



Emerging Financial Market Watch

Overview

Emerging economies' currencies rose against an increasingly weak dollar in October. Confidence in emerging economies' equity and debt markets also bounced back considerably from the peak of the financial crisis. What will emerging economies do in the face of their rising currencies? How will they stabilize their economies without thwarting growth in the productive economy?

Focus: Capital controls stage a comeback in Brazil

Brazil's economy has been going through a steady recovery. On the back of record low interest rates, higher commodity prices, and forecasts for faster economic growth, the Brazilian real has been rapidly appreciating, by 4% against USD in October, which triggered worry in the government about the prospect for a balanced, durable economic growth. In response to the rising real, the government announced on October 19 an imposition of a 2% tax on foreign purchases in the country's equities and fixed income markets. Questions have since arisen: will capital controls be effective in reducing volatility and stemming the appreciating real? Will other emerging economies follow suit? We believe that capital controls will indeed be effective in the short term in reducing market volatility and stemming the rise of the Brazilian real; yet the impact will phase out in the long term. Furthermore, heavily relying on weak currencies due to their export-driven economies, some Asian countries are likely to follow in Brazil's footsteps in the future.

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