Currency wars to intensify in 2013

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The simmering currency war among the world's major economic powers is set to heat up significantly over the coming year following the decision by the US Federal Reserve earlier this month to step up its so-called "quantitative easing" program.

Under the new initiative the Fed will expand its holdings of financial assets from their present level of $2.9 trillion to some $4 trillion by the end of 2014 through continuing purchases of mortgage-backed securities and Treasury bonds.

The effect of these measures will be to place further downward pressure on the US dollar. This inevitably leads to action by other countries to devalue their own currencies in order to try to remain competitive in international markets, threatening to spark an open currency war.

The signs of such a conflict are already apparent with incoming Japanese Prime Minister Shinzo Abe demanding that the Bank of Japan pursue an "unlimited" easing of monetary policy in order to create inflation and lift the economy out of the semi-permanent recession that has dogged it for a considerable portion of the past 20 years.

Besides the hope that it will provide a boost to the domestic economy, a key motivation behind Abe's demand is the desire to force down the value of the Japanese yen. The relatively high value of the yen, resulting from the fall in the value of the US dollar, has caused Japan's largest corporations, especially in the electronics industries, to suffer significant trading losses in the past period.

In addition to the US and Japan, the British and European central banks are also pursuing their own versions of "quantitative easing" in the face of continuing stagnation.

The official justification offered by the Fed for the intensification of its program is the continuing weakness of the US economy and high unemployment rates. But this is largely a smokescreen for the real agenda, which is to provide continuing supplies of ultra-cheap money to the banks and finance houses to finance their operations in financial markets, enabling them to sustain profits in the face of continuing stagnation in the real economy.

However, the so-called spillover effects from these measures threaten to destabilize the world economy as a whole as other major powers seek to counter their effects.

In an address to the Economic Club of New York a few days before the announcement of the latest Fed measures, retiring Bank of England Governor Mervyn King pointed to the growing global economic tensions. Since the London summit of the G 20 in April 2009 and the decision to pursue stimulus measures, he said, things had "gone backward" and there has been no agreement on how to rebalance the world economy.

And the situation could worsen over the next year. "I do think 2013 could be a challenging year in which we will, in fact, see a number of countries trying to push down their exchange rates," King said. "That does lead to concerns. Will other countries react in kind? What will happen? The policies pursued by countries for domestic purposes are leading to tension collectively."

When the major powers met in the wake of the outbreak of the financial crisis in September 2008, there were promises all round that the mistakes of the 1930s would not be repeated. At that time, tariff barriers were erected as each of the major countries pursued a "beggar thy neighbour" policy against its rivals, exacerbating the contraction in world markets. The lessons of that period had now been learned, it was insisted. But the monetary policies of the world's major central banks threaten to turn into a repeat, in another form, of the conflicts of the Great Depression.

Smaller economies, especially those reliant on export markets, are already being hard hit as the value of their currencies continues to rise. Central bank data reveal that over the past two years, Brazil, Chile, Colombia and Peru have spent $135 billion in international financial markets to try to bring down the value of their currencies.

The impact of the policies pursued by the Fed and other major central banks on such countries was the subject of politely phrased but nonetheless pointed remarks contained in a speech by Reserve Bank of Australia Governor Glenn Stevens in Thailand earlier this month in which he warned that the "degree of disquiet" was growing.

While it was "open to policymakers to claim that their unconventional policies" were having an expansionary effect, he said, "the slowness of the recovery in the US, Europe and Japan, I suspect, leaves others wondering whether major countries are relying more on exporting their weaknesses than has been the case in most previous recoveries." In the guarded language generally employed by central bankers, that is about as close as it gets to an outright challenge to the official justifications.

In October 1971, in the immediate aftermath of President Nixon's decision to remove the gold backing from the US dollar and shatter the 1944 Bretton Woods Agreement that had laid a key foundation for post-war capitalist expansion, US Treasury Secretary John Connally is reputed to have told his European counterparts: "The dollar is our currency, but it's your problem."

More than 40 years on, the Fed's policy of devaluing the dollar, which still remains the world economy's reserve currency, threatens to have no less far-reaching consequences than the ending of the Bretton Woods system.

Today the global economy is far more integrated than it was at that time. Financial derivatives and other complex financial instruments, which did not even exist then or which were just beginning to make a limited appearance, now form key components of the global financial system.

The official justification for the policies of the Fed and other major central banks is that they are needed to counter the continuing effects of the financial crisis of 2008. In fact, they are deepening the conflicts among the major powers and setting up the conditions for even bigger financial disasters.

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