December 10, 1997

NYT

How Asian Currencies Tumbled So Quickly

By JONATHAN FUERBRINGER

In early May, Japanese officials, concerned about the decline of the yen, hinted that they might raise interest rates. The threat never materialized. But it proved to be the first sign of an Asian flu that six months later is still spreading and has already prompted around $100 billion in international pledges for a cure.

The Japanese threat shifted the decisions of global investors, who immediately began to sell Southeast Asian currencies, setting off a tumble not only in the currencies but in the local stock markets as well.

Leapfrogging from Thailand to Indonesia to Hong Kong, the financial shivers eventually shook Wall Street, sending the Dow Jones industrial average down a record 554 points on Oct. 27. From its sickbed, Asia is now faced with a new year that promises very slow -- if any -- growth, painful bankruptcies and rising unemployment.

Speculators -- and the hedge funds they manage -- have been singled out by Asian politicians and others as the proximate cause of the turmoil, which spread to South Korea and continues to rattle Japan.

But the real story is much more complex, filled with bankers, corporate treasurers and mutual-fund managers from the region and around the world who, unlike speculators, were not trying to profit from the fall of the currencies but still contributed significantly to their declines. Joined by many local companies, these agents actually had a very strong vested interest in keeping the currencies stable.

There is no way to recreate the exact train of selling that pushed the currencies beyond the brink. But in interviews with bankers, economists, currency traders, portfolio managers, hedge-fund executives and corporate treasurers in Asia and elsewhere, a picture has emerged of the sequence of events and the players who were central to the drama.

First, the talk of a Japanese interest-rate increase raised fears among commercial bankers, investment bankers and others about the safety of big investment positions that were predicated on currency stability.

As these investors scurried to liquidate holdings in local currencies, the anxiety spread. Big foreign companies operating in the region became frightened, too, and scrambled to convert local revenues into dollars. And finally, local companies rushed to get yen and dollars. With everyone running for the exits, the Thai baht, the Indonesian rupiah and other regional currencies were trampled.

"Big movements in asset markets don't tend to happen unless all the actors move from one side of the ship to the other," said Peter Fisher, head of market intervention at the Federal Reserve Bank of New York.

Michel Camdessus, the managing director of the International Monetary Fund, said in a speech in Malaysia on Dec. 2 that the IMF had been studying the impact of speculators in all this. "But from what

we know so far," he said, "it would be a mistake to blame hedge funds."

Among the first to take the stage in the summertime drama were the bankers and treasurers, and a financial technique of theirs known by some as the carry trade.

For years, because of rock-bottom interest rates in Japan and low rates in the United States, banks, investment houses and insurers had borrowed in yen and dollars and put the proceeds into short-term notes in Southeast Asia that were paying far higher rates. These are the so-called carry trades.

The trades attracted so many investors because the Southeast Asian currencies had been stable for years. Still, they did not come without risks. Should foreign interest rates rise, or the currencies start to lose their value, the profits would diminish -- or might turn into losses.

Indeed, just the threat of a Japanese rate rise was enough to cause some investors to unwind their positions. That meant they sold their Asian notes and, in the process, the local currencies.

"If you had 50 banks doing it, that could create some pressure," conceded David Puth, head of foreign exchange in New York for Chase Manhattan, which had been involved in carry trades. "There are big forces in the market that are totally separate from speculators making a bet."

American companies that do big business in Asia, like Dell Computer Corp., added to the pressure as they rushed to protect themselves against further declines in the value of the local currencies in which they were paid. They did this by hedging, which allows an investor to lock in an exchange rate.

Mutual funds, like the T. Rowe Price New Asia Fund, moved, too, selling Asian securities and converting the proceeds back into dollars, further driving down the value of Asian currencies.

But chief among the participants were the many local companies and banks in Thailand, Singapore, Malaysia, Indonesia and South Korea that had borrowed billions of dollars at low rates abroad. Some used that money to expand; many banks used it for lending in overheated real-estate markets.

As their currencies fell in value, the amount the companies and banks owed in dollars and yen skyrocketed. To make their payments, these players also scrambled to get into dollars or yen.

What makes a currency move "is the enemy within, the corporates," said Chris Tinker, regional head of economics and debt research at ING Barings Asia in Hong Kong. Camdessus of the IMF added, "The most important factor in the depreciation of exchange rates was the rush by domestic corporations to buy foreign exchange."

