

The friendly hegemon

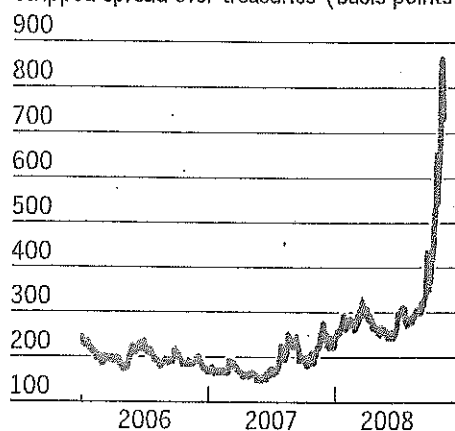
Troubled times can bring people together, or fling them apart. So it is heartening that most responses to the current crisis have been centripetal rather than centrifugal. The European Central Bank has entered into foreign currency swaps with Iceland and Switzerland, even though they are outside the eurozone. The European Union has dusted off a financing mechanism last used in 1993 to help Hungary. Now the US Federal Reserve is spraying money around the world too, having opened swap lines of \$30bn each to Brazil, Mexico, South Korea and Singapore.

Arguably, this is more significant than Wednesday's interest rate cut.

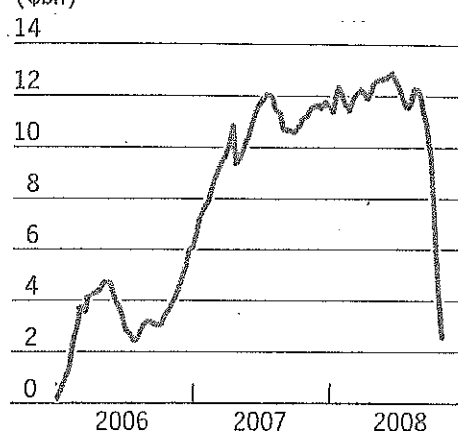
It means that Ben Bernanke believes Mexican collateral is as safe as, say, the UK's. It means these countries need not turn to the International Monetary Fund, the usual method of channelling liquidity to the developing world, so avoiding the IMF's strict loan conditions. Most importantly, it will ease the shortage of dollars that has ravaged emerging markets. In the good old days, like a year ago, some believed emerging sovereigns might even be sounder credits than the debt-burdened US. That, plus the chase for yield, squeezed emerging bond spreads over

Spread thin

JP Morgan EMBI + bond index
Stripped spread over treasuries (basis points)



Cumulative flows into energy debt funds (\$bn)



Sources: Thomson Datastream; Deutsche Bank

US Treasuries to historically tight levels. Since then spreads have blown out eightfold – another sign of how credit has dried up around the globe.

Emerging markets have now rallied sharply. Indeed, the Fed's action may mark a watershed that the research boutique Gavekal has compared to the Plaza Accord of 1985, when the Fed extended unlimited lines of credit to other central banks, which then forwarded them to their own commercial banks. The Fed's move

underlines the status of the dollar as the world's reserve currency. It is also a rejoinder to doubters of US geo-economic power. In effect the Fed has become central banker to the world's central banks – or at least those that are US allies or important trading partners. As for the rest, they will need huge dollar reserves of their own to look after themselves – like Russia. Others may well find themselves trudging down lonelier and poorer roads.