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THE 'FRAGILE 5' TAPER TANTRUM

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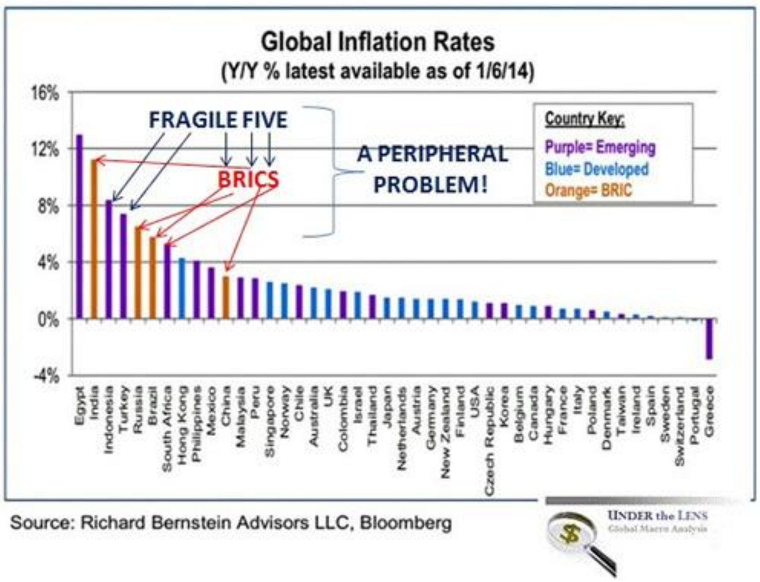
The 'Fragile 5' Taper Tantrum

Turmoil, panic, retreat: it's not been a pretty start to the year for emerging market currencies and stock markets. Here, in a few charts, is the key to understanding the story of 2014 so far.

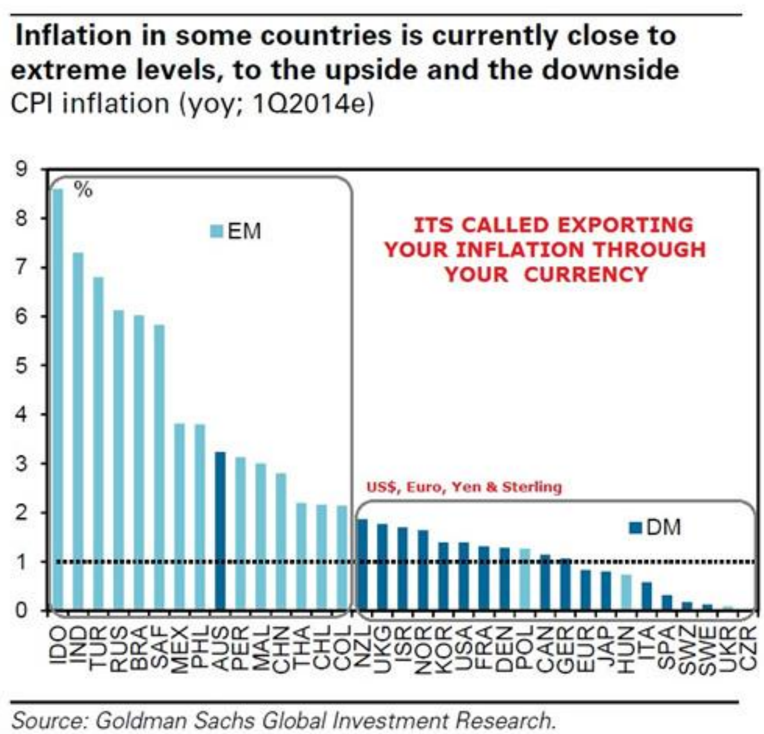
The Fragile 5 and other emerging countries have fleeing hot money problems, deficit current accounts which are becoming more difficult to fund, slowing economic growth from slowing export demand and domestic inflation which is causing serious social and political problems.

