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STAND BY: THE CRISIS IS JUST BEGINNING !

Most, if not all, banks of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC) are in trouble, today.

Crisis may not be too strong a word to use to describe the situation in many banks of the territory.

And there is a great deal more trouble, yet to come.

These problems will materialise within the next 12 months to 36 months.

This is not to suggest that HKSAR banks will collapse, but, for certain, profits will partially collapse in the coming few years – at least.

And the main and immediate reason for this depressing scenario boils down to the situation with regard to the deteriorating prices of real estate in the HKSAR – prices, which are likely to fall even lower in the next few years.

Historically, real-estate prices have been the backbone of banking for the HKSAR, with lending practices, being based on the market value of bricks and mortar, to a very great extent.

Real-estate prices, though they have gone through some very deep troughs in the past, have, always, recovered, rather spectacularly, in the fullness of time.

But it was time that was the essence in yesteryear.

Today, there appears to be no sign that real-estate prices will recover in the next few years.

And time is, still, of the essence.

This scenario leaves a number of HKSAR banks, if not all of them, looking at a situation whereby the loans that they afforded to investors and home-owners are only marginally covered by today's market prices of property, used as collateral.

In many cases, investors and home-owners are looking at negative equity values of their purchases of HKSAR properties.

Banks are repossessing hundreds of pieces of property in efforts to limit their losses, perceived and real.

They are selling those repossessed properties at prices, which, in terms of just 2 years ago, are lower by 65 percent or more.

Even if HKSAR property prices were to climb by 100 percent in the next 12 months, it would still be only about 70 percent of the average price of properties of a few short years ago.

In short, there would still be insufficient *'cover'* for banks to allow customers, using property as collateral for loans, to continue: The banks would close their doors to such customers.

And a 100-percent gain in property prices in the HKSAR, within the next year, is to expect an ant to be able and willing to try to rape an elephant.

Many banks, which lent money to companies in order to allow those companies to purchase their offices (or more, in some cases), are now looking at cash-flows of those companies before renewing credit facilities, which are, now, renewed semi-annually.

An example of this was that Sir Run Run Shaw, who, in the past has never had to worry about raising money for any project, being among the richest of the rich in the HKSAR, was forced to ante up sufficient money to permit his Shaw Brothers (Hongkong) Ltd (Code: 80, Main Board, The Stock Exchange of Hongkong Ltd) to complete construction of its new studio in Tseung Kwan O, New Territories, the HKSAR.

Sir Run Run Shaw's private company had to tip about $HK445.70 million into the Shaw Brothers' *'pot'* – because the publicly listed company's traditional bankers turned down an application for more money from the publicly listed company in order to complete construction of the studio.

Sir Run Run Shaw is the Chairman of Television Broadcasts Ltd (Code: 511, Main Board, The Stock Exchange of Hongkong Ltd) and, at 96 years of age, the determination of the banks, not to extend any more money to the mogul's company, must have come as a rather rude awakening.

The British concept of banking – *'What is your collateral, please?'* – no longer seems to apply in the HKSAR, it, having been replaced by the US concept of banking: *'What is your cash-flow, please?'*

Still, the Chinese concept of banking – *'What is your name, please?'* – is in vogue, but even former golden names are becoming suspect, today, in the HKSAR, as Sir Run Run Shaw, recently discovered to his dismay.

For people with a great deal of spare cash, it would appear that today is a good time to strike, picking up seemingly cheap properties, from prime commercial property, to industrial property, to residential property.

But the smart money is waiting because it is only too clear that there will soon be a glut of properties, coming onto the market, as banks look to clear force majeure property portfolios, with which they are lumbered.

From a balance-sheet point of view, many banks will be forced to bite the bullet, as auditors make demands for Provisions in tens of billions of dollars.

(No public company would want to have its accounts qualified at this late stage in the game)

This will continue to dent the Bottom Line of many a bank, without question.

In the case of The Bank of East Asia Ltd (Code: 23, Main Board, The Stock Exchange of Hongkong Ltd), the Chairman, Mr David Li Kwok Po, has, only recently, openly admitted that his bank had to sell not less than 200 pieces of property, all of which were repossessed in the past year or so.

In addition to companies with properties, pledged to banks as collateral for loans, there is the added problem of many of the construction companies of the HKSAR.

Many local banks lent hundreds of millions of dollars to property companies.

These property companies, in the past, had been considered good customers to which banks afforded, what they termed, secure loans.

But there is a big difference between a secure loan and a sound loan.

Security can vanish, in a matter of months, or be whittled down in a relatively short space of time, or, in the case of a ship, the vessel can sink in a matter of minutes.

Whereas, the sound loan is one whereby the principal shareholder of a corporate entity, or the *'proprietor'* of an entity, stands behind the loan.

As was the case in respect of Sir Run Run Shaw and his company, Shaw Brothers.

However, even the sound loans of yesteryear are, today, being carefully scrutinised by banks, which, just a few years ago, would never have dreamed of doubting the very prominent figures, who were standing behind, what was thought to be, the soundest of sound loans.

Today, it is quite clear that a number of HKSAR and PRC moguls, presently enjoying a prestigious and privileged position in their respective communities, will not be able to meet their, and their children's/families' financial commitments to banks and other lending organisations if push comes to shove.

If it comes down to the wire, these moguls are likely to allow their charges to go down the tubes, leaving the lending banks, screaming for their money.

