Low for Long: International Perspectives on the Policy Implications

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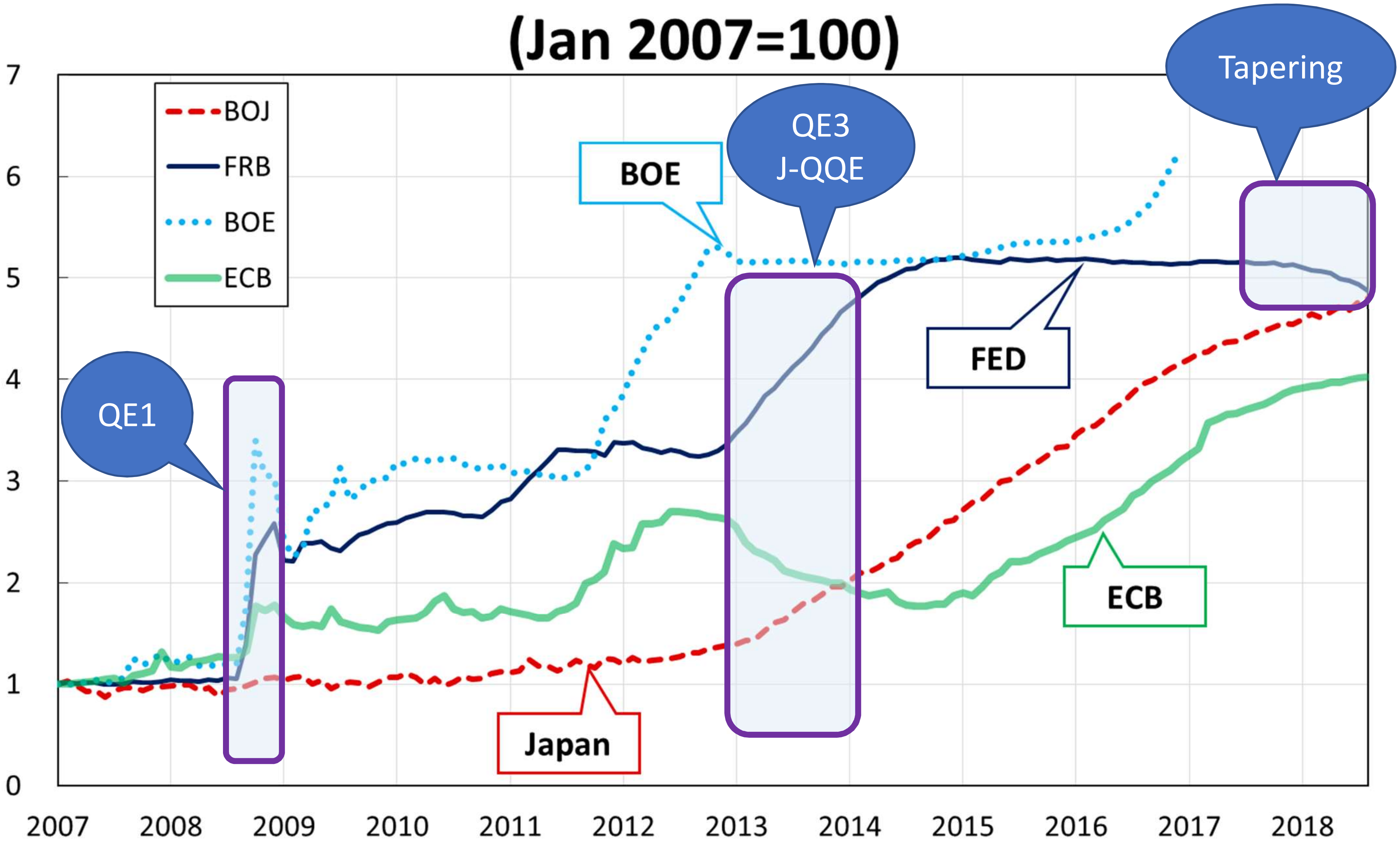
- An “international currency war” has broken out, according to Guido Mantega, Brazil’s finance minister, as governments around the globe compete to lower their exchange rates to boost competitiveness. – Financial Times, Sept. 28, 2010

