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Recent Problem of Global Capitalism: Rate of Exchange Wars

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Abstract

Globalization has a vital role in economic, social and political modeling of the 20th century. Along with globalization, trading contracts, discounts in the applied tariffs and expanded trading networks have restored economics to a totalitarian structure. Favorable and unfavorable effects of this totalitarian structure, generated by rapidly expanding globalization, have revealed themselves in time. However, given the economic crises experienced in global economy during recent years, unfavorable and destructive effects of globalization are discussed a lot more. Hence, during the second quarter of 2007, the crisis, which started in the real estate market in USA and reflected in financial and real sectors, has folded into a global dimension and driven many EU countries to the brink of bankruptcy, particularly Greece, and this in turn has become the most prominent indication of destructive effects recently. Countries, especially USA, which experienced depression with the effect of the crisis, have been seeking solution for reinstating economic power in the centerline of protectionism. Indeed, a similar search was observed following 1929 Crisis and especially USA had increased protectionist measures following the crisis in its economy surrounded by high customs walls. These arrangements made in quota and tariffs in 1930s substantiate as interventions in the rate of exchange nowadays. Countries, which interfere in the rate of exchange and attempt to solve their economic problems by securing drop of their national currency against foreign currencies, influence exports of other countries and gain substantial power advantage. Thus, this war started years ago by China, one of the greatest economies in the world, was continued by USA due to 2008 Crisis and by Japan and China later on, and has carried the rate of exchange war appeal into the international agenda once again. However, USA, supporting the economy with dollars by purchasing bonds from the market starting in the first year the crisis emerged, announced a decrease in the bond program that was continued for five years by considering the improvement experienced in macroeconomic data by the end of 2013. Certainly this decrease would create unfavorable effects for economies struggling for financing the current deficit in developing countries specifically. Since the decrease in bond purchase would increase bond interests in USA, directing of capitals to USA market by foreign investors would affect countries unfavorably such as decrease in hot money flow in developing countries.

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In this study, the way the developed countries, for instance USA and Japan, referred to monetary expansion was scrutinized and the rate of exchange wars were examined, and negative effects of this policy on the economy of developing countries, especially in the economy of Turkey were studied, when decrease in monetary expansion was observed in USA in the macroeconomic data.
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1. Introduction

Together with the mortgage crisis, countries –mainly the USA- having entered into a period of recession and willing to get out of this recession gravitated towards a search for economy policies. Especially the method implemented by the USA under the name of monetary expansion package had a negative effect on the economies of other countries by increasing tension in the markets in a short period of time and became the focus of criticisms by many developing countries, mainly Brazil. This is because depreciation of dollar due to the USA's adoption of the monetary expansion policy had a negative effect on the exports of other countries and these countries stepped into action against the USA's Exchange rate intervention policy. So much so that a similar policy implemented by Japan against the USA in the first months of 2013 brought up the currency war discourse to the international agenda. Prime Minister of Japan, Shinzö Abe, stated that the monetary expansion policy was implemented to put a stop to the inclination towards recession in his country and achieve the targeted inflation objective of 2%.

Having livened up due to the currency war discourse at the beginning of 2013, markets were diverted to a different direction upon a statement in may by the FED front relating to the fact that purchasing of bills of Exchange will be reduced in 2014. Having resorted to monetary expansion to save its economy from recession in 2008, FED exposed developing markets to hot Money flow intensely while leaving the markets of developing countries in a difficult situation upon its announcement in the last FOMC meeting of 2013. Countries like Brazil, Indonesia, Turkey, South Africa, India took their place among the countries to be effected by the tapering implemented by FED most.

2. Search for a New Economic Power: Currency Wars

History of world economy has witnessed many crisis and policies changing after these crisis. Functionality of traditional policies implemented had the opportunity to be tested with each crisis and companies worn out by crisis started endeavoring to take their economies under preservation.

