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Turmoil in International Financial Market under Rapid Depreciation of Emerging Countries' Currency

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Since early this year, turmoil in international financial and currency market has stemmed from the rapid depreciation of emerging countries' currencies and attracted global attention. In January, the Argentine peso depreciated rapidly, triggering financial and currency market turmoil. While the Argentine peso had been viewed as stronger than indicated by the economic reality and remained under downward pressure, the Argentine authorities had supported the currency through peso-buying and dollar-selling market interventions. But Argentine foreign currency reserves declined from $52.1 billion in 2010 to $30.5 billion at the end of 2013, and to around $20 billion at the end of January, leading market players to doubt that Argentine authorities could continue market interventions to support the peso. This induced a rapid peso decline.

The Argentine government is trying to defend the currency and fight inflation with interest rate hikes that could dampen the economy further. Argentina had continued its economic growth by expanding exports of commodities including soybeans, its mainstay product, amid a commodity boom. As the boom has ended with doubts emerging about the Chinese market's growth potential, however, various challenges and uncertainties about economic fundamentals have emerged in Argentina. Future developments are difficult to predict.

The Argentine currency's decline may fall short of attracting global attention as long as any subsequent turmoil is limited to inside the country. The problem is that the impact can be expected to spill over to other emerging countries plagued with similar structural problems and expand further into the world. In fact, the Argentine problem has already exerted downward pressure on the currencies of other emerging countries, such as Turkey and South Africa, and prompted their monetary authorities to raise interest rates. Fears have also emerged about the financial markets of Brazil, India and Indonesia. These five countries are plagued with common structural problems, including current account deficits, rapid inflation and high dependence on foreign funds for domestic economic growth. They are therefore called the "Fragile Five."

Financial market fears in these emerging countries are attributable primarily to their respective domestic fundamental economic problems, as explained above. From the global perspective, however, we see the impact of a U.S. plan to reduce monetary easing by tapering the third quantitative easing program. The growing U.S. economic recovery led the Federal Reserve Board to decide late last year to gradually reduce monetary easing. The Fed is now steadily implementing the decision. Under ultra-easy U.S. monetary conditions, investors have undoubtedly poured abundant money into buying various risk assets. The monetary easing reduction could prompt them to withdraw money from risk assets throughout the world.

In this way, a capital drawback from fragile countries has brought about the abovementioned turbulence and turmoil. On the stock market, investors have enhanced their risk-off moves, causing a rapid decline. As a result, stock market destabilization has spread from the abovementioned emerging countries to the United States and the rest of the world. In this kind of trend, investors shift money to less risky assets to avoid risks as much as possible. Due to such moves, the yen has risen again, contributing to the Japanese stock market decline.

Amid the growing fears, the market direction remains uncertain. For the immediate future, the market turmoil could deteriorate further depending on details and interpretations of key U.S. economic indicators, including jobs data. Another focus of attention may be the immediate future of the Chinese economy. China’s economic growth is expected to decelerate to a 7.0–7.5% range this year from 7.7% in 2013. In addition, shadow banking and financial product problems have been cited as factors affecting the future Chinese economy. China and other emerging countries are running out of “steam” after driving the global economy following the Lehman Shock, while seeing the emergence of various destabilizing factors. The United States is recovering on the benefits of the shale revolution while its future recovery remains uncertain. In trying to anticipate whether the present global financial market turbulence and turmoil would end or deteriorate further, we must keep a close watch on how the world’s first and second largest economies will perform.

The international financial market turmoil originating from emerging countries is important for anticipating the future international energy market for several reasons. First, the turmoil can affect global macroeconomic trends and impact economic growth and energy demand. Second, the turmoil could weaken demand for energy (and commodities) as well as global economic growth, given that most of the present global energy demand growth depends on expanding demand in emerging countries. Third, such energy demand growth drop could be coupled with growing expectations of medium-term energy supply growth to lower energy prices in the international market. Fourth, any financial market turmoil could induce a capital flight from risk assets, which could be combined with changes in energy and commodity market fundamentals to exacerbate price fluctuations. Fifth, if international energy prices decline rapidly for the four abovementioned reasons, it may exert negative impacts on the Middle East and Russia, which depend heavily on energy exports. Such development could have various political, economic and geopolitical implications. We should closely watch the future course of the present financial market turbulence and turmoil, including their impact on the international energy situation.

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