- “Does the currency depreciation that typically accompanies an easing of monetary policy unfairly disadvantage trading partners? The answer is generally no, for two reasons.” – Ben Bernanke, Polak Lecture, Nov. 5-6, 2015

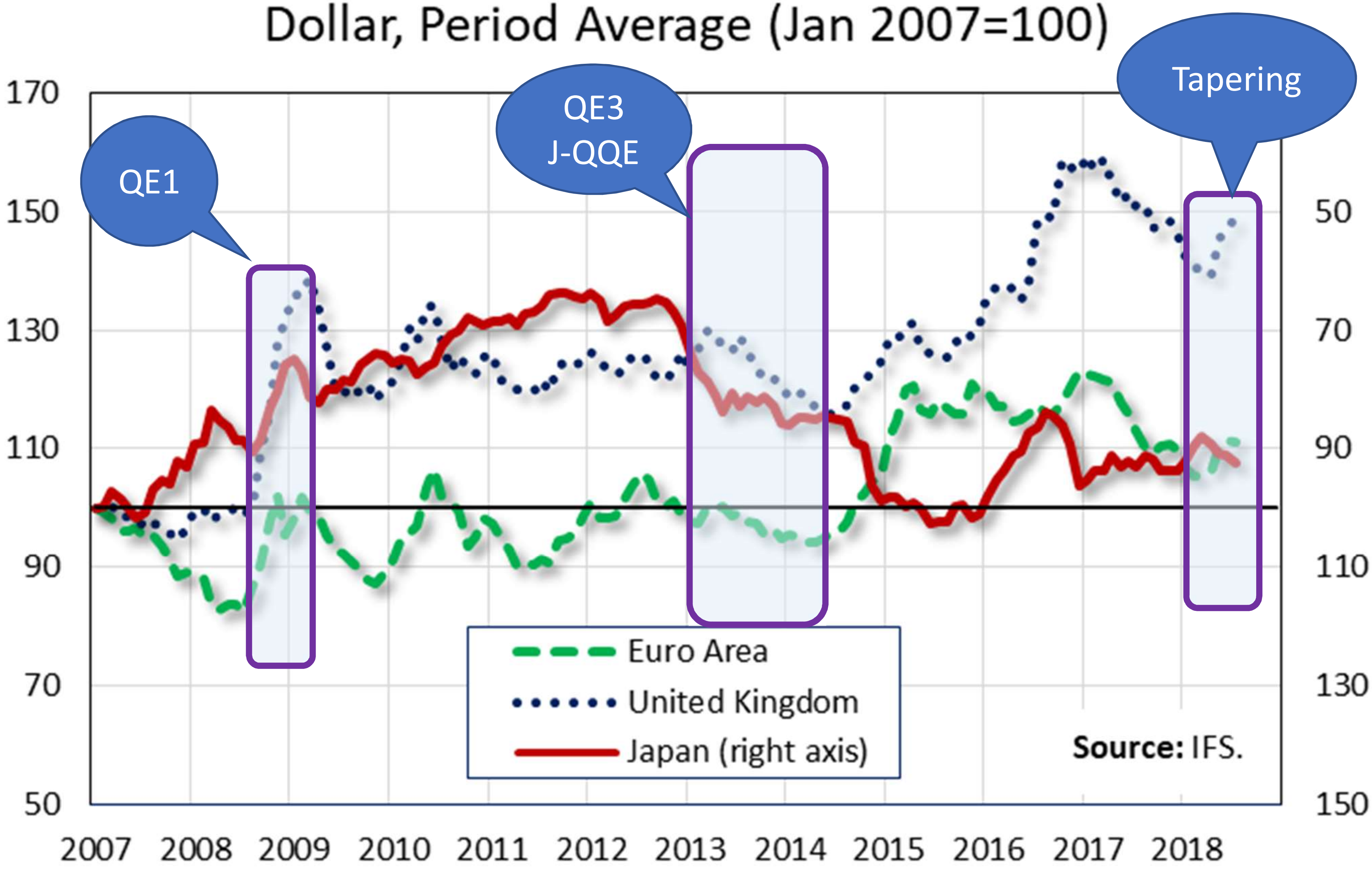
Outline

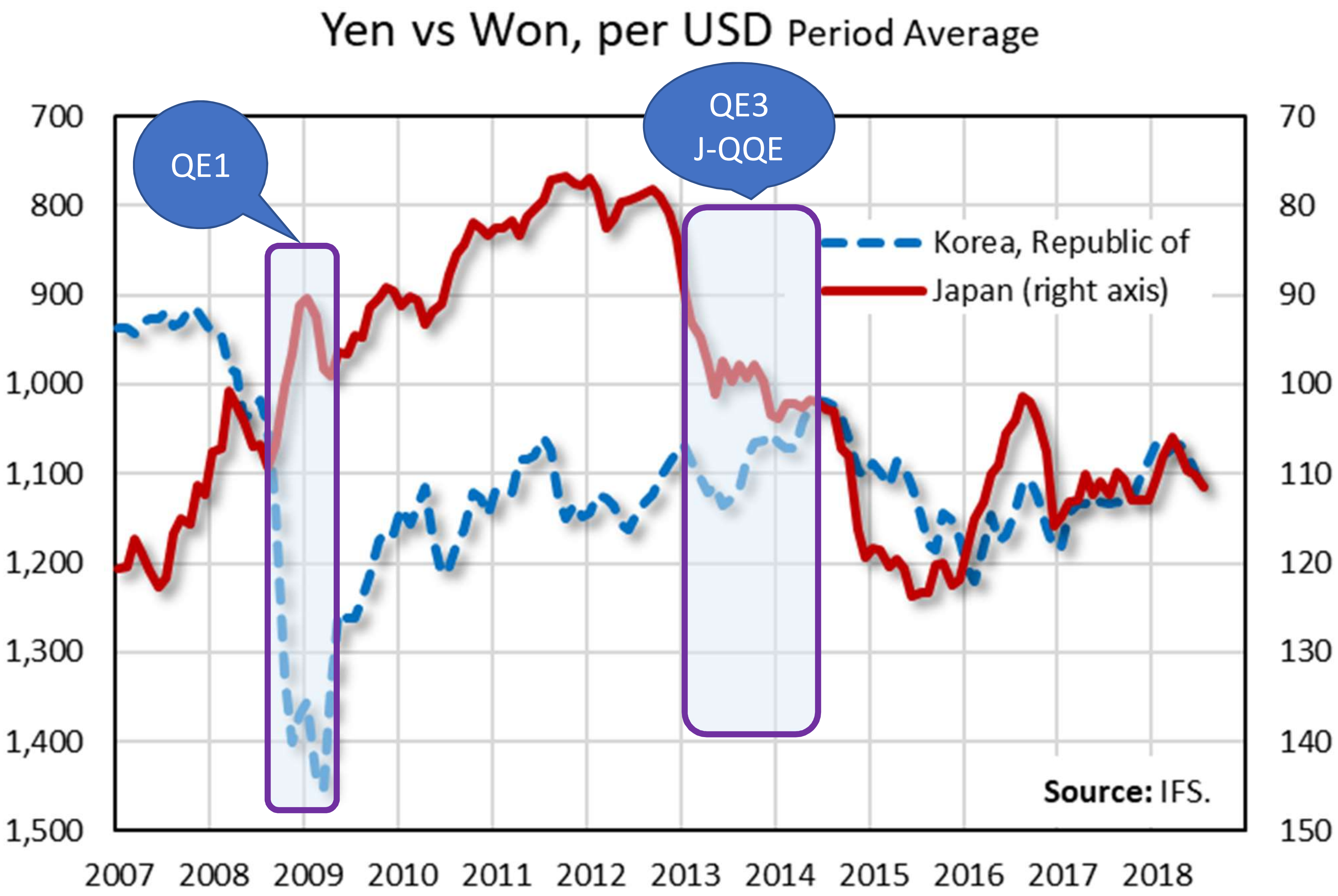
- Was QE (2009-2012) competitive devaluation?
  - "No" among advanced countries
  - But the Yen appreciated as BOJ stayed out of QE
  - EM with appreciation complained of currency war (mid 2010)
  - US argued that monetary policy is for domestic purposes; growth will benefit the world
- Taper tantrum (2013) and exit from QE
  - EMs with depreciation complained
- "Low for Too Long"?
  - "No" among advanced countries
  - Exporting easy money and a bubble to EM?
  - Maybe, in some EM, like China?
- Could we have done it better?
  - Coordinated, global QE?
  - EM would find it difficult to follow. Better to adopt capita flow management
- **Let us see some data first**

