The Washington Post

Politics

Fed rate policy unintentionally pressures emerging economies

By Paul Wiseman|AP
August 15

WASHINGTON — President Recep Tayyip Erdogan is blaming the United States for Turkey's financial crisis, ignoring homegrown problems like high debts, raging inflation and his own erratic policies.

Yet one of the threats facing Turkey and other emerging-market countries really is made-in-America: By ratcheting up U.S. interest rates, the Federal Reserve has — unintentionally — led investors to pull money out of emerging markets like Turkey, strengthened the dollar's value and made it harder for foreign companies to repay their dollar-denominated debts.

The resulting flight of capital into safer and higher-yielding U.S. investments has sent many emerging-market currencies tumbling. The MSCI Emerging Markets Currency Index has sunk nearly 8 percent since early March.

Especially vulnerable are countries with weak economic fundamentals: Runaway inflation, bulging trade deficits, piles of foreign debt and paltry foreign-currency reserves available to intervene in the markets to help prop up their own currencies.

Turkey is Exhibit A: Inflation is running near 16 percent a year. The country buys much more than it sells abroad. Its borrowing binge has left Turkey highly vulnerable. Erdogan has rattled global investors by pressuring the country's central bank not to raise interest rates — the conventional response to high inflation. High interest rates normally help strengthen a nation's currency. But they also tend to slow economic growth, something Erdogan clearly wants to avoid.

Erdogan has named his son-in-law as finance minister, blamed foreigners for his country's woes and escalated tensions with Turkey's longtime ally the United States. On Wednesday, Turkey said it was increasing taxes on U.S. products like cars, alcohol and coal in retaliation for President Donald Trump's move to double tariffs on Turkish steel and aluminum. The two countries are feuding over Ankara's decision to arrest an American pastor and try him on espionage and terrorism charges related to a failed coup attempt two years ago.

The Turkish lira's value recovered a bit on Wednesday, by 5 percent to around 6.05 lira per dollar, after the government acted to shore it up by reducing the daily limit in bank foreign currency swap transactions. But even with Wednesday's gain, the lira is down 38 percent against the dollar since early March.

Yet among the currencies of emerging economies, it's hardly alone: Argentina's peso has lost 34 percent over the same period. That nation is grappling with a corruption scandal and double-digit inflation. Argentina's central bank just jacked up its benchmark rate to 45 percent.

Likewise, South Africa's rand has tumbled 18 percent. That country's economy hasn't achieved even a modest 2 percent annual growth in five years. And it runs a gaping deficit in its current account, the broadest measure of trade.

A crumbling currency inflicts many damaging consequences: Companies that borrowed in dollars — the global reserve currency — have to come up with steadily more money in their local currencies to repay U.S. dollar debts. Having to do so also raises risks for the banks that lent to them.

That's the kind of squeeze that ignited the catastrophic 1997-1998 Asian financial crisis. A currency disaster in Thailand infected the entire region, and East Asian economies absorbed devastating damage.

Fears of a replay have gripped financial markets as Turkey's crisis has intensified. "Contagion" is the word analysts use to describe their nightmare of seeing Turkey's problems spread across the developing world.

Still, most economists remain optimistic for now that another such crisis can be avoided. For one thing, Turkey's economy is uniquely mismanaged.

"Turkey is the No. 1 country we had our eyes on for a potential financial crisis in the Obama administration," said Jason Furman, a Harvard economist and a former chief economist for President Barack Obama.

Turkey's "economic circumstances are so different than many other emerging markets," Furman said, referring to the country's debts and Erdogan's unconventional policies.

And emerging-market countries learned lessons from the debacle two decades ago. Many piled up reserves to fend off speculative assaults on their currencies. At the start of 1997, emerging-market countries' reserves amounted to barely 6 percent of their economic output. Now, they equal nearly

18 percent, according to the Institute of International Finance, a banking trade group.

“Emerging-market countries, on the whole, have much stronger financial positions than they did 20 years ago,” the Wells Fargo Investment Institute said in a report Tuesday. Their foreign debts, for instance, have fallen from 38 percent of economic output in 1999 to 29 percent last year.

What’s more, emerging-market economies, for the most part, appear relatively stable. The International Monetary Fund expects them to collectively register growth of roughly 5 percent this year and next, which would be the best showing since 2013.

Turkey’s troubles are “unlikely to trigger a meltdown — just a fair bit of volatility in currency and financial markets,” said Eswar Prasad, a Cornell University economist and senior fellow at the Brookings Institution.

“Turkey is in a crisis because of a particular potent mix of bad economics mixed with even worse politics,” Mandy Xu, a Credit Suisse analyst, wrote in a research report.

More worrisome, Xu and others say, is the prospect of a sharp slowdown in the Chinese economy, the world’s second-largest after the United States. China’s growth slowed in the April-June period. Beijing has tightened lending controls over the past year to stem a surge in debt. The IMF expects Chinese growth to decelerate to 6.6 percent this year from 6.9 percent in 2017.

That slowdown poses at least a threat for emerging-market countries that export raw materials to Beijing. Among those with the most to lose are the Philippines, Russia, Malaysia, Brazil and Argentina, economist Vanda Szendrei of Oxford Economics noted in a research report.

China’s economy is also under threat from its escalating trade war with the United States. Charging that Beijing deploys cybertheft and other predatory tactics to try to surpass America’s technological dominance, President Donald Trump has imposed tariffs on $34 billion in Chinese products and is readying taxes on an additional $216 billion.

Negotiations to defuse the standoff have gone nowhere.

“We really need to see a bit of a truce,” said Gabriela Santos, global market strategist at J.P. Morgan Asset Management.

___

AP Economics Writer Christopher Rugaber contributed to this report.

—

Follow Paul Wiseman on Twitter at https://twitter.com/PaulWisemanAP

Copyright 2018 The Associated Press. All rights reserved. This material may not be published, broadcast, rewritten or redistributed.