Currency War or Attempts at Reflation?

Lenin asserted almost a century ago that “the surest way to destroy a nation was to circumvent its currency”. The Weekly Standard of February 9, 2013 published an article about him where Irwin Seltzer harangued that “Lenin would welcome the [current] currency war”, in that it would (according to him) help destroy capitalism… Would we have spent a century for nothing? Have we therefore not learned anything in a hundred years? Because it is vital to overcome the stifling orthodoxy of today, as of this unique mind-numbing thought, which never tires from teaching us that the policy of quantitative rate cuts undertaken by some central banks lead straight to universal monetary conflict. In addition, without being able to explain to us this alleged relation of cause and effect between the expansionist policy of a central bank and the weakening of its national currency. But it is true that those who use this warlike terminology still do not understand the process of money creation put at the service of an economy that they stubbornly refer to as “manipulation” or “hazardous experimentation” undertaken by the central bank. Whereas it should instead be leaning toward the dynamism and innovative spirit of some central banks whose efforts are entirely oriented towards restoring economic activity and reducing unemployment. For example, how not to endorse wholeheartedly the second wave of quantitative rate cuts (QE2) of $600 billion set up in November 2010 by the U.S. Federal Reserve? Let us remember this very troubled period of a stagnant U.S. economy despite excessively low short-term interest rates accompanied by an intense fragility in the European banking system. Did the Fed not wisely then turned on its printing press to compress its long-term rates, critical to any recovery, while providing valuable support to European banks? It was, however, largely taxed at the time of seeking to weaken its currency (by printing generously) through leveraging monetary creation, that thus would allow a recovery by exports. For the advocates of neo-liberalism (and a shrinking state), the Federal Reserve openly plotted with the clear intention to devalue the dollar and unfairly boost its economy. Does the drop in the green back negatively affect the unemployment rate in Brazil or the backlog of orders of Chinese companies, as the leaders of these countries continue to claim? All this makes it possible to relativize considerably the fluctuations in interest rates, the success of issuing bonds, the identity of those which
hold the Treasury bills and even the threats of insolvency. Is the strengthening of the currency of these countries not simply the result of their accession to the status of industrial and commercial power? So why all this anxiety and fuss around these issues of public deficits that are really not so? Why not consider the effect of currency appreciation at the same time as the cause and the consequence of the enrichment of a nation? Probably because economists and leaders confuse their pockets with that of the state! All mechanisms ignored by almost all analysts – as leaders – opting instead for a vocabulary and a cataclysmic description while monetary creation reduces unemployment in the “integrated” savings while accelerating industrialization of the emerging countries. In fact, a country’s debt differs altogether from private debt. In this regard, there is debt and debt and it would be completely counter-productive not to distinguish them since, by doing so, we contribute actively to penalizing the state, therefore ourselves. Do the United States and Japan have warlike intentions when they try to reverse their unemployment and fight deflation through monetary creation? First, let’s note that when it generates deficit, that is to say, when it creates money, the state issues simultaneously an asset in favor of the private sector but without the latter having to offset this debt by a bond or constraint of any kind. Since, far from being the sought after goal, the depreciation of their respective currencies is only the collateral effect of their expansionist policy. Thus, public debt represents a net gain for the private sector and therefore for the economy. Contrary to the Chinese position which used and abused monetary manipulation, the policies put in place in the U.S. and Japan can effectively provoke a devaluation of their currency but not similar in any way to manipulation, much less so to any “war”. And this, contrary to the private sector which, not having the ability to print money, and not being capable of crediting accounts at will, cannot be indebted beyond a certain threshold. Unlike war, which is obviously a negative sum game (I destroy you, you destroy me), an expansionist monetary policy is a “win-win” process, most often followed by benefits for the country which puts it into place, and by extension to its trading partners. The private sector can thus easily switch to a Ponzi scheme. Must the British decision to leave the gold standard in 1931, gradually followed by the United States and France, not precede the restoration of their growth? This term is, on the other hand, not found in the vocabulary of a state which has its own sovereign currency, and therefore which is not obliged to borrow. Is it not by abandoning gold and its corollary, namely the expansion of the monetary base, which finally turned the page of the Great Depression? As a result, the obligation of governments – and which markets impose on them – to balance their budgets and public accounts can be revisited under another perspective. And those looking to rewrite history must review their copy because it is
