Quarterly Report on the Economic Environment

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GLOBAL ECONOMIC ENVIRONMENT- Third Quarter 2019

Introduction

This is the first report on the global economic environment that will be published quarterly in the framework of the series of indicators and analyses that the Port Authority of Valencia offers to the Port Community, and to society as a whole, to help understand the context in which it undertakes (and will do so in the near future) commercial activity, in general, and maritime activity, in particular, at the global level.

In these Quarterly Reports on the Economic Environment the reader will find three distinct sections. The first, Economic Climate and Trends, is a presentation summarised in the form of a traffic light system of the situation and evolution of the main elements that define and/or determine the global economic environment. The second, the Situation Decalogue, provides a more extensive description of the processes, data and most important decisions that occurred in the months prior to the completion of the report, and that are fundamental for global economic development. All this while respecting the aim of these quarterly reports to facilitate understanding of the keys to the economic environment with a moderate time commitment. Finally, the section Under the Microscope offers the reader greater detail on some of the events and processes that, in a longer term perspective, affect the international economic situation. The "Currency War" is the subject of interest in this first Quarterly Report.

Economic Climate and Trends

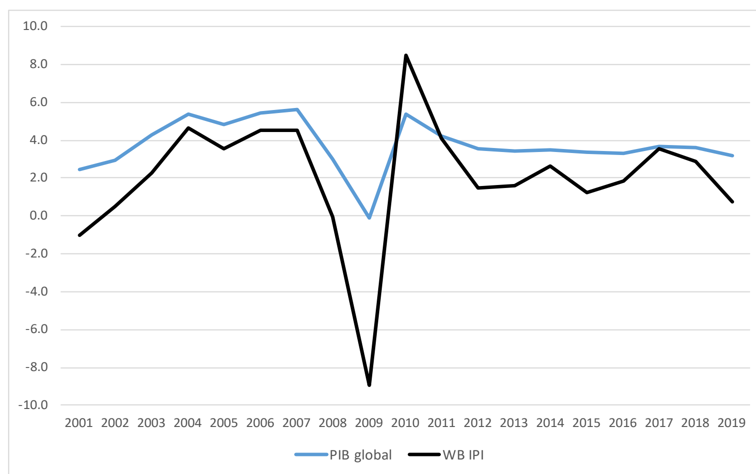
Determinants	Situation	Trend
Economic Activity		↓
Trade and exchange tensions		↔
Monetary policy		↑
Fiscal policy		↔
Raw materials markets		↔
Geopolitical tensions		↑

How to understand the Economic Climate and Trends Chart:

a.- **Determinants**:

1.- Economic activity: ratings from the most recent measurements of activity and confidence indicators (*World Bank industrial production index*; IFO, ZEW, Tankan, Chicago ISM, as well as various PMI). See Figure 1.

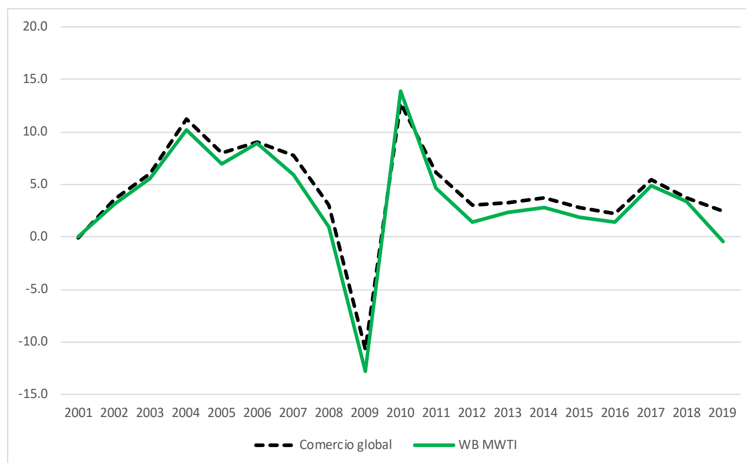
Figure 1.- Industrial Production Index (World Bank) and Growth of Global Gross Domestic Product. Relationship in the long term. Inter-annual variation.



Source: own calculations. Data: World Bank; International Monetary Fund.

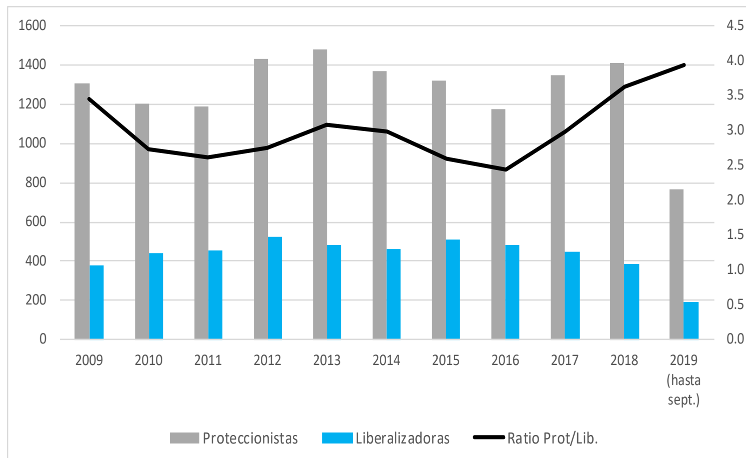
2.- Trade and exchange tensions: ratings from the most recent measurements of the *World Bank World Merchandise Trade Index*, the quantification of protectionist/market-opening measures offered by *Global Trade Alert* (see Figures 2 and 3), and the measures and statements which could be considered as exchange rate manipulation by the major countries in the global economy.