As a matter of fact, following the 1929 economic crisis in America, Hoover - US President at the time- concluded the agreement involving the boosting of customs duty receipts imposed on some products imported to the USA on 17th June 1929. After that, protectionism precautions swept all over the world and prices of imported products increased (www.euractiv.com.tr). Later on, England acted its part in these developments too. England, who defended free trade and spread it all over the world, made significant increases in customs duty gravitating towards protectionism and displayed an aggressive attitude imposinng quotas on import. Import quotas, which is a protectionism policy, and customs duties imposed on imported goods swept among the countries and lead to a failure to get out of the recession for a long time. Protectionism policies called the "beggarthyneighbour" policy (Horsewood& Sen &Voicu, 2009) that appeared in the 30s refers to the attempts of a country that has encountered economic imbalance at adjusting its balance by gravitating towards practices that will unbalance the economy of another country (Eğilmez,2013). It is also observed today that countries implement the protectionism policies implemented in the 30s in the form of intervening with Exchange rates. In other words, such Exchange rate adjustments carried out by some countries in a manner that will upset the balances in the economies of other countries for the sake of adjusting economic imbalances created by the crisis are defined as "Currency Wars" (Wheatley, 2010).

USA's surrounding its economy with high customs walls to get rid of the effects of the crisis in the 1930s pushed other countries to protectionism precautions as well, prices of imported goods increased and as a result, countries

had to resort to devaluation to be competitive (Işık & Duman, 2012).. When the period between World War II and the Bretton Woods era up until 1970 is examined, on the other hand; currency wars did not happen in this period as the values of main currencies were set between each other. Whereas after the 1997 Asian Crisis, moves aimed at insuring competitive power with devaluations were observed (Ercan, 2012). However, in 2001, the currency war having manifested itself further upon fixation by China of its local currency Yuan to the US dollar rendered Chinese goods advantageous in the international goods market (Eğilmez,2013). Countries warned China to decrease the value of its national currency but China declared that it would continue indexing its local currency Yuan to dollar until its presence is perceived in the market in terms of low unit price so that it did not lose its advantage and maintained its activity in the goods market. However, the USA increased the force it used on the Chinese side to settle the value of its local currency and upon these constraints, China gave up fixing the value of its Money to dollar in 2013 and let it depend on the market conditions. However, the currency war, which left its mark on year 2013, caused China to panic and China continued maintaining the value of its currency low abandoning the restrained appreciation tendency of Yuan. By the way, the similarity between the new policies implemented by FED, which warned China intensively, after the mortgage crisis and China attracted attention. That is, FED, which charged China with causing significant destruction in the US economy due to its local currency it kept low for its own sake, has caused the same destruction to the economies of developing countries in person today (Blinder, 2010) .In order to temper the crisis, the USA resorted to interest discount, which is the traditional political tool, first, and when discounts in the interest rates were not enough for the recovery of the economy, it announced its first quantitative expansion package as 600 billion dollars n 2008 (Brahmbhatt & Otaviano, Ghosh, 2010). In march 2009, on the other hand, it announced a package aimed at purchasing real estate based on mortgage worth 750 billion US dollars, which acted as the continuation of monetary expansion package and bills of Exchange worth 300 billion dollars. The USA smothered the market with liquidity by implementing a monetary expansion (QE2) worth 2,3 trillion dollars as of year 2011 (Tunç, 2013). Claiming that the economic data was not as it had expected it to be, the USA announced the 3rd monetary expansion package (QE3) in 2012 and stated that it would buy substantial amounts of mortgage bonds from the market. An unemployment rate of 6.5% and inflation rate of 2% are among the goals set by the USA. The company stated that it will continue offering liquidity to the economy somehow until it achieves these figures and once for all, announced the 3rd monetary expansion package foreseeing mortgage based asset purchasing worth 40 billion dollars a month in september 2012. The package stated that the USA would continue unlimited purchasing of bonds and monetary expansion as long as employment and unemployment did not reach the desired level (Kaya & Barlas, 2013) [Table1].

