Weakening Emerging Market Currencies

What is the issue?

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Many of the emerging market economies' currencies including that of India are weakening against the U.S. dollar.

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What are the recent developments?

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- The Indian rupee weakened past the 71 mark for the first time recently.
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- It has registered a loss of about 10% of its value against the dollar since the year's beginning.
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- This makes the rupee the worst-performing currency in Asia.
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- Other emerging market currencies too have suffered much larger losses.
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- They, notably, include the Turkish lira, the Argentine peso and the South African rand.
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- The Argentine peso has lost more than half of its value in 2018.
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- It witnessed a sharp loss of more than 10% on a single day.
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- This happened despite a 15 percentage point increase in interest rates by Argentina's central bank.
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- It was an effort to stem the outflow of capital and shore up the value of the currency.
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What are the causes?

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- **External** - A common factor is the increasing demand for the dollar across the globe.
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- The U.S. Federal Reserve raised the interest rates earlier this year (2018).
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- The resultant tightening of liquidity in the West has played a major role in strengthening of the dollar.
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- Emerging market countries earlier benefited from the West's easing of monetary conditions.
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- These are now facing the impact of a return to the West's tight monetary policy.
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- Investors who earlier put their money in emerging markets have recently preferred American assets.
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- As, this has become more attractive now yielding higher returns. Click here to know more.
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- **Domestic** - Emerging market economies cannot simply blame external economic factors.
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- The management of these economies has generally been far from ideal.
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- This is particularly true when it comes to hard-hit economies like Turkey and Argentina.
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- A key trouble of emerging market economies is the higher domestic inflation in relation to the economies in the West.
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- So it is natural that their currencies slide in value over time against the dollar and other major Western currencies.
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What is the way forward?

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- Shift of capital across the globe due to interest rates variations is normal.
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- There is need for a drastic change in emerging markets' monetary policy as against that of the West.
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- The role of emerging markets' central banks in the current scenario is crucial.
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- Their mandate should be to let their currencies find their true value in a smooth manner.
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Source: The Hindu

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