The underlying cause of the rout, Camdessus contended in his speech, was the mistaken faith of millions of investors in the stability of the smaller Asian currencies. Such misplaced faith makes the Asian decline similar in its origins and its unfolding to the European currency crisis of 1992 and 1993, when sudden, surprising declines in the British pound, the Italian lira and other currencies ended a long period of stability there.

In Southeast Asia, the frame of mind that led investors to rely on the stability of currencies was shaped by the prevalence of "pegs" -- direct and indirect -- that local governments put in place to tie, or effectively fix, their currencies to the movements of the dollar. So certain were many investors of that stability that they refused to pay the cost of insurance, through hedging, against a currency fall.

"You had banks and financial institutions that believed so much in the peg because they made money on the peg," said Ang Thiam Huat, the group treasury manager at NatSteel Ltd. in Singapore. "So over time, it is deemed to be riskless," he explained, adding, "Peer-group pressure in the financial community is so strong that if you said it was risky, people would look on you as an outcast."

But a currency trader based in Singapore for a major U.S. investment bank, who spoke on condition of anonymity, said: "Nobody is going to admit that they did not hedge well. We have people who are still lying about their exposure."

Dell Computer, which is based in Austin, Texas, was in the same position as hundreds of local companies in Asia, taking advantage of currency stability but without insurance against a fall.

"We didn't implement the hedge in many countries, because of the peg and the low volatility," said Mark Stevens, the controller of Dell's Asia Pacific Group. Slightly more than 6 percent of Dell's annual revenue of $11 billion comes from Asia.

Not until June, when the Thai baht had been under strong pressure for a month, did Dell begin to hedge against a decline in the currency. Stevens first bought insurance in the form of options, which for a fee gave Dell the right, but not the obligation, to turn baht into dollars at a set rate. Before long, however, it did actual trades that would convert the next several quarters of baht revenue into dollars at set rates.

Dell made a similar move in Malaysia in July, Stevens said, because the negative economic news there made the company feel that the currency, the ringgit, could not resist the pressure to fall.

But the problems in Southeast Asia did not make companies rush immediately to hedge their currency exposures elsewhere. Dell, for example, did not hedge in South Korea until October, in part, Stevens said, because of the high cost -- about 10 percent of the amount being hedged.

In Hong Kong, Dell hedged on Oct. 23, the day the stock market there fell 10.4 percent. Dell had waited because the Hong Kong dollar's tie to the American dollar was the most secure.

As the turmoil worsened, Stevens said, Dell increasingly relied on hedges. Its coverage in the region is now nearly 100 percent for the next several quarters.

At the T. Rowe Price New Asia Fund, which has holdings throughout the region, withdrawals by individuals began to mount in the summer after the sharp decline in local stock markets.

At the end of June, the fund had $1.9 billion under management. But between July 2 -- when the baht was devalued -- and the end of November, withdrawals exceeded new deposits by more than half a billion dollars, according to AMG Data Services, which tracks mutual-fund performance. That outflow, together with the sharp fall in the stocks in its portfolio, left the fund with just $844 million.

Chip Wendler, a vice president of Rowe Price-Fleming, which manages T. Rowe Price international funds, said his funds did not have to do too much selling at the market low points. But he acknowledged what he called the "marginal" impact that the selling of local securities and the conversion back into dollars had on Asian markets when the entire mutual-fund industry is taken into account. Still, he argued, such transactions alone "would never have cracked the currency."

Certainly, the speculators played a role, too. "I am sure that there were specs shorting the rupiah in Indonesia," said a top analyst at a major hedge fund, who spoke on the condition that he not be

identified. "They saw what the corporates were doing and joined in."

To short a currency, an investor borrows an amount in local money and converts it to a stronger currency, betting that the local currency will decline in value, and thus can be bought back at a lower price when it comes time to pay off the loan. The investor profits on the difference between the two prices.

But, said Jeffrey Lim, director of structured products at American Express Bank in Singapore, "The speculators would never have been as successful as they have been unless everyone jumped on the bandwagon."

That view -- of the speculator as just one of the players on the field -- was echoed by Camdessus in his Dec. 2 speech in Kuala Lumpur, Malaysia.

"It is becoming increasingly difficult," he said, "to distinguish between the activities of hedge funds and other institutional investors."

The IMF report on the European currency crisis of the early 1990s summed up that situation in a strikingly similar way.

"The difference between hedging and speculation becomes blurred when most market participants become convinced -- rightly or wrongly -- that a nontrivial change in exchange rates is coming, and that the change is likely to be in one direction," it said. "In that circumstance, everyone gets into the act."

Copyright 1997 The New York Times Company