

## Global Currencies and Stocks: Juxtaposed with Tapering

The Federal Reserve Bank, arguably the most influential bank of the world first hinted at ending its stimulus programme in May '13. Consequently, there was an upheaval in emerging economies' currency and stock indices post the remark by the then Fed Chairman, Dr. Ben Bernanke. The Federal Reserve Bank eventually started its tapering programme from January '14 when the Bank's purchase of mortgage-backed securities was reduced from \$40bn per month to \$35bn per month and the buying of the longer term Treasury securities was moderated to \$40bn per month from \$45bn per month, thereby commencing the tapering of the unconventional quantitative easing programme. The Fed has consistently been trimming the stimulus down by \$10bn every month since January '14.

In the context of the tapering, the performance of currencies and stock indices across countries over the last one year is tracked in two time windows-

- The 'pre-tapering' period from May'13 to Dec'13 (period following the first announcement by Dr. Ben Bernanke and subsequent anticipation in markets) and
- The 'tapering' period from Jan'14 to May'14.

By the end of May'14 the ongoing monthly bond buying programme was reduced to \$45bn per month contracting the overall stimulus by a total of \$40bn. The various countries are clubbed together in three distinct groups. Currencies and stocks of these countries are then examined within the broad groups. Finally, the report is concluded with conjectures drawn from the examination.

*The data on the stock indices is taken from The Economist and that on the exchange rates is from Pacific Exchange Rate Service.<sup>1</sup>*

### A. BRICS Economies

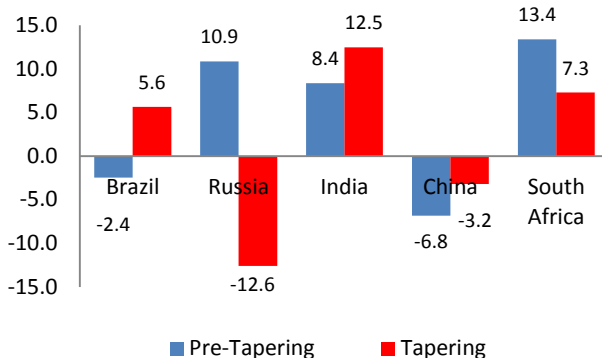
By May '13, the stimulus by the Fed was in its full force which implied large supply of dollars which were channeled to a large extent to the emerging markets and in particular to the BRICS group of countries by means of investments. It is intuitive that the dollar would begin appreciating in the FOREX market upon the commencement of tapering as the 'easy money' provided by the Fed would start depleting. It was believed that such a move would eventually lead to an increase in interest rates making US bonds once again attractive.

This in turn had led to a capital flight out of emerging countries and subsequently caused sharp depreciation in currencies and fall in stock indices at the time. This happened across the board on the expectation of a recovery in the USA, which would be the trigger for the Fed to actually go ahead and lower their quantitative easing programme.

The announcement effect of tapering had a stronger effect on markets than the actual tapering as may be viewed in the graphs below. Depreciation has been captured with positive sign and appreciation with negative sign.

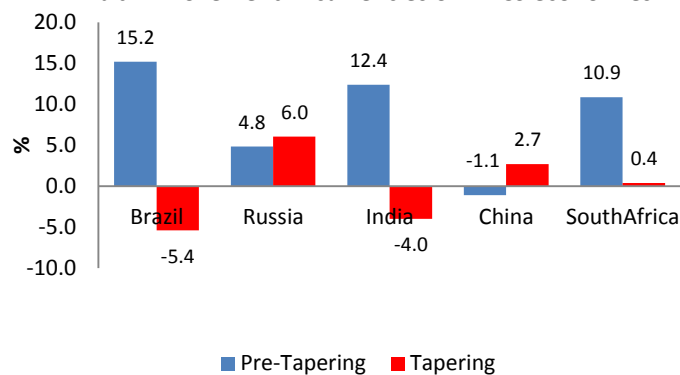
<sup>1</sup>Change in stock indices is calculated as the closing index on 14<sup>th</sup> May '14 over the closing on 5<sup>th</sup> June '13.

