Low for Long: International Perspectives on the Policy Implications

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For Initial Remarks in the panel at the Federal Reserve of Boston Conference
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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)

- BOJ
- FRB
- BOE
- ECB

QE1
QE3
J-QQE
Tapering

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

- QE1
- QE3
- J-QQE
- Tapering

Source: IFS.
Yen vs Won, per USD Period Average

QE1
QE3
J-QQE

Source: IFS.
Domestic Currency per U.S. Dollar, Period Average
S. Africa, Brazil, and India

- **QE1**
- **Currency War** Sept 2010
- **QE3** J-QQE
- **Taper Tantrum**, May 2013

Source: IFS.
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