Figure 2.- World Merchandise Trade Index (World Bank) and Growth of World Trade. Relationship in the long term. Inter-annual variation.



Source: own calculations. Data: World Bank; International Monetary Fund.

Figure 3.- Evolution of protectionist and market-opening measures on world trade since the Great Recession.



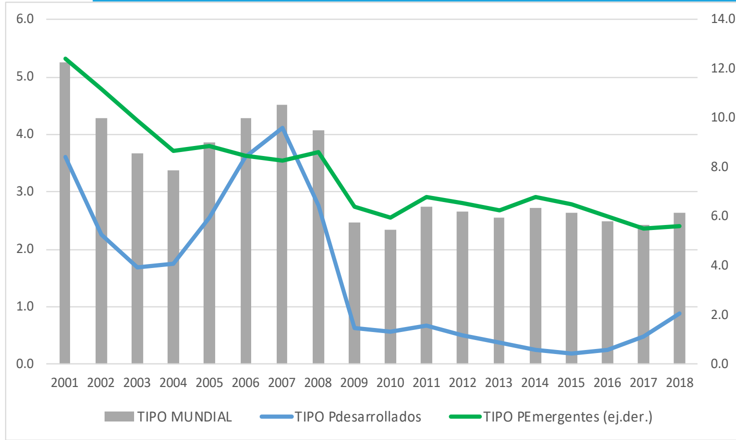
Source: own calculations. Data: Global Trade Alert.

3.- Monetary policy: ratings based on the weighted global interest rate of the world's major central banks (accounting for about 77-80% of world GDP), as well as the movements, during the six months prior to the submission of the report, in reference interest rates set by the same (see Figures 4 and 5). Forward guidance carried out by the managers of these central banks are also considered.

4.- Fiscal policy: ratings based on the fiscal position and the ability to implement expansionary fiscal policies of the 40 major global economies, all of them with a joint weight of 88% of global GDP and individual weight of at least 0.4% of global GDP. Data from the *Global Fiscal Monitor* database of the International Monetary Fund.

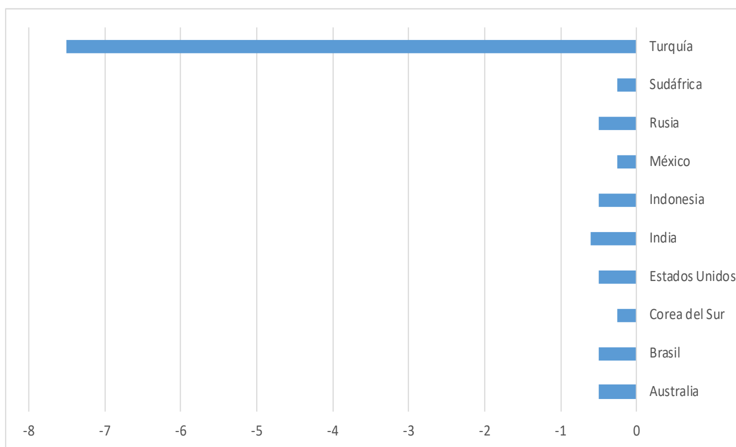
5.- Raw materials markets: ratings from the most recent data from *World Bank Commodity Price Data*, with five major indices including up to 72 raw materials, as well as the events that may alter the behaviour of the prices of basic raw materials significantly in the short term. See Figure 6.

Figure 4.- Evolution of international interest rates (reference rates of the Central Banks; %).



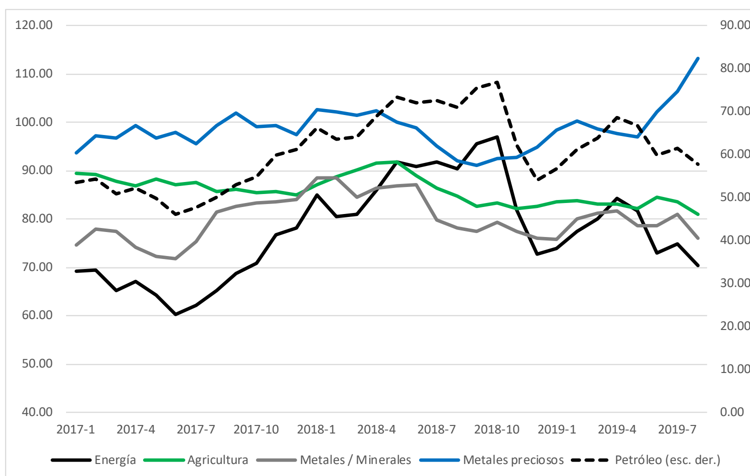
Source: own calculations. Data: Central Banks; International Monetary Fund.

Figure 5.- Movements in the last six months in the reference rates of the major central banks (% of variation accumulated in the period)



Source: own calculations. Data: Central Banks.

