ICYMI: International Opposition Grows to Japan's Currency Policy

Please see the below articles of world leaders calling on Japan not to "politicize" its exchange rate by weakening the yen at the expense of other nations' economies and sparking a currency war.

AAPC is encouraged to see that Japan's currency manipulation policies are getting the attention of world leaders who are concerned with the impact of Japan's policies on their own economies and global commerce.

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Bundesbank Head Cautions Japan
Wall Street Journal, Brian Blackstone
01.21.13

Bundesbank President Jens Weidmann warned Japan not to "politicize" its exchange rate by pursuing an overly aggressive monetary policy, reflecting mounting concern in Europe that other central banks may cheapen their currencies as a means of stimulating economic growth. Japan's government as well as Hungary's "are intervening heavily in the duties of the central banks, pressuring for a more aggressive monetary policy" that threatens central-bank independence, Mr. Weidmann said in a speech on Monday. "A consequence, whether intended or not, could lead to an increasingly politicized exchange rate. Until now, the international monetary system has come through the crisis without a race to devaluation, and I really hope that it stays that way," Mr. Weidmann said. Foreign-exchange rates are emerging as a central issue for global central bankers who are trying to jump-start ailing economies with little room to reduce interest rates. If countries outside the euro zone engage in these policies, it could drive the value of the euro higher, derailing recovery hopes by making European exports more expensive in global markets. Japan's new government is pressing the Bank of Japan to set a 2% inflation target, double its current objective. The prospect of aggressive monetary easing has in recent weeks pushed the yen lower against other major currencies. The Bank of Japan is expected to announce its new inflation target and additional asset purchases after its policy meeting on Tuesday. Government-backed appointees to Hungary's central bank have ensured five straight months of rate cuts over the protests of the bank's governor and his deputies. European officials have reacted with growing alarm as their currency, the euro, has risen. The euro gained nearly 7% against a wide basket of currencies since late July, when European Central Bank President Mario Draghi signaled that the ECB was willing to intervene aggressively in euro-zone government bond markets. It is up 10% against the U.S. dollar over that time frame, and traded at around $1.33 late Monday in Europe. The ECB's bond plan calmed fears of a euro-zone breakup, boosting the euro. The ECB hasn't purchased any bonds yet, keeping its balance sheet steady. The ECB has resisted cutting interest rates near to zero as the Federal Reserve and Bank of Japan have done. Jean-Claude Juncker, head of the euro-zone finance ministers' group, last week said the euro's value was "dangerously high," threatening the currency bloc's recovery. German Finance Minister Wolfgang Schäuble said he found Japan's policies "worrying." UniCredit UCG.MI -0.84% economist Marco Valli estimates that a 10% rise in a currency's value tends to shave 0.8 percentage point from gross domestic product after six months, though this damping effect from the higher euro will likely be offset by the improvement in European financial markets. ECB officials have so far played down the euro's strength, and expect the bloc's economy—which hasn't expanded since the third quarter of 2011—to recover later this year. The ECB's Mr. Draghi said at his monthly news conference on Jan. 10 that the euro is near its long-term average. Germany's export-reliant economy should recover this year, the Bundesbank said in its monthly report, citing improved prospects for exports. But the effects of the higher euro could weigh on economies in Southern Europe such as Spain and Italy, analysts said. These countries are trying to revamp their economies to cut labor costs and make their products more competitive in global markets. A higher exchange rate makes that process harder. "In general for a country like Italy, where you have problems of labor costs or price competitiveness, the exchange rate is more important than it is in other countries," Mr. Valli said. Until Monday, Mr. Weidmann largely directed his criticisms over monetary policy toward the ECB, particularly its new bond-purchase plan. Mr. Weidmann worries that such policies blur the line between fiscal and monetary policy, and weaken the central bank's independence. It is rare for central bankers, including Mr. Weidmann, to criticize the monetary policies of other countries. Monday's warning to Japan was the German banker's most explicit to date. Bundesbank officials worry that, because of Japan's economic might, the Bank of Japan's policies could have a signaling effect to other central banks, particularly if they are successful at weakening the yen and boosting exports. Such policies, if enacted around the globe, could lead to inflation and a loss of central-bank independence. Mervyn King, who heads the Bank of England, said last month that 2013 "could be a challenging year in which we will, in fact, see a number of countries trying to push down their exchange rates. That does lead to concerns."

