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FEATURED Q&A

Why Are Emerging Market Currencies Being Hit So Hard?

Several emerging market currencies, including the Brazilian real, have fallen against the U.S. dollar this year. // Image: pxhere.com.

Q A number of emerging market countries, including several in Latin America, have experienced currency depreciations and a significant decline in foreign exchange reserves in recent months. The Argentine peso has fallen about 25 percent year to date against the U.S. dollar, while Brazil's real currency has fallen 13 percent and hit a new two-year low on June 6. What factors are driving emerging market currencies this year? Which Latin American countries face the biggest risk of currency volatility looking ahead to 2019? What are the consequences of these trends for economies of the region, and how should policymakers in affected countries respond?

A Alicia Bárcena, executive secretary of the United Nations Economic Commission for Latin America and the Caribbean: "There has been a strengthening of the dollar in the international financial markets, but the current levels are similar to those prevailing last November. What is happening with the currencies of emerging economies is only part of this process. These economies may be the most exposed to exchange rate volatility, but they are not the only ones. The dollar also appreciated against the currencies of Canada, South Korea, the Eurozone, the United Kingdom and others. However, currencies including those of Japan, China, Colombia and Costa Rica appreciated in this period. Various reasons are found for this dynamic of the exchange rate. Among the factors that have 'systemic' connotations include international monetary-financial conditions, in which the withdrawal of stimulus plans and the normalization of monetary policy has increased the demand for U.S. assets. Also, idiosyncratic factors such as macro-

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Duque Wins Colombia's Presidential Vote

Iván Duque, a conservative former senator, defeated Gustavo Petro, a leftist former guerrilla and Bogotá mayor, in Colombia's presidential runoff on Sunday.

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Bunge Postpones Plan for IPO of Brazilian Unit

The U.S.-based commodities giant said it was postponing the initial public offering of Bunge Açúcar & Bioenergia amid low global prices for sugar and "adverse market conditions."

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Some 2,000 Migrant Children Separated From Parents in U.S.

An immigration policy announced in April by U.S. Attorney General Jeff Sessions has resulted in the separations of at least 2,000 children from their parents in six weeks.

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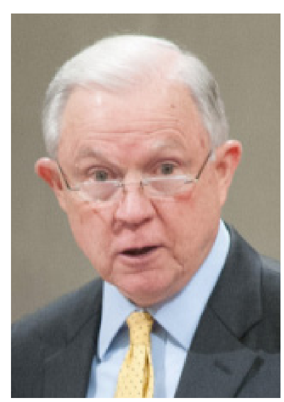

Sessions // File Photo: U.S. Department of Justice.

POLITICAL NEWS

Right Wing's Duque Wins Colombian Presidential Election

Iván Duque, a conservative former senator and protégé of former President Álvaro Uribe, won Sunday's presidential runoff in Colombia, defeating Gustavo Petro, a leftist former guerrilla and mayor of Bogotá. With virtually all ballots counted, Duque garnered 54 percent of the vote to Petro's 41.8 percent, according to election authorities. Duque's running mate, Marta Lucía Ramírez, a former senator and defense minister, will become Colombia's first female vice president. Approximately 4.2 percent of voters cast blank ballots. At 41, Duque will be among Colombia's youngest presidents, and his election was the first since the Colombian government's 2016 peace accord with the Revolutionary Armed Forces of Colombia, or FARC. Current President Juan Manuel Santos' efforts surrounding the peace deal won him the Nobel Peace Prize. During his campaign, Duque has pledged to rewrite parts of the peace accord to include harsher punishments for war crimes committed by FARC leaders, Reuters reported. In his victory speech Sunday night, Duque vowed to maintain peace in Colombia and unite the country. "Peace is something all Colombians yearn for and peace means that we turn the page on the fissures that have divided us," he told supporters in Bogotá as confetti fell from the ceiling. Duque said he would press forward with implementing disarmament and reintegrating former FARC rebels into Colombian society. He also vowed to fight corruption, improve education and strengthen security, Reuters reported. Duque is likely to face opposition to changing the peace deal in Colombia's Constitutional Court and in Congress, where most parties favor the current accord. "He is going to have a harder time passing reforms to the peace agreement than he would have his supporters believe," Sergio Guzmán, lead Colombia analyst at Control Risks in Bogotá, told Reuters. Guzmán pointed out that the Constitutional Court has already ruled that the accord cannot be altered. In his concession speech, Petro told supporters that he would lead a vigorous opposition to Duque in the Senate, where he will have a seat, The Wall Street Journal reported. "We're not going to ask for [posts in] ministries or embassies," Petro said. "We don't agree with him, and we believe he is wrong about what he said" in the campaign. Approximately 19.3 million people, or just more than half of Colombia's registered voters, cast ballots on Sunday, Reuters reported. The figure suggested that some centrists declined to vote for either candidate. On the economic front, Duque has vowed to implement tax cuts and more support for extractive industries such as coal and oil, Colombia's top exports. The government has said it expects the country's $324 billion economy to grow 2.7 percent this year.

