CRUMBLING BRICS: A CURRENCY PERSPECTIVE

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"I need a dollar dollar, a dollar is what I need…
Bad times are coming and I reap what I don't sow…
Well let me tell you something, all that glitters ain't gold…
It's been a long old trouble, long old troublesome road
And I'm looking for somebody, come and help me carry this load".
Aloe Blacc's song, "I Need a Dollar"

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OVERVIEW AND CONCLUSION

Assorted marketplace wizards around the globe for many years have praised past and predicted future stellar (or at least rather robust) growth for key emerging and developing nations. These countries not only display cultural diversity. They also manifest a significant range in economic development, arrangements, focus, and strengths. Though many embrace democracy to some extent, their political characteristics and stability are far from uniform. Despite this variety, the popular BRIC acronym, standing for Brazil, Russia, India, and China (now including South Africa), coined by Goldman Sachs nearly 15 years ago, acts as a rough shorthand summary for much if not all of the emerging/developing nation group.

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Marketplace history of course need not entirely or even substantially repeat itself. However, the recent appreciation of the United States broad real trade-weighted dollar ("TWD") warns of erosion in global economic output rates.

The TWD established a major bottom at 84.2 in April 2008 (Federal Reserve Board, H.10; monthly average, March 1973=100). After climbing to 86.7 in August 2008 and 88.8 in September 2008, it bounded to over 93.8 in October 2008. Recall the noteworthy acceleration of the worldwide financial crisis after mid-September/October 2008. Its March 2009 pinnacle around 96.9 represented a 15.1 percent bull advance relative to April 2008.

After deteriorating to its major trough around 80.5 in July 2011, the TWD meandered sideways within a narrow range for about the next three years. Its high over that span was June 2012's 86.3. Yet in recent months, as it did beginning in April 2008, the broad real trade-weighted dollar has marched steadily higher. A five percent bull move in the TWD from its July 2011 trough at 80.5 equals about 84.5, a ten percent climb about 88.6. A fifteen pc rally gives 92.6, a 20pc leap about 96.6.

September 2014's 86.6 broke through June 2012's barrier, with December 2014's attaining 90.5. January 2015's 92.4 rose 2.1 percent over December 2014. The TWD's 14.8 percent ascent from the July 2011 depth rivals its April 2008 to March 2009 move. Significantly, its January 2015 level neighbors that of October 2008 and is not too distant from March 2009's 96.9 elevation.

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What do FX movements (trade-weighted, effective exchange rates) within the BRICS universe reveal nowadays? Their recent travels differ to some extent from the 2007-09 crisis adventures. However, as during the darker days of the worldwide economic disaster, the current currency voyages of Brazil, Russia, India, and South Africa generally display depreciation. As in the earlier period, however, China's currency has rallied recently on an effective exchange rate basis. Looking forward, these currency patterns alongside TWD strength do not merely confirm the TWD bull move, but also emphasize the likelihood of further slowing of global real GDP.

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According to the International Monetary Fund's "World Economic Outlook Update" (1/19/15; Table 1), world real GDP output expands slightly from 2014's 3.4 percent to 3.5pc in 2015 and 3.7pc in 2016. Economic optimists may huff and puff that this shows the world is performing better and better. Yet this IMF viewpoint represents a .3 percent cut for both 2015 and 2016 relative to its October 2014 prediction.

In any case, concentrate on emerging market/developing economies. Are there cracks in the façade of booming growth in this category? The 2014 expansion was 4.4 percent, a modest retreat from 2013's 4.7pc. The 2015 growth rate inches down to 4.3pc. The IMF believes output will blossom to 4.7pc in 2016. However, its January 2015 Update slashes the October estimate .6pc for 2015 and .5pc for 2016. Though China's real GDP growth rate remains enviable, 2014's 7.4pc slips to 6.8pc in 2015 and 6.3pc in 2016.

The MSCI emerging stock markets index ("MXEF"; from Morgan Stanley) lurks well beneath its 4/27/11 high around 1212.

CURRENCY HISTORY: BRIC HOUSES

In the documentary film "Crumb", the artist Robert Crumb declares:
"It used to be that people fermented their own culture, you know? It took hundreds of years, and it evolved over time. And that's gone in America. People now don't even have any concept that there ever was a culture outside of this thing that's created to make money. Whatever's the biggest, latest thing, they're into it."