Table 1.Monetary Expansion Package Announced by FED and ECB

	FED	ECB	REMARK
November.08	QE 1		1st Quantitative Expansion Package involving purchasing of bonds worth 600 billion US dollars
March.09	QE 1 Extension		Mortgage based real estate purchasing worth 750 billion US dollars and buying of bonds worth 300 billion dollars as a continuation of QE 1
June.09		LTRO 1	1st Long Term Financial Operation worth 442 billion euros offering funding with one year maturity
May.10		SMP	Real Estate Market Program including the buying of public and private sector debt instruments (purchasing worth 209 billion Euros having been made as of January 2014, such is being sterilized)
November.10	QE 2		2nd Quantitative Expansion Package including the purchasing of bonds worth 600 billion US dollars
September.11	Operation Twist		Maturity Exchange Program worth 400 billion US dollars aiming at exchanging bonds worth US dollars with maturities of less than three

			years with those with a maturity of 6-30 years
December 2011& February 2012		LOTRO 2	2. Long Term Financial Operation worth 1019 billion euros insuring funding with maturities of one and three years
June.12	Operation Twist Uzatımı		Additional bond Exchange worth 267 billion US dollars under the Maturity Exchange Program
September.12	QE 3		3rd Quantitative Expansion Package foreseeing purchasing of mortgage based assets worth 40 billion US dollars (It was declared that purchases will continue until a remarkable improvement is observed in growth and employment)
September12		OMT	Direct Monetary Transactions foreseeing bond buying according to the demand from countries in the Euro zone (No limits up have been set)

Source: Central Bank of Republic of Turkey: Ekonomi Notları (2013).

Whereas many countries were disturbed by such practice of the USA, the first verbal criticism came from Minister of Finance of Brazil Guido Mantega. Charging the USA with starting a new currency war, Mantega reported that the monetary expansion performed by America had turned the scale both in Brazil and in other countries significantly by way of exposing to hot Money flow (Wheatley, 2010). Despite Mantega's criticism aimed at the EU relating to the fact not only did countries with damaged economies lose their price advantages in the international trade but also they incurred great losses as their economies were affected negatively; Japan's giving acceleration to the currency war all over again to take its economy out of the recession it had been in for 20 years and achieve its interest rate target of 2% aggravated the problem (Kuroda , 2013). In connection with the unbalancing of Japan's economy as a result of the Asian Crisis it experienced in 1997 and 2008 crisis, which gave all world economies a deep shock , Bank of Japan took a strong step unprecedented in the history of Bank of Japan and put a monetary expansion package –like the USA's- worth a high amount into practice in order to decrease the effects of the crisis and get its country out of the recession its economy is in(Mortimer-Lee, 2012) Following Bank Of Japan's announcement that it will put new bonds against 1, 5 trillion dollars on the market in 2 years and that it will buy bonds worth 7 trillion yens a month; it was observed that yen lost in value vis-a-vis dollar (Tunç,2013). Many countries – mainly the USA- reacted to such loss in the value of yen which caused a remarkable change in the markets. Thus, Japan found itself in the line of fire the USA had found itself in the previous years this time. In this context, countries not having been able to react to the monetary expansion implemented by the USA bigly started taking precautions urgently to protect their economies when they realized that Japan depreciated its local currency with its monetary expansion policy. After Japan, Korea and Switzerland intervened in their quotations; whereas, Brazil, which is a Latin American country, increased its withholding rates in order to avoid a revaluation of its national currency (Tunç, 2013)Venezuela devaluated its local currency Bolivar at the rate of 32% and it was observed that New Zealand, Australia and Turkey reduced interest rates (Zigah,2013) .

However, attempts of developing countries at protecting their economies from vulnerability by reducing interest rates did not work and these could not countries could not break away from experiencing hot money flows. Turkey with a developing country status did not want its economy to become vulnerable having experienced excessive hot money flow. However, from a different point of view, it is thought that it needed that incoming hot money as its foreign Exchange reserves were low. Consequently, it seems to be difficult for Turkey, whose foreign Exchange reserves are seriously low, to take part and fight in the currency wars. When, on the other hand, foreign Exchange reserves of such developed countries as China, Japan; we come across high figures. When the figures are examined, it is explicitly understood why these countries took active part in the currency wars. Another reason why we could not take place in the forefront during the currency wars is the our economic power was not sufficient. When countries such as Japan, the USA, China are examined, the reason why they implemented exchange rate manipulation, which is an easy money policy tool, was the ability of their countries to gain competitive advantage over other countries. When the shares of these countries in world trade before entering the currency wars are

examined, it is observed that they are quite high (Bergsten & Fellow &Director Emeritus, 2013). Therefore, developing countries like Turkey cannot implement what these countries taking active part in the war confiding in the fact that the share they get is high already. These countries, whose share in the world trade volume are already low, will not be able to implement the policy after a while when they try to take active part in the currency war due to the inadequacy of their foreign Exchange reserves and the policy they are implementing will come to end without gaining competitive advantage as the share they get from trade is low.