Duque and his running mate, Marta Lucía Ramírez, celebrated victory with supporters on Sunday night. // Photo: Duque Campaign.

Some 2,000 Migrant Children Separated From Parents in U.S.

The zero-tolerance immigration policy that U.S. Attorney General Jeff Sessions announced in April has resulted in the separation of at least 2,000 migrant children from their families in six weeks, The Washington Post reported. President Donald Trump has blamed the separations on a 2008 bipartisan human trafficking bill that he interprets as requiring the separation of families. Many have criticized the policy, including former First Lady Laura Bush, who compared it to the Japanese-American internment camps of World War II and called it "cruel" and "immoral," CBS News reported.

NEWS BRIEFS

Seventeen Killed When Device Explodes in Caracas Nightclub

A tear-gas device exploded during a brawl in a Caracas nightclub on Saturday, killing 17 people and injuring five, The Wall Street Journal reported. The explosion set off a stampede among the hundreds of people in attendance. Venezuelan interior minister Néstor Reverol announced the nightclub was ordered to close and seven people were arrested, including the person suspected of activating the device and the owner for allowing weapons into the establishment that "threatened its integrity."

At Least Eight More Killed Amid Nicaragua Violence

More violence in Managua has increased tensions in recently renewed peace talks between President Daniel Ortega's government and civil society groups, the Associated Press reported. On Saturday, a house fire and a street shooting killed at least eight people, with the Ortega administration denouncing "delinquents" for the attacks while civil society groups blamed police and government employees. The two sides are discussing security concerns, electoral reform and potential changes to the Supreme Court. More than 160 people have been killed since the political crisis began in April, the AP reported.

Proposed Chile Student Loan Program Would Cost $8 Billion

The Chilean government estimates that its newly proposed student loan program for higher education would cost $8 billion in its first four years, La Tercera reported on Sunday. If approved by Congress, President Sebastián Piñera's plan is expected to reduce the costs of the current program, which is maintained by private banks, by 66 percent once it is fully implemented by 2043.

Democrats in Congress are currently pushing a bill by Senator Dianne Feinstein (D-Calif.) to block the policy. Republican lawmakers who usually defend the Trump administration have remained notably silent, according to The Washington Post, though Republican Senators Susan Collins of Maine and Jeff Flake of Arizona jointly wrote a letter to the secretaries of Homeland Security and Health and Human Services demanding more details about the separations at the U.S.-Mexico border. Trump claims that Democrats' loopholes to immigration laws have permitted the illegal entry of young members of the MS-13 international gang and asserts that the zero-tolerance policy is in the interest of "every American child," The Washington Post reported. White House officials say the policy serves as leverage in negotiations regarding a new immigration bill in Congress.

Former First Lady Laura Bush called the separations "cruel" and "immoral."

BUSINESS NEWS

Bunge Postpones Plan for IPO of Brazilian Unit

Commodities giant Bunge Ltd. on Friday called off plans to publicly list shares in its Brazilian sugar and ethanol unit, Reuters reported. In a statement, the White Plains, N.Y.-based company said it was postponing the initial public offering of Bunge Açúcar & Bioenergia amid low global sugar prices and "adverse market conditions." A price freeze on fuels last month set by the pro-market administration of Brazilian President Michel Temer in the face of crippling transportation strikes has raised concerns that heavy subsidies for oil-based fuels could return. Subsidies in Brazil have undercut the profitability of sugar cane ethanol in recent years. The company, which has been struggling with heavy debt, has posted modest losses in recent quarters. Despite lower prices, the unit said earlier this month it plans to crush between 20 and 21 million metric tons of cane in the current season, up from 19.6 million in 2017-18, AgraNet reported. The company's eight mills plan to process 61 percent of the crop into ethanol, a larger percentage than recent years, as producers expect high prices for oil will push consumers driving flex-fuel vehicles in Brazil to switch to cheaper ethanol derived from sugar cane.

