The Effects of Fed's Quantitative Easing Policy on Emerging Markets, by Berkol Alevli

In our global era, all economies are assumed as "most likely independent" and especially emerging markets started having more confidence in themselves with great growth rates, but there is still a fact that bigger economies have a great impact on others. To confirm that, we have witnessed how Ben Bernanke's speech that Fed would most likely taper its quantitative easing (QE) policy has made emerging economies such as Turkey, South Africa, India and so on significantly vulnerable. Right after this signal to markets, Central Banks had to react rapidly with sharp decisions such as increasing the rate of government bonds (10 years) and following tougher monetary policy.

The effect of this painful process has lessened on September 18 by the speech of Bernanke again: Fed announced that they are going to maintain the QE policy. But it is jotted down that countries shining with their spectacular economic growth rates became very fragile in last 4 months. In order to understand the effects better in our region, recent incidents seen in emerging economies of Southeastern Europe (Bulgaria, Romania, Turkey and a plus due to its recent crisis: Greece) have been analyzed and seen that the decision hit economies differently, according to macroeconomic data supported by Eurostat.

As it is well-known, Fed follows the monthly asset-purchasing program which means that the Fed buys $85 billion a month in Treasury and mortgage-backed securities.[1] This program also balances the markets' exchange demand & supply. In the case of tapering this amount, drought of exchange (particularly dollars) occurs in markets and currency rates and interest rates of 10-years government bonds rise.

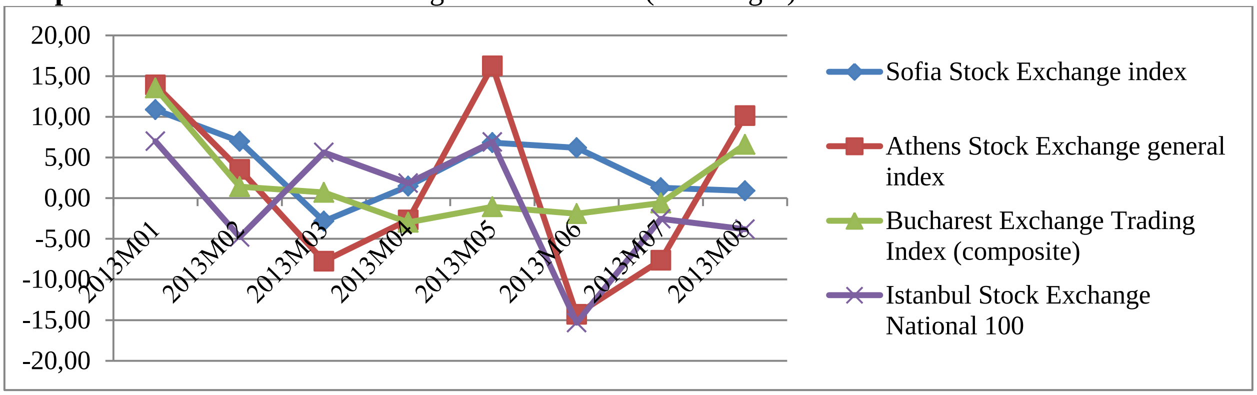
After May 22, stock exchanges of these countries have performed in different ways. Although the index of Athens Stock Exchange (Greece) has decreased considerably since the end of month, it rose again in the second week of July and reached its peak this year. But it is not possible to say that Sofia Stock Exchange (Bulgaria) and Bucharest Stock Exchange (Romania) were affected by Fed so far, there were only slight changes since Bernanke's speech.

Istanbul Stock Exchange (Turkey) has dramatically been hit by Fed's decision and also damaged by Gezi Park riots which started on May 28 initially to contest to urban development plan for

[1]Cox, J. (2013, September 19). *Fed: No Taper*. Retrieved October 28 2013, from http://www.cnbc.com/id/101043947

Istanbul's Taksim Gezi Park. Index of Istanbul Stock Exchange has declined sharply from 92.000 points to 65.000 and has been striving to recover since September 18.

