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FOREIGN EXCHANGE

Fresh Stress Grips Weakest Emerging-Market Currencies

Dramatic market moves highlight a heavy international dependence on the dollar

By Mike Bird and Saumya Vaishampayan

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The Argentine peso hit a record low—prompting the country's central bank to raise interest rates to 60%—and the Turkish lira slid further, as emerging markets most vulnerable to a rising dollar bent under the stress on Thursday.

While Argentina and Turkey are in particular trouble because of domestic issues, developing economies around the world are being squeezed as the Federal Reserve raises interest rates, boosting the U.S. currency. That has pushed up the cost of some developing nations' large dollar-denominated debts, prompting central bankers to voice concern about the Fed's direction.

Emerging markets were rattled by a 7.5% overnight fall in the Argentine peso against the dollar after President Mauricio Macri said he had asked the International Monetary Fund to speed up delivery of a $50 billion bailout. On Thursday, the Argentine central bank raised interest rates by 15 percentage points to 60% to curb the decline, but the currency fell further and finished the day with a 12.2% loss.

People walking past a currency-exchange office in Istanbul. PHOTO: CHRIS MCGRATH/GETTY IMAGES

Meanwhile, Turkey's lira fell 2.8% against the dollar Thursday, putting it close to the low it hit earlier this month on worries about political interference in monetary policy and the country's large dollar debt pile.

The South African rand fell 2.5%, while the Indonesian rupiah finished the day at its lowest level against the greenback in nearly three years. The Brazilian real was close to a more than two-year low and India's rupee hit a record low.

The tumult highlights a heavy international dependence on the dollar. Some 48% of the world's $30 trillion in cross-border loans are priced in the U.S. currency, up from 40% a decade ago. Exchange-rate fluctuations affect the ease of servicing that debt. And with U.S. interest rates still low by historical standards and the dollar only halfway back to its 2016 highs, the stress could increase as the Fed keeps tightening.

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"After what we saw happen in Turkey, the market started to ask what country was next: South Africa, Brazil, Indonesia," said Eric Wong, a fixed-income portfolio manager at Fidelity International. "The market is still gripped at times by fear, trying to differentiate the good ones from the bad ones."

The market moves come amid a debate about the effects of U.S. monetary policy on the rest of the world—and how they might cycle back to the U.S.

"Given the dominance of U.S. financial markets and institutions, and the dollar's prominence in global finance, any actions taken by the Fed inevitably reverberate around the world," said Eswar Prasad, professor of economics at Cornell University.

Fed Chairman Jerome Powell said in May that "the role of U.S. monetary policy is often exaggerated" when it comes to global financial conditions, with fast growth in emerging economies, and commodity prices, playing bigger roles in capital flows. His counterparts in India and Indonesia, however, have voiced concerns about the Fed's policy direction and pleaded for more international coordination.

The strain is felt most palpably by governments and companies that rely heavily on overseas funding. Moody's Investors Service compares external debts due in the next year and bank deposits from overseas against currency reserves to compile an "external vulnerability indicator." The measure points to fragility in South Africa, Argentina and Turkey, as well as Ghana, Sri Lanka, Malaysia among other countries.

In the case of Turkey, external debts stood at 53% of gross domestic product at the end of 2017, according to the International Monetary Fund.

Last week, the lira rebounded amid moves by officials to make betting against the currency difficult for international investors. But investors believe those short-term effects have faded, and markets are again focusing on the country's underlying woes.

Investors are concerned that President Recep Tayyip Erdogan of Turkey has pressured the central bank to hold down interest rates, despite rocketing inflation and the lira's 44% fall against the dollar this year. The central bank didn't return calls seeking comment.

"None of the problems that led to the accelerating depreciation have been solved in Turkey," said Antje Praefcke, an analyst at German lender Commerzbank . "The cautious tinkering with symptoms on the part of the government and central bank and last week's holidays granted the lira a brief breather, but not more."

Currencies pegged to the dollar have also come under pressure. Hong Kong has spent heavily to defend its link to the dollar, while central banks in Bahrain and Lebanon have pledged to maintain their pegs.

Raghuram Rajan, the former governor of the Reserve Bank of India, said neither the Fed nor emerging-market policy makers could ever perfectly attune their economies to one another.

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"Unfortunately, this is a reality of the world we live in," Mr. Rajan told The Wall Street Journal last week from the Jackson Hole, Wyo., symposium on monetary policy. "Hopefully we will eventually filter some international responsibility into the mandates of central banks, to avoid such negative spillovers."

The Fed's effects on the rest of the world may eventually flow back to the U.S., as the rising dollar and higher bond yields make debt more expensive and suck money out of other countries, harming their economies and international trade demand. As the Fed has raised rates and unwound its massive bond-buying program—known as quantitative easing—the yields on U.S. Treasurys have increased, making that market more attractive for international investors.

"There's a stark divide between the Fed thinking that the effects of unwinding QE will be minor, local and likely to already be priced in, versus what we find in market terms, which is that it's likely to be major and global," said Matt King, global head of credit-products strategy at Citi.

—Jon Sindreu
contributed to this article.

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