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Macro Market Insights

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A Bumpy Road Forward

"The experience of the market place of this past week will be indicative of this entire year; I think we are going to be in a world of much greater volatility. That doesn't mean we end up in a bad place... but there will be quite a bit of disruption"

-Blackrock CEO Larry Fink speaking at the World Economic Forum in Davos, Switzerland

It was quite the ending to a week that was nothing short of a meltdown in the world's emerging market economies. What represented the world's engine of growth a few years back with the likes of relatively larger nations like China, South Africa, Russia, India, and Brazil has quickly shifted to a point of fragility for financial markets everywhere. Perhaps, now we are witnessing the correction in equity markets, particularly in the United States, which many had been calling for, but we cannot discredit the impact of the demand for US dollars at the result of funds that are departing emerging economies.

In the last few weeks, its fear and contagion spreading though these markets that have caused their respective currencies to lose significant ground against the US dollar. And it is at the direct effect of investors selling their foreign assets, and the currency used to purchase them in order to return to the US. Just to look at a few examples, the Russian Ruble and the South African Rand are at their lowest levels since the 2008 financial crisis. The Turkish Lira was down four percent on the week and that was with the world's central banks stepping up in support and purchasing a billion pounds worth of lira.

But the most intriguing story has to be the Argentinian peso, the biggest loser of them all, seeing its lowest level in 12 years as their government abandoned a policy that had required their citizens to save only in their domestic peso, instead of US dollars. By the end of the week, the Argentinian currency was trading around 8 pesos to a dollar, but due restrictions and lack of availability of greenbacks, reports of black market transactions had the peso at 13 to a US dollar.

News of the world's faltering emerging economies is not to outstrip the potential for global growth in 2014. There is still very much a level of cautious optimism (which seems to be the key word) for global growth going forward, but it has become no question that the emerging markets are what will unsettle this picture. Some seem to suggest that the US Federal Reserve tapering their bond-purchasing program is the direct cause of the run from emerging markets, but as Larry Fink (quoted above) goes on to suggest, that takes a too simple approach to the problem.

The fact of the matter is not all these different markets can be painted with the same brush. However, they often are because when there is turmoil they all sell off together; however, it's important to understand the shortfalls in some of their fiscal policies that contribute to this disruption. For example, overreliance on a strong China as a trading partner or failing to implement policy that acts to curtail what has been rampant levels of inflation, with the most extreme scenario being Argentina at an inflation rate close to 25 percent.

The bond market and the US dollar were the benefactors of a resurgent level of volatility in the markets these last few days. In addition to this, we also witnessed gold trading higher reaffirming its safe haven characteristics. We should let this volatility comes as bit of a sobering reminder for how correlated the world's financial markets remain, and how disorder in Buenos Aires leads to trepidation in New York and beyond.