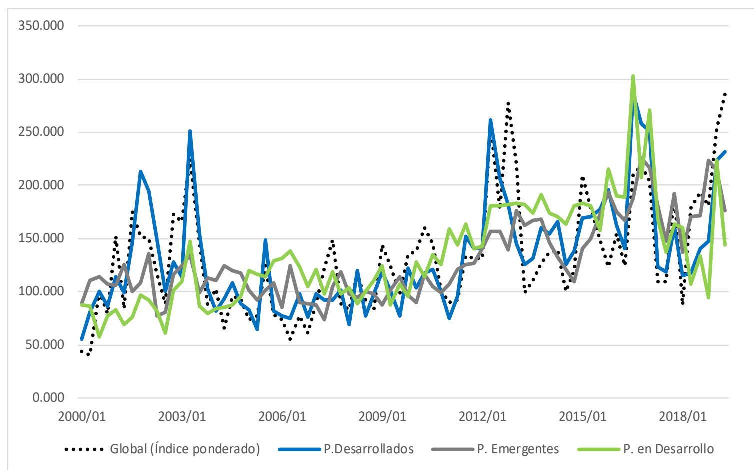
Figure 6.- Evolution of the prices of raw materials. Main groups (World Bank, 2010 = 100)



Source: own calculations. Data: World Bank.

6.- Geopolitical tensions: ratings from the most recent data from the *World Uncertainty Index,* (International Monetary Fund; see Figure 7), as well as the events and statements likely to significantly alter the international geopolitical context, potentially significantly affecting the global economy.

Figure 7.- Evolution of the Global Uncertainty Index (International Monetary Fund)



Source: own calculations. Data: International Monetary Fund

b.- **Economic climate**: a colour scale from the most negative/contractionary level for the evolution of the world economy (red), up to the most positive/expansive (blue) is defined for each of the determinants and considering the time of drafting the report, in the following order:

c.- **Trend**: indicates the foreseeable evolution, from the time of writing the report and in the short term (following 3-6 months), for each of the determinants, with options for improvement (↑), stability (↔) or deterioration (↓) for the same.

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Situation Decalogue

I.- The international economy is at its most delicate moment since the end of the Great Recession. Growth forecasts, systematically revised downwards during recent months, point to overall rates around and even below 3% for 2019 and 2020, clearly lower than the growth potential of the world economy, and the weakest since 2009. What was understood until recently as an "mid-cycle adjustment" or as a "soft patch" (probably a slight understatement) has become a clear slowdown…at least. It should be remembered that, although prolonged, the current phase of growth has been unequivocally weak from a historical perspective.

II.- In the western manufacturing sector we cannot talk of anything but the recession. Both activity and confidence indicators point to the present and future decline of production, employment and exports. Doubts over growth, commercial turbulence and the unique problems of the crucial automotive industry (in the grip of the regulatory changes generated in the transition toward the electric vehicle, an intense and now historic surplus production capacity at the global level and specific problems affecting some of the large manufacturers) are the basic factors in explaining that recession.

Although for some areas the limited weight of the manufacturing sector in developed countries in the start of the twenty-first century is of note, both in value added and employment (figures ranging from just over 10% in the United States or France and slightly more than 20% in Germany and Japan, with Spain in an intermediate position), we should not forget the essential role of the sector in terms of exports, technological development and carry-over effects on service activities. And, in particular, it is still an essential employment niche for workers with intermediate qualifications, one of the pillars of the Western middle class, already very damaged by globalisation and automation processes in recent decades. Therefore, although technically the secondary sector cannot generate a global recession, the impact of its considerable current weakness will be noticeable in various fields (including, of course, maritime transport).

III.- The factors to which this period of weakness can be attributed are geopolitical tensions, and, above all, commercial tensions (tariff wars, in particular, but not only, between China and the United States; the return of the "currency war"; the foreseeable commercial implications of Brexit…). The benchmark of the International Monetary Fund dedicated to capturing these causal factors of uncertainty (*World Uncertainty Index*), is at its peak.

Although the public discourse of the main political actors involved in such confrontations offer limited expectations for improvement, it should not be forgotten that the negative effects of decisions taken can become the most effective incentive to start reversing them. For example, both the need for the Trump administration to avoid an economic deterioration that adversely affects the electoral chances of the current President in November of 2020, such as the risks of a sharp slowdown in growth for the momentous change in the Chinese growth model, and the no less remarkable transformation in the practical application of the hierarchy of power in the country, both introduced by Xi Jinping, could be the key to a relaxation, at least partial, of the commercial confrontation between both countries. In addition, it cannot be ruled out that, with the resources - of varying nature - used by each politician to convey to their citizens as a victory what has been nothing but a series of damaging manoeuvres to the entire world economy, both could be declared, at the same time, winners of the confrontation.

Without diminishing the relevance of those aspects of the economic cycle, the structural factors that remained unresolved since the Great Recession or even before (unmanageable debt levels, both public and private, dependence on an unprecedented monetary laxity for growth, absence of structural reforms that tackle the transcendental demographic, technological and environmental challenges that threaten the economy - and society - worldwide) must not be ignored, because these structural burdens hinder the response to more cyclical crises.

IV.- As a result of all of the above, it is not surprising that the most worrying growth data for the current

and future quarters correspond to the Eurozone and Japan. By combining very low potential growth rates due to widely present structural factors that have barely been tackled, with its condition of exporting powers (its market share in world trade far exceeds its weight in global production), it can be understood that the threat of the recession (with which Germany is already flirting at the time of writing these lines) is perceived as particularly pronounced. But the growth of the United States and other developed countries is also being seriously affected by the scenario described.