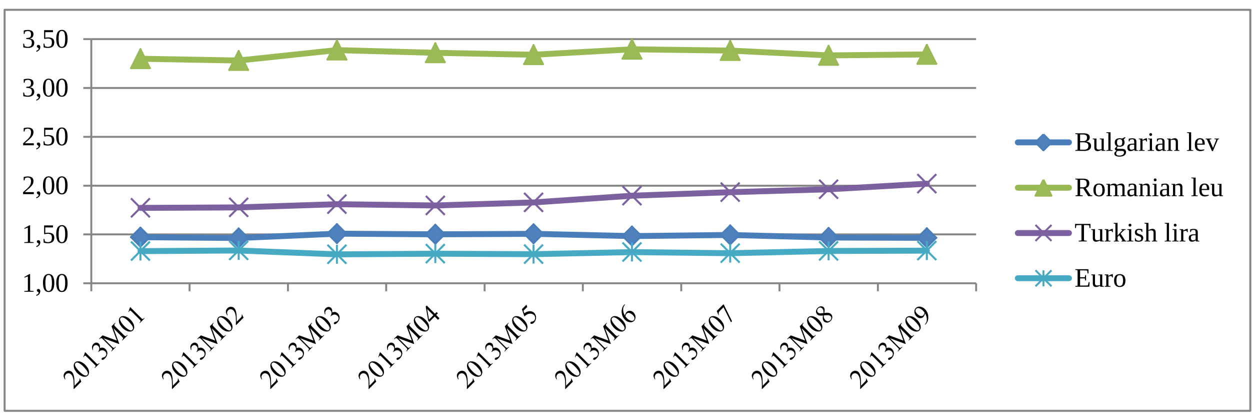
Graph 1. Reaction of Stock Exchange Indexes to Fed (% Changes)



Source: Eurostat, 2013

Currency rates affect the balance of import & export performances and it is crucial to keep companies active in trading. Starting from the end of May, and with the effects of Gezi Park riots, Turkish Lira got weak against American Dollar by a rate of %11 in a month, while Euro followed ups & downs but stayed in the safe corridor and so did Romanian Leu. Lev, Bulgarian currency, has reached its second peak as its lowest value against dollar in 2013 even though it has been considered as stable during the process.

Graph 2. Comparison of Currency Rates against US Dollar



Source: Eurostat, 2013

Central Banks needed to take crucial steps in order to protect the economy, especially countries like Turkey which tries to strengthen its economy by attracting foreign investments and is more vulnerable to external shocks due to this reason, modified the interest rate of government bond (10 years) and Turkish Central Bank (CBRT) used its foreign exchange reserves in order to maintain the stability of currency rate. After the Fed's decision, the rate of government bonds (10 years) was sharply rose by 4% by CBRT. On the other hand, National Bank of Greece increased the interest rate of government bonds (10 years) from 8% to 11% in June, whereas National Banks of Bulgaria and Romania boosted also their interest rates for the related bonds around 1%.

Tapering the QE causes currency rates rise up and automatically this situation leads Central Banks to spend their foreign exchange reserves in order to loosen the market with dollars. Foreign exchange reserves in Bulgaria and Romania lessened on June with their continuous ups and downs trends but one must remember that the reason of fewer effects in these countries is also due to the fiscal policy in European Union.

Turkey has been the most affected country among others in term of foreign exchange reserves. Combining two important incidents happened almost at the same, Turkish foreign exchange reserve has been damaged by a decline of 12 billion dollars in a month, even though there was a great improvement for the period of January-May, 2013. The important thing here is that Turkey recovered and got the reserves restored rapidly since July.

No change has been seen in credit ratings for these countries due to crisis. To sum their performances according to the credit ratings agencies, Greece fighting to survive from the crisis since 2008 is assumed as highly speculative. Romania and Turkey are "investable" countries for Moody's and Fitch but not for S&P. Bulgaria is situated at a better position by having lower medium grade from three credit rating agencies.

