BRICS Biggest Currency Depreciation Since 1998 to Worsen

By Ye Xie and Michael Patterson - Jun 25, 2012

The largest emerging markets, whose economies grew more than four-fold in the past decade, are making losers out of everyone from central bankers to Procter & Gamble Co. (PG) as their currencies post the biggest declines since at least 1998.

For the first time in 13 years, the real, ruble and rupee are weakening the most among developing-nation currencies, while the yuan has depreciated more than in any other period since its 1994 devaluation. P&G, the world’s largest consumer-goods maker, cut its profit forecast for the second time in two months last week in part because of currency losses. Brazil’s Fibria Celulose SA (FIBR3), the biggest pulp producer, asked banks to loosen restrictions on dollar loans as the real hit a three-year low.

Investors are fleeing the four biggest emerging markets, known as the BRICs, after Brazil’s consumer default rate rose to the highest level since 2009, prices for Russian oil exports fell to an 18-month low, India’s budget deficit widened and Chinese home prices slumped. Investors are bracing for more losses as economic growth slows.

“I am quite bearish,” Stephen Jen, a managing partner at hedge fund SLJ Macro Partners LLP and a former economist at the International Monetary Fund, said in a phone interview from London. “When the global economy and capital flow slow down, it’s going to expose a lot of problems in these countries and make people stop and ask questions. A run on the currency could be particularly ugly.”

Ruble’s Retreat

Currencies from Brazil, Russia and India will probably decline at least 15 percent further by year-end, said Jen, the former head of global currency research at Morgan Stanley.

Brazil’s real lost 12 percent this quarter through June 22, the biggest drop among the 31 most-actively traded currencies tracked by Bloomberg. The 11.5 percent depreciation in the ruble and 10 percent drop in the rupee were almost twice the retreat in the euro. China’s yuan, which was kept unchanged during the global financial crisis in 2008 and 2009, fell 1.2 percent since March after the government widened the amount the currency is allowed to fluctuate each day.

The ruble sank 2.4 percent last week, while the rupee fell 2.9 percent to a record low against the dollar and the real dropped 0.8 percent.

Foreign Reserves

India’s currency rebounded 0.4 percent at 11:06 a.m. in London as the government said it increased the amount of rupee-denominated debt overseas investors can own, one of several measures unveiled to support the currency. The yuan fell as much as 0.3 percent to 6.3827 per dollar, the weakest level since Nov. 29, before closing little changed. The ruble strengthened 0.1 percent.
A decade after Goldman Sachs Group Inc. (GS)’s Jim O’Neill coined the term BRIC, China has become the second-largest economy while Brazil, India and Russia are among the 11 biggest worldwide. Their combined gross domestic product rose to $13.3 trillion last year from $2.8 trillion in 2002 as their share of the global economy increased to 19 percent from 8 percent, according to IMF data. Together, they control $4.4 trillion in foreign-exchange reserves, about 40 percent of the total.

The MSCI BRIC Index (MXBRIC) of shares has surged 281 percent during the past decade, compared with 34 percent for the Standard & Poor’s 500 Index (SPX) as the real and the yuan strengthened more than 30 percent. Local-currency debt in the BRIC nations returned an average 86 percent in dollar terms since data for JPMorgan Chase & Co. indexes on all four countries began in October 2005, versus a 48 percent increase in U.S. Treasuries.

**Export Boost**

The countries are still strong enough to account for 80 percent of growth at New York-based Goldman Sachs, the fifth-biggest U.S. bank by assets, Chief Executive Officer Lloyd Blankfein said at the St. Petersburg International Economic Forum in Russia’s second-largest city on June 21.

Weaker currencies will stimulate economic expansion by making exports more competitive, said Warren Hyland, an emerging-market money manager at Schroder Investment Management, which oversees about $319 billion worldwide. He’s been buying ruble bonds of Russian companies.

Earnings at the nation’s commodity producers, including OAO GMK Norilsk Nickel (GMKN) and Polyus Gold International Ltd. (PGIL), will get a boost because their sales are in dollars while the bulk of their costs are in rubles, New York-based Morgan Stanley said in a report this month.

Weaker currencies are hurting U.S. companies that rely on developing-nation revenue to offset slower growth in the U.S., Europe and Japan.

**Lower Forecasts**

P&G, led by Chief Executive Officer Bob McDonald, said in a June 20 presentation at the Deutsche Bank Global Consumer Conference in Paris that foreign-currency fluctuations will cut 2013 earnings growth for the maker of Tide washing detergent and Bounty paper towels by about 4 percentage points. China is the Cincinnati-based company’s second-largest market and some of the firm’s biggest businesses are in Russia and Brazil, P&G said.

Philip Morris International Inc. (PM), the world’s largest listed tobacco company, reduced its 2012 earnings forecast the next day because of currency swings. The New York-based maker of Marlboro cigarettes gets more than 40 percent of its operating profit from Asia and Latin America, according to data compiled by Bloomberg.

**Pandit’s Expansion**

A weaker real and lower interest rates in Brazil may reduce Coca-Cola Co. (KO)’s second-quarter profit by $30 million, according to JPMorgan. The Atlanta-based company left about $3 billion in cash in Brazil at the end of 2011 to take advantage of the country’s higher interest rates, Chief Financial Officer Gary Fayard said in a conference call in February. Half of the positions were left unhedged, he said.

Brazil’s central bank President Alexandre Tombini has cut the benchmark Selic rate by 2.5 percentage points this year to 8.5 percent, while the real has depreciated 9.7 percent.

