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- Renier van Zyl

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ANOTHER EMERGING MARKET CRISIS? THIS TIME IT IS DIFFERENT…

Millennials and Generation Z are unlikely to remember that, back in 1997, Asia was dealt a significant blow by the United States (US) Federal Reserve (Fed), who, through their actions, caused the US dollar to appreciate substantially. Halfway around the world it was July 1997 and monsoon season was on its way in Thailand, but that year the country's currency, the baht, would experience a monsoon of a different kind. When the US Fed raised rates in 1997 to fend off increased inflationary pressures, the Thai baht's peg* snapped against a very strong US dollar. This led to a series of currency crashes, one after the other, across emerging markets (EMs), such as Indonesia, South Korea, and Russia. What happened to the baht, however, was not an anomaly, as similar events led to the Latin American debt crisis of the 1980s and the Mexican crisis of 1994. This begs the question whether EMs and the rest of the world are in for another round of pain as the US Fed battles eye-watering levels of inflation.

But what is needed for an EM crisis? In each of the above-mentioned cases, capital flooded into these markets before the events even started. With their coffers full of cash and most of the debt denominated in US dollars, all that was needed for a financial calamity was for someone to turn up the heat: In came the US Fed with their monetary policy tools and out went most of the capital. This, in turn, highlighted underlying EM problems, such as weak balance sheets, poor regulations, rocky financial systems, etc. Whilst some of the aforementioned problems were plain to see before the events played out, it would be naïve to assume that anybody could see the crisis coming, which speaks to the very core of what a crisis is.

Today, investors and economists might scratch their heads and wonder whether Mark Twain was correct when saying that "history never repeats itself, but it does often rhyme", especially when they assess the current events in Sri Lanka and Argentina. I cannot blame them as these fears are exacerbated by everyday headlines that emphasise slowing global growth as well as the impact of elevated food and fuel prices on companies and individuals around the world. But, upon closer inspection, things look very different compared with two decades ago.

For one, fewer EMs have dollar pegs (like the one that Thailand had) today than ever before. In addition, EMs are less dependent on international financial institutions for financing: Only about 60% (down from 80% in 2006) of financing comes from the International Monetary Fund (IMF). China has replaced a large part of this financing and has become such a large lender to other EMs that its lending habits rival that of the World Bank in scale. And then finally, the countries most at risk of defaulting on their debt today only account for 5% of the global gross domestic product (GDP) and 3% of global public debt, figures much lower than two decades ago.

A bigger threat to global and EM stability today is China, where non-financial sector debt has risen at a breakneck speed since 2008. For now, a silver lining to China's debt problem is that foreign investors hold only about 11% of Chinese sovereign debt, and with interest rates still relatively low, China still has some room to manoeuvre. Investors must, however, know that the situation can change quite quickly. It would, therefore, be prudent for countries who recently applied for BRICS membership and are struggling with their own woes, such as Iran and Argentina, to not consider China as their saving grace.

Whilst investors might be concerned about how the situation is unfolding in the world right now, it is important to remember that the probability of another EM crisis seems a lot lower than in the past. Also, the impact would almost certainly be more limited than before.

**The Thai Central Bank pegged the baht to the US dollar from the mid-1950s until 1997.*