Merkel Takes a Swipe at Japan Over Yen
Wall Street Journal, Harriet Torry
January 25, 2013

German Chancellor Angela Merkel on Thursday stepped into a growing debate over the threat of a global currency war, taking a swipe at Japan's recent moves to weaken the yen and warning that political leaders must not use central banks to clean up their policy mistakes. Weighing into the discussion at the annual World Economic Forum summit of executives and policy makers in Davos, Switzerland, Ms. Merkel echoed the increasing concern in Germany that some countries, most notably Japan and the U.S., are using monetary policy as a way to enhance their economic competitiveness. "I don't want to say that I look towards Japan completely without concern at the moment," she said, adding that, "In Germany, we believe that central banks are not there to clean up bad policy decisions and a lack of competitiveness." The comments were unusually blunt for the typically understated German leader, underscoring concern in Germany that a global currency war would wreak havoc on the world economy just as Europe appears calmer after the upheaval caused by the euro-zone debt crisis. Germany, the economic motor in Europe, is teetering on the edge of recession. Germany relies on demand from the global economy, especially Asia and emerging markets in Latin America, to offset slumping demand in Europe. The recently-elected Japanese government of Prime Minister Shinzo Abe is trying to end years of chronic deflation and recession by putting the Bank of Japan under pressure to weaken the yen as a way to boost exports. Japan's new government is pressing the Bank of Japan to set a 2% inflation target, double its current objective. Raising inflation makes its currency cheaper, causing the prices on Japanese goods outside the country to fall. Moves to weaken the yen set off alarms in Germany, where policy makers fear an all-out exchange-rate war could undermine efforts in Europe to fix broken fiscal policies that led to the euro zone debt crisis. They also fear that "competitive devaluation" could fuel a debate in Europe about the role of the European Central Bank. The ECB's sole inflation-fighting mandate came under intense scrutiny during the euro-zone debt crisis. Speaking in Davos, Ms. Merkel said the ECB had moved to the "edge of its mandate" in efforts to support weakened euro-zone economies by buying their bonds. She said the ECB had rightly "set limits" to its actions, requiring fiscal reform as conditionality for its willingness to weigh into the crisis. But many European leaders see the ECB's mandate as too narrow and would like to empower the central bank to be able to do more to promote growth in the euro-zone economy. Against this backdrop, German policy makers are calling on governments in the U.S. and Japan to fix their fiscal policy rather than resort to throwing on the printing presses at their central banks. Last week, German Finance Minister Wolfgang Schäuble lashed out at Tokyo and Washington in a speech in the Bundestag, or lower house of the German parliament. He suggested that while the world points the finger at the euro zone, Japan and the U.S. through monetary policy easing are pouring excessive liquidity into global financial markets and creating new risks to the global economy. Jens Weidmann, president of the Bundesbank, Germany's influential central bank, warned Japan in a speech on Monday not to politicize exchange rates by pursuing an overly aggressive monetary policy. "Until now, the international monetary system has come through the crisis without a race to devaluation, and I really hope that it stays that way," Mr. Weidmann said. Japan rejects accusations it is engineering a weaker yen and stirring a global currency war. In an interview Thursday, Vice Finance Minister Takehiko Nakao said the government's moves are aimed at tackling the country's persistent deflation, not competitively devaluing the yen to stir exports. In Europe, Ms. Merkel said, the ECB has only been used to buy time for policy makers to fix fiscal and economic policies and make their economies competitive through reform. Europe still needs to address its weaknesses and overcome the scourge of youth unemployment, the worst legacy of the region's economic and debt crisis. "If Europe is in a difficult situation today," she said, "we must implement structural reforms today so we can live better tomorrow."

[Russian Central Banker Warns of Global "Currency Wars"]

Wall Street Journal, Andrey Ostroukh
January 16, 2013

The budgetary policies of the world's central banks are leading to major global imbalances and could lead to currency wars, Russia's central bank's first deputy Chairman Alexei Ulyukayev said Wednesday. "We are on the verge of very serious and confrontational actions in the sphere, which is, not to get too emotional, called 'currency wars'," Mr. Ulyukayev said at an economic forum in Moscow. Mr. Ulyukayev cited the recently elected Japanese government's stepped up efforts to stimulate Japan's deflation-dogged economy and talk down the yen, which has sent the currency tumbling. Quantitative easing by leading central banks including the U.S. Federal Reserve is also pressuring other major currencies like the dollar. "This is not a way to unity of global macroeconomic regulations, but to separation, segregation, to a break-up into separate zones of influence--all the way to very strong competition, all the way to global trade and currency wars, which is indeed counterproductive," he said.

