The world wisely edges away from talk of a currency war

By Barry Eichengreen

Central banks accept the US and Japan are going for global growth, argues Barry Eichengreen

The diplomatic communiqués that follow international summits are rarely noteworthy. They have to be acceptable to everyone, so tend toward the lowest common denominator. But the Group of 20’s most recent communiqué, following its meeting on the sidelines of the spring meetings of the International Monetary Fund and World Bank, contains one sentence of consequence. "Monetary policy,” it reads, “should be directed toward domestic price stability and continuing to support economic recovery according to the respective mandates of central banks”.

The significance of this addition should not be overlooked. It means that the Bank of Japan is to be applauded, not criticised, for the aggressive asset-purchase programme it has adopted in the effort to hit its 2 per cent inflation target.

It also implies that the Federal Reserve’s heavy use of quantitative easing and forward guidance are entirely appropriate given its dual mandate to pursue low inflation and high employment – more so now that other instruments that could be used to achieve those goals, notably fiscal policy, are currently unavailable.

This is a significant advance from the “currency war” rhetoric that prevailed earlier this year. Back then, the BoJ’s new policies were impugned as an effort to depreciate the yen and gain an export advantage. The BoJ and Fed were criticised for unleashing a torrent of capital flows into emerging markets. Now, in contrast, officials in other countries, while still less than fully comfortable about the consequences, realise that they would be even worse off had the Fed and the BoJ responded to them. Capital inflows and local currency appreciation may be uncomfortable for emerging markets but renewed recession in the US and Japan, which could be induced by premature abandonment of easing, would be worse.

What brought about this healthy change in perspective? First, developed world central bankers have done a better job at communicating their intentions. Haruhiko Kuroda, governor of the BoJ, has made clear that his goal is to end deflation and encourage financial institutions to diversify into risk assets, not to push down the yen. He has backed away from suggestions that the BoJ might buy foreign assets instead of Japanese government bonds – usefully so since buying foreign assets would do less to support Japanese financial markets and be seen as an attempt to depress the currency.
For his part, Ben Bernanke, chairman of the Fed, speaking last month, rejected the accusation that the accommodative policies of the Fed and other advanced country central banks constituted competitive devaluation. Rather than “beggar-thy-neighbour” actions, he suggested, these are better regarded as positive-sum “enrich-thy-neighbour” policies. The conclusion extends even to emerging markets, which may be unhappy about some of the side-effects but would be even unhappier about continued stagnation in the advanced economies.

Second, policy makers in emerging markets have acknowledged that, if capital inflows create macroeconomic and financial dangers, then the right response is to deploy the appropriate macro-prudential policies. Where regulation of domestic financial markets and institutions does not suffice, it can be backed up with taxes and restrictions on capital inflows, as some countries are already doing.

Singapore has imposed borrowing caps and higher downpayment requirements on homebuyers. Hong Kong has doubled the stamp duty on big property transactions and instructed banks to hold additional capital against real estate lending. Brazil, once a leader in currency war rhetoric, is now a leader in using transactions taxes to discourage excessive capital inflows.

The latest G20 communiqué repeats its predecessors’ boilerplate about not targeting exchange rates for competitive purposes and avoiding excessive volatility of financial flows. But it is more an endorsement than an indictment of prevailing policies.

Officials complaining about other nations’ easing should consider that the alternatives – lower global demand – might be worse. And policy makers in advanced countries need to communicate their plans clearly. Only then are we likely to see through the fog of currency war.

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