

# Exchange rate policy

Raghuram G. Rajan

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## Undervaluation

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Japan

What can be  
done?

- Undervaluation of the currency is a subsidy to a country's export sector
- The subsidy is financed by **taxing** importers and domestic consumers

# The poor subsidizes the rich

## Undervaluation

### Persuading China

### The Lesson of Japan

### What can be done?

- Other Asian countries also intervenes in the foreign exchange markets
- Poor households across Asia are effectively **taxed** and subsidizing the consumption of rich households in industrial countries
- Export sector will remain competitive only if undervaluation persists

# Interest rate policy

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What can be  
done?

- If domestic interest rates are high, central bank will incur a huge loss
- It would also attract more foreign capital inflows, and put a pressure on exchange rate
- As a result, China has to mirror the US's loose monetary policy
- Doing so risks creating credit, housing, and stock market bubbles
- This is exactly the case in Taiwan

# Alternative policy?

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What can be  
done?

- If the central bank can not raise interest, what can be done to prevent asset market bubbles?
- Selective credit controls
- In Taiwan: 奢侈稅 + 土地融資政策

# Loose money policy

## Undervaluation

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What can be  
done?

- Low interest rate reduces household income and consumption
- Making China more dependent on foreign demand (export)
- Lower interest rate is a distortion of price system, leading to inefficient investment projects

# Persuading China

Undervaluation

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What can be  
done?

- China remind [the author] how Japan made the mistake of agreeing to US pressure in 1987 and allowed Yen to appreciate sharply
- The Chinese would prefer to proceed more slowly and deliberately
- However, the Japanese may have left the transition from export-oriented growth to more balanced growth **until too late**



- Plaza Accord (1985): Japan agreed, under U.S. pressure, to allow the Yen to appreciate against the dollar
- Bank of Japan (BOJ) cut interest rate sharply with an intension to boost both the stock and property markets to reshape Japan to a domestically-led economy (through wealth effect) (p. 63)

- The policy triggered stock market and real estate bubble
- BOJ started to raise interest rates in the early 1990s
- The collapse in stock and real estate prices led to an economic meltdown whose effects are still being felt

# What can be done?

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What can be  
done?

- Negotiations
- Trade wars

“But each country was then quick to point out why it was not responsible for the imbalances and why it would be so much easier for some other country to push a magic button to make them disappear.”

“[IMF] declared that they had been a success: there had been a free and frank exchange of views.” (Rajan (2010), p. 209)

French President Nicolas Sarkozy:

"It's clear we must move towards a more flexible exchange rate system that would allow the world to absorb shocks. But this system cannot evolve without rules, coordination and oversight, or instability will prevail."

(2011.3.31)

## US Treasury Secretary Geithner:

The gap between flexible and managed exchange rate policies was “the most important problem to solve in the international monetary system today. ... This asymmetry in exchange rate policies creates a lot of tension.”

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What can be  
done?

- 2010年11月3日美國 Fed 宣布將再度採行**量化寬鬆** (quantitative easing, or QE) 政策: 買入**長期公債**, 以降低美國政府長期公債之利率
- 傳統的貨幣政策是買賣**短期債券**

## QE2 and exchange rate

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Japan

What can be  
done?

- 一般認為, QE2 是針對中國的匯率干預以及美國對中國貿易逆差而來
- QE2 使美國政府長期公債之利率下降, 各國央行會出售美國政府公債, 把資金移往其他國家, 這將造成美元貶值



# Roles of the government

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What can be  
done?

“This crisis has resulted from a confusion about the appropriate roles of the government and the market. We need to find the right balance again ...”

“We should have no illusions: change is difficult for all countries, though they all stand to gain in the long term”