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In the currency universe, most financial, political, and media storytellers focus on cross rates between two nations, such as the US dollar versus the Chinese renminbi. However, analysis of the broad real trade-weighted effective exchange rates for a given country offers better insight into the overall situation for that nation's currency.

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What are present-day percentage weights within the broad real TWD for the BRICS? (Federal Reserve, H.10). Only China's is substantial, a massive 21.3 percent. Brazil constitutes 2.1pc, Russia 1.4pc, and India 2.0pc; South Africa's share is so minor that it does not even make the Fed's table. Compare the Euro area's 16.4pc, Canada's 12.7pc, Mexico's 11.9pc, and Japan's 6.9pc.

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The Bank for International Settlements provides real effective exchange rates ("EER"; CPI based; monthly average, 2010=100) for numerous nations around the globe, including the BRICS. The latest BIS release (1/15/15) provides data through December 2014. The BIS EER statistics are less current than the Fed's H.10 for the broad real TWD, which extends through January 2015.

However, January 2015's 92.4 for America's TWD is a 2.1 percent boost versus December 2014. Various recent dollar cross rates suggest the greenback from the broad real trade-weighted perspective remains quite sturdy. Assuming that dollar trade-weighted strength generally will tend to coincide with EER weakness for Brazil, Russia, India, and South Africa, it is reasonable to conjecture that the longer run current bearish patterns for those nations in the following table have not changed dramatically relative to those shown through December 2014. What about China? Although the renminbi has weakened somewhat relative to the dollar in the past few weeks, its notably bullish EER trend (since May 2014) probably remains intact. In any event, the next BIS EER release will happen soon, in mid-February 2015.

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The trading patterns for the broad real TWD are very similar to those reported by the BIS for the US dollar EER. After the US EER achieved a major low at 96.4 in April 2008, it jumped to 101.2 in September 2008. It soared to 106.8 in October 2008, peaking at 110.6 in March 2009. Compare the US EER 93.0 July 2011 bottom and June 2012's 99.7 interim top with those for the TWD. In September 2014, the EER smashed its way to 100.5; December 2014's EER is 104.9.

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Recall the acceleration of the worldwide economic crisis (and decline in the S+P 500) in 2008 as the broad real TWD appreciated. The S+P 500's major peak occurred 10/11/07 at 1576, but its final high was 5/19/08 at 1440, close in time to the April 2008 TWD bottom. The S+P 500 collapsed from around 1313 (8/18/08)/1265 (9/19/08). The S+P 500's major bottom at 667 on 3/6/09 occurred the same month as the broad real TWD pinnacle.

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The EER moves for the various BRIC currencies (and Mexico) in the following table do not occur in precisely the same fashion. Start dates and end dates sometimes differ; the percentage moves of the various EERs are not always the same. Although the times of the EER turning points do not always exactly coincide with the rally in the broad real trade-weighted dollar (whether in 2007-09 or in the current scene), the EER travels (especially when interpreted together) clearly display a pattern in relation to the TWD's major trend.

Although Mexico is not formally a BRIC member, it is an important developing nation and very significant US trading partner. Hence the table includes it.

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THE CURRENT FX SCENE | **GLOBAL CRISIS ERA (2007-09)**

BRAZIL

Recent High(s)	Recent Low(s)	High	Low
110.0; July 2011	84.7; Dec 2014	96.8; Aug 2008	72.2; Dec 2008
93.2; July 2014	[near 83.6; Aug 2013]		

[July 2011 is the 1994-2014 EER record high. The all-time low for that span is October 2002's 42.0.]

RUSSIA

Recent High(s)	Recent Low(s)	High	Low
110.1; Feb 2013	72.2; Dec 2014	104.0; Nov 2008	84.4; Feb 2009
104.4; June 2014			

[February 2013 is the 1994-2014 peak. Although October 1994's 40.9 represents the record depth for the ruble in the BIS data series, recall January 1999's 43.5, a 52.0 percent crash from January 1998's 90.6 peak.]

