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Examining the Causes and Potential Policy Responses to Emerging Market Currency Contagion

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Abstract

The differentiation in economic fundamentals and policies is highly pronounced among emerging markets countries. Yet emerging-market sector exposures often share a relative lack of liquidity, and during currency market sell-off episodes, such liquidity challenges can exacerbate market impacts and cause contagion. This article examines the causes and mechanics of the currency contagion in emerging markets countries that occurred in the spring of 2013 and went into the winter of 2013–2014. This episode has often been blamed on the potential ending of quantitative easing (QE) by the

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U.S. Federal Reserve. Our key conclusion is that, rather than the U.S. debate about ending QE, the episode was instead caused by the following factors: relative out-performance by the U.S. equity market in 2013, economic growth deceleration in many emerging markets countries, rising political risks, and the mechanics of asset allocation shifts away from emerging market exposures.

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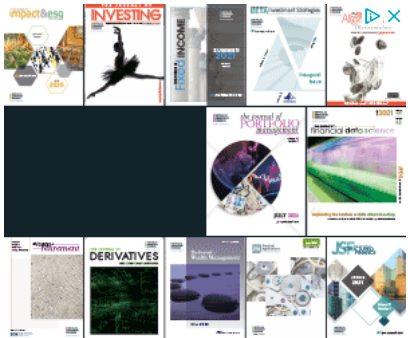
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