holding substantial amounts of US dollar denominated debt.

Contagion among Asian tigers

During the Asian financial crisis, we saw that problems in one country can lead to a contagion and afflict neighboring countries. The trouble in Thailand started to spread like wildfire to other Asian tiger economies such as Malaysia, Indonesia and the Philippines.

We also saw that the other Asian tigers suffered from the same problems as Thailand. Malaysia, Indonesia and the Philippines all experienced dwindling reserves from defending overvalued currencies. This led to massive currency devaluations, causing corporates to be saddled with US dollar denominated debt, which resulted in a pronounced weakness in the banking sector.

PSEi – from 3,400 to 1,000

When the Asian financial crisis ensued, the PSEi fell from its then all-time high of 3,448 in February 1997 to a low of 1,075 in September 1998. From peak to trough, the PSEi lost 68.8% of its value in just one and a half years. Consequently, most stocks lost 70-90% of their value.

Structural reforms after the Asian financial crisis

After the Asian financial crisis, the BSP and the Philippine government implemented crucial structural reforms to insulate the economy from future crises. In response to our country's experience in 1997, our forex reserves were built up to provide stronger backing to the Philippine peso. From an import cover of only one to two months, our reserves can now cover 8.7 months worth of imports.

Aside from this, the BSP took on the challenge of reforming the banking sector in order to facilitate a faster recovery. Asset cleanups and recapitalization programs were initiated while regulation and supervision were tightened to strengthen the banking sector. In this light, we would like to congratulate Mr. Say Tetangco for his remarkable performance during his 12-year stint as BSP Governor. Mr. Tetangco played a crucial role in ensuring that the banking sector came out stronger after the Asian financial crisis. In my conversation with him just last Friday, Mr. Tetangco mentioned that he is confident that he is leaving the central bank under the competent leadership of BSP Governor Nesting Espenilla. Moreover, he said that the country is in a much better position to deal with crises and external threats.

Likewise, the government under our previous presidents implemented various structural reforms to strengthen our economy. These include the deregulation of certain sectors, the privatization of many state-owned assets, the removal of fuel subsidies, as well as the increase in VAT and sin taxes. We explained this in greater detail in our book "Opportunity of a Lifetime" (see Chapter 5 – Fiscal Reform in the Philippines).

Lessons learned from the Asian financial crisis

We have written many times about the Asian financial crisis in our past articles (see *Asian financial crisis, - ten years after*, July 9, 2007 and *The US can learn from the Asian financial crisis*, January 21, 2008). We also discussed key takeaways from the country's experiences during those times in various chapters of our book. We summarize and enumerate these lessons below.

1. **Be aware of risks.** A key takeaway from the Asian financial crisis is that companies should monitor risks associated with their currency and debt exposures. Back then, dollar-denominated floating rate notes (FRNs) were in vogue due to lower interest rates. Local corporates became complacent and stuffed their balance sheets with US dollar denominated debt without properly accounting for foreign exchange risk. This resulted in many corporate defaults, as the peso value of the dollar liabilities ballooned when our currency experienced a massive devaluation.
2. **Monitor the macroeconomic indicators.** Aside from tracking economic growth, other macroeconomic indicators such as fiscal position, forex reserves, current account, balance of payments and currency movements should also be carefully monitored. It is crucial to understand the drivers behind these indicators in order to properly appreciate macro risks and external threats.
3. **Watch geopolitical and global macro developments.** It is quite apparent that markets and economies are more interconnected now. Thus, it is incumbent upon investors to watch geopolitical and global macro developments. We have always said that events in neighboring countries or even in faraway places such as the US and Europe can affect the trajectory of our financial markets.
4. **Be mindful of the contagion effect.** From our experience during the Asian financial crisis, we can see that problems in one country can spread to other neighboring countries and result in a contagion. It is therefore important to understand how countries, economies and markets are interconnected (*The 'IPIS' theory*, February 22, 2010).
5. **Capitalize on opportunities during crises.** Throughout history, we have seen that full-blown financial crises and large-scale credit problems can cause savage bear markets and sharp corrections

in stocks. Given this, investors must comprehend how these problems arise in order to understand how they can be solved. History also presents many analogies and parallelisms which allow us to learn from past experiences. On a personal level, it is likewise essential to learn from one's mistakes in order to maximize the opportunities that crises and bear markets present.

6. **Diversify your assets and risks.** We have often stressed the importance of diversifying one's investment portfolio in order to avoid tail risks. However, investors and companies should also diversify risks. In the Asian financial crisis, we saw that the balance sheets of local corporates were not properly positioned to handle foreign exchange risk, thus rendering them extremely vulnerable to the sudden and massive devaluation of the peso.

Time in the market vs. timing the market

Because of the complexity of the global economy and financial markets, timing the market is extremely difficult even for professionals. This is why we advocate peso cost averaging or buying on a regular basis for non-professionals and investors who cannot consistently monitor stock market movements. If one was focused on timing the market, he may have been severely affected by the Asian financial crisis, which caused many stocks to lose 70-90% of their value. However, if one invested on a regular basis, he would have been able to take advantage of the opportunities that various financial crises present by buying a certain portion of his portfolio when stocks are trading at extreme bargains.

A stronger Philippines – 20 years after the Asian financial crisis

We have seen that financial crises can decimate companies and even countries. Those who do not learn from their mistakes and implement corrective measures have gone bankrupt and have not fully recovered from the Asian financial crisis. Thus, it is important for investors to study past crises in order to learn from the experiences of corporates, countries and other investors. Fortunately, our government and the central bank took on the difficult task of implementing structural reforms in order to ensure that our economy is better insulated against financial crises, contagions and other external threats.

Breakout growth through tax reform

Last week, Finance Secretary Sonny Dominguez said in a statement that he expects the economy to deliver breakout growth of 7% or higher with the timely implementation of the undiluted tax reform package (*Tax reform – the next big catalyst*, February 20, 2017). The passage of the tax reform bill should ensure that the government's fiscal position will remain healthy even as it plans to engage in massive spending to upgrade our country's infrastructure network. This will usher in a stronger phase of growth which can result in new highs for our economy and the stock market.