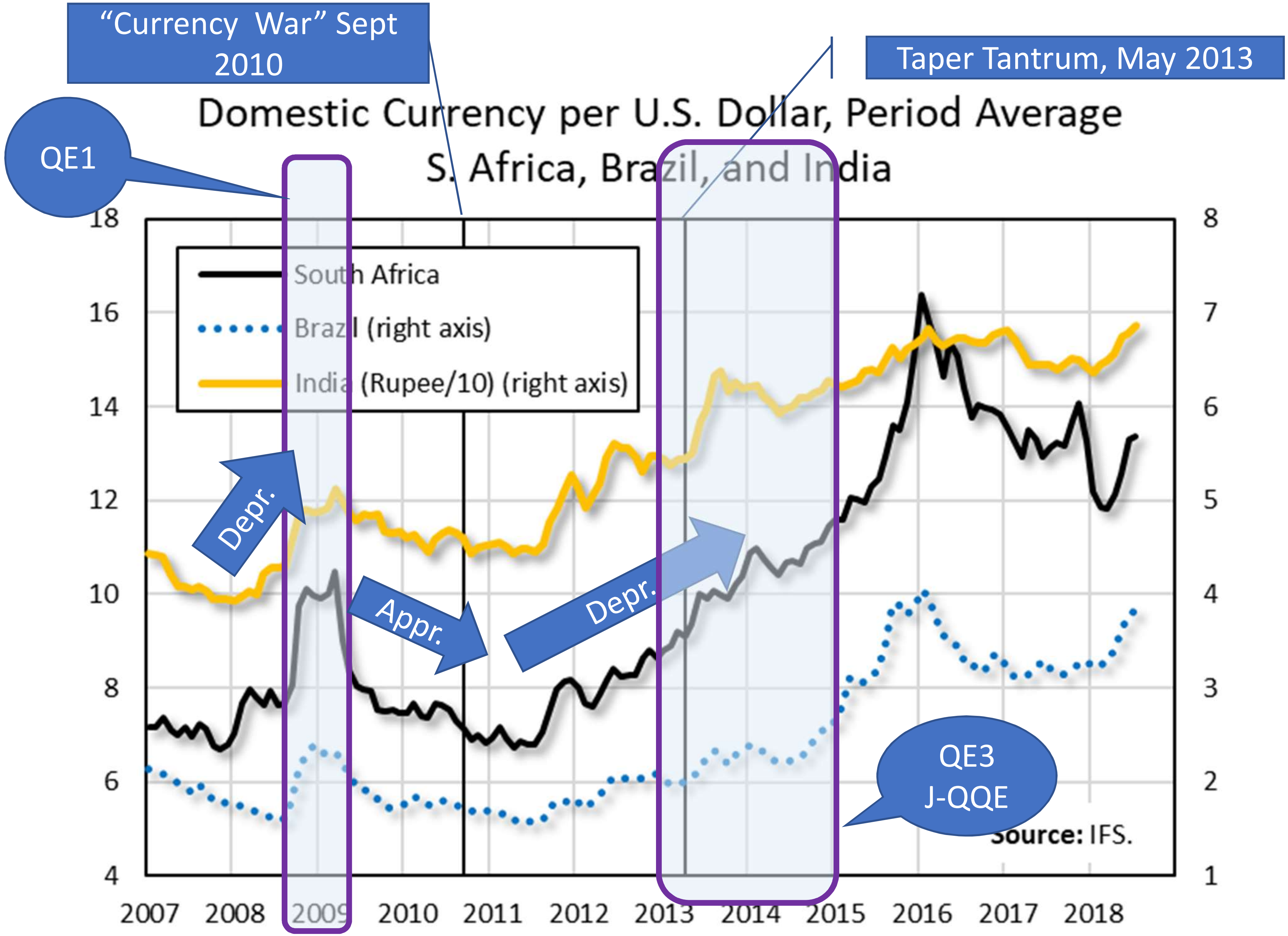
Balance Sheets of 4 Major Central Banks (Jan 2007=100)



