Fragile Five Unravel as Developing Economies Suffer: Currencies
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By Ye Xie and Newley Purnell
Aug. 8 (Bloomberg) -- Emerging-market currencies are trailing their peers in advanced economies by the most since 2009 as a global recovery eludes countries from China to Brazil.
The 20 most-traded developing-nation currencies tracked by Bloomberg weakened an average 5.3 percent against the dollar in the past three months, compared with a 1.1 percent gain for the six comprising IntercontinentalExchange Inc.'s Dollar Index.
That's the biggest gap since the height of the banking crisis four years ago. Options prices signal that the Indonesian rupiah, Turkish lira and Brazilian real will tumble further.
At a time when U.S. manufacturing is expanding at the fastest pace since 2011, developing-nation industrial output is at a four-year low as China's slowdown cuts demand for everything from Brazilian iron ore to Malaysian palm oil.
Economists predict U.S. growth will quicken to 2.7 percent next year from 1.6 percent in 2013, while forecasting China will expand 7.5 percent versus an 8 percent median estimate in May, data compiled by Bloomberg show.
"Developed-market growth has probably been a bit faster than anticipated and emerging growth has been a little bit slower," Paul Denoon, who oversees $27 billion as the head of emerging-market debt at AllianceBernstein Holding LP, said in an Aug. 6 phone interview from New York. For developing currencies, "we're definitely more on the cautious side," he said.

'Fragile Five'

Morgan Stanley's strategists named South Africa's rand, India's rupee, the real, rupiah and lira the "fragile five," because their countries are finding it increasingly difficult to attract foreign capital to finance trade deficits.
Emerging countries accounted for eight of the 10 worst performers among 31 major currencies tracked by Bloomberg since May 7, with the real sliding 13 percent and the rupee losing 11 percent, touching a record low this week. Gains over the past three months were led by a 2.7 percent jump in Japan's yen and increases of more than 1 percent for the Swiss franc and euro.
The 17-nation euro-region economy will grow 0.1 percent in the second quarter, ending an unprecedented six straight quarters of contraction, according to the median estimate in a Bloomberg News survey before official data on Aug. 14.

Economists predict 1 growth for the area in 2014 after a 0.6 percent contraction this year. The largest emerging economies of Brazil, Russia, India and China will expand 5.9 percent next year compared with 5.7 percent in 2013, according to the median estimate in a Bloomberg survey.

‘Growing Divergence’

A gauge of manufacturing activities in developing countries fell to 48.8 in July, the lowest level since 2009, according to data compiled by Capital Economics Ltd. The purchasing managers’ index for U.S. manufacturing jumped to 55.4 last month, indicating the fastest growth since June 2011.

“There remains a strong and growing divergence between developed markets and emerging markets in the momentum of economic recovery,” Morgan Stanley strategists led by Rashique Rahman wrote in an Aug. 6 report. “We retain a cautious view for the medium term, particularly in currencies, given ongoing concerns over the growth outlook for emerging markets.”

ICE’s Dollar Index, which tracks the greenback against major developed-nation currencies including the euro, yen, British pound and Swiss franc, fell to a seven-week low of 81.089, from 82.253 on May 7, data compiled by Bloomberg show.

India’s rupee weakened to a record 61.8050 per dollar on Aug. 6, while Brazil’s currency touched a four-year low of 2.3162 yesterday. The yen strengthened to 96.37 per dollar today from 98.88 three months ago, while the euro climbed to as high as $1.3369, the strongest level in seven weeks, from $1.3171.

Forecasts Missed

About 54 percent of companies in the MSCI Emerging Market Index of stocks have reported second-quarter earnings that trailed analysts’ forecasts, compared with 35 percent for members of the developed-economy MSCI World Index, according to data compiled by Bloomberg.

The slowdown in China is contributing to lower prices for raw materials and commodity exporters in developing nations.

China’s economy grew 7.5 percent in the second quarter, heading for the slowest annual expansion since 1990.

Another 1 percentage-point decline in China’s growth would cut the average expansion of developing countries by 0.7 percentage point to 4 percent, a “stall speed,” Citigroup Inc. economists including Guillermo Mondino wrote in a July 22 note.

Even with the recent pickup in the developed world, the U.S. and Europe are still expanding at a slower pace than the biggest emerging markets. On average, developing economies will grow more than four times the 1.2 percent rate in advanced

countries this year, the International Monetary Fund forecast
July 9.

'Too Far'

The developed-world recovery will eventually spill over to emerging-market currencies as U.S. and European customers increase purchases of exports, according to Steffen Reichold, an economist at Stone Harbor Investment Partners LP.
"The theme has been taken a bit too far, and we think we're going to see that turn over the coming months," Reichold said in an Aug. 6 phone interview from New York. Some currencies "have gotten quite a bit cheaper in the EM space" and "we're in a phase now where we'll likely see a bit of a rebound" in the Mexican peso, South African rand and Turkish lira, he said.

Rupiah Bears

Option traders are the most bearish on the rupiah among the 31 most-traded currencies tracked by Bloomberg. They demand a premium of 5.4 percentage points for the rights to sell the rupiah over options to buy, according to the three-month risk reversal rate. The gap reached an 11-month high of 6 percentage points on June 6, data compiled by Bloomberg show.
The premium for the real, lira, rand and Peruvian sol are at least 2.9 percentage points, compared with 1.3 percentage points for the euro, Swedish krona and Norwegian krone.
Capital is also fleeing developing countries since the Federal Reserve signaled in May that it may scale back the money it prints for its $85 billion of monthly bond purchases, funds that contributed to demand for emerging-market assets in the past.
"Near-term I'm bearish EM," Win Thin, the global head of emerging-markets strategy at Brown Brothers Harriman & Co. in New York, said in a phone interview yesterday. "To me it's a combination of the tapering story and the fundamental story, which isn't horrible, but everything sort of lined up for EM in 2010, 2011, even 2012. But then the cracks started last year, and the crack has started to widen."
Surpluses in developing nations' current accounts, the broadest measure of trade, will narrow to 1 percent of gross domestic product this year, the least since 2001, according to the IMF. Advanced nations' deficits will shrink to 0.1 percent of GDP, from 1.2 percent seven years ago, the Washington-based organization estimates.
"So suddenly they export less, they import more, so they're doing the opposite of what developed economies were doing for a few years," Pierre Yves Bareau, the London-based

head of emerging-market debt at JPMorgan Asset Management, which oversees $1.5 trillion, said in a phone interview. For emerging-market currencies, “that’s the main driver.”

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