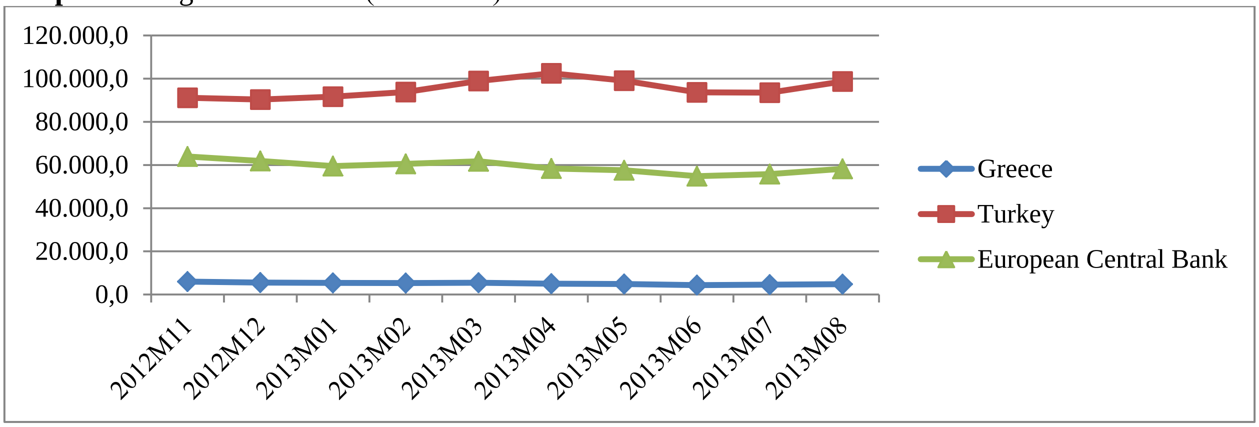
Table 1. Countries' Credit Ratings (2013)

Country	**S&P**		**Moody's**		**Fitch**	
Bulgaria	BBB	Stable	Baa2	Stable	BBB-	Stable
Greece	B-	Stable	C	-	B-	Stable
Romania	BB+	Stable	Baa3	Negative	BBB-	Stable
Turkey	BB+	Stable	Baa3	Stable	BBB-	Stable

Source: Trading Economics, 2013

Tapering the QE also causes investors worry about the future of the economy in the country which they invest. Foreign investors in Turkey who forecasted the unstable conditions both economically and politically tended to take their investment in one night, in a manner of speaking. The same decline but not with the amount could be seen for European Central Bank (ECB), again both Turkey and ECB have reassured investors and total amount of foreign investments reverted. Foreign investments in Greece have been decreasing since 2008, thus it is not possible to argue the effects of Fed in Greek economy in term of foreign investors' roles.

Graph 3. Foreign Investments (millions €)



Source: Eurostat, 2013

Numbers do not lie: according to the macroeconomic and financial indicators, Turkish economy has suffered most. Besides Greece has already been struggling to emerge from obscurity, Romania and Bulgaria have much smaller economies compared to Turkey and for that reason there are no significant changes and effects in these three countries after Fed's monetary policy. On the other hand, due to rapidly withdrawing policy of foreign actors, Turkey which needs foreign investments considerably in order to lower the current deficit and has made significant steps in last 10 years has used its foreign exchange reserves and increased the interest rates of government bonds in order to protect the currency rate.

Decision makers such as Central Banks needed to make a statement to press constantly between May 22 and they still do that: they discussed the expectations of Fed's further decisions and belt-tightening policies. The storm seems to be ceased by the speech of Bernanke on September 18 which surprised economists but also quite important in the way of its positive effect on markets.

It is not expected that Fed will maintain its asset-purchasing program forever; according to Bernanke, reconsidering the decision of this policy is likely when the unemployment rate falls to 6.5%[2], which is not anticipated soon by economists. This four-months-long process shows that Fed could shake markets by its sudden decisions and financial crises cause deep damages to economies in the existence of political crisis as well. Although all settled down recently, Central

[2]Zumbrun, J. (2013, September 19). *Fed Refrains From QE Taper, Keeps Bond Buying at $85 Bln*. Retrieved July 28, 2013 from, http://www.bloomberg.com/news/2013-09-18/fed-refrains-from-qe-taper-keeps-bond-buying-at-85-bln.html

Banks will take this “little” crisis as crucial warnings and improve their policies. A short reminder about Fed: with the recent support of Obama, Janet Yellen will be the first female chair of Federal Reserve at the end of January in 2014 and we will be here discussing effects of her decisions on markets.