Exhibit 1: Change in stock indices of BRICS economies



Source: The Economist, Pacific Exchange Rate Service

Exhibit 2: Movement in currencies of BRICS economies



(-) Appreciation, (+) Depreciation

## • Stock Indices

### ○ Pre-tapering

- In the pre tapering period, stock indices in Russia, India and South Africa rallied by 10.9%, 8.4% and 13.4% respectively. Stocks in these countries were largely insulated from the impact of anticipations pertaining to the impending tapering by the Fed. Domestic factors clearly made a difference. Also this indicates that equity flows from overseas continued while debt went into the negative territory.
- Brazil and China recorded a fall in stock indices in the pre tapering period, with China losing the most by 6.8%. The contraction in China's Shanghai Stock Exchange can be attributed to the slowdown in the country which dented investor sentiments acutely.

### ○ Tapering

- With the commencement of tapering, stocks appear to have grown rapidly (May'14 over Dec'13). India's key stock index, Sensex registered the maximum growth at 12.5% within the BRICS group of countries driven by the increased optimism in the country regarding the establishment of the new government with an unprecedented majority which led to a surge in investor sentiments.
- The Brazilian stock index turned the corner and registered a growth of 5.6% while the South African index gained 7.3%. The euphoria surrounding the new government in Brazil influenced stock movements and strong corporate performance facilitated the growth in the South African Index in late May '14.
- Chinese Stocks contracted by 3.2% during the tapering period. This was primarily on account of a slowdown in the manufacturing sector in the country which seeped into slower GDP growth in Q1 2014 and thereby impaired investor sentiments.
- Russia was the other country in the group with negative growth of 12.6% in the tapering time window. The country was engaged in a severe geo-political struggle with Ukraine which led to sanctions being issued against influential Russians by the Euro countries and the USA. Investors' reactions were rather strong causing the RTS Index to move downwards.

## • Exchange Rate

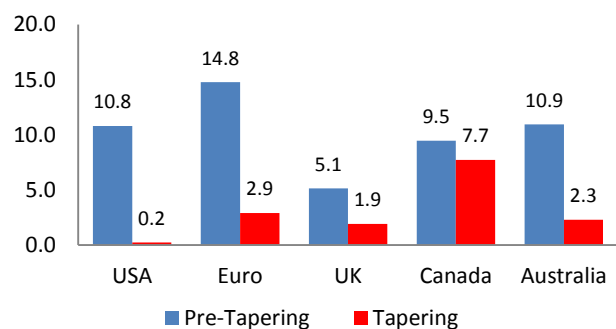
Currencies of almost all BRICS economies have witnessed less depreciation in the tapering period relative to the 'pre-tapering' period, suggesting thereby that the threat of tapering put stronger pressure as opposed to the actual event.

- *Pre-tapering*
  - The Brazilian Real, Russian Ruble, Indian Rupee and South African Rand all plunged against the USD in the ‘pre-tapering’ period. Brazilian Real depreciated the most as it fell by 15.2% vis-à-vis the USD in Dec’13 over May’13.
  - Indian Rupee fell sharply in August ‘13 and reached a low of Rs 68.78. The currency recorded a depreciation of 12.4% to stand after Brazil among the BRICS economies during this period. South African Rand recorded a 10.9% depreciation. The Russian Ruble fell by a relatively smaller 4.8% against the USD in the ‘pre-tapering’ duration.
  - The Chinese Yuan was the exception as it appreciated by 1.1% against the USD in the ‘pre-tapering’ stage. This was on account of its continued strong CAD.
  
- *Tapering*
  - With the onset of tapering, the Indian rupee appreciated by 4% against the depreciation of 12.4% in the pre-tapering period. There was a strong role played by intrinsic factors in this recovery.
  - The Brazilian Real appreciated the most among the BRICS economies at 5.4%. The South African Rand on the other hand, depreciated only by 0.4% vis-à-vis the depreciation of 10.9% in the ‘pre-tapering’ stage.
  - However, the Chinese Yuan fell against the USD by 2.7% and the Russian Ruble depreciated by 6% in the ‘tapering’ time window. This was clearly on account of the domestic forces at play in both countries. China was laden with concerns over the economic growth in the country whereas the violence across the border with Ukraine led to a loss in confidence in the Russian Ruble.

