Hong Kong and the Credit Crunch

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More than a year into the global financial crisis, there seems to be no end to the bad news. Those who at the beginning might have felt that the economy in Hong Kong would be largely unaffected have been left disappointed. That belief was bolstered by the fact that Hong Kong's economy and finances were seen as becoming increasingly more intertwined with that of the People's Republic of China than with the United States or Europe. The PRC has of course been the economic miracle story of the last few years, with huge foreign currency reserves and apparently never-ending growth. But it has now become clear that much of that growth depended upon demand for manufactured goods from economies that are now experiencing a severe downturn.

Further "comfort factors" for belief in the Hong Kong market had been that property prices had remained buoyant as had the stock market – experiencing a significant boom in 2007 and even though those levels drifted off, the Hang Seng Index in April / May of 2008 was still some 20% to 25% higher than at the start of 2007. A result of this, at least anecdotally, is that Hong Kong businesses were carrying good levels of cash or easily realizable assets and that any "credit crunch" was therefore of less concern as long as the Index remained aloft.

However, stock prices can fall quickly – the Hang Seng Index has fallen around 50% in the last six months. Property prices too, which seemed to be remaining rather robust in the first half of the year, have taken a sharp turn south since the summer, returning to levels last seen a year ago and, it would seem, continuing on the same trajectory.

Clearly any isolation or perceived isolation of Hong Kong was not be enough to resist the strong winds that blew from the US to dramatic effect during mid-September 2008, starting with the collapse of Lehman Brothers and then, within a day or so, news of a US Government rescue of AIG. It became clear very quickly that the collapse of Bear Stearns about 6 months earlier had not been a one-off event. A key problem now, in Hong Kong as well as elsewhere, is a confidence crisis, particularly for lenders and suppliers. It is easy for customers to believe rumours which, when acted on, can cause real problems, an example in Hong Kong was a run on Bank of East Asia being apparently caused by SMS messages.

For insolvency professionals, the new economic climate is likely to see an increase in work, but it is interesting to speculate how such work will differ from previous recessionary periods. The conventional wisdom has been that the next "round of restructurings" would be led by hedge funds and investment bankers (especially debt traders). However, there are not many of the latter left and a number of hedge funds are reportedly being badly hit given that the problem that has hit the economy appears primarily to be in the financial community itself. For companies facing financial difficulties one big problem will be working out precisely who the players in the restructuring are to be. A further complication in this regard will result from the large increase since the last "round of restructurings" in the use of credit derivatives. One potential problem here is that the lending side of a bank may not even know (due to the necessity to keep information barriers in place) what credit protection (or additional exposures) the bank as a whole has. This could lead to some interesting negotiations in restructurings and possibly some red faces and difficult legal issues in more formal court-led administrations, where cards will necessarily have to be laid on the table rather than clutched to the chest.