V.- Although the growth data provided for the major emerging countries are expected to be much higher than in the OECD countries, the economic slowdown in China (linked both, at least as much, if not more, to attempting to curb excess credit and to increase private debt and that of local governments in recent years, and the trade problems with the United States) and India (the result above all of internal structural problems, not only economic), continues to be noticeable. The recent Indian growth is the weakest in six years, while the Chinese growth is the weakest in three decades. Of special interest is Chinese authorities' use of stimuli, both fiscal and monetary, which will revive growth in the face of this increasing interest in curbing the accumulated imbalances that dominated until a few months ago.

The rest of emerging Asian countries begin to seem affected by both the disruption that protectionist measures introduce into Global Value Chains that have benefited these economies over the past two decades and by the lower demand pull from what is increasingly its main client, China, a circumstance that also affects exporters of raw materials of a good part of the developing world. Despite this, some of these Asian countries (Vietnam and Bangladesh are, so far, the most conspicuous examples) can take advantage of the displacement of productive activity from China to circumvent the new Americans tariffs, but quantities are moderate in absolute terms and in the process could turn these countries into the latest object of the wrath of the Trump administration.

Indonesia seems to be the only major world economy (currently seventh in size, in terms of purchasing power parity), with robust and stable growth (continuous, an annual rate between 5 and 6%), most recently with the support of the Central Bank, which has adopted an expansive drift to try to ensure its continuity.

VI.- The circumstances in the large emerging countries outside the Asian continent are much more worrisome. The top politicians of countries in the top twenty global economies in terms of GDP seem more focused on combating spectral international conspiracies with domestic support (Turkey, Russia), evoking revolutions of centuries gone by (Mexico) or antagonising their own people along with the rest of the world (Brazil) than taking the necessary measures to overcome the serious structural deficits threatening the economic growth in their countries, certainly poor in the cases cited.

The very low profitability of financial investments in the West (except those with obvious risks) is favouring the existence of capital flows of a certain intensity toward the emerging world and developing countries, which allows the worrying situation to be concealed, but not changed. As history, recent and not so much, has shown, these flows could be reversed at the first sign of alarm, leading to these countries directly towards recession. Note that, even with this relative prosperity of "downhill" capital flows, there are economies, from Argentina to South Africa, already in situations that would be difficult to sustain.

VII.- The use of monetary policy, both conventional and non-conventional, as a main formula to try to sustain economic growth (first in the developed world, increasingly in the developing world), has fundamentally altered the behaviour of the interest rate curve, in addition to the level of the same. Recently, the attention of many commentators has been fixed on this alteration of the normal structure of interest rates, due to a historical regularity (actually, more or less valid only for the United States) that shows that this inversion of the rates curve (with the long-term below the short-term) is a relatively reliable anticipation of recession.

They are, however, the consequences of the current level of interest rates in the West, to virtually any term, which should arouse more doubt. A historical record of 17 billion dollars of public debt that are negotiated at negative interest rates (30-year deadlines even for countries with greater credibility) constitutes the most eloquent expression of this situation. The risks that arise from this, among others, are the adoption of high-risk investment strategies, the extreme volatility of capital flows to the pursuit and capture of benefits, however minimal they may be (the danger that this entails especially for certain emerging countries has

already been pointed out), and the development of financial products, more or less novel, more or less opaque, that seek to hide this risk inherent in profitability. Readers with a good memory will recall that all these processes were linked to the most recent financial crisis. Of course, for an over-indebted world, the reversal (i.e. the normalisation) of interest rates could cause a collapse of a magnitude difficult to predict.

VIII. In fact, the monitoring of monetary policy practised by the major (and secondary) central banks around the world would conclude that the extreme laxity on their part (note that our Economic Climate Chart grants it the most expansive level, and with a tendency to worsen) is perceived as an almost permanent fact, with no prospect of reversal, not only in the short term, but even in a generous medium term. In fact, proposals to accentuate injections of additional liquidity abound from all kinds of forums. We will be able to explore the costs (in the financial world and in the real economy) of this unprecedented monetary policy, due to the intensity and duration of the expansion, in a future Quarterly Report in our section "Under the Microscope".

At this point, it suffices to note that turning what was pure monetary heterodoxy just a decade ago into norm, confusing an emergency situation in which such heterodoxy saved the world economy from the Depression with a state in which the exceptional nature is permanent, has made governments and markets purely dependent on the continuing and growing stimuli of Central Banks. And this implies that their so defended independence from governments and markets is increasingly doubtful in practice, at least. So it should come as no surprise that, the Administrations of the United States or Turkey, even India, are disqualifying or even dismissing the central bankers who do not follow the guidelines of the respective Presidents, however outlandish they may be; or that senior executives of large investment funds (Larry Fink, CEO of Black Rock, for example) are encouraging banks to acquire shares in bulk (a policy, which, curiously enough, would especially benefit those funds). On the other hand, and more relevant in the short term, all studies suggest that additional doses of these monetary policies have increasingly less effect on the real economy.

IX. Given the general scenario described and the palpable depletion of the resource employed in the last decade to tackle the difficulties of the world economy (monetary policy), there is a growing consensus on the lines of action that would, at the very least, improve forecasts. Of course, the first step would be to move from confrontation to cooperation, reducing commercial and geopolitical tensions that, as revealed in our Economic Climate Chart and this very decalogue, are the elements that are hindering growth.