**B. Developed Economies**

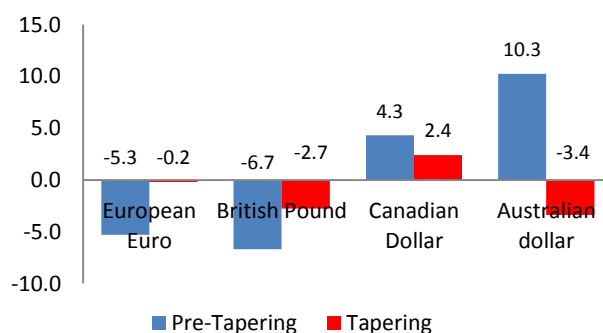
The stocks and currencies of UK, Euro zone, Canada, USA and Australia are overviewed in the group of developed countries below. *The exhibits below depict the movement in the stock indices and exchange rates of some developed countries.*

**Exhibit 3: Change in stock indices of developed countries**



Source: The Economist and Pacific Exchange Rate Service

**Exhibit 4: Depreciation in currencies of developed countries**



(-) Appreciation, (+) Depreciation

**• Stock Indices**

The developed countries overall recorded a healthy growth in the stock indices as economic growth was resurrected and forecasts of economic recovery remain stable with the IMF having projected a growth of 2.2% in

2014 for the advanced economies higher than the 1.3% growth for 2013<sup>2</sup> even as the Fed continues to wind down its quantitative easing. The move to taper itself sent signals that the US economy was on the recovery path and would show signs of growth in the coming months. Stock indices in the developed economies recorded higher growth in the 'pre-tapering' period compared with the tapering period.

- *Pre-tapering*
  - The FTSE Euro 100 index recorded the maximum expansion at 14.8%, Australia's All Ordinaries and the Dow Jones industrial Average in the USA were second at 10.9% and 10.8% growth respectively.
  - Canada's S&P TSX grew by 9.5% during this window and UK's FTSE100 grew by a modest 5.1%.
- *Tapering*
  - Dow has remained virtually flat at a growth rate of 0.2% as of end of May '14 after tapering began.
  - The Canadian stock exchange recorded the maximum growth among the developed countries at 7.7%. Australian stock index and the FTSE Euro 100 witnessed a modest growth of 2.3% and 2.9% respectively.
  - Lastly, FTSE 100 (UK) grew only by 1.9%.
- **Exchange rate**
  - *Pre-tapering*
    - The European Euro appreciated by 5.3% and the Sterling Pound appreciated by 6.7% against the USD during this period.
    - The Canadian and Australian dollar depreciated vis-à-vis the USD. The former lost 4.3% and the latter lost 10.3% against the USD.
  - *Tapering*
    - The Australian dollar marked a strong recovery after the commencement of tapering. The currency appreciated by 3.4% against the USD over this period.
    - The sterling pound continued to appreciate even after the onset of tapering at 2.7% against the USD supported by positive economic data with a fall in unemployment and expanding factory output indicating that the economy is improving.
    - The Euro is largely unaffected and continues to hover around the same level with a slight rise of only 0.2%. The currency rose in mid 2013 as the expectations of economic recovery in the Euro region gained momentum. However, the growth projections for the region stand lowered today and the ECB is continuing with its stimulus in order to aid the recovery process. This has led to the Euro falling marginally against the USD in recent times.
    - Canadian dollar lost relatively lesser with a depreciation of 2.4% during this period compared with the fall of 4.3% in the 'pre-tapering' period.

---

<sup>2</sup>According to the IMF's World Economic Outlook-April '14. More recently, the World Bank projected a growth of 1.9% for developed countries in 2014 as against a growth of 1.3% in 2013.

### C. Asia Pacific Economies

The Asian Pacific region includes most of the emerging market countries. These were the countries that witnessed a marked depreciation in domestic currencies following Dr. Ben Bernanke's comments regarding tapering as foreign investors withdrew their investments causing a paucity of the US dollar in the markets.

The table below depicts the movement in the stock indices and exchange rates of the Asia-Pacific countries.

**Table 1: Movements in Stock indices and Exchange Rates of select Asia-Pacific Countries**

Asia Pacific Economies	% Change in Stock Index		% Change in Exchange Rate	
	Pre-Tapering	Tapering	Pre-Tapering	Tapering
Japan	25.2	-11.6	2.5	-1.5
Hong Kong	5.6	-3.1	-0.1	0.0
Indonesia	-14.5	16.8	23.9	-4.5
Malaysia	5.2	0.7	7.5	-0.6
Singapore	-2.3	2.9	0.8	-0.5
South Korea	2.7	0.0	-5.0	-2.9
Taiwan	5.3	3.1	-0.2	1.4
Thailand	-14.7	7.5	8.6	0.6

Source: The Economist, Pacific Exchange Rate Services(-) Appreciation, (+) Depreciation

#### • Stock Indices

Stock indices in the Asia-Pacific have had a mixed performance over the last one year.

