

Implications of a Currency War

What is the issue?

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- Trade skirmishes have raised fears of a global currency war.
- In this context, it is important to gauge its possible implications for India and other economies around the world with a historic precedent.

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What did the 2008 Financial Crisis unleash?

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- **Crisis** - Immediately after the collapse of “Lehman Brothers Bank” in the US that kicked off the 2008 financial crisis, economic panic spread globally.
- The biggest concern of countries then was to avert a sharp slide in their respective economic growth curves and prevent loss of jobs.
- **Actions** - U.S. and members of the EU embarked on expansionary fiscal and monetary policies (spending more and keeping interest rates low).
- To secure their growth, some countries turned protectionist in due course by introducing non-tariff barriers and occasionally raising import duties too.
- Another strategy used by some countries was to either devalue their currencies, or deliberately keep the value suppressed in international markets.
- Significantly, this helped them to keep their exports cheaper in the world market and thereby sustain international demand for their produce.
- China, Japan and South Korea were noted to actively suppress their currencies in international markets through central bank interventions at that time.

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- Such interventions of competitive lowering of currency values using monetary and exchange rate instruments was termed “international currency wars”.

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How was this currency trend resolved?

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- Unilateral competitive actions by countries was hindering the effective recovery of the global economy and deepening the trouble.
- Considering the enormity of the issue, US had called for a summit of top 20 economies (G20) for the 1st time, which met at Washington DC.
- India, the 13th largest economy then, was a member of the G20, and the grouping accounted for almost four-fifths of the world economy.
- The single most important decision by the summit leaders in DC was to coordinate efforts and strive for a broad revival of the global economy.
- In this context, competitive actions to keep currency values low was decried as a malpractice in international trade.

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Why has the talk of currency war revived again?

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- **Trade War** - Global trade skirmishes have intensified lately with the US President Trump threatening to slap comprehensive tariffs on Chinese goods.
- While tariffs have made Chinese goods costly in the U.S., the recent depreciation of Chinese yuan (almost 8% against USD) has partly offset this.
- While this is largely due to slower growth in the Chinese economy, it has frustrated Trump, who is mulling more tariffs to contain China.
- Similarly, trade tensions between the US and Europe too has escalated after both imposed tariffs on each other after Trump started the chaos.

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- **Protectionism** - Trade tensions may tempt countries to use monetary policy instruments to competitively devalue their currencies as a counter to tariffs.

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- This may lead to further chaos and worsen the overall scenario that would already be marred with disrupted supply chains.

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- Such actions might spell doom for all economies and make the whole world poorer by a considerable margin.

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What is scenario in India?

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- **Local Metrics** - In the last 10 years, the Indian economy has grown rapidly, rising from being the 13th largest in 2008 to the 6th largest in 2018.

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- However, the rising crude oil prices has been pressuring India's balance sheets immensely, leading to large "balance of payment" deficits.

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- This is might trigger a macro economic crisis and also lead to flight of foreign and local capital elsewhere, thereby ushering in a self fuelling prophecy.

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- Further, this will adversely impact inflation, interest rates and currency value (Indian rupee has already depreciated 6.8% against the dollar since Jan 2018).

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- RBI recently tightened the money flow by increasing the interest rates further, which might help in curtailing inflation and stemming the outflow of capital.

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- **International Metrics** - India has been increasingly getting integrated more with global markets over the years.

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- Hence, an upswing in the world economy is likely benefit India too.

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- An international currency war due to heightened tariff tensions can hurt the global economy, and in the process hurt India's growth prospects too.

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