not the German hyper inflation of the early 1920s which ascended Hitler to power, but the deflationary Brüning policy a decade later. It becomes obsolete. Within this same Germany which today dictates austerity and contraction throughout Europe, as if – it neither – retained the teachings of the past… After all, the first use of currency is not so much to buy other currencies than, especially, to use it in the exchange of goods and products! Indeed, as we have seen before, however little a country has an independent monetary scheme, the mass of its debts and the limits of its deficits as the pace of issuing its bonds fall within its own decision, because no one would in theory be able to impose them on it. That is why the loss in value of any given currency encourages the consumer to acquire more durables, and the company to invest in its equipment and production. Contrary to the gold standard regime and the indexation of a national currency to another referenced currency, the floating exchange rate system therefore gives a nation latitude and freedom to act potentially fully and completely. Isn’t the depreciation of a currency reflected in the value of these goods and products which become mechanically more expensive? Is this not peculiar to a sovereign nation? The increase in prices and tariff – and in other words: inflation! An extremely tough and generally widespread urban legend demands, however, that the state be “respectable and responsible” by balancing its budget – or at the very least that it gets close to balancing it – with the objective of not exhausting its national resources and not “spiraling” out of control. Does it not motivate companies to produce more goods for sale at the best price, and consumers to buy today in anticipation of a further increase in these prices? That is why the expansionist policy of the industrialized countries in integrated economies can have a widespread ripple effect on all their exports. He sees this as an exemplary value for the whole of society which should not let its expenses spiral out of control. Some nations are certainly not in a position to improve substantially their foreign trade. According to him, the state should be present to lead citizens to the way to discipline to get them back on track… If this is the case, it is necessary to note that today we are witnessing a radical shift in paradigm since it is the turn of modern and evolved but extremely deficit States who need to get back on track! The fact remains that the overall level of world exports will improve vastly since Japan will sell more cars, the U.S. more aircraft, the European Union more machines… In short, the creation of money and the consecutive loss in value of certain major currencies will lead to falling unemployment and higher incomes. That does not matter: that this logic of reversal of values is pushed further and therefore we use to dismantle the myth of the frugal state. In what amounts to a much more globalized economic recovery than a war. In fact, the state – with a monopoly on printing money – is able to credit accounts, including those of its creditors. Competitive devaluations are
not a zero-sum game which allows the country that practices them to boost its exports at the expense of those who have decided (for reasons of aberrant principle) not to enter into the arena of this monetary multiplication. As such, it does not have to leave it to the markets to determine its financial costs, and even less its public policies. Instead, they are a great tool for economic resurrection, especially if the country in question falls within its objectives in terms of inflation, due to imported goods necessarily made more expensive by the loss in value of its national currency. Ceding to market pressure by having to publicly borrow thanks to the bond instrument is therefore strictly voluntary for a state. You can actually only remain appreciative of the explicit target of 2% inflation set by the Japanese government, which will be launched through multiple acquisitions of securities and other assets to provide the means to achieve doubling its monetary base over the same period! This state believes in playing the game. Quantitative rate cuts are therefore amplified and expanded. In reality, it only plays the game of investors whose sole preoccupation is to grow their savings. Emphasis will be placed at the same time on the quantity and quality of these interventions which will take place at an annual rate of 60-70 trillion yen, i.e. about $600 to $700 billion, which represents the accumulated “QE1” and “QE2” programs in the United States. That is why a country such as Spain, which abdicated its monetary policy (to the EDB), has today been reduced to borrowing from the markets at astoundingly high interest rates to finance itself. Like the U.S. Federal Reserve in its “QE2” program, the Bank of Japan will purchase long-term Treasury bonds, but it will buy also shares on the stock market and real estate properties. The Greek or Spanish cataclysmic experience further demonstrates the cruelty of markets and rating agencies which have completely taken control. The stated and ultimate purpose is to instill valuable reflation, only able to fight and defeat the rampant depression that has plagued this country for many years. Public deficits will continue to persist so long as the growth rate remains lower than the rate of return on the State’s bonds. Make no mistake: this new Japanese “experience” is certainly the most important business – and worthwhile – from a central bank, which, since the days of Paul Volcker in the U.S. and the large means put in place to fight against inflation in the late 1970s and early 1980s! In this regard, it is necessary to understand that the European Union is not really confronted with a debt crisis, but with a problem of sluggish growth, the effects of which naturally spill over into its public deficits. If the Bank of Japan manages to revive subdued inflationary pressures, it will manage to lessen the debt burden of the country while presiding over a return to job-creating growth. Weren’t the rates of refinancing Spain’s debt consistently between 5.4 and 5.9% between
January 2000 through May 2002 without anyone worrying about it or predicting cataclysm?

