Hedge Funds Shorting Mexico Peso Means More Emerging-Market Pain

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By Ben Bain and Isabella Cota

(Bloomberg) -- There will be no reprieve from the swoon in emerging-market currencies as far as hedge funds are concerned.

And to get a sense of how bad it might get, look no further than the Mexico peso, the most-traded currency in developing nations and the market’s proxy for risk. So-called net shorts - the difference between the number of bearish wagers on the peso by hedge funds and other large speculators versus bullish ones - last week surged by the most since March 2007.

Hedge funds are souring on the peso as the Federal Reserve moves closer to raising interest rates, which threatens to siphon away more capital from developing nations and depress their currencies even more. Minutes of the Fed’s October meeting, released Wednesday, showed policy makers “intended to convey” that a December rate increase may be appropriate.

“Investors are expecting U.S. dollar strength across the board and peso shorts are one way to capture this move,” said Alejandro Silva, a partner at Chicago-based Silva Capital Management, which oversees $180 million of assets. **“As always, the most liquid and largest EM currency in the world will get its fair share of interest.”**

The peso has tumbled 11 percent against the dollar this year, touching a record low in September. The government said Thursday it will extend daily dollar auctions at least through January to cope with sharp declines amid volatility in global markets. The central bank said it will continue offering $200 million daily in auctions triggered when the peso weakens by 1 percent from the previous day’s rate. It will also offer an additional $200 million in a sale that will occur when the currency declines by at least 1.5 percent.

The currency gained 0.7 percent Friday to 16.5112 per dollar as of 2:10 p.m. in New York.

The peso’s slump has helped push losses on local-currency government debt this year to 8.5 percent in dollars, on pace for the worst year since 2008, according to Bank of America Corp.

“It looks like the speculative community has reloaded on dollar longs as they expect the Fed hike will reinforce the dollar strength,” said Pablo Cisilino, who helps manage about $42 billion in emerging-market debt, including Mexico bonds, at Stone Harbor Investment Partners LP in New York.