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Global trade to shrink

T. K. JAYARAMAN

The World Trade Organization (WTO) predicts global trade would decline in 2012.

The Eurozone debt crisis and uncertainties in America have led WTO to revise downwards its global trade outlook.

The International Monetary Fund (IMF) is likely to lower its July global growth forecasts of 3.5% in 2012 and 3.9% 2013 at the annual meeting scheduled on Oct 9. Following these indications, WTO has reduced its April 2012 trade growth forecast of 3.7% to 2.5% and the forecast for 2013 from 5.6% to 4.5%.

The WTO said its estimates assumed that the policy measures are enough to avoid a breakup of the euro and for stimulating the American economy. The measures announced by European Central Bank (ECB) for the 17-member Eurozone and by the United States Federal Reserve (the US Fed) in September are expansionary in nature.

The ECB will be buying long term government debt of defaulting countries to bring down their borrowing costs. The US Fed action of buying long term government bonds and private sector mortgage securities is aimed at soaking the economy with liquidity and for encouraging banks to increase their lending at already low rate of interest. These actions have a fancy name: quantitative easing (QE). QE already added money supply in two rounds. Under its third round, the Fed will pump in US$ 40 billion each month until the unemployment of 8.1% is brought down to a lower level.

These expansionary monetary policy measures are for promoting domestic investment and job creation. However, these policy measures are strongly criticized by one of the emerging nations, a group known as BRIC. The acronym BRIC stands for: Brazil, Russia, India and China.

Brazil protests US action

Brazil considers it as a protectionist move.

In a floating exchange rate regime, additions to money supply by a central bank of country have an immediate impact. Expectations of inflation would decrease demand for its currency and its financial assets. When the currency loses its value, it is depreciation. Consequently, the exports of the country become cheaper and its imports become more expensive.

The depreciation is not deliberately intended.

Only a country under a fixed regime, such as Fiji, takes a deliberate decision: devaluation of its currency, after considerable thinking, weighing pros and cons. The objective is pointed: to correct balance of payment disequilibrium. Devaluation renders exports and tourism more competitive, and imports more expensive.

The US dollar and euro are floating currencies. The value of the currency is determined on a daily basis by interaction of supply and demand forces. Depreciation is an automatic result of an increase in money supply. It is only a by-product. Already, the ultra-conservatives led by US Congressman Ron Paul have been accusing the Fed for debasing the US dollar under QE 1 and 2.

No doubt, US exports are now more attractive to foreigners. It also helps developing countries which are oil dependent. Oil prices are denominated in American dollars. Fiji and other island countries whose currencies have strengthened in recent years against US currency, have found their currency appreciation beneficial!

Guido Mantega, Brazil’s finance minister says the American dollar depreciation is a calculated move to shut out Brazil’s products into US. Just as countries under fixed exchange rate regimes react by competitive devaluation to blunt the advantage gained by others, Mantega warns that currency wars would ensue.

Retaliatory measures

In fact, the Fed action was followed by Japanese reaction. Bank of Japan resorted to a programme of monetary expansion, as its currency is a floating currency.

Brazil imposed retaliatory measures in 2010 to prevent its currency, *the real,* from appreciating against the US dollar. It imposed a tax on capital inflows into Brazil from the US. Known as hot money, capital flows out from a country with weakened currency to others seeking higher return. Though withdrawn after some time, Brazil threatens it would re-impose a tax on capital inflows from the US.

Brazil's central bank has also intervened heavily in currency markets to hold *the real* from rising by heavy purchase of US currency in reverse swaps. Aside from imposing import tariffs on 100 American products, it also cut interest rates to a record low of 7.5 percent.

Sounds familiar: biscuit and kava wars?

Faced with a big trade deficit in 2007, Vanuatu suspended trade and stopped imports of biscuits from Fiji. So too Fiji, when it wanted to protect domestic kava farmers, stopped kava imports from Vanuatu.

The trade war is now on a sophisticated level: it is currency war!

Professor Jayaraman teaches economics at Fiji National University, Nasinu campus.