2. Morgan Stanley Economy Report: Fragile Five

It was found out that, with the 2008 crisis, global markets became dependent on each other and the foreign developments created a domino effect on the economies of other countries. Although FED's feeding the market with dollar by increasing its bond buying fractionally as an exit strategy rendered the economies of developing countries fragile; it increased the opportunity for these economies, whose foreign Exchange reserves are inadequate, to find cheap dollar from the market (Orakçıoğlu, 2014).However, following the FOMC meeting, in which the fact that the monetary expansion program was going to be dissolved was signaled last May, money and fund outflow was experienced in the rising market economies, which had been experiencing intense money flow since the very year this program started being implemented. These countries with fragile economies already entered into a more difficult period because of such move by FED.

Following the signals of bond tapering first reported categorically for the first time by FED on 22 May, Morgan Stanley talked about a group of countries called the "Fragile Five" in his economy report for August. This group of five consisting of Turkey, Brazil, Indonesia, South Africa and India having the profile of countries most affected by FED's policies, these countries common characteristics in terms of twin deficits due to their deficit spending and current account deficits, inflation on the targets of their central banks, their addiction to hot money and unrest created in their economies by the oncoming general-local elections(Romei, 2013).

Due to the approach of macroeconomic data to the desired level on the last days of 2013 and upon the opinion that continuing bond buying did not provide benefits to the economy anymore, FED announced that it would economize 10 billion dollars on bond buying as of January 2014. While markets could still not tolerate reduction of bond buying worth 85 billion dollars maintained since September 2012 to 75 billion dollars with a reduction of 10 billion dollars; a second decision was made in the first FOMC meeting of the year headed by FED President Ben Bernanke for the last time. Taking into consideration the increase in the labor market and the positive progress in household and business world spending into consideration, FED increased monthly bond buying to 65 billion dollars further decreasing it by 10 billion dollars (Sharf, 2014).Central Banks of especially the developing markets – mainly Brazil- increased their policy interests rates to avoid outflow of funds from their countries and devaluation of their national currencies versus dollar by using interest rate as a trump card starting from the FOMC meeting, in which the reduction in bond buying was signaled for the first time, in May (Monaghan, 2014)

In the face of 10.3% devaluation in Brasilian Real vis-a-vis dollar as of may, when the discourse of future reduction of bond buying in Brazil circulated in Brazil, which was having a difficult year due to especially the political unrest it was experiencing; the Central Bank intervened using interest rate as a trump card and became the country that increased its interest rate the most among the countries called as the "Fragile Five" having achieved an increase of 200 basis points in policy interest rate(www.cnnturk.com)Another country increasing its interest rate among countries in questio with fragile economies was Indonesia. Indonesian Central Bank having made a 175-basis point increase in its policy interest rate since May increasing its policy interest rate from 5,75 to 7,50; it could not avoid the unpredictable devaluation in Indonesian Rupee vis-a-vis dollar despite such move. Despite the increase in interest rates, the Exchange rate did not decrease and the devaluation in the Indonesian Rupee against dollar was recorded as 23.4% (www.sabah.com.tr).

Devaluations experienced by Indian Rupee, the currency of India included among the five fragile in the report published by Morgan Stanley against dollar were also remarkable. Indian rupee, which faced a devaluation of 13% against dollar in 2013 used interest rate as a trump card just like the other four countries in the fragile five Finally, increasing its policy interest rate 25 base points from 7.75% to 8% with a shocking decision made on 28 January, the Indian Central Bank RBI increased its interest rates for five times as of May with this decision. Head of Central Bank Rajan, who made an explanation after the decision, stated that reduction of the high inflation figures had

priority over growth and emphasized the fact that the preservation of the value of Rupee