But the second element, which would also be reinforced by international coordination, particularly in Europe, would entail the use of an expansionary fiscal policy, certainly not centred on uncontrolled current expenditure, which would detract much more from the future than it would bring to the present, but a Programme built in response to the structural challenges facing the global economy and that would allow return rates significantly higher than the zero (or negative) current interest rates, to healthier levels (which, given the starting point, means higher). This Programme should focus on the physical infrastructure (we cannot stress enough the blatant need for these, for example, in Germany or the United States, not only in peripheral economies) as well as technological infrastructure, to transform manufacturing processes and societies as a whole according to the crucial demographic and environmental challenges, and the adaptation of workers, enterprises and administrations to unprecedented innovations in sectors, techniques and interactions between agents involved in the latest wave of technology.

The absence of measures, even against the groundswell of demand for these from almost every corner, including international institutions and central bankers (even the main German business organisation, champion of the budgetary surpluses), is alarming, and a product of different factors: first, the particularly difficult time for acceptance of any initiative that involves international cooperation. Second, the mistrust of some on the proper use of funds, given that there are also voices, as noted, that claim the need for more public expenditure on anything at all. Third, that not all countries are in a position to undertake this expansion (which makes it all the more important for it to be coordinated), although, of course, with the current interest rates supported by public debt, there is scope for action for more than a few developed economies, and some emerging economies. Finally, and although in decline, there are voices convinced of the inconvenience, in any case, of fiscal expansion with the current levels of public indebtedness.

And yet, all of these objections have little robustness in the face of the need to act, both against the weak point in the global situation and against the above-mentioned structural challenges that could be

addressed by this Programme.

X. Generally, raw materials markets are a less destabilising element in the scenario described (see our Economic Climate Chart and the figures in the Annex). On the one hand, widespread weak growth limits demand, and with it price pressures. In addition, even when geopolitical shocks (Middle East) or massive technological transformations (transition to electric vehicles) generate bottlenecks in supply or demand pressure, there always seem to be additional resources, although not necessarily in the most stable countries or places with low cost extraction, that promptly enter the market. Thus, lithium, which not long ago became the subject of speculative tensions in anticipation of demand for new car batteries, has seen its price drop by half in a year and a half and additional supply which may be available to the market in the short term, tripling current production. Even the initially alarming impact of attacks on the Khurais and Abquaiq Saudi oil refineries in the price of crude oil (with increases of 20%) was quickly absorbed by the existence of the country's reserves, the potential use of international strategic reserves and the margin of increase in the production of other exporters of crude oil.

Of course, the above is not an obstacle to recognising that a lasting conflict in the Middle East that provokes an escalation in the price of oil of a certain magnitude and duration would be the last nail in the coffin of the economic expansion that began after the Great Recession, leading the world economy into recession.

In any case, the only tensions in recent months (beyond the one-off episode described above) correspond to the market of precious metals, which entails a defensive reaction to the threat of economic crisis and not a causative factor for the latter.

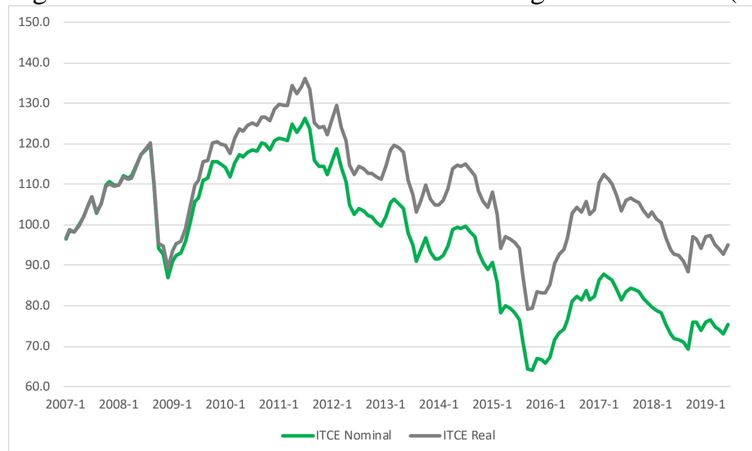
Under the Microscope. The "currency war"

A historical practice with an innovative and eye-catching name…

The existence of competitive devaluations (i.e., adjustments forced by the political and economic leaders of a country to cheapen the cost of exports and - although this is not a such a common objective and it tends to respond to the interests of more specific groups - make imports more expensive) date as far back as exchange rates not strictly tied to a benchmark pattern, and yet these actions still occur, although they require more justification than in a schema such as the present in which each government sets, alone or in concert with others, the exchange rate model that they want.

However, this practice jumped to the forefront of the media in September 2010, when Guido Mantega, then the Minister of Finance of Brazil (in office between 2006 and 2015) introduced the idea of the existence of a "currency war", launched, from their perspective, by developed countries (especially in the United States, with the Federal Reserve at the front) by adopting all kinds of measures, particularly monetary policies, from conventional to the most novel, to respond to the devastating effects of the Great Recession. The consequence of this behaviour was, to say the least, double, and very worrying for emerging countries like Brazil. First, the depreciation of currencies such as the dollar detracted competitiveness from exports from these countries, to the benefit of the United States. On the other hand, the minimum rate of return on investments in developed countries, given the low interest rates, caused massive capital flows (in no small measure, short-term) towards emerging markets, causing price pressures, excessive credit growth and, above all, serious risks if and when such capital returned to the West.

Figure I.- Nominal and real effective exchange rate of Brazil (2007=100).