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economic conditions, growth, inflationary pressures, levels of interest rates and the degree of sub-valuation of the currency can undoubtedly magnify the effects of external turbulence, causing reactions that exceed those observed in other markets. The degree of exposure of the economies of the region, and the stability of their currencies depends very much on factors that are beyond our reach. Therefore, authorities should focus on avoiding the magnification of the external volatility. This is possible through policies that promote economic growth and macro-financial stability. Policymakers should use the tool kits at their disposal to avoid second-order effects and to try to sustain recovery. The region has also strengthened the availability of international reserves and other external assets, especially those economies that benefited from the commodity boom. Some authorities have actively used this tool to reduce the volatility of their currencies."

A **Alfredo Coutiño, director for Latin America at Moody's Analytics:** "The significant depreciation reported by Latin American currencies in the past few years, and aggravated during 2018, is explained by external and domestic factors. First is a steady strengthening of the U.S. dollar against most currencies as a result of the continuous advance of the U.S. economy. Second is the attractiveness gained by U.S. bonds in terms of interest rates, given the normalization of the Fed's monetary policy. This also implies loss of rate competitiveness for Latin American bonds given the reduction of the rate differentials. Third, adverse domestic factors have increased risk aversion in the region. These have included financial crisis in Argentina, political turmoil in Brazil, uncertainty in Mexico surrounding trade negotiations and elections, and widening imbalances in some countries. Fourth are the anti-trade policies displayed by the U.S. government, posing a risk to the global economy. All these factors have generated a steady weakening of Latin American currencies, which is reflected in higher demand for U.S. dollar, and consequently expressed in the reduction of international reserves in central banks. Also, beyond the potential currency overshooting reported, Latin American currencies are correcting the overvaluation generated by the excess of global liquidity deployed during the post-recession years. Definitely, the countries facing more currency risks are those with wider fiscal and external imbalances, given their dependence on external financing. Currency instability poses a double risk for economies: first, because the uncertainty inhibits consumption and investment decisions, and second, because it could degenerate in financial crisis. The short-term defense mechanism for central banks is to use the monetary artillery to reduce currency volatility. The longer-term policy is a return to policy discipline in order to adjust macroeconomic imbalances. Latin

> **"Adverse domestic factors have increased risk aversion in the region."**
> — Alfredo Coutiño

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America should not forget that 'the farther the economy is from the equilibrium the more vulnerable the currency is to speculative attacks.' "

A **Barbara Kotschwar, adjunct professor at the Center for Latin American Studies at Georgetown University and senior private sector specialist at the World Bank:** "Emerging market currencies have recently seen the worst volatility since China's sudden 2015 devaluation. Across the globe, emerging markets—Turkey, Argentina, Brazil, Mexico, Russia and South Africa—have experienced large downward swings. While each country's situation is different, a common factor has been expectations of a hike in U.S. interest rates—validated last week. U.S. interest rate increases draw funds out of emerging markets. Continued threats of global economic instability (for example, increasing China-U.S. trade tensions) contribute to investor queasiness. And when investors feel queasy, emerging markets suffer. Domestic factors also contribute. The Mexican peso's election year nerves have been amplified by fears that President Trump may scuttle NAFTA. Uncertainties about Brazil's election build upon nervousness regarding recent political turmoil. Brazil is also susceptible to Argentine contagion. Argentina, despite its IMF package, has seen the peso decline. Investors' confidence is based more on historical experience than recent policy, and worries about the fiscal and current account abound. What can we expect for Latin American currencies? Elections in Brazil and Mexico as well as the United States this year portend continued uncertainty. Latin American companies are also highly exposed to volatility. Weighted average corporate debt-to-equity ratios are over 100 percent for Argentina, Brazil, Chile and Mexico, leaving the private sector vulnerable. This may make it more difficult for policymakers to maintain balance in the next period."

A **Ana Heeren, managing director for strategic communications and Latin America head at FTI Consulting:** "Latin American free-floating currencies tend to absorb the pressure from a rising U.S. dollar. Generally speaking, Latin American governments finance in local currency and have large foreign exchange reserves to pay back dollar-denominated debt. Countries currently facing the highest levels of volatility are Argentina and Brazil, but other countries in the region are not unscarred. The upcoming elections happening in the region have contributed to currency volatility, uncertainty over what new trade and monetary policies will look like bring anxiety to investors around the world, and the U.S. trade protection threats that can significantly affect exports are the main factors for currency instability. In terms of policies, central bank intervention has proven effective in managing currency volatility in the short term. Just last week, Brazil's real rose upwards of 5 percent after the central bank flooded the market with foreign exchange swaps, successfully stopping the real's depreciation. But in the long term, only economic policies that promote growth and help balance budgets can achieve and sustain stability."

> **"Central bank intervention has proven effective in managing currency volatility in the short term."**
>
> **— Ana Heeren**

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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