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CURRENCIES

Sharp Drops in Currencies Hint at Spreading Volatility

Declines in the Russian ruble, Turkish lira and other currencies signal that recent turmoil in stocks may be hitting other assets

The Russian ruble tumbled 6.8% against the dollar last week. **PHOTO:** ILYA NAYMUSHIN/REUTERS

By Chelsey Dulaney and Ira Iosebashvili

April 15, 2018 7:00 a.m. ET

Volatility is returning to a corner of the foreign-exchange market that has largely been resilient to recent stock and bond tumult, with currencies from Russia to Hong Kong posting outsize moves amid worries over global trade and interest rates.

Hong Kong's dollar last week hit the lowest level allowed under a more than three-decade-old U.S. dollar-peg agreement, forcing the de facto central bank to step in to defend the Hong Kong currency. Other currencies, from Russia's ruble to Kazakhstan's tenge, fell last week as investors confronted rising geopolitical tensions. Those moves came alongside a relatively calm week elsewhere, in which the Dow Jones Industrial Average gained nearly 2% and the U.S. dollar was little changed against a basket of currencies.

The gyrations are an alarming sign for some investors, who have been looking for indications that the recent volatility in stocks is seeping into other markets. Currency markets have been calm this year, and some worry investors aren't prepared for major global shifts, including tightening monetary policy in the world's biggest economies, that could threaten a yearslong emerging-markets rally.

In the week ahead, investors will also confront news that the U.S., U.K. and France launched missile strikes on Syria as retaliation for a suspected chemical-weapons attack. While officials have indicated there aren't currently plans for more strikes, it is likely to add to tensions between the U.S. and Russia—which has supported the Syrian regime—and could inject more volatility into emerging-market assets and oil markets, where prices have been rising on concerns that the conflict will disrupt production in the Middle East.

“Rising hostilities in the Middle East tend to push oil prices higher and bond yields lower,” said Jack Ablin, chief investment officer at Cresset Wealth Advisors.

Others are concerned that foreign exchange could become the next arena in a burgeoning trade conflict between the U.S. and China. A decline in China’s yuan spurred by the tensions, analysts say, could send a broad range of Asian and developing-market currencies lower.

“People are starting to think about the prospect of devaluation as a tool to support growth and trade,” said Paresh Upadhyaya, a portfolio manager at Amundi Pioneer Asset Management. “U.S. trade policy, geopolitical risk, global growth...if all these start to turn, it could lead to an ugly meltdown.”

A JPMorgan Chase & Co. index that tracks expected volatility in emerging-market currencies last week rose to its highest level since February’s market rout. Another JPMorgan metric for major currencies—such as the dollar and euro—continued to fall, suggesting that volatility remains confined to the more sensitive currencies of developing and emerging-market nations.

Investors say one major threat to currency-market stability is the growing trade spat between the U.S. and China. Although tensions have eased since earlier this month, when the world’s two largest economies threatened to impose tariffs on billions of dollars of each others’ goods, few expect the calm to last.

Some investors fear that China could retaliate against U.S. protectionist policies by devaluing its currency, which has risen about 10% against the dollar over the past year.

“If China were perceived to be signaling it wanted a weaker yuan...that’s a pretty effective way of offsetting any trade gain the U.S. might try to achieve through tariffs,” said Brad Setser, a senior fellow at the Council on Foreign Relations.

Vulnerable currencies include the South Korean won, Singapore dollar and Thai baht, as well as those of other export-dependent Asian nations, analysts said.

Eswar Prasad, a professor in trade policy at Cornell University, said any effort to devalue the yuan could quickly backfire on China. Its devaluation of the yuan in 2015 sparked a global market selloff and set off a wave of capital outflows that China spent around $1 trillion in reserves trying to halt.

Devaluation “would be a tool that could actually hurt the Chinese a lot more than it would hurt the U.S.,” said Mr. Prasad. “It would really set the Chinese back in terms of what they’re trying to accomplish with financial-market opening.”

The rise in global policy and trade tensions has roiled other emerging-market currencies. The Russian ruble tumbled 6.8% against the dollar last week after the Trump administration announced new sanctions against government officials and business magnates in Russia. Kazakhstan’s tenge dropped 2.3% against the dollar, highlighting fears that the ruble’s decline will upend trade between the neighboring countries. The Turkish lira fell 1.3% as the emerging-market volatility sharpened investor concerns over the health of its economy.

The declines mark a reversal from a monthslong rally that took emerging currencies and stocks to multiyear highs, as investors brushed off uncertainties surrounding global trade and politics to focus on strong economic growth in those economies. An MSCI index of emerging-market currencies has gained around 2% this year, while its benchmark emerging-market stock index has risen 1%. That compares to the S&P 500's 0.7% decline and the Stoxx Europe's 2.6% fall.

A jump in volatility could also pressure countries whose currencies remain tied to the dollar, such as Saudi Arabia and Qatar. Pegged currencies are often only allowed to trade at a specific rate or within a tight band, and volatility can make upholding those levels more difficult as other factors—such as investor flows in and out of the country—buffet the currency.

Many developing nations linked their currencies to the dollar decades ago in a bid to insulate their economies from volatility. But the dollar's surge from 2011 to 2016 and a multiyear commodity-price rout forced many countries to cut those ties as they became too expensive to maintain.

In 2014, Russia's central bank began taking steps to allow the ruble to float freely as the country's economy came under stress. Countries including Nigeria, Egypt and Kazakhstan have abandoned or loosened their ties to the dollar recently.

"Pegs don't fare very well in a market that's volatile," said Mark McCormick, North American head of FX strategy at TD Securities. As markets become less stable, "the pegs will be challenged," he said.

—Saumya Vaishampayan contributed to this article.

Write to Chelsey Dulaney at Chelsey.Dulaney@wsj.com and Ira Iosebashvili at ira.iosebashvili@wsj.com

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