22 March, 2021

Emerging market hiked interest rates amid rising US bond yields

When the sharp spike in US treasury yields threaten to emerging markets, Turkey along with Brazil and Russia, is part of the group of the first emerging economies forced to raise interest rates in the wave of global reflation caused by the ultra-expansionist fiscal and monetary policies of the United States and other major economies since the outbreak of COVID-19. Despite the signal from the US FOMC said that it is no rush in raising the Fed benchmark rate, such speech failed to keep the dollar rise in check, some emerging markets currencies are under pressure and thus they need to start rising rate to counter the depreciation pressure.

Benchmark interest rate change in Mar 2021

Country	Inflation (%)	The latest benchmark Interest Rate (%)	Increased %	Market expectation (%)
Brazil	5.2%	2.75%	+0.75%	+0.5%
Turkey	15.6%	19.0%	+2.0%	+1.0%
Russia	5.7%	4.5%	+0.25%	Remain the same

Hike interest rate due to risk of currency free fall

With more positive outlook of US epidemic due to the better than expected vaccine rollout and the further injection of substantial fiscal stimulus from the US government, such as the passage of US$900 billion and US$1.9 trillion relief bill respectively in Dec 2020 and Mar 2021, it is expected US economy will be significantly pushed up and enjoyed a very bullish growth in 2021. As a result, along with a more bullish economic recovery, it is expected US government bond yield will rise further as the US Fed may start the tapering much earlier than expected. With higher US government bond yield, the yield spread against emerging currencies will become wider, which will lead to larger appreciation pressure for the US dollar. The rapidly rise in US bond yields and the appreciation of US dollar has triggered investors pulling out money from emerging markets. Therefore, it has put emerging markets currencies, such as Russia's ruble, Brazil's real and Turkey's lira under pressure. In order to prevent the possible cross-border capital outflows and currency devaluation, some emerging markets are thus being forced to raise their own interest rates, even though their economies may not be ready yet.

By the first week of March, the daily outflow of funds from emerging markets was about US$290 million, which was the first-time outflow of funds from emerging markets since October last year, according to the Institute of International Finance, which track the cross-border flows. In fact, most emerging markets currencies are facing depreciation in the wake of rising US bond yields, MSCI emerging market currency index has continued its longest consecutive week of decline since August 2019. The MSCI Emerging Markets Stock Index fell for the first time since February 26 and already dropped more than 10% from its February high.

USD/BRL

The central bank of emerging markets raised interest rates in the hope that their currencies could withstand the pressure of depreciation. However, among the three countries with hiked interest rates, only the Brazilian real has meanwhile skidded, closing at 5.59 to the dollar on 24 Mar.

Source: Bloomberg

USD/TRY

The lira soared after the central bank of Turkey hiked interest rates larger than expected from 17% to 19%. However, after Central Bank Governor Naci Agbal was ousted by Turkish President Erdogan on 20 Mar, lira plunged 15% to 8.4850 versus dollar, near the record low of 8.5793 recorded in November 2020. The stock market also experienced a sharp fall and triggered circuit breakers

Source: Bloomberg

USD/RUB

The ruble is at a two-week low against the US dollar at 76.5 though the Russian Central Bank raised the benchmark rate on 19 Mar.

Source: Bloomberg

Hike interest rate due to risk of hyper-inflation

Amid vaccine rollout and more positive outlook for economic recovery pushed upward pressure in global commodity prices especially food price, metals and oil rose rapidly in the past months and eventually lead to a substantial inflation hike in some emerging markets. According to the World Bank, global food prices have risen by more than 20% amid COVID-19 since May 2020. Some metals, such as copper and iron ore, their price have risen by 25% and 65% respectively in 2020. The oil price which dropped to negative in Apr 2020, have rebounded sharply to over US$60 in Mar 2021. All of the above increases had significant impact to the general price level in most emerging markets as their price level are more affected by the natural resource prices. For example, the average food prices in Brazil rose by 16% in 2020, among which the prices of staple food, rice and black beans, increased by 70% and 40% respectively, according to the Brazilian National Geographic and Statistics Bureau. In fact, the situation in Brazil is just a microcosm of most emerging markets. In light of the rising inflation risk, most emerging markets are forced to hike their interest rate to prevent the inflation to lose of control (and also due to the concern on currency depreciation mentioned above).

Brazil

On 17 Mar, Brazilian central bank raised its benchmark interest rate by 0.75% to 2.75%, this is the first hike since 2005 and higher than market expectation of up 0.5%. The Brazilian Central Bank indicated another hike of the same magnitude could be coming at its next meeting in May.