Exchange Rates, Domestic Currency per U.S. Dollar, Period Average (Jan 2007=100)




Yen vs Won, per USD Period Average
QE1
QE3
J-QQE
Korea, Republic of
Japan (right axis)
Source: IFS.
700
800
900
1,000
1,100
1,200
1,300
1,400
1,500
70
80
90
100
110
120
130
140
150
2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018



"Currency War" Sept 2010
Taper Tantrum, May 2013
QE1
Domestic Currency per U.S. Dollar, Period Average
S. Africa, Brazil, and India
South Africa
Brazil (right axis)
India (Rupee/10) (right axis)
Depr.
Appr.
Depr.
QE3
J-QQE
Source: IFS.
18
16
14
12
10
8
6
4
8
7
6
5
4
3
2
1
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018

Why was QE criticized more than conventional monetary policy?

- With ZIRP, the currency channel became a primary transmission channel
  - Spillovers to other countries are greater
  - BOJ played a catch-up game with QQE in 2013
  - EM countries experienced capital inflows (and complain)

- Does US normalization (exit from QE and/or ZIRP) restore the equilibrium exchange rates?
  - EM countries experience capital outflows (and complain)

Bernanke defense

- Does the currency depreciation that typically accompanies an easing of monetary policy unfairly disadvantage trading partners? The answer is generally no, for two reasons.
- (1) "although monetary easing usually leads to a weaker currency and thus greater trade competitiveness, it also tends to increase domestic incomes, which in turn raises home demand for foreign goods and services."
- (2) "trading partners have the means to compensate for shifts in their international competitiveness through policy adjustments of their own"

Low for too Long?

- Domestic
  - Bad for asset owners, asset managers and pension funds?
  - Encourages risky investment, resulting in a bubble?
  - What if a next recession comes before normalization?

- International
  - Higher capital flows to and from EM countries?
  - Higher volatility (of Forex) to EM countries?
  - Exports of a financial bubble to EM countries?

Better alternative way?

- Internationally coordinated Fiscal policy? Yes, we did in 2009 (London G20 Summit)
  - Increased government spending in each country
  - Effective in mitigating aggregate demand decline
  - But, spending went to some not-so-useful projects in some countries
    - Chinese ghost towns with local government debts
- Internationally coordinated QE, possible?
  - Japan could have avoided a severe recession in 2009-10 if they adopted QE
  - EM could also adjust fiscal and monetary policy, temporarily
- EM countries can also adopt capital flows management
- A possible bubble can be managed with Macro-Pru