Source: own calculations. Data: Bank for International Settlements.
Note: Upward (downward) movements imply appreciation (depreciation) of the effective exchange rate

As can be seen in Figure I, the moment in which Guido Mantega made his famous statement, the Brazilian real rate was in full appreciation, almost 50% in nominal terms in less than two years, compounded in real terms by the higher average Brazilian inflation with respect to its trading partners. Certainly, the effects highlighted by the minister began to materialise (the rate of growth of Brazilian imports of goods and services more than quadrupled that of exports in 2010 and 2011). In fact, both in academia and among policy makers the impact on third countries, in the areas of trade and capital flows of extremely expansionary monetary policies in the West, it has frequently been noted as significant.

However, and unfortunately for the Brazilian Finance Minister and in support of his detractors (who responded to his proclamation of the "currency war" by claiming that it was more a reflection of the internal shortcoming of the Brazilian economy than these external effects), as can be seen in Figure I, since mid-2011 there was a sharp and prolonged depreciation of the real rate (as a result of these internal weaknesses and the lack of structural reforms in the country, as well as the perspective of a forthcoming modification of the monetary policy of the Federal Reserve, which turned out not to be the case), which led to its own series of additional problems for the country. To the extent that this claimed depreciation also happened to other

major emerging markets not long after (India, Indonesia, Turkey, South Africa, giving rise to the label of "the fragile five"), the concept of "currency war" was parked for a while.

Why is it "war"?

Obviously, adopting measures (see following section) that cause currency devaluation is not an action that is well received by trading partners (and falls within the very expressively called "beggar-thy-neighbour policies"), and this can give rise to retaliation. In addition, a currency that loses value makes imports more expensive, which can be irreplaceable in some cases, as happens for many countries in the case of hydrocarbons. If we add the risk of inflation, the loss of purchasing power of the country's citizens and the possible outflow of capital (not at all friends with inflationary processes or loss of value of investments, if these have been carried out in the currency of the country and without coverage clauses against exchange-rate movements), it would seem that the disadvantages of starting a competitive devaluation are too many to move in that direction.

However, the frequency of these behaviours imply that benefits that outweigh the costs are anticipated (highly debatable whether this would be so, and depends on each case). The momentum that a weak currency implies for the export sector (and for tourism) is the key to this vision. This factor is especially important in situations of heavy indebtedness in the economy (a normal situation a decade ago, at the outbreak of the crisis, and also in the present). The components of domestic demand are weakened in the face of an accumulation of debt by families (private consumption), companies (private investment) and/or the public sector (public consumption and investment); in this scenario the last component of demand, the exterior, exports, becomes critical.

When the crisis affects an economy, but not its trading partners, the loss of value of its currency is not as detrimental to said partners and, in fact, in the absence of interference, the foreign exchange market will lead to the depreciation of the aforementioned currency. Economies in difficulty are not attractive, resulting in net capital outflows and the above-mentioned depreciation, which, precisely, should be an element to correct such difficulties. But when it comes to a generalized crisis, devaluation efforts pitch countries against each other, giving rise to the "currency war", in which it is difficult to find winners. In any case, the advantage will always be for anyone who enjoys the privilege of offering the benchmark international currency and with it sets the rules of the game to some extent. Therefore, the United States.

How does a currency become weak?

There are different formulas to force the depreciation of a currency, more or less (or not at all) subtle. The most immediate is direct intervention in foreign exchange markets, the common strategy of several Asian countries (later in this analysis we will address the specific case of China) at various times during the past decades. To do this, the country's own currency must be sold against (therefore buying) foreign currency, usually dollars or euros. Note that, while interventions to strengthen the country's own currency have a clear limit (in this case, selling strong currencies against the national currency, and this is constrained by the existence of such currencies), and often doomed to failure, there is no limit a priori for the amount of their own currency that can be created to weaken (the disadvantages of such a strategy have already been noted above, but if they are considered less than the benefits, it can be implemented without predetermined constraint).

A second option, which was used by some large emerging countries (Brazil, India) at the beginning of this decade, essentially aimed to curb short-term capital movements, lies in the establishment of limits on entry, investment or the possibility of repatriation of such capital, and/or tax on such short-term flows. This procedure, understood more as a defensive measure against the risks associated with extreme mobility of these financial flows than as a real effort to competitively devalue the currency, have been met with greater sympathy in recent years, even by institutions like the International Monetary Fund, in particular as an instrument of last resort in support of other stabilising measures on the part of emerging countries.

Finally, and although never presented as measures aimed at manipulating exchange rates (at least by the central bankers that implement them), the reduction of interest rates to historic lows and the unprecedented injection of liquidity (be it for the acquisition of public and/or private debt or to increase credit), has been the recipe that, from the United States to the Eurozone, through the vast majority of the rest of Western countries, have put downward pressure on the value of currencies that have flooded the respective economies. To the extent that such currencies, in particular the US dollar, have a global dimension and the

evolution of their value generates significant effects in many countries, this route is the one that caused the aforementioned public statement from the Minister of Finance of Brazil.

And why not fix the exchange rates?

