NEWSLETTER

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ECONOMIC COMMENTARY - By Francois Stofberg

Euro uncertainty pulling at emerging currencies

The rand has remained resilient amidst considerable pressure from a weakening euro and a liquidity drain, away from emerging economies towards US safety. An unravelling Italy and Spain are placing pressure on the euro in favour of a stronger US Dollar – the result has been depressed emerging market currencies. Although the euro-region grew at its fastest rate in a decade last year, recent events showed just how fragile the region still is.

Italy was left in chaos after President Sergio Mattarella vetoed the economy minister nominee of the new populist coalition government. Although he was happy with all the other nominees, he voted against the strong Eurosceptic nominee of the economy minister holding to his belief that austerity is still the way to go. The result was that the prime-minister elect stepped down, the coalition fell through, and Carlo Cottarelli, a pro-austerity economist formally employed by the International Monetary Fund, got the job. He's been tasked by President Sergio Mattarella to prepare for yet another round of elections. Italy's chaos spooked investors who believe that another election could further extend the populist foothold in Italy. Fears are that this would incline them towards a referendum on exiting the EU, like what happened in Britain (Brexit).

Over in Spain, Prime Minister Mariano Rajoy faces a vote of no confidence after 30 of his party members were found guilty on corruption charges, i.e. benefiting from illegal funds. Opposing parties are calling for a new government as the latest corruption conviction was only one in a multitude of scandalous charges hovering over the People's Party (the current ruling party).

As political tensions continue to fuel a euro selloff by investors, demand for the US Dollar should increase which can add additional pressure on the rand and other emerging market currencies. As if that wasn't enough, emerging markets are faced with capital outflows as investors dump riskier stocks in favour of the US. Faster growth, rising interest rates, and the potential for an even stronger dollar, all signal greater returns in the US – the result is capital flows towards the US and an even stronger dollar. Those emerging countries who have been hit hardest are those who are dependent on foreign currencies to finance their trade deficits (like South Africa) and have a large share of local debt denominated in a foreign currency (luckily not South Africa).

Turkey has been the hardest-hit emerging market, experiencing a 17% depreciation of their currency. But, their problem goes much deeper. Not only do they have one of the largest trade deficits in the G-20 group of nations but their inflation rate is higher than 10%. Instead of increasing interest rates, like the clever guys at the South African Reserve Bank did, their president halted the increase to win some votes in the upcoming election. A non-dependant central bank has never been in favour with international investors and the lira is paying the price for it.

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