Notably, the pandemic in Brazil is still not under control, let alone the invasion of variant virus worsening the situation. The number of infections in the Brazil has surpassed India, with more than 11 million infected, the second highest in the world. And nearly 285,000 people have died of COVID-19 in Brazil, second only to the US. Amid worsening pandemic, Brazil's economy contracted by 4.1% in 2020. With still severe pandemic and slow vaccine rollout, it is very likely that Brazil’s economic recovery in 2021 will not be very promising and will be slower than previous expectation.

Brazil's inflation rate rose to 5.2% in February for the first time in 4 years, above the bank's target of 3.75%. The rise in inflation is mainly due to higher food price (with YOY increase of 14.5% in Mar 2021), meanwhile, rising oil prices also pushed up household energy costs

Source: Bloomberg

Turkey

On 18 Mar, Turkish Central Bank hikes 2% on benchmark interest rate from 17% to 19%, above the market expectation of up 1%. Given the upside risks to inflation expectations, the bank said that they decided on employing "a front-loaded and strong additional monetary tightening and additional monetary tightening will be delivered if needed''.

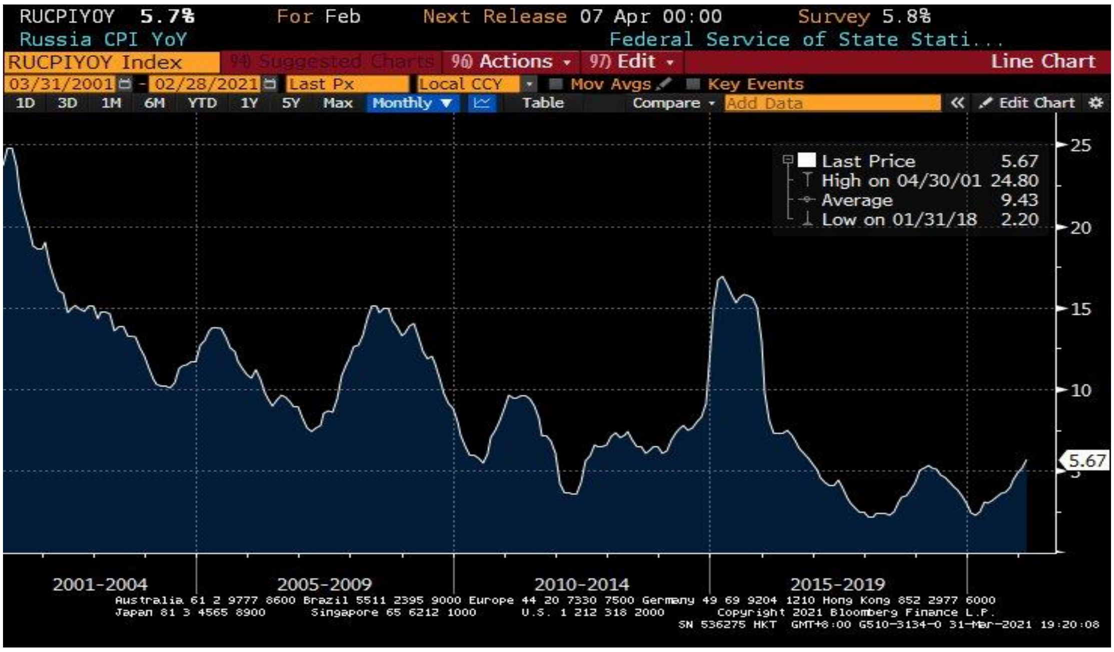
Turkey CPI, the inflation in Turkey remained mostly between %6-10% from 2004 to 2016. However, it jumped over 10% to double digit since 2017, and now has reached 15.6%.

Source: Bloomberg

Russia

On 19 Mar, the Bank of Russia was in line with the rate hike by central banks of Brazil and Turkey, raised the key rate by 0.25% to 4.50%, and indicated that will embark on a monetary tightening cycle triggered by a weaker ruble that pushed inflation higher. The central bank governor explained the rate decision as the economy is recovering with a greater confidence while inflationary risks have increased. The central bank further said the economy was expected to recover to pre-pandemic levels before the end of 2021, saying it "holds open the prospect of further increases in the key rate at its upcoming meetings."

Russia CPI increased to 5.7% in February 2021



Source: Bloomberg

Source: The Rio Times, Bloomberg, Financial Times, BBC News, Reuters, Statista, Yahoo Finance

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