Mounting turmoil in emerging markets

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There are now clear indications that the plunge in the value of the Argentine peso and the Turkish lira in recent weeks is the most graphic expression of a developing “emerging markets” crisis with global implications.

Argentina remains in the eye of the storm as emergency measures, including the lifting of the bank rate to 60 percent, intervention by the International Monetary Fund and commitments to begin further austerity measures, have failed to halt the flight of capital.

The social consequences are immediately apparent. A major university study has reported that the already depleted buying power of the country’s retirees has fallen by at least 30 percent since President Mauricio Macri took power at the end of 2015, and is now down to where it was at the time of the collapse of the country’s economy in 2001. Further attacks are now being directed at ever-wider sections of the population in response to the latest collapse.

The fall in the Turkish lira has abated somewhat in the last few days. But it could resume at any time if the central bank does not take action to lift interest rates at its meeting next Thursday.

The currency turmoil is now spreading across the spectrum of emerging markets, with an index of equity markets for these countries down by more than 20 percent since January and entering bear market territory.

Yesterday, the Indonesian rupiah fell to close it its lowest level since the Asian financial crisis in 1998. The country’s share market suffered its worst day in two years, falling by 3.8 percent, while yields on government bonds rose to 8.49 percent, the highest since January 2016. Indonesia, which has been described as the nearest thing to Argentina and Turkey in the Asian region, has come under financial pressure because of its dollar indebtedness and its current account deficit.

In the Philippines, the peso fell to a 12-year low against the US dollar amid concerns over inflation and the impact of a strengthening US dollar.

The South African rand has fallen to its lowest level in two years following the release of data showing that the country had experienced two consecutive quarters of negative growth in the first half of the year. Output in sub-Saharan Africa’s most industrialised nation fell by 0.7 percent in the second quarter, following a 2.6 drop in the first three months of this year.

The Mexican peso has also come under pressure, not least because of uncertainty about the future of the North American Free Trade Agreement.

While there are particular issues in each of these countries, the currency falls are a product of the strengthening US dollar and the increase in interest rates, which is starting to suck capital back into American markets, creating dollar liquidity problems.

This is combined with the growth of uncertainty, especially for commodity-exporting countries, resulting from the escalation of trade war measures by the United States against China. The administration is set to announce plans for levying tariffs on a further $200 billion worth of Chinese goods, on top of the tariffs already imposed on $50 billion worth, possibly as early as this week.

As the *Financial Times* reported this week, analysts from the French financial firm Société Générale commented: “Can emerging markets turn the page and find their feet after the assault of August? Expectations are low, and more worryingly, if one looks at currencies like [the Australian dollar] or at European stocks, cracks are starting to appear in the G10 as concerns over trade and growth from tightening conditions in EM take their toll.”

This week, Bloomberg published a significant report by well-known financial analyst Satyajit Das warning of what he called a "textbook emerging market crisis," in which large debts combine with a domestic credit bubble, uneconomic projects, financial speculation, the reliance on commodity exports and inadequate currency reserves.

Based on these criteria, he noted, "the number of emerging markets at risk extends well beyond Turkey and Argentina."

The most striking indication of a developing crisis cited in his report was the escalation of debt. Total emerging market debt increased from $21 trillion (145 percent of gross domestic product) in 2007 to $63 trillion (210 percent of GDP) in 2017. The foreign currency debt of these countries has doubled in the same period to around $9 trillion, with China, Indonesia, Malaysia, South Africa, Chile, Mexico, Brazil and some eastern European countries saddled with foreign currency debt between 20 and 50 percent of GDP.

He noted that EM borrowers in total needed to repay or refinance $1.5 trillion of foreign debt in 2019 and the same amount in 2020 and "many are not earning enough to meet those commitments."

Combined with tightening global liquidity, resulting from interest rate rises in the US and tensions arising from trade conflicts, "weaknesses in the real economy and the financial system feed each other in a vicious cycle."

While the situation is commonly described as an "emerging markets crisis," this is something of a misnomer because its origins lie in the heart of the financial system not in its extremities.

In the years following the eruption of the global financial crisis in 2008, the US Federal Reserve, after bailing out the banks and finance houses, pumped trillions of dollars into financial markets, making available ultra-cheap money that facilitated the continuation of the speculation that had caused the crisis.

With interest rates in the US and other major economies at historic lows, money from banks and investment funds poured into emerging markets, where rates were higher. Now this money is being pulled back into the US as interest rates there start to rise.

This takes place under conditions where the potential volatility of the global financial system has risen to new heights in the ten years since the financial crisis as a result of the rapid increase in the use of computer trading, accelerating the speed with which massive funds can move in an out of markets.

The business channel CNBC this week reported an analysis conducted by Marko Kolanovic, one of JPMorgan Chase's leading financial analysts, warning that a new financial crisis could take the form of "flash crashes" such as the 1,600-point intraday drop on Wall Street in February.

So far, such turmoil has occurred under conditions of economic expansion in the US, but the "new market" has not been tested amid a recession. Under such conditions, there could be a rush to sell, removing liquidity and leading to a cascading decline in prices.

"Suddenly, every pension fund in the US is severely underfunded, retail investors panic and sell, while individuals stop spending," he said.

Pointing to the social and political consequences, he concluded: "The next crisis is also likely to result in social tensions similar to those witnessed 50 years ago in 1968."

The turmoil in emerging markets and its connection to the major banks and investment houses is a sure indication that none of the contradictions of the global financial system that exploded in 2008 has been overcome. In fact, the policies of the major capitalist government and central banks have only created a new series of financial powder kegs.