To this end, the recent example of Japan – which is to create money and promote inflation – is clearly to be followed and replicated within the so indecisive European Union. Robust growth would in fact allow the State to offset this charge while providing opportunities and confidence to financial players. Far from being a zero-sum game, competitive devaluation supported by an inflationary ambition is there an irreplaceable lever in reviving an anemic, even deflationary, economic activity. This is precisely why it is now vital to focus exclusively on the growth rate of our economies, while relegating this obsession with deficit reduction to the background having the perverse effect of stopping the activity. Besides, the Nikkei is not the only stock exchange to have applauded the tough decisions of the new Japanese government, since all global financial markets have understood the benefits of such a monetary creation on global recovery. Finally, as it is strange to note today that they are the same ones who did not see the financial crisis coming who persist on the path of austerity, orthodoxy and who set themselves up as great defenders of the public purse and large deficit slayers. At a time when the “core” European countries begin to falter: France with 1997 industrial production levels and its German counterpart to 2007 levels and retail sales at an unprecedented decline of 4.7% for the same country. Now when Indeed, they were the same one who yesterday indulged in – and with – the financial markets fully delivered to themselves, and who often drew juicy profits, which have now – against all expectations – become fanatical, even fetish, about limiting public spending. The European Central Bank should be proactive and deign, in turn, to get its “hands dirty” from its printing press, instead of, like the European leaders, continuing to whine and stigmatize the Japanese initiative. While it and many nations within the heart of Europe are obsessed with the financing costs of their sovereign debt, they seem still unable to grasp that a country issuing its own floating currency does not have to undergo the retaliatory measures of financial markets. In this regard, the case of Japan which is financed by abysmally low rates despite tremendous public debt is once again illuminating. It suffices that the last-resort lender, i.e. the central bank, transfers cash into the Treasury’s account knowing that the other side of the coin is inflation. A sovereign nation with a sovereign currency can therefore be fiscally irresponsible without the soaring cost of financing its public debt encumbering its growth. But have the ECB, Germany and the other exemplary nations of the EU only understood that the cost of financing their public debt close to zero – or zero – is precisely the best reflection of stagnant economies, even on the edge of the precipice? As higher financing costs of the public debt can also be a signal for a state to redi-
rect its liquidity in favor of future investments and at high added value, and to interrupt its “Keynesian” expenses in view of the recovery ahead. Therefore, that Germany (or Switzerland) derive no pride in their negative rates because it really is not the ability to obtain financing at low prices that will advance their economic recovery. Therefore it is only when the economy is working at full capacity that extra public spending – but also businesses and households – induces inflation. In the same vein, the austerity policies and contraction necessarily and inevitably lead to… more economic contraction. Under this assumption of full capacity, inflation can be further avoided by a gradual reduction in public spending which would, at any rate, be counterbalanced by increased investment by the private sector within a framework of a booming economy. Because only an activist policy mixing monetary creation and pressure on their currencies will enable European citizens to see the light at the end of the tunnel. The acceleration in public spending is therefore not likely to generate inflationary pressures by causing a run on consumption and aggregate demand in the context of an activity that is slowing down, no more so than it would threaten (as was seen above) the solvency of the sovereign state in question. It is then that the cost of financing the European sovereign debt will increase: a clear signal of the great return to economic growth. Let’s therefore stop pretending that the creation of money and the monetization of debt lead to insolvency and inflation. When will Europeans finally understand that there is nothing to fear than fear itself? Rather let’s try to qualify and put into perspective by understanding that a given economic context is able to “cash in” extremely liquidity injections and support a widening of its deficits while being able to bounce back.