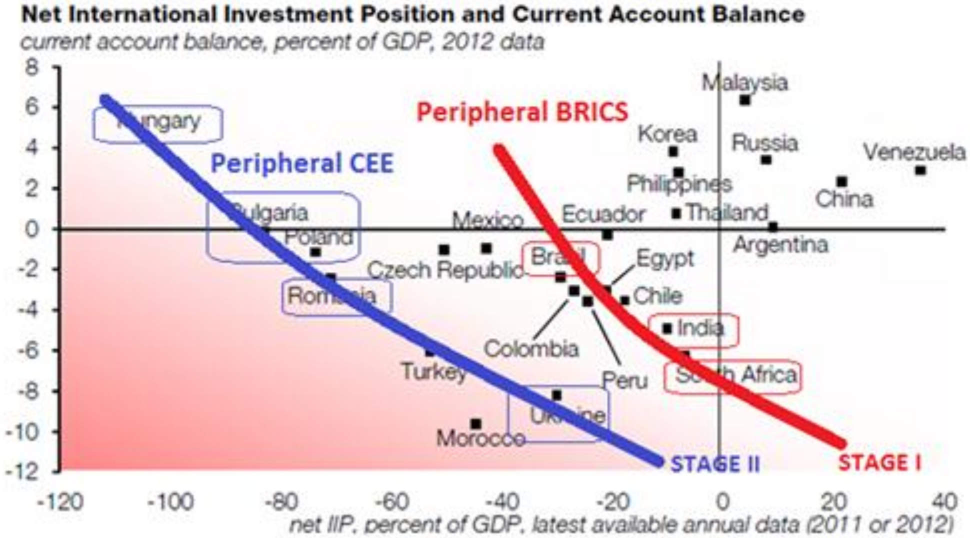


The problem is a direct result of Quantitative Easing and central bank asset expansion by the Developed Economies.

Effectively they have been exporting their inflation to those who have little choice but to react to it.

The problems are serious and rapidly getting worse and potentially creating contagion effects with even weaker peripheral nations.

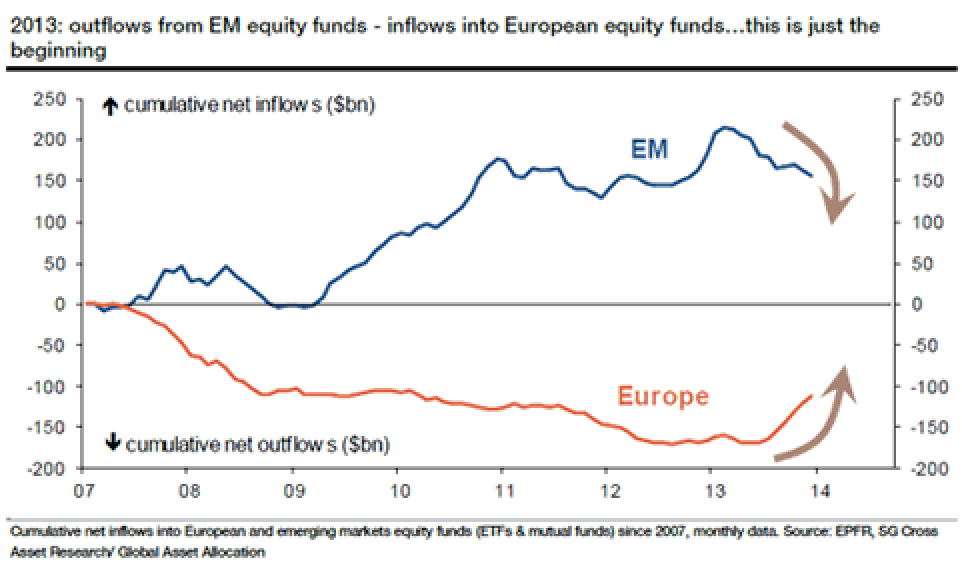




The Equity Context

As the base of the turmoil is the reverse of the post-crisis trend in capital flows, which began last summer on talk of the Fed taper.

Money is leaving the emerging markets and returning to Europe. EPFR Global, which tracks investment flows, estimates that emerging market equity outflows hit $12.2bn in January.