If the behaviour modification interventions that supply and demand would determine for the different currencies are common and conflicting, could the problem not be resolved by recovering systems of fixed exchange rates, previously in force at different times in history, without going any further between 1945 and 1973, under the umbrella of the Bretton Woods agreements? Although the supporters of such an alternative have their arguments,that of stability being most relevant, there are two big obstacles to implementing it at present. The first, institutional in nature and divided into two aspects: on the one hand, there is no currency or commodity (in the style of gold in previous periods) that can serve as a pattern in a world with the current movements of goods, services and capital, and not dependent on governments (the Special Drawing Rights of the International Monetary Fund, beyond an infamous name, do not cease to be a basket of major currencies). On the other hand, there is no international institution with the credibility necessary to manage a system in which, let us not forget, fixed would not mean unchangeable, because devaluations and revaluations of the parities should be authorised in economic circumstances that so require it.

Precisely the second problem with fixing the exchange rates is that their mobility is an automatic adjustment mechanism in situations of crisis, which would disappear. As has already been indicated, while the free play of supply and demand depreciates the currencies of countries with problems, its improved competitive capacity serves as an instrument for the recovery (as long as it is not a country strategically dependent on a high volume of imports, which become more expensive at the worst possible time). What's more, a system of fixed exchange rates would force the monetary policy of a country in difficulty to sustain the parities of their currency, probably by raising interest rates to curb the tendency towards depreciation, an action that would aggravate the crisis. The loss of two macroeconomic policy instruments (exchange rate and monetary) seems too costly to ensure the stability of the exchange rate and avoid competitive devaluations. The debacle suffered by several Southeast Asian countries in the late 1990s, obliged by the International Monetary Fund to defend (including increases to stratospheric levels of interest rates) their parities with the dollar, highlighted the gravity of this loss. Many experts would indicate the collapse of the Greek economy from 2010 as a further example, although in this case the structural factors behind it are much deeper and more persistent than the availability or unavailability of all response macroeconomic instruments. Finally, fixed exchange rates are susceptible, as soon as the fundamentals of the economy divert from the established parities, to speculative attacks, some of which have entered economic history almost as a pugilistic cartel (George Soros vs. Bank of England, 1992).

Therefore, one would tend to think that, rather than giving up the advantages of flexibility (unless immersed in a well thought out process of economic and monetary integration), some other alternative should be sought. We will come back to this point a little later.

The return of the "Currency War": China and exchange rate manipulation

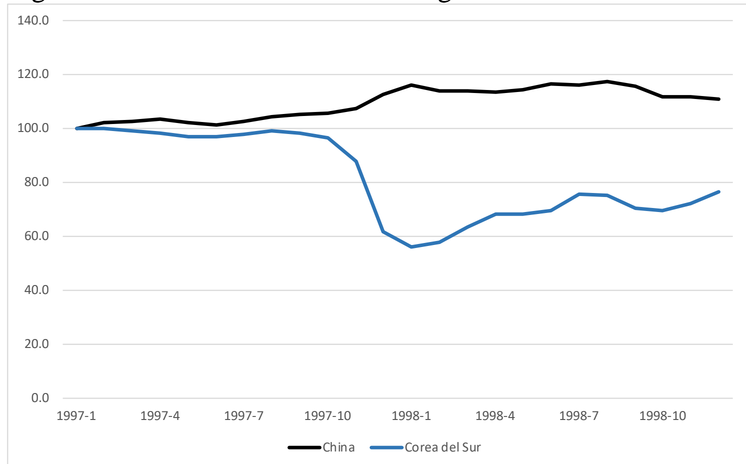
The term coined by Guido Mantega has come back into fashion in 2019, in this case the mouth (or tweets) of Donald Trump, accusing China (and, subsequently, the European Central Bank) of unfair devaluations of the Renminbi (and the Euro). Although the European case seems more a tortious effort to pressure the Federal Reserve to move interest rates according to what the US Administration believes is most appropriate, accusations of exchange rate manipulation by China have a long history. Are they justified?

Of course, the unique exchange rate scheme of the Renminbi is not a model of transparency. It consists in allowing the market the possibility of achieving a limited daily oscillation (upwards or downwards), in theory with respect to a basket of currencies with unknown weights, in practice, it appears that the U.S. dollar, to start next day quote with an exchange rate that does not necessarily relate to that determined (under restrictions) by the market on the day in question. Therefore, it is an exercise of opacity and permanent intervention that opens the doors to these allegations of manipulation. However, when one observes the trajectory of the Renminbi and the actions of the Chinese authorities in the last quarter of a century, the perspective is quite different.

Thus, during the Asian crisis that began in the summer of 1997, China even allowed a certain appreciation of its currency, compared to the strong depreciation experienced by developing countries (neighbours and trading partners) punished by the massive outflow of capital that was the biggest manifestation (external) of the crisis (see the very different evolution of the Renminbi and the Korean Won in

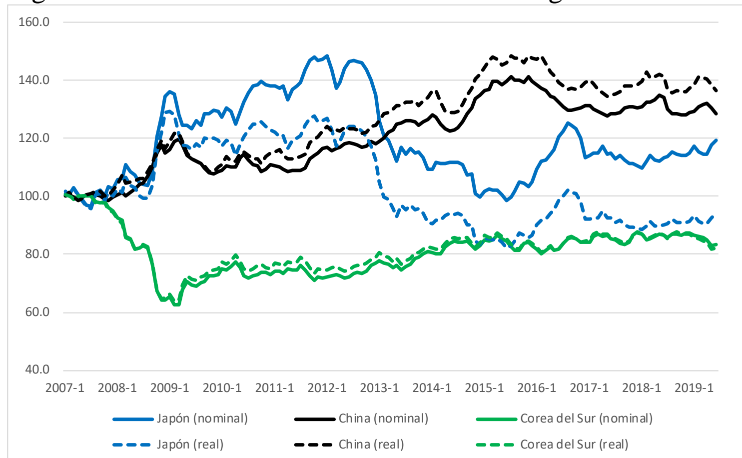
Figure II, as an example). More opportunistic behaviour from China would have complicated the recovery in South-east Asia, although it is true that at that time the weight of Chinese foreign trade (the country was not yet integrated into the World Trade Organization) was much lower than at present, and, with it, the cost of allowing this appreciation of the Renminbi.

