US, Japan intensify currency wars

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Several central banks around the world continue to implement aggressive monetary policies in order to minimize deflation risks, overcome the credit crunch, and provide an impetus for economic growth.

These actions, though sorely needed in the context of an underperforming global economy, have caused numerous conflicts, dubbed by some observers and governments as "currency wars."

In particular, downward pressure on the value of the dollar and the yen in the wake of excess liquidity through quantitative easing and/or lower interest rates has provoked a number of complex effects on the relative competitiveness of European, Latin American and Asian economies.

The European Central Bank, for instance, cannot use monetary policy to affect the exchange rate. Several Latin American and Asian countries are pursuing tighter budgetary and monetary policies due to inflationary pressure or persistently high inflows of capital.

These persistent asymmetries have generated much concern and led government officials in countries such as Brazil to blame the United States for "exporting" its problems, and France to ask the European Central Bank to become much more active.

The recent G20 summit at Moscow included currency manipulation as an explicit item on its agenda.

The goal was to avoid a chain reaction in the form of competitive devaluations, something that would greatly distort global trade and capital movements. The G20 represents 90 percent of global GDP and 75 percent of the world's population.

The Moscow meeting ended with a declaration as opposed to a commitment to action.

"We will refrain from competitive devaluation. We will not target our exchange rates for competitive purposes," read the resolution approved by the finance ministers, echoing the statement of the G7 of just a few days earlier. Both sets of countries declared a commitment to letting the markets set exchange rates.

While the Japanese government has managed to avoid being explicitly criticized for its monetary and exchange rate policy, some governments have taken good notice.

The beleaguered European economies, in particular, have suffered from the common currency's appreciation relative to the yen. Nobody expects, however, a different trend in the next few months.

Meanwhile, neighboring countries like Australia and Indonesia seem to be accepting a cheaper yen in exchange for Japanese economic growth.

Although both the European Central Bank and the International Monetary Fund believe that the euro trades quite closely to its long-term averages, businesses complain almost daily about the hands-off stance of policymakers.

The recent economic growth data from Germany and France corroborate that the end to the Eurozone's double-dip recession is not in sight. This is bad news for Europe's unemployed.

It is also a very bad omen for the global economy because if the Eurozone feels forced to manage its exchange rate, currency wars will get worse, not better.