The following charts from the Financial Times give a sense of the carnage presently underway due to the impact of the implementation of the US "TAPER" policy. It is much broader than just the larger economies of the "Fragile 5" of:

- Brazil
- India
- Indonesia
- Turkey
- South Africa

Widespread hit

Whilst individual countries have been hit harder than others, the sell-off is widespread, with the MSCI Emerging Market Index now at its lowest level since last summer.

S&P Dow Jones analyst Howard Silverblatt calculates that 17 out of 20 emerging markets fell in January.

Currency woes for Argentina

The biggest year-to-date faller in the currency market – down over 18 per cent against the dollar – after the government decided devaluation was preferable to further declines in foreign reserves.

At one point – you can see where on the chart – the government allowed the currency to fall 15 per cent in a single day.

Pain for Turkey

Turkey's political turbulence (this week a criminal investigation was opened into police officers involved in the detention of government-connected figures in an anti-corruption sweep) has rocked markets.

Its equity and currency markets have both been hit. At one point in an attempt to halt the lira fall the central bank raised its overnight interest rate from 7.75 to 12 per cent after an emergency meeting.

Whilst the lira rallied following the rate hike, relief was only temporary.

Chile suffers from China slow down fears

Like other big commodity exporters (such as Russia and Brazil) Chile has been hit on fears of a slow down in China – the ultimate destination for many of it exporters.

China's manufacturing activity slipped to its lowest level in six months, extenuating fears of weaker growth – and demand.

Caution on the Russian Ruble

The Russian Ruble was the second biggest losers in January after the peso. However, it has recovered slightly after the finance ministry scrapped a debt sale.

A sign perhaps investors think the losses were overdone?

Don't forget South Africa

Hit by fears that strikes in the mining industry would would undermine one of its key exports – and sources of foreign exchange – the rand has been under severe pressure.

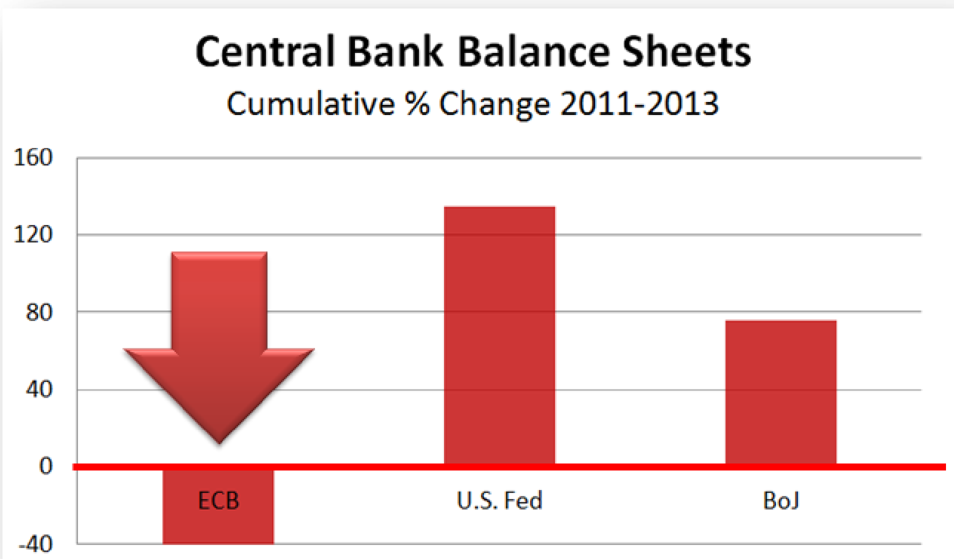
Top emerging market currency losers year to date against the US dollar (spot price)

1. Argentine peso – 18.7 per cent
2. Russian ruble – 6.6 per cent
3. Hungarian forint – 5.9 per cent
4. South African rand – 5.8 per cent
5. Chilan peso – 5.5 per cent

(Source: Bloomberg)

CONCLUSION

If the US is going to maintain its present "Taper" policy then the EU must quickly take up the slack! The EU is highly likely to implement its own version of Quantitative Easing (QE) in the not too distant future.



The upcoming March 7th ECB meeting is going to be an important market event date.

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