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No, it's not 1997, but Asia is still exposed to nasty risks

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Some reckon there are enough parallels between financial conditions now and just before the Asian financial crisis to warrant serious concern

Next week doesn't only mark the 16th anniversary of Hong Kong's handover. It is also the 16th anniversary of the Thai baht's devaluation: the moment when a local financial crunch in Bangkok went regional, triggering Asia's catastrophic currency crisis.

That might seem a distant memory, but there are enough parallels between financial conditions now and then to prompt some to ask whether Asia today is on the verge of a similar economic abyss.

In early 1997, as in 2013, Asia's asset markets had been lifted to new highs by an inrushing tide of cheap foreign capital. With confidence in the region's future high and local currencies strong, Asian businesses borrowed enthusiastically to fund evermore ambitious investment projects, many of them in fast-rising local property markets.

Then, as now, debt levels rose sharply and current account balances deteriorated, even as in Hong Kong home prices surged to a record high.

Then things started to go wrong. With the US Federal Reserve adopting an increasingly hawkish stance, international liquidity conditions began to tighten.

In response, foreign investors started to yank their funds from the region, and Asian currencies came under increasing stress as official reserves dwindled.

With the Thai devaluation, the outflow became a flood. Regional currencies plunged, borrowers defaulted, under-capitalised banks imploded and economic growth evaporated.

In Hong Kong, stock and property prices crashed as the city entered a deflationary spiral that lasted six long years.

With memories so traumatic, it's not surprising that the financial turmoil of the past couple of weeks has reminded many of the early stages of the 1997 contagion.

"For students of Asia, and those who have lived through the tumultuous summer of 1997, the latest gyrations cause deep unease," noted HSBC economist Frederic Neumann yesterday.

Similarly, analysts at UBS looked at the near 60 per cent fall in Thailand's net foreign exchange reserves over the past couple of years to ask, "Is there an impending currency crisis?"

Happily, there are enough differences between Asia today and back then to rule out a repeat of the 1997 crisis.

With the exception of the Hong Kong dollar, Asian currencies are no longer pegged, so there is no question of central banks attempting to hold indefensible lines in the sand.

Asian banks are better run, less leveraged, better capitalised than in 1997, and are far more able to withstand financial turbulence.

And although current account positions have been deteriorating lately, most Asian economies, except for Indonesia and India, are running surpluses, rather than deficits.

Finally, since 1997, Asia's central banks have accumulated plentiful foreign reserves, while the development of the region's capital markets has allowed more local-currency borrowing.

As a result, Asian countries have more than enough official reserves to cover their near-term foreign-debt obligations.

Although there is no question of a full-blown repeat of the 1997 crisis, the coming months could still be painful for some regional economies.

In a paper published this week, analysts at Morgan Stanley argued that both Indonesia and, to a lesser extent, Thailand are uncomfortably exposed. A sudden reversal of capital flows, they warn, would shut local companies out of international debt markets, trigger nasty asset price falls, prompt a sharp depreciation in local currencies, push up inflation, and force domestic interest rate increases which would dampen demand and weigh on growth.

So, although Asia is in far better shape now than in 1997, for many, next week's anniversary will be an unpleasant reminder that there are still some nasty economic risks out there.

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