EMERGING MARKETS

GHEORGHE CARALICEA-MĂRCULESCU,
Associate Professor, Phd,
„Constantin Brâncuşi" University of Tg-Jiu

ABSTRACT

The emerging markets are winning the currency war, because at this very moment its the battle of global financial institutions , as to who is more vulnerable and more exposed to the debt crisis and have their hands in more risky assets. US and Euro with their intertwining the financial stuff of the nation, the banks and the corporations are in a deep mess. One goes down, takes the other ones too. Right now , they all are struggling and getting beaten up , while the emerging markets are quiet and not really expressing their stands on the current situation except are reacting by all only putting their own houses in order.

KEY-WORDS: currency war, foreign capital, creditworthiness, global spending

One more such victory

The emerging economies are winning the currency war. No one is celebrating

A year ago Brazil's finance minister, Guido Mantega, declared that the world had entered into a "currency war". He worried that in a depressed global economy, without enough spending to go around, countries would sally forth and grab a bit of extra demand for themselves by weakening their currencies. The dollar, for example, fell by 11% against Brazil's real in the year to August 2011, much to the chagrin of Brazil's manufacturers. Like other emerging economies it fought back by imposing taxes and other restrictions on foreign purchases of local securities.

But the invasion of foreign capital that so worried Mr Mantega has now turned into a shambolic retreat. The outflows have dragged down the exchange rates of almost every emerging economy since the beginning of August (see chart 1). Having spent much of the past year fretting about their currencies' rise, central banks across the emerging world have now intervened in the markets to slow their currencies' fall. In a currency war, where each side fights to gain competitiveness against the others, these tumbling exchange rates presumably count as victories. But they are Pyrrhic.

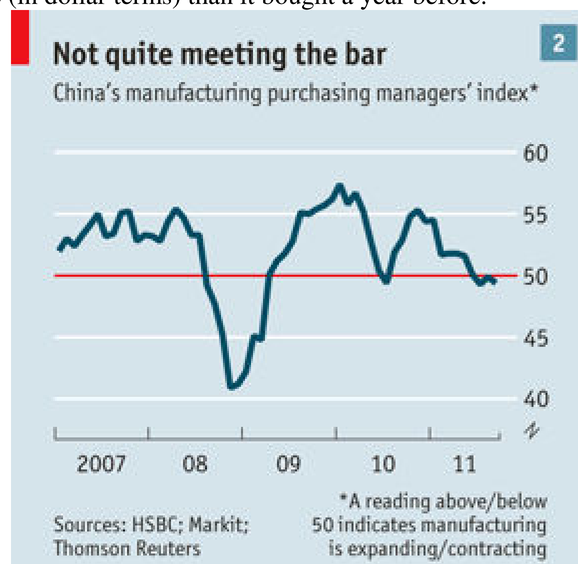
That term originates with the Greeks—Pyrrhus was a Hellenistic general whose victories against Rome came at a grievous cost to his own side. The Greeks are also partly responsible for more recent reversals. As the government in Athens teeters on the brink of default, investors have begun to doubt the creditworthiness of other euro-zone governments, as well as the banks that lent to them. The gathering unease has left global investors less willing to tolerate the risks associated with volatile emerging economies.

Indeed, some are unwilling to tolerate risks of any kind. They are accumulating cash by selling other assets, from gold to Thai equities, more or less indiscriminately. An index of emerging stockmarkets prepared by MSCI has fallen by over 20% since August 1st, despite a rally on September 27th. The worry now is that bonds will follow suit. Foreign investors hold a third of the local-currency debt issued by Indonesia, Korea, Malaysia, Mexico, Poland and

Turkey. In a conference call, Bhanu Baweja of UBS worried that the stomach-churning developments in Europe and America might prompt these investors to "puke" up their bondholdings.

A cheaper real, zloty and rupee will help emerging economies win a bigger share of global spending. But that is small consolation if global spending declines. The volume of exports from Latin America and Asia did not surpass its pre-crisis peak until the first quarter of this year, according to the Netherlands Bureau for Economic Policy Analysis. And foreign sales are bound to fall again as America stagnates and a two-speed Europe converges on a single, slower pace.

Falling export orders was one of the complaints voiced by Chinese manufacturers in a preliminary survey of purchasing managers published by HSBC last week. The survey showed manufacturing shrinking from the month before (see chart 2), adding to the gloom on world markets. But HSBC's China economist, Qu Hongbin, believes GDP will still grow at an annual pace of 8.5-9% in the second half of this year. China's economy is not as dependent on exports as it was, he points out. International trade (exports minus imports) contributed a little less than nothing to the country's growth in the first half of this year. And imports have remained strong: in the traumatic month of August, China imported 30% more (in dollar terms) than it bought a year before.



These imports included iron ore and other materials destined ultimately for China's construction industry, which has become a mainstay of the economy's growth, but also a headache for its policymakers. To quell property prices, the government is trying to starve real-estate developers of financing. First, it restricted bank lending; now it is removing trust-company financing from the menu. But even as it curbs the top end of the property market, the government is urging local authorities to build affordable housing. Bricks are still being laid, even if less profit is being made. Homebuilding is surprisingly buoyant (housing starts increased by 32% in the year to August), even as home builders take a battering on markets.

If the world economy were to collapse, emerging economies have scope to ease policy. Michael Buchanan and his colleagues at Goldman Sachs calculate that emerging Asia could offset a growth shock of up to 5.1 percentage points, if they allowed their interest and exchange rates to fall to their lowest points in the crisis, and their budget balances to deteriorate as far as they did in 2009.

In Israel, where inflation expectations have fallen, and Brazil, where they have not, central banks have already started cutting rates, even though inflation in both countries remains above the official target. Thailand's new government is beginning a fiscal splurge, including generous purchases of rice from the country's farmers, that may prove better timed than it seemed when it was promised.

But other emerging economies will be more reluctant to stimulate, precisely because they have done so before. India's central bank is still preoccupied with the inflation that quickly ensued after the financial crisis abated. As recently as September 16th, it raised interest rates for the 12th time in 18 months. And China is only now coming to terms with the bad debts amassed by local governments during the stimulus lending of 2009 and 2010. Loans worth perhaps 2 trillion-3 trillion yuan ($310 billion-630 billion) may have already turned sour, according to China's banking regulator. It is now scolding banks for the recklessness that was urged upon them during the crisis. If the central government decides that another stimulus onslaught is necessary, it may find the banks are less willing footsoldiers. Even successful battles leave casualties in their wake.

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