“We continue to be concerned by Coke’s reliance on this income source,” JPMorgan analysts led by John
Faucher wrote in a note to clients on June 7, reducing their 2012 profit estimate to $4 a share from $4.06.

Kent Landers, a spokesman for Coca-Cola, declined to comment.

**Fibria Loans**

Citigroup Inc. (C), which has been expanding in Latin America and Asia under Chief Executive Officer Vikram Pandit, may take a $3 billion to $5 billion “hit” this quarter related to foreign exchange losses, Charles Peabody, a New York-based analyst at Portales Partners LLC, said in an interview with Bloomberg Television on June 20. The losses may reduce Citigroup’s book value, or assets minus liabilities, he said.

Peabody, whose recommendations on shares of New York-based Citigroup during the past year produced the highest total return among 31 forecasters tracked by Bloomberg, cut his rating on the stock to the equivalent of sell from buy in March.

“Citi’s unique global footprint and exposure to the higher economic growth regions of the world will drive above-average book value growth over time,” Jon Diat, a Citigroup spokesman, said in an e-mail. “The suggestion that having non-U.S. exposure is somehow detrimental to Citi’s ability to continue to grow value over time is simply wrong.”

Local companies in the BRIC countries are also being hurt. Sao Paulo-based Fibria said on June 11 that it renegotiated loan covenants after the real’s decline increased the cost of servicing foreign obligations. About 90 percent of the company’s net debt is in dollars, according to company filings.

**Yuan Debt**

The rupee’s drop has hurt Indian companies by fueling inflation and reducing the scope for lower borrowing costs, said V. Ashok, the chief financial officer of Essar Group, the utility and shipping company owned by billionaire brothers Shashi and Ravi Ruia. India’s central bank unexpectedly left interest rates unchanged on June 18.

“One has no clue where it is going to end,” Ashok said in a June 22 phone interview from Mumbai. “The uncertainty and the volatility is the biggest concern.”

A weaker yuan is sapping demand for local-currency debt sold in Hong Kong, where international investors speculate on China’s foreign exchange rate. The average yield rose to a four-month high of 5.35 percent on June 5 from 4.82 percent at the end of March, according to data compiled by Bank of America Corp. Wang Changshun, chairman of Air China Ltd. (601111), told reporters this month that the company’s income from foreign-currency transactions will drop about 80 percent.

**Bearish Bets**

“All the BRIC looked ugly,” John Taylor, who oversees $3.5 billion as founder of currency hedge fund FX Concepts LLC in New York, said in an phone interview on June 19. The real and ruble will suffer “fairly decent” declines later this year as a global recession spurs investors to buy dollars as a haven, Taylor said.

After spending most of last year introducing policies to weaken their currencies, emerging-market governments are now working to limit the slide amid capital outflows.

Brazil’s government pared a tax on overseas loans on June 14 and has used swaps to add dollars to the market. Russia’s central bank sold U.S. currency this month to slow the ruble’s retreat, according to Chairman Sergey
Ignatiev. India cut the amount of overseas income companies can hold in foreign exchange last month, spurring them to repatriate earnings. The ownership ceiling on government bonds was raised by $5 billion to $20 billion, the central bank said in an e-mailed statement today.

Investors withdrew $6.3 billion from Brazil’s stocks and bonds in May, the most since at least 2010, central bank data show. Russian capital outflows reached a net $46.5 billion in the first five months of the year, including $5.8 billion in May, which is “a lot” for the country, Ignatiev told reporters in St. Petersburg on June 6.

**Consumer Defaults**

Derivatives traders see no sign of a turnaround.

Wagers on a weaker real on Sao Paulo-based BM&FBovespa’s futures exchange rose to $4.7 billion on June 12, the most since February 2010, according to data compiled by Bloomberg.

Option traders are the most bearish on the ruble since October and they expect price swings in the rupee to be the biggest in Asia, the data show. Twelve-month forward contracts on the yuan are pricing in a further decline of 0.7 percent in 12 months.

A surge in bad loans in Brazil will weaken the real further, said Amit Rajpal, who manages global financial funds for London-based Marshall Wace LLP. The default rate on consumer debt rose to 7.6 percent in April, matching the highest level since December 2009, as lending growth slowed to 18 percent from a record 34 percent in September 2008, according to the central bank.

**India Deficit**

“What we’ll see now is basically a full-blown credit problem,” said Rajpal, who predicts rising defaults in Brazil will resemble the collapse of the U.S. subprime mortgage market five years ago.

In India, Prime Minister Manmohan Singh is grappling with trade and budget deficits, corruption scandals and fighting in the ruling coalition. The country may become the first among the BRIC nations to lose its investment-grade rating, Standard & Poor’s and Fitch Ratings said this month. India’s budget gap amounted to 5.8 percent of gross domestic product, compared with 4.2 percent in Portugal and 3.9 percent in Italy, according to data compiled by Bloomberg.

China has cut its growth target this year to 7.5 percent, from the 8 percent goal that had been in place since 2005. Home values fell in a record 54 of 70 cities tracked by the government in May, while industrial production growth slowed to a three-year low in April.

In Russia, the price of Urals crude, the country’s main export blend, sank 26 percent this quarter. Russia relies on oil and gas for about 50 percent of its budget revenue.

Investors are still too bullish on assets in the BRIC nations as Europe’s debt crisis weighs on emerging economies, said Eric Fine, a money manager at Van Eck Global.

“They will do poorly when the world is doing poorly,” Fine, whose firm oversees about $35 billion, said in a phone interview from New York. “I don’t believe in decoupling.”

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