INDIA

Recent High(s)	Recent Low(s)	High	Low
103.4; July 2011	84.5; Sept 2013	102.2; July 2007	86.0; Mar 2009

[India's December 2014 EER is 89.2, a modest rise from the September 2013 depth. However, India's EER still persists in a longer run bear pattern. The December EER level is quite distant from its July 2011 peak. In addition, the December EER is only about 5.6pc above the September 2013 low, and it also remains close to the March 2009 bottom.]

SOUTH AFRICA

Recent High(s)	Recent Low(s)	High	Low
103.3; July 2011	74.4; Feb 2014	94.6; Oct 2007	71.9; Oct 2008
[Dec 2010 top 105.3]		[Oct 2007 was drop-off point, but earlier tops 111.1 Dec 2004 + 109.8 Feb 2006]	

[South Africa's December 2014 EER is 78.2. Although this is above the 74.4 low, South Africa's EER remains in a bear trend. As was the case for the Indian EER, its December 2014 EER still is far from its July 2011 peak. In addition, December 2014's 78.2 neighbors February 2014's bear move low to date and stands fairly close to October 2008's 71.9.]

MEXICO

Recent High(s)	Recent Low(s)	High	Low
106.9; April 2013	96.9; Dec 2014	113.8; Aug 2008	87.5; Feb 2009

[Note that the EER for the peso rallied in the early stage of the 2007-09 crisis. From a bottom during the Goldilocks Era at 104.0 in June 2006, it mounted to its August 2008 peak. It cratered after September 2008's 109.9. Its all-time EER high is March 2002's 133.1, its record bottom March 1995's 62.4.]

CHINA

Recent High(s)	Recent Low(s)	High	Low
126.2; Dec 2014	114.0; May 2014	107.4; Feb 2009	88.7; Oct 2007
			[+ low 83.8 May 2006]

[Unlike the crumbling effective exchange rates for the currencies of Brazil, Russia, India, South Africa, and Mexico over the two eras, China's EER shows a significant bullish pattern. China's December 2014 EER is a record high. After falling to 95.6 in November 2009, China's EER marched higher. January 1994's 65.6 is the lowest over the 1994-2014 horizon.

The renminbi's current cross rate level against the US dollar level, near 6.25, indeed is about 3.5 percent lower than its 1/14/14 cross rate high of 6.04. However, this rather minor cross rate shift, when seen in the context of the context of China's forceful EER bull move, clearly does not tell the entire Chinese currency story. Although the BIS states the US represents 19.0pc of China's EER, the Euro area share is large as well, at 19.4pc, as is Japan's 15.9pc.]

THE JAPANESE YEN'S BREAKDOWN

The blues great Howlin' Wolf sings in "Smokestack Lightnin'":
"Ah-oh smokestack lightnin'
Shinin', just like gold
Why don't ya hear me cryin'?"

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Though Japan is not a BRIC, its EER history is worth a look in relation to the current worldwide currency context. First, recall that during the 2007-09 worldwide economic disaster, the Yen EER trotted from 79.4 in July 2007 to 85.9 in September 2008; it then rapidly flew up to 95.5 in October 2008, reaching its summit at 106.6 in January 2009. Although during the crisis period Japan's EER bull climb began prior to the bull move in the US TWD, the currencies of both nations (and China) advanced.

After declining to 94.3 in April 2010, the Yen EER ascended to 105.7 in October 2011, close to January 2009's major high. But like a fragile house of sticks facing a fierce storm, the Yen EER began to break down from July 2012's interim high at 102.7. By January 2013, it was 86.9. After August 2013, it sagged below 80.0. By December 2014, it had achieved a new low of 69.1, down about 34.6 percent relative to its October 2011 plateau.

Thus the Japanese EER's disintegration during its bear move over the past couple of years contrasts dramatically with its bull trend during the worldwide financial crisis that emerged in 2007 and accelerated in 2008. The downtrend of the Yen EER in recent months also differs from the rallies in the TWD and Chinese EER. What about a very long term viewpoint on the Yen EER? Underline that its December 2014 level collapses about 54.0pc relative to April 1995's all-time high at 150.3.

Over the past couple of years, has Japan engaged in competitive depreciation and currency warfare? In any case, Japan, despite its monumental currency depreciation and mammoth quantitative easing, still has mediocre economic growth and suffers from deflation/too low inflation. Japan's economic sluggishness and low inflation in the face of its sustained depreciation and money printing policies represent a further danger warning regarding prospects for worldwide economic growth.

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