DOHA DATELINE

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Currency war is resulting in trade war

THE WEAKENING OF Japanese yen against many currencies has once again drawn attention to currency war and trade war. Recently Bank of Japan (BoJ) confirmed that it is doubling its inflation target to two per cent, and would commence open-ended purchases of government bonds. The yen hovered near three year lows against the dollar at 93 and against euro at 126. Weakening of yen benefits Japanese's exporters and has contributed to recent rally in Nikkei index on hopes of economic recovery. However, this action may compel other export driven economies with similar actions. There is a possible currency war consisting of competitive devaluation as countries try to get trade advantage by weakening their currency. In 2010 and 2011 BoJ had intervened in the forex market to prevent strengthening of yen, however, its current monetary easing action itself has weakened the yen significantly.

The US Federal Reserve, Bank of England, European Central Bank and BoJ have continued to keep their interest rates low and bring easing measures to revive their economies from the global financial crisis. Keeping the interest rates low for a long time has also increased the risk of currency war.

Since the middle of last year, the euro has appreciated over 10 per cent compared to the dollar and over 25 per cent compared to yen. This makes European exports extremely expensive in America and Japan, while making American and Japanese exports cheap in Europe. This has also raised concerns among some of the eurozone countries. France and the southern countries want the ECB to have more easing measures to bail out countries that need it and also devalue the euro at the same time. But Germany, the Netherlands, Austria and Luxembourg are opposed to bigger bailouts and also to devaluing the euro. A weaker euro can support exports from countries such as Spain and Italy. Germany, which recently had one of the highest trade surplus in 2012 may also have benefited from a weak euro.

Japan's weak yen can impact South Korea, which is it major Asian export rival. South Korean manufacturers such as Hyundai and Samsung Electronics have expanded their market shares partly due to weak won. Exports contribute significantly to South Korea's economy and a stronger won can impact its economy. Earlier in 2011 concerns were raised by Japan on South Korea on depressing the value of the won. Currently 1JPY = 11.73 Korean won and Korean won has strengthened against JPY in recent times.

With the recent revival of the long-embattled euro, the Swiss franc has lost strength and is around 1.23 against the euro. This can give room for Swiss central bank to raise the floor. Earlier in September 2011, the central bank fixed a minimum exchange rate of 1.20 Swiss francs to the euro and after this action investors flocked to the Swiss franc which was traditionally regarded as a safe-haven currency, as worries grew over the debt crisis in the eurozone.

The G-7 countries have agreed in London this month that economic policies should be "oriented towards meeting domestic objectives and not towards setting specific exchange rates. A currency war would damage the global economy, whose recovery from the financial crisis is still fragile, by hurting trade.

Countries will retaliate to expansionary monetary policy not with expansionary monetary policy of their own, but with tariffs. After great crash in 1929 countries devalued currencies. This currency war turned into a trade war, with countries eventually resorting to tariffs and counter-tariffs, as they tried to grab a hold on an ever-shrinking pie of demand. The collapse of global trade due to protectionist trade policies contributed to the Great Depression. The risk of currency war currently prevails in global economy and will result in trade war.

The author is the group chief executive officer at Doha Bank. Views expressed are his own and do not reflect the newspaper's policy