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Turmoil in Emerging Economies: A Symptom of a Global Crisis

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This summer's crisis of the so-called "emerging market" economies reached a new stage last week, as India, Brazil, Turkey and Indonesia all announced emergency measures in an attempt to stem a plunge in their currencies and stock and bond markets.

India, whose rupee has fallen 15 percent versus the US dollar since the start of the year, announced restrictions on the amount of money individuals and companies can send abroad. Turkey raised its interest rates in hopes of curtailing capital flight that has driven down the lira by 10 percent. Indonesia announced steps to increase the availability of dollars in its markets, increase taxes on luxury items and reduce oil imports. Its rupiah has dropped 8 percent this year.

Brazil's chief central banker, Alexandre Tombini, canceled plans to attend the annual conference of the US Federal Reserve at Jackson Hole, Wyoming at the last minute in order to announce a $60 billion program aimed at halting the real's slide. The Brazilian currency has lost 20 percent of its value against the dollar.

The decline in these currencies, along with South Africa's rand, has turned into a rout since May 22, when Fed Chairman Ben Bernanke signaled his intention to begin paring back the US central bank's massive program of dollar-printing and bond-buying, possibly as early as this September. Since last December, the Fed has been pumping $85 billion a month into the financial markets by purchasing US Treasury securities and mortgage-backed bonds.

This third round of so-called "quantitative easing," along with short-term interest rates that have been kept at near zero since late 2008, depressed long-term interest rates in the US and made virtually free cash available to banks and speculators. In addition to driving up US share values and bond prices and boosting corporate profits, this windfall for the financial elite fostered a flood of speculative capital into the so-called emerging economies.

For five years, beginning shortly after the Wall Street crash of September 2008, the banks and hedge funds flooded cheap dollars into economies such as India, Brazil, Turkey and Indonesia, where higher interest rates and faster economic growth guaranteed huge returns on their investments.

Now, along with the prospect of a reduction and ultimate halt in the money-printing operation of the Fed—which had been duplicated by central banks in Britain, Europe and Japan—has come higher interest rates in the US and a reversal in the flow of capital. Almost overnight, the hot money that had boosted the emerging economies has stopped pouring in, and these countries have been hit with a massive flight of capital back to the US and other so-called developed countries.

Some figures provide an indication of the scale of the financial shockwaves hitting these economies. According to Société Génerale, the emerging markets' bond and stock funds registered net outflows of $20 billion and $26.5 billion respectively over the three months ending August 21.

Investors removed a record $37 billion from emerging market stock and bond funds in June. In the week ending August 21, $1.76 billion was pulled out of emerging market equity funds—more than double the amount that was removed the previous week.

Funds have flowed out of emerging market bonds for 13 straight weeks. In the week ending August 21, another $1.3 billion was removed, up almost $500 million from the previous week.

The MSCI Emerging Market Index is down more than 10 percent this year, while the world index, covering all developed country stock markets, is up 10 percent. The 10 largest emerging markets have all lost money this year.

Many central banks have sought to reverse or at least slow the currency declines by using foreign currency reserves to intervene in the markets. Central banks in the so-called developing world lost $81 billion of emergency reserves through capital outflows and currency market interventions since early May.

Turkey has spent about 15 percent of its reserves since May. Indonesia's reserves are down 26 percent from their 2013 peak. Capital flight and plunging currencies wreak havoc on these economies in different ways. They stoke inflation—already at 10 percent in India. They increase the cost of imports, including vital resources such as oil. And they increase the real cost of paying off debts denominated in dollars and other foreign currencies.

In many of these countries, banks and corporations took advantage of the relatively high exchange rate of their currencies, under conditions where the Fed's policies were cheapening the dollar, to take on dollar denominated debt. Now they are finding it difficult to meet their debt payments because it costs much more to purchase dollars with their national currencies.

The crisis is particularly sharp for countries that built up large current account deficits and used the hot money pouring in to cover their debts. Now they face the possibility of insolvency. India is one such country. It has a huge current account deficit and a large government debt. There is already talk of India applying for a bailout loan from the International Monetary Fund.

Other countries in this predicament include Brazil, Turkey, South Africa and Indonesia. The last of these recently reported a sharp growth in its current account deficit in the second quarter of this year.

Underlying the financial problems of emerging market countries is the absence of any genuine recovery in the real economies of the United States, Europe or Japan and, instead, a further deterioration in the global economy. The massive infusion of cheap money by the central banks of the US, Europe and Japan into the financial markets is itself an attempt to pump life into a near-dormant world economy.

But while it subsidizes corporate profits and the fortunes of the rich and the super-rich, it does virtually nothing to address mass unemployment, declining living standards and growing poverty. On the contrary, the ruling classes and governments of the US, Europe and Japan all combine vast handouts to the banks with austerity for the masses of working people. Their talk of promoting growth and job-creation is always linked to so-called "structural reforms"—a euphemism for the destruction of all forms of economic security for workers, wage-cutting, the casualization of labor, privatization and the gutting of business regulations.

The financial deterioration of the emerging economies is bound up with a sharp slowdown in economic growth. Brazil, whose gross domestic product grew by 7.5 percent in 2010, saw its GDP increase by a mere 1 percent in 2012. India, which averaged 8 percent annual growth between 2006 and 2011, is projected to grow by just 5 percent next year.

But the sharp slowdown in these and other developing economies, including China, is itself a result of continuing slump in the US, Europe and Japan. The US economy is barely growing, Europe is mired in recession and Japan is struggling to record significant growth despite having adopted a radical and highly risky policy of monetary stimulus and yen devaluation.

Under these conditions, the export and commodity boom that had sustained the real economies of Brazil, India, Turkey and the others could not but collapse. This is what underlies the reversal, according to Citigroup, in the current account balance of the emerging market economies, excluding China and the Gulf states, from a 2.3 percent surplus in 2006 to a 0.8 percent deficit this year.

Speaking at the Fed's Jackson Hole conference on Tuesday, IMF Managing Director Christine Lagarde alluded to the growing crisis of the emerging market countries, saying: "Developments this summer have indicated that we are in a dangerous new phase. The stakes are clear: we risk seeing the fragile recovery derailed."

Without offering any concrete plan of action, outside of a continuation of "fiscal consolidation" and "structural reform," Lagarde sought to reassure the markets by pledging that the IMF stood ready to "lend its material support wherever it is requested and relevant."

The reality is, however, that the ruling classes for whom Lagarde speaks have no way out of a crisis that, five years on, is more clearly than ever a systemic crisis of the world capitalist system.

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