But that is not all.

When HKSAR banks were hungry for business, they were affording prospective new home-owners up to 70 percent of the market value of their proposed new homes.

Today, they rue that determination.

In addition, while the banks were perfectly happy to advance up to 70 percent of the assessed value of a new flat/house/office, etc, in order to clear their stocks of flats, many HKSAR developers had been offering discounts of up to 25 percent of the stated, advertised selling price of units, luring prospective investors/home-owners to them.

At such generous terms, it meant that a prospective, new home-owner could move into a new flat for very little money, up front.

In some cases, the bread-winner would not even have to put his hand into his pocket in order to secure a new home for his family.

Today, however, the situation is vastly different: These same home-owners are looking, in many cases, at negative equity values – and without the wherewithal to service the interest factor or whittle down the principal.

This situation has come about without any fault being attributed to the hungry home-owners because wages and salaries have fallen, dramatically, over the past few years, and, in many cases, the principle wage-earner is unable to earn sufficient money to keep the creditor wolves away from his door.

What is likely to happen, in such cases, is that the families will just walk away from their problems, leaving banks to pick up the pieces.

From the property developer's point of view, he has his money and could care less about the banks' problems.

One has seen this of late, with banks, now accepting that the industry average for defaulting credit-card holders is about 15 percent – which is at a record-high level.

The War And The Prospects Of War

As TARGET has stated, many times before, the world of today is akin to a housewife, baking a giant apple pie, using 6 different ingredients.

The omission of any one of the ingredients will alter the final product.

In the US, there is a Texan who, in TARGET's opinion, tends to shoot from the hip, without taking careful aim.

President George W. Bush has declared his intentions to oust President Saddam Hussein of Iraq from office and *'to liberate'* the country from the iron fist of the Iraqi political regime of the past quarter of a century.

The cost of this war, according to TARGET's estimate, is about $US1 trillion, in all.

That price includes the cost of sending in the troops on the basis that the war will last about 6 months – about 250,000 soldiers, airmen, with a naval flotilla in support – and about $US108 billion to keep ground troops in Iraq for a period of about 18 months after the cessation of hostilities.

(For more details on the cost of the US, waging war on Iraq, please see TARGET Intelligence Report, Volume V, Number 15, published on January 22, 2003)

There is not enough money in the Bush kitty to pay for the war so that, no doubt, the printing presses will have to be cranked up in order to spew out some more US dollar bills.

When President George W. Bush, in a White House Press Conference, was asked what he thought would be the cost of a war with Iraq, he, flatly, stated that he did not know, but that that cost, whatever it might be, would not be as great as would be the cost of leaving President Saddam Hussein alone in his desert fiefdom.

The effect of printing more US dollars, in order to fund the war effort and all the other economic stimulus packages that the US President is trying to push through Congress, will be inflationary, resulting in The (US) Federal Reserve Board, having to start to increase short-term interest rates.

This is likely to come about later in the year, perhaps, closer to Christmas.

But come it must.

In the interim, on the basis that President George W. Bush does push the war button, the effects will be, definitely, a rapid increase in the price of crude oil, a rapid decrease in the number of people, travelling internationally, for whatever reasons, more airlines will declare that they are unable to pay their bills as they fall due, a heightened state of alert in major business centres, around the world, hotels in popular tourist spots, finding themselves with occupancy levels of 30 percent, or less, and, generally, consumer confidence, internationally, at floor level.

A guns economy will replace today's butter economy of the US as the war machine cranks up speed in order to churn out those armaments to permit the strongest nation in the world to win the good fight against the evil oppressor of the Middle East (TARGET, here, paraphrases the words of President George W. Bush).

For the HKSAR, especially, it could find itself in a very difficult situation.

As with many Asian cities, where tourism plays an important role in their respective economies, without the tourist's dollar, businesses will be forced to close their doors.

Banks will be left, holding onto tens of hundreds of screaming corporate *'babies'*, all crying for *'milk'* (cash).

And there will be no *'milk'* to feed them.

As interest rates rise, depending on the increase, of course, it will exacerbate an already very difficult situation.

For the weaker HKSAR banks, they may have to make some kind of arrangement to obtain further funding as investors look for a safe haven for the cash that they have left.

(In Japan, it has, already, been confirmed that even the biggest banks are looking for further injections of cash, in the HKSAR and the US – and Japan is the world's second largest economy)

This is not to suggest that there will be a run on any bank, again TARGET emphasizes, because, at the first sign of material problems in any HKSAR bank, no doubt, Beijing will come to the rescue.

Face is everything to the Oriental mind; and, Beijing does not want to run the risk of seeing its great HKSAR experiment – One-Country, Two-Systems – be known as a terrible catastrophe.

Just how long it will take for an economic recovery to take place in the HKSAR and in many other parts of Asia is anybody's guess, but it will be very interesting to see how many old-timers survive the coming economic holocaust.

In the meantime, it would appear that cash is king, and it will remain king for at least the next few years.

Those companies that do not have a cash, fall-back position may wish that they had made provisions for a contingency fund – because they will be especially vulnerable, with banks, snapping at their heels.

This analysis is meant to be read in conjunction with last Wednesday's lead report:
WHEN THE U.S. REAL-ESTATE BUBBLE BURSTS, WHAT THEN ?

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