

Currency Wars and Unconventional Policy

Philip I. Levy February 14, 2013



Style

VS.

Substance



Substance

• Growth – January IMF WEO Forecast

	2013	2014
Advanced Economies	1.4	2.2
Emerging Market and Developing Economies	5.5	5.9

• Inflation (consumer prices)

	2013	2014
Advanced Economies	1.6	1.8
Emerging Market and Developing Economies	6.1	5.5

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Grim Updates

- Eurostat today
 - In fourth quarter 2012, eurozone economy shrank
 0.6% vs. 0.4% expectations
 - Biggest drop since 2009:I.
- Reports from Japan
 - GDP fell 0.4% in 2012:IV
 - Third straight quarter of decline



Style

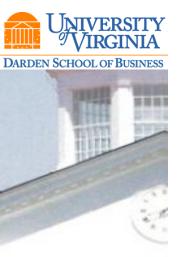
- The G7 opines:
 - "We... reaffirm our longstanding commitment to <u>market-determined exchange rates</u> and to <u>consult</u> <u>closely</u> in regard to actions in foreign exchange markets..."
 - Fiscal and monetary policy limited to meeting "our respective domestic objectives" and "not target exchange rates."
- Heading into the G20: worried statements about looming <u>currency wars</u>



Is there anything to this?

• Concerns:

- Competitive Devaluation and Beggar-thy-Neighbor.
 - Arguments about what really happened in the 1930s (Barry Eichengreen).
 - Just make sure that other countries can respond. Can be problematic with numerical targets.
- Are we worried about inflation or deflation?
 - Reciprocal interventions would just expand global money supply. Not bad if deflation is the worry.
 - Sweet spot should lie between deflation and raging inflation. Hard to stick the landing.
 - The answer may differ between countries.





The Global Macro Environment

- Slow growth
- Structural change meeting political obstacles
- Conventional measures pushed to extremes
 - Fiscal expansion (with rumors of austerity)
 - Monetary policy hits zero lower bound, quantitative easing
- Heightened sensitivity

• <u>Upshot</u>: Policy measures are available, but approach with diplomacy and caution

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