

Argentine financial crisis could signal broader turbulence

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Argentina's decision on Tuesday to ask the International Monetary Fund (IMF) for financing to help stem the slide of the peso has raised the question of whether this could be the start of a crisis affecting other so-called emerging markets.

Argentine President Mauricio Macri announced he was going to the IMF after three interest rate hikes in ten days by the country's central bank—the latest lifting its rate to 40 percent—failed to halt the sell-off.

Argentina is seeking a “flexible line of credit” (FCL) of some \$30 billion, to come without conditions attached by the fund. Whether the country obtains such a stand-by facility is another question. The IMF stipulates that FCLs are designed for countries with “very strong fundamentals and policy track records.”

IMF managing director Christine Lagarde issued a statement saying Argentina was a “valued member” of the IMF and discussions had begun on “how we can work together to strengthen the Argentine economy.”

Those words sound an ominous warning for the mass of the Argentine people who recall only too well the devastation imposed under IMF intervention in 2001, when one in five workers lost their jobs, banks closed and the peso lost two thirds of its value.

The Argentine crisis forms part of a developing global turbulence in which a number of countries with high debts are coming under pressure because of rising interest rates and an appreciation in the value of the US dollar.

As the *Financial Times* noted in a comment earlier this week, the Argentine crisis of 2001 did not spread to other markets. “Yet this time, Argentina's woes are not isolated. Not only is there a global cause, in the stronger dollar and rising interest rates, but there is also fairly widespread weakness.”

Turkey may be next in line, with the lira hitting a

record low this week. President Recep Tayyip Erdogan announced yesterday that together with his top economic advisers he would take action to curb inflation and halt the slide in the currency. But no specific measures were announced. Turkey's central bank may be forced to again lift interest rates after earlier raising its rate by 75 basis points.

A government statement said the central bank would continue to use the instruments it had in its possession and “in the period ahead our country will continue on the path of growth-based policies.” These statements are considered unlikely to calm market movements. The lira has fallen for months due to widening current account deficit and rising inflation.

The Turkish economic situation is complicated by elections on June 24, both for the presidency and parliament. The government is seeking to make economic concessions to voters amid fears that the elections could be closely run.

The lira has lost about 13 percent of its value against the dollar since the start of the year, sparking fears this could cause problems for corporations that have large dollar-denominated debts.

Indonesia is also being adversely affected. Its stock market is on a downward trend and interest rates on government bonds are rising. The rupiah is down to a 28-month low against the dollar. International investors have dumped \$2.2 billion worth of stocks and bonds since the beginning of April, and the central bank is considering raising interest rates for the first time since 2014.

A report on Bloomberg noted that foreign investors own almost 40 percent of Indonesian government bonds, among the highest in Asia, making “the economy especially vulnerable to a slump in sentiment and sharp outflows.”

Besides Argentina and Turkey, the Institute for International Finance has said that Ukraine, China and South Africa are most vulnerable to changes in “risk appetite,” while “asset valuations look most stretched in Hungary, Korea, Thailand, Poland and the Czech Republic.”

Last month the IMF warned that 40 percent of sub-Saharan economies were at high risk of debt stress because they were struggling to finance foreign currency debts after their currencies had depreciated.

One of the key factors driving the rising turbulence is the expectation of further interest rate rises in the US. The Federal Reserve is on course for a further quarter percentage point rise at its next meeting in June.

The impact of US interest rate rises on emerging markets was addressed by Fed chairman Jerome Powell in a speech delivered in Europe earlier this week. He spent some time on the “spillover effects” of US policies.

The basic theme of the speech was that “normalization” of monetary policies in the major economies should continue to prove “manageable” for emerging markets and “markets should not be surprised by our actions if the [US] economy evolves in line with our expectations.”

But Powell did not dismiss “the prospective rises emanating from global policy normalization. Some investors and institutions may not be well positioned for a rise in interest rates, even one that markets broadly anticipate. And of course future economic conditions may surprise us as they often do.”

Besides the rise in US interest rates and the dollar, other factors causing market turbulence include the impact of the intensifying trade war between the US and China, and the fallout from the US decision to unilaterally withdraw from the nuclear deal with Iran.

In 1998, when the Thai baht collapsed, setting off a major crisis throughout South East Asia, US President Bill Clinton referred to it as a “glitch” on the road to globalisation. But the Asian financial crisis rebounded on the US with the collapse of the Long Term Capital management. That required a bailout by the Federal Reserve lest it set off a meltdown in US financial markets.

It is not yet clear whether the present market instability will have a similar impact. However, the Argentine crisis and the tremors in emerging markets

could be warning signs that the financial house of cards created by the pumping of trillions of dollars into the financial system since the crisis of 2008 may be starting to shake.



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