Philequity Corner (August 20, 2018)
By Wilson Sy

Turkey – Contagion?

Last week, global markets were roiled by Turkey's currency crisis. A US-listed ETF for Turkey, TUR, dropped 24% in 2 days and is down 51% YTD. After Trump's tirades against Turkey, The Turkish lira fell as much as 20% in one day, hitting its lowest point against the US dollar in history. Even though the lira recovered from its lows last week, it is still down 37% YTD. The turmoil in Turkey dragged down EEM, the emerging markets ETF, which lost 6% over 4 days. The Philippines was no exception to this, losing as much as 5.1% from its recent high of 7879 when it hit a low of 7479 last week.

Rubbing salt into the wound

Already suffering from fiscal and economic maladies, Trump just had to rub salt into the wound. Last August 10, Turkey became the latest target of the tweeter-in-chief. Trump said that "I have just authorized a doubling of Tariffs on Steel and Aluminum with respect to Turkey as their currency, the Turkish Lira, slides rapidly downward against our very strong Dollar! Aluminum will now be 20% and Steel 50%. Our relations with Turkey are not good at this time!" Last Friday, Trump once again tweeted that "we will pay nothing for the release of an innocent man, but we are cutting back on Turkey!" Trump warned that more economic sanctions are forthcoming unless the country hands over detained American pastor Andrew Brunson.

Perfect storm

Once the darling of emerging markets and one of the fastest-growing economies in the world, Turkey fueled its expansion with mountains of foreign currency debt. In fact, according to the IMF, Turkey's foreign currency debt amounts to more than 50% of its GDP. Moreover, Turkey's borrowing binge led to massive current and fiscal deficits. These twin deficits and mounting dollar debt were further exacerbated by the severe depreciation of the Turkish lira. Unfortunately, it seems that Turkey is actually in the midst of a perfect storm.

US Dollar breaks out

With some European banks exposed to Turkish assets, the drop in the Turkish lira and stock market caused euro to break down. After breaking the crucial 1.15 support level, the euro traded as low as 1.13, its lowest in more than a year. This caused the dollar index, DXY, to break the 95 resistance level as it touched a 1-year high. Apart from a potential contagion, this breakout in the US dollar put additional pressure on currencies globally.

1997 Asian Financial Crisis redux?

With the lira in free fall, some economists were saying that Turkey's financial crisis could lead to an emerging market contagion similar to what happened during the 1997 Asian Financial crisis. With investors now wary of an emerging market contagion, currencies of many developing countries also broke down. The breakout of the DXY further aggravated their depreciation.

In Word and In Deed

Amidst this backdrop, the BSP's 50 bps rate hike last August 9 could not have come at a better time. In a strongly worded statement, BSP Governor Nestor Espenilla Jr. said that "the BSP reiterates its strong commitment and readiness to take all necessary policy actions to address the threat of high inflation and deliver on its primary mandate of price stability." With the highest rate hike in 10 years, Espenilla showed his resolve in staving off inflation not only in word, but also in deed.

Timely, decisive, crucial

Because of the turmoil in Turkey, the recent 50 bps rate hike was not only timely but also crucial. If the BSP had raised rates by only 25 bps, our stock market and peso would have fallen much more, possibly even breaking strong support levels. It is fortunate that the BSP took decisive action and maintained its hawkish language, leaving the door open for another rate hike this year.

Turkey will not have a major effect on global economic growth

Although Turkey's problems have caused global equity markets to drop, the relatively small size of its economy means that any potential contagion will not have major effect on global economic growth. However, the dampened sentiment in Europe and emerging market assets is what is roiling markets. Combined with the US-China trade war, the environment for investing has been perilous.

"It's complicated"

2018 has proven to be a very difficult year for investing. Markets have been very volatile as there are many significant events happening at the same time. Domestically, many factors require constant monitoring as these have a significant impact on stock prices. In fact, many of our readers and clients have been asking for our opinion on different topics. Below are some of the most frequently asked questions:

1. Will Turkey lead to another contagion similar to the 1997 Asian Financial crisis?
2. Will oil go to $100 or $50? Why are gold and copper dropping?
3. Will the Philippine peso strengthen or weaken? Will inflation be contained?
4. Will the US-China trade war end amicably or will it worsen? How does it affect the Philippines?
5. Have we seen the low in this correction? Is it time to buy or should I stay in cash?

Investors briefing on September 1

Because markets are too volatile and event-driven now, it would be quite hard to definitively answer all of these questions in our weekly articles. Thus, it is best that these are answered in a live Q&A or through a market outlook presentation. If you want your questions answered, please register and attend our market outlook on Saturday, September 1, 9:30AM at the Meralco Theater.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.