Figure II.- Nominal effective exchange rate indices of China and South Korea (1997:1 = 100).



Source: own calculations. Data: Bank for International Settlements.
Note: Upward (downward) movements imply appreciation (depreciation) of the effective exchange rate

Figure III.- Nominal and real effective exchange rates of China, Japan and South Korea (2007=100).



Source: own calculations. Data: Bank for International Settlements.
Note: Upward (downward) movements imply appreciation (depreciation) of the effective exchange rate

From a longer perspective, note in Figure III the ostensible appreciation, both nominal and real, of the Chinese currency since the Great Recession, in marked contrast with two other Asian economies (with significantly higher income levels), also prone to intervention in the foreign exchange market, and which have been much less criticised in this area, at least in recent years. Thus, while the Renminbi has appreciated by 30% in this period (40% if we add the inflation differential), the sharp appreciation of the Yen in the early years after the crisis was reversed from 2012 by the actions of the Abe Administration and the world's more expansionary monetary policy (to which we must add the competitiveness gained with the virtually zero inflation rate in Japan). Interestingly, if as a result of these data we had to declare a winner of the "currency war", it would be South Korea that, with an economy that has grown solidly to the country's already advanced level of development, has enjoyed a real and nominal depreciation of 20% over the past decade with few alerts from the leaders of other countries.

It seems, therefore, that China has especially forced its currency downwards at this critical period of the world economy. What is more, the episodes in which the country's Central Bank has intervened to *strengthen* the Renminbi are sufficiently well known, the most marked of which took place between mid 2016 and early 2017, when the Chinese foreign exchange reserves were reduced by more than 900000 million (justifying a total volume of close to 4 billion, considered by many analysts as excessive until prior to this

episode), in an attempt to combat the output of private capital as a result of the doubts about the change in basic aspects of the economic model and on the progressive financial liberalisation (or not) of the country.

In fact, the impression could be drawn that the Chinese Government has used what is revealed, according to these data, as an unfounded accusation, at least compared to actions by other countries to depreciate their currencies, including Western ones, to mask numerous practices of manipulation of international trade, much more pernicious and illegal within the framework of the World Trade Organization, and that only recently seem to have been clearly placed on the table, giving the Trump Administration one of the only arguments shared by many other countries (which, for the most part, anyway, oppose US unilateral measures). Forced transfer of technology through joint ventures, essential to operating in the country; exports favoured by intense and widespread dumping practices; market reserves and credit privileges for large public companies that, with that support, win international competitiveness; blatant and permitted, if not encouraged, violations of intellectual property… all of this has given China competitive illegitimate advantages not effectively hindered by existing international schemes. And without the need for exchange rate manipulation. All of this must be unequivocally corrected, although indiscriminate and unilateral tariffs are not the right way.

A final note in this area. Some fora speak of a certain western naivety since China's entry into the WTO, allowing these practices because it was thought that progressively, as its global integration increased, the Asian colossus would comply with internationally accepted standards of its own volition. Sincerely, it seems more likely that the reason for this permissiveness was in the monumental benefits arising from the entry into the Chinese market for Western companies, and not in this supposed naivety. When the competitiveness of Chinese companies begins to move to a good portion of these European, Japanese and American companies not only from the Chinese market, but the global market, there is no more room for tolerance. But it is not easy to reverse what was allowed for two decades.

Notes for a solution… unlikely with the current international panorama

How to avoid new episodes of "currency wars", in a world in which the pace of economic growth suffers, and in which the accumulated debt restricts most countries, despite the intensity of monetary expansion, the strength of domestic demand?

In a word, multilateralism. First, to agree on the need to avoid exchange rate manipulation, submitting the specific measures that could be understood as tending towards this to a review by international agencies, probably with the International Monetary Fund as the main candidate. The growing flexibility of the IMF in recent years in assessing restrictive measures of capital movements allows us to anticipate that both these and explicit actions to devalue currencies would be analysed and authorised (or not) without a predetermined judgement.

Second, that same multilateral perspective, this time supported by recovering the effective functioning of the WTO, should stop (and reverse) the cataract of protectionist measures, especially on tariffs, adopted in recent quarters, as well as addressing, with the requirement of correction in a short time, some of those unacceptable practices referred to above to gain international competitiveness carried out by China (not exclusively by this country, it is noted).

Third, and more in the medium term, redefine the structure of functioning of the International Monetary System, reducing the dominant role of the dollar, even in a scheme of balance between several dominant currencies (not easy to develop and not necessarily effective in economic terms), either through an authentic global currency (in this case, the difficulties would be primarily political and technical, in that order). The decisions of the United States Administrations and of the Federal Reserve would cease to produce side effects as significant as they currently are in the rest of the world.

Of course, at this time, there is neither the will nor the credibility among the main actors of the international arena to advance along these lines. The reader must be prepared to contemplate new scuffles (even battles?) in the "Currency War".

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