##### ○ Pre-Tapering

- Japan's Nikkei witnessed a staggering growth of 25.2% before the tapering began as the country appeared to enjoy the consequences of Abenomics which reversed the state of stagnation in the economy.
- Countries like Hong Kong, Malaysia, Taiwan recorded a growth in their stock indices in the range of 5-6% during this period.
- However, stock indices in Indonesia, Thailand contracted sharply by 14.5% and 14.7% respectively as the anticipation of the tapering and its potential spillover increased over the period.
- Singapore's stock exchange also dropped by 2.3%

##### ○ Tapering

- Ironically, the stock indices recording maximum loss in the 'pre-tapering' period turned around after the onset of tapering to record maximum growth. For instance, Indonesia's Jakarta Stock Exchange grew the most among Asia-Pacific economies at a rate of 16.8% and the Stock Exchange of Thailand (SET) expanded by 7.5%
- Stock indices in Taiwan and Singapore registered modest gains at 3.1% and 2.7% respectively. Whereas Malaysia's Kuala Lumpur Stock exchange grew marginally by 0.7%.
- Interestingly, Japan's Nikkei having grown the most in the pre-tapering recorded maximum contraction in the tapering period as it fell by over 11%.
- Hong Kong's Hang Sang Index also contracted by 3.1% against the growth it recorded in the pre-tapering period.

- **Exchange rate**

As is evident in the table above, most Asia-Pacific currencies appreciated after the tapering programme of the Federal Reserve Bank began.

- *Pre-tapering*

- Further to the contraction in stock indices, Indonesia and Thailand suffered significant depreciation in their currencies relative to the USD during this time. The Indonesian Rupiah fell by 23.9% High inflation, a wide Current Account Deficit (CAD) and increasing demand for the US currency to repay international debt had contributed to the fall in the domestic currency. The Thai Baht also recorded a loss of 8.6% against the USD.
- Malaysian Ringgit lost 7.5% against the USD and the Japanese Yen also depreciated by 2.5% during this time.
- South Korean Won rose by 5% , Taiwanese Dollar and Singapore dollar also gained around 0.2% being unaffected by the threat of the tapering.

- *Tapering*

- There was a remarkable turnaround as the tapering eventually began. After having depreciated sharply, the Indonesian Rupiah appreciated the most by 4.5%.
- In spite of the ongoing tapering, currencies like the South Korean Won and Singapore Dollar gained against the USD driven by positive domestic growth in the backdrop of sound financial markets and low inflation. South Korea in particular enjoys a healthy trade surplus which has led to a rise in foreign currency reserves. Lastly, the Korean Central Bank has kept the dollar demand under control since February 2012 and has further maintained a stable policy which has helped reduce the volatility in the exchange rate.
- Japanese Yen appreciated by 1.5% and the Malaysian Ringgit also gained slightly. The Hong Kong dollar however, has remained flat.

### Concluding Remarks

- Currencies of the emerging economies in Asia-Pacific and also the BRICS group have tended to weaken when the tapering programme was announced but strengthened after the commencement of tapering. In case of developed countries, appreciation continued for 3 out of the 4 currencies, and in case of Canada, the rate of depreciation was lower. Therefore, the news of tapering was more serious for currencies than the actual tapering.
- Overall, it can be concluded that the stock indices in emerging economies have grown significantly in the tapering period as opposed to the 'pre-tapering' period indicating that investor confidence has not been susceptible to the winding down of the Fed's stimulus plan, and was driven by other factors. Also, it may be surmised that while foreign debt flows may have slowed down, those into equities did not.
  - India appears to be healthily placed currently with the rupee having marked significant appreciation comparable to other international currencies.

Contact:

**Madan Sabnavis**

**Chief Economist**

madan.sabnavis@careratings.com

91-022-67543489

**Garima Mehta**

**Associate Economist**

garima.mehta@careratings.com

91-022-61443526

**Disclaimer**

*This report is prepared by the Economics Division of Credit Analysis & Research Limited [CARE]. CARE has taken utmost care to ensure accuracy and objectivity while developing this report based on information available in public domain. However, neither the accuracy nor completeness of information contained in this report is guaranteed. CARE is not responsible for any errors or omissions in analysis/inferences/views or for results obtained from the use of information contained in this report and especially states that CARE (including all divisions) has no financial liability whatsoever to the user of this report.*