[ECB issues new 'currency war' warning]

Investment news
January 22, 2013

European Central Bank policymaker Jens Weidmann has warned that putting pressure on central banks to pursue more aggressive monetary policies could spark 'currency wars' in the future. He highlighted the force Japan's new government has exerted on the BoJ to deliver bolder monetary easing and the actions of Hungary's government as threats to central bank independence, Reuters reports. "Already alarming violations can be observed, for example in Hungary or Japan, where the new government is interfering massively in the business of the central bank with pressure for a more aggressive monetary policy and threatening an end to central bank autonomy. "A consequence, whether intentional or unintentional, could moreover be an increased politicisation of exchange rates," said the Bundesbank chief, who also sits on the ECB's Governing Council. "So far the international currency system has come through the crisis without a devaluation competition, and I hope very much that remains the case." Last Wednesday, Russian central banker Alexei Ulyukayev said Japan is acting to weaken its currency and there is a danger other countries will follow its lead, prompting a round of devaluations. Meanwhile, Weidmann warned there was no quick fix for the eurozone and the US to overcome their debt problems, although he said the German economy remains in "good shape". "The adjustment process to bring state finances and economic structures back into order is not a matter of months or a few years," he said.

Japan Rebuffs Currency Manipulation Claims
Wall Street Journal, Mitsuru Obe
January 25, 2013

Japan rejected growing international criticism that it is easing its monetary policy to drive down the yen, with Tokyo's finance minister on Friday characterizing concerns expressed by German Chancellor Angela Merkel as "misplaced." Despite growing claims that Tokyo is resorting to a beggar-thy-neighbor policy of weakening its currency to give its exports a competitive edge, Japanese officials continue to stand by their position that the yen's recent weakening is a correction from its excessive strength. "The criticism of currency manipulation is misplaced," Finance Minister Taro Aso said at a news conference, referring to Ms. Merkel's comments. "Monetary policy easing by the Bank of Japan is aimed at lifting the country out of deflation early." On Thursday, the German leader voiced concern that Japan was resorting to easy monetary policy to weaken the yen. Her comments came after the BOJ, in response to strong political pressure, decided on Tuesday to adopt a 2% inflation target and to embark on an open-ended easing policy from next year. "I don't want to say that I look toward Japan completely without concern at the moment," Ms. Merkel said, adding that, "in Germany, we believe that central banks are not there to clean up bad policy decisions and a lack of competitiveness." Ms. Merkel's comment is the latest in a string of remarks by officials of other nations expressing concern that the policies of the new Japanese government led by Prime Minister Shinzo Abe may trigger a currency war or a competitive devaluation of currencies. Mr. Abe came into power in late December after winning a landslide general election on a platform calling for aggressive monetary easing to beat both deflation and the yen's persistent strength. The yen has depreciated over 10% since November when Mr. Abe embarked on his campaign. But his finance minister said the yen's slide was a justified move given how strong it has been. "My understanding is that we're in a phase where the one-way, excessive strength of the yen until now, is being corrected," Mr. Aso said. Officials in Seoul have warned that they may have to take in response to a weaker yen. Many South Korea manufacturers compete against Japanese firms. Bank of Korea Gov. Kim Choong-soo said last week that a sharp drop in the yen could provoke an "active response to minimize any negative impacts on exports," while Seoul's Vice Finance Minister Shin Je-yoon urged G-20 nations to discuss the adverse effects of monetary easing in the U.S., Europe and Japan when the group meets in Moscow next month. Amid their rejection of the criticism, some Japanese officials are also seeking to allay overseas concerns. Economy minister Akira Amari said Friday that he wants to resolve such concerns when he speaks at the annual World Economic Forum summit of executives and policy makers in Davos, Switzerland, where Ms. Merkel also made her remarks. "[Ms. Merkel] seems to have made careful comments that she wasn't completely 'worry free'," Mr. Amari said. "But I'd like to explain our position [at Davos] so there won't be any worries at all."

Bank of Japan Reignites Currency War Debate
Yahoo Finance, Lauren Lyster
January 22, 2013

They're back. Or perhaps they never went away. Currency wars are making headlines again with the Bank of Japan's decision to double its inflation target to 2% while committing to open-ended asset purchases next year. The news comes as Japanese Prime Minister Shinzo Abe has been pressuring the central bank to devalue the yen. Bloomberg reports this move is the BOJ's strongest commitment yet to end two decades of stagnation. The yen rose after the announcement, signaling that some investors were disappointed with the BOJ's decision. Bundesbank head Jens Weidmann is the latest policymaker to warn of a brewing currency war, according to Reuters. He joins Russian Central Banker Alexei Ulyakeyev and St. Louis Fed President James Bullard, who have both accused Tokyo of monetary protectionism and raising the specter of "beggar thy neighbor" policies. U.S. automakers have even weighed in on Japan's monetary policies. Detroit News reports a trade group representing the Big Three opposes the BOJ's efforts and has urged Obama to denounce them, arguing that Japan is trying to restrict access to the auto market there. Jim Rickards, author of Currency Wars and senior managing director at New York-based investment bank Tangent Capital Partners, says a currency war between Japan and the U.S. started years ago. "It's really a continuation of the currency war that began in 2010 started by the Fed and Treasury to devalue the dollar," Rickards tells The Daily Ticker. Referencing the currency wars of the 1920s and 1930s, Rickards says these fights go on for 5 to 15 years, and he expects competitive devaluations to continue. "They keep going on, that's what 'beggar thy neighbor' is all about," he argues. "The U.S. started devaluation in 2010, but then you have Brazil, Switzerland, now Japan and others joining in. It's like a ping-pong match. It goes back and forth." It's a game of ping-pong that nobody wins. Rickards says currency wars can lead to inflation or trade wars and sometimes even actual wars. Rickards cites Singapore and Europe as two examples of regions that aren't cheapening their currency to promote exports. This is just one reason why Rickards has been bullish on these currencies. "When you have two currencies, they can't both devalue against each other at the same time, it's mathematically impossible," he says. "So if you understand the U.S. wants a cheaper dollar, you have to have a stronger euro. There's no other way it can play out." Earlier this month, the euro hit a nine-month high against the dollar. Rickards expects the euro to continue to strengthen and cites Chinese capital as a source of investment. China's growth has recently rebounded from its deepest slump since the financial crisis. The economy grew 7.9% in the fourth-quarter of 2012. For 2013, Rickards' favorite currencies are the euro, the Singapore dollar, the Canadian dollar and the Australian dollar. His least favorites are the British pound sterling and the U.S. dollar.

Big Mac Index Cooks Abe's Claim Yen Still Too Strong: Currencies

Masaki Kondo, Bloomberg
January 24, 2013

The increasing number of Japan's trading partners who say Prime Minister Shinzo Abe's campaign to drive the yen lower has gone too far are gaining ammunition from measures designed to assess the relative cost of goods. The yen's nominal rate of 90.40 per dollar today is 16 percent lower than the level that takes into account differences in consumer prices in Japan and the U.S., according to the Economist magazine's Big Mac index. That's the widest disparity since 2009 and makes the yen the most undervalued of any Group of 10 currency, according to the gauge, which measures worldwide prices of McDonald's Corp. (MCD)'s signature burger. Abe economic adviser Koichi Hamada said 100 per dollar is a "good level" for the yen amid rising criticism globally of the nation's moves to support exporters. The prime minister isn't likely to get any sympathy from Group of 20 finance ministers meeting next month in Russia, where a central banker warned of a "currency war" of competitive devaluation. "Overseas governments will probably voice their objections to Japan relying upon a weaker yen for economic recovery," Hiroshi Morikawa, an economist in Tokyo at the Institute for International Monetary Affairs, which conducts research for the government, said Jan. 23. "Developed nations seemingly shared the view that the yen was overvalued when it was at the 70 level, but such a view is likely to recede." 'Politicizing' Currencies Michael Meister, the parliamentary finance spokesman for German Chancellor Angela Merkel's party, said this week that Japan risks retaliatory action by G-20 nations. European Central Bank governing council member Jens Weidmann warned this week against "politicizing" the yen exchange rate. The Economist's index uses the ubiquitous hamburger's local price as a barometer of costs of labor and materials in countries worldwide. The price was $4.33 in the U.S., based on the latest survey, while the cost in yen in Japan was equivalent to $4.09. The theory of purchasing-power parity contends that undervalued currencies will appreciate over time to close the gap, and vice versa for overvalued currencies. When the yen touched a 4 1/2-year low of 124.14 per dollar on June 22, 2007, it was 35 percent undervalued by the Big Mac index, the most among G-10 currencies. From that point, it surged 65 percent to a postwar record of 75.35 on Oct. 31, 2011. Peso, Real At the end of 2011, the Mexican peso was undervalued by 44 percent against the dollar, the most among major currencies. Last year, it was the biggest gainer, rising 8.4 percent. Brazil's real was 27 percent overvalued in December 2011, preceding a 9 percent slump in 2012. The yen was the worst performer in the past three months among the 10 developed-nation currencies tracked by Bloomberg Correlation-Weighted Currency Indexes. It plunged about 13 percent during the period on speculation the Bank of Japan (8301) would accede to pressure from Abe to double its inflation target to 2 percent and pledge unlimited money printing. BOJ Governor Masaaki Shirakawa, who's due to step down in April, and his board came through on both requests at the end of a policy meeting on Jan. 22, though it delayed the extra easing till next year, spurring a three-day rally in the yen. Japan's core inflation rate hasn't been above 2 percent for more than a year since 1992 and has averaged zero over the past two decades. Data today showed Japan is a long way from inflation of any kind. Consumer prices excluding fresh food fell 0.2 percent in December from a year earlier, the statistics bureau said in Tokyo today, marking the seventh decline in eight months. 'Aggressive Easing' The yen is on course for an 11th weekly drop, a record in Bloomberg data going back to 1971, and it touched 90.69 per dollar today, the weakest since June 22, 2010. "Shirakawa has left room for the next BOJ chief to do more aggressive easing," Daisuke Karakama, a market economist in Tokyo at Mizuho Corporate Bank Ltd., said in a Jan. 23 interview. "The dollar-yen pair has soared at an almost vertical angle since November, and this kind of gain is impossible to continue without a correction. Yen weakness hasn't changed course." Abe is counting on a drop in the currency to bolster an economy that's estimated to have shrunk for the three consecutive quarters through Dec. 31. Hamada, a retired Yale University economics professor who advises Abe on monetary policy, said Jan. 18 that 100 per dollar is a "good level" and that chipmaker Elpida Memory Inc. went bankrupt because the BOJ didn't expand its balance sheet fast enough to halt currency appreciation. Deputy Economy Minister Yasutoshi Nishimura yesterday echoed Hamada's opinion on the 100 yen level. G-20 Meeting Leaders from G-20 countries said in September 2009 that the members will undertake monetary policies "in the context of market-oriented exchange rates that reflect underlying economic fundamentals." Finance chiefs and deputy central bank governors from G-20 nations will gather next month in Moscow. Japan's Finance Minister Taro Aso last month questioned whether the nations had stuck to their pledge to avoid competitive currency devaluations, saying "foreign countries have no right to lecture us." The yen appreciated almost 30 percent against the dollar from the start of the U.S. Federal Reserve's first round of so- called quantitative easing in November 2008 until it reached the record in October 2011. Elpida, Japan's last maker of computer-memory chips, filed for bankruptcy four months later, citing the effect of the strong yen. Currency appreciation makes Japanese-made products costlier overseas, putting exporters at a disadvantage against foreign rivals such as South Korea's Samsung Electronics Co. Official Grumbling Japan's trading partners are starting to grumble that the yen has fallen too far. It tumbled 18 percent against the Korean won last year, the most on record going back to 1986. Bank of Korea Governor Kim Choong Soo said on Jan. 14 his nation needs an "active" response in case exchange-rate volatility rises. Alexei Ulyukayev, the first deputy chairman of Russia's central bank, said on Jan. 16 that leading economies are on the brink of a "currency war" to keep up with Japan. Fed Bank of St. Louis President James Bullard said this month that he was "a little disturbed" by Japan's exchange-rate strategy. Officials from Germany and Taiwan have also joined in the chorus of complaints this week about the yen's drop. "Currency policies tend to draw attention because major economies have little room left for further monetary easing," Minori Uchida, the Tokyo head of global market research at the Bank of Tokyo-Mitsubishi UFJ Ltd., said in an interview on Jan. 24. "We're likely to see more comments from officials on exchange rates, so there'll be a tug-of-war between those remarks and expectations for a weaker yen." Yen Depreciation The yen will probably finish this year at 90 per dollar before depreciating to 94 next year, according to median estimates of analysts surveyed by Bloomberg. The currency has traded at an average of about 101 in the past decade. Abe said this week that the government intends to correct an "excessively strong" yen and that his administration's mission is to get back a strong economy. Japan's government and central bank are "committed to reflate the economy and directly or indirectly to weaken the yen," Callum Henderson, the Singapore-based global head of currency research at Standard Chartered Plc, said on Bloomberg Television on Jan. 23. "There's no question that this is a further aspect of the currency wars, but if that's what it takes to reflate the Japanese economy, then that's exactly what's going to be done."

Asian Currencies Fall Most in 6 Months as Yen Fuels Intervention

Bloomberg, David Yong
January 25, 2013

Asian currencies fell this week by the most since July as a slide in the yen fanned concern regional central banks will intervene to prevent exchange-rate gains that may hurt exports. Officials from Russia to Thailand have voiced concern that Japan's intention to weaken the yen will stoke competitive devaluations. The

Bloomberg-JPMorgan Asia Dollar Index retreated from a 16-month high as the yen dropped for an 11th week. Samsung Electronics Co. said yesterday that gains in the won, which strengthened 8.3 percent in 2012, may cut operating profit by 3 trillion won ($2.8 billion) this year. “The authorities are getting more uncomfortable with sharp appreciation against the dollar and the yen,” said Wee-Khoon Chong, a strategist in Hong Kong at Societe Generale SA. The uncertainty surrounding global growth, currency gains and the risk of intervention are prompting retreats in regional currencies, he said. The Asia Dollar Index, which tracks the region’s 10 most- active currencies excluding the yen, fell 0.6 percent this week after touching 118.89 on Jan. 18, the highest level since September 2011. The won declined 1.6 percent to 1,074.05 per dollar in Seoul, according to data compiled by Bloomberg. The Thai baht dropped 0.6 percent to 29.91 and the Philippine peso lost 0.2 percent to 40.658. Intervention Talk The baht ended a seven-week rally, the won slumped by the most since May and Malaysia’s ringgit had its worst week since June. South Korean authorities have sold the won this month and Taiwan’s central bank did the same on most days in the past nine months, according to traders. The Philippines’ record-high foreign-exchange reserves show the extent of central bank intervention, Deputy Governor Diwa Guinigundo said on Jan. 15. The won fell as overseas investors pulled $990 million from Korean stocks this week as the government hinted at more measures to curb appreciation. Finance Minister Bahk Jae Wan said on Jan. 23 that gains in the won were too steep after the currency extended last year’s advance to reach a 17-month high of 1,054.49 per dollar on Jan. 15. Taiwan’s Premier Sean Chen asked the central bank and economic affairs ministry to closely monitor the effects of the Bank of Japan (8301)’s monetary easing measures aimed at weakening the yen. The Taiwan dollar fell 0.7 percent this week to N$29.25, the most since the five days to June 1. Malaysia Elections Malaysia’s ringgit slipped 1.2 percent to 3.0490 per dollar for the week amid concern investors will sell local stocks as a general election approaches. The FTSE Bursa Malaysia Composite Index of shares dropped 2.3 percent this week, the worst performance since May. “Investors could also be pricing in uncertainty ahead of the general elections that must be called by end-April,” according to a research note yesterday from Kuala Lumpur-based Malayan Banking Bhd. (MAY) The baht completed its biggest weekly loss since June amid concern its appreciation to a 17-month high will hurt exports. Finance Minister Kittiratt Na-Ranong said Jan. 24 he would like to see the baht “a little bit” weaker as appreciation was putting pressure on exporters. Elsewhere in Asia, China’s yuan fell 0.1 percent this week to 6.2205 per dollar, halting a three-week advance. Indonesia’s rupiah weakened 0.2 percent to 9,653. India’s rupee was little changed at 53.6850 after reaching a three-month high of 53.3800 on Jan. 22.

Threat of Currency War Looms Over The Alps
Wall Street Journal, David Cottle
January 22, 2013

As financial heavyweights head to Davos for their annual alpine conclave, they might have expected some solace from the world's markets, which are in much better shape than they were this time last year. Instead it seems they'll be worrying about the possibility of currency wars. Some have already started. Bank of England Governor Mervyn King told the Economic Club of New York in December that 2013 could be marked by widespread competitive devaluation, or "actively managed exchange rates" as he put it with central-banker nuance. In short he feared that national leaders would seek to boost their country's economic growth by weakening its currency. This gloomy prognosis already seems prescient. By Jan. 16 the deputy head of Russia's central bank Alexei Ulyukayev felt moved to warn that we are now "on the verge of very serious and confrontational actions in the sphere, which is, not to get too emotional, called 'currency wars'." Not much nuance there. Small wonder then that Andrew Milligan, head of global strategy at U.K. fund manager Standard Life, which manages £157.6 billion, thinks that foreign exchange markets will now be "very close to the top of the Davos agenda." The first shots in the current round have been fired by Japan. Its central bank Tuesday did as it had been urged to by a new administration desperate to stimulate the economy. It adopted the yen-clobbering combination of a new inflation target (2% instead of 1%), and an open-ended asset-purchase program, beginning next year. This action had been well-flagged and has seen the dollar rise 17% from the base of 77.13 yen made in September 2012. Japan's actions came in response to the monetary policy of western central banks, notably the U.S. Federal Reserve. Record-low interest rates and sustained quantitative easing had long taken the shine off the dollar and forced investors to look elsewhere for yield. The greenback spent late summer and fall of 2012 bumping along the 78 yen mark, uncomfortably close to the record low of 75.31 hit in October 2011, before suspicions of more combative Japanese monetary policy saw it rise up to the 89 handle in January, briefly topping 90. "Japan is simply picking up the gauntlet laid down by the Fed, said Mr. Milligan. But ripple effects can already be seen. Stung by the prospect of a weaker yen hitting its own exporters, Bank of Korea Governor Kim Choong Soo said on Jan. 14 that a steep drop in the yen could provoke an "active response to minimize any negative impacts on exports and investor confidence." Two days later Vice Finance Minister Shin Je Yoon said South Korea wants the G-20 talks in Moscow to focus on adverse effects of monetary easing in the U.S., Europe and Japan. South Korea also announced Tuesday measures to help smaller businesses hit by a surge in the Korean won, which has risen 26% against the yen from the beginning of last year. In Europe, Bundesbank President Jens Weidmann warned Japan Monday not to "politicize" the exchange rate with aggressive policy, reflecting mounting concern in Europe that Tokyo won't be alone in doing exactly that. Jean-Claude Juncker, Prime Minister of Luxembourg and the outgoing chief of the Eurogroup, sent the euro lower with his remark that it was looking 'dangerously high' on Jan. 15. Objectively this was barely explicable. The euro has had a strong start to the year but hasn't broken above long term averages against major rivals. However, as Marshall Gittler, head of global foreign exchange strategy at IronFX Financial Services put it, "the euro is clearly not dangerously overvalued except in a world of competitive currency devaluations." Even a relatively strong euro will be no help to member states stuck with low growth and waning competitiveness. The problem for Davos delegates, and the rest of us, is that the foreign exchange market is vast, international and hard to police. Lena Komileva, managing director and chief economist of G+ market Economics thinks we are in a situation that is in some ways very similar to the one that preceded the Bretton Woods system, recalling the first attempt at a negotiated monetary order for the industrialized world. "There is prevailing sense of 'no pilot in the cockpit' when it comes to exchange rate arrangements," she said. No such pilot will emerge from the Alps this week, but we might, just get a flavor of which way the conversation will go as 2013 matures. One sad possibility is that debate on currency debasement is itself debased, into a slanging match of mutual national blame. This could have been the first, real postcrisis Forum, a modest celebration of bullets dodged, from that euro implosion to the U.S.' fiscal cliff. Instead it seems that the chance of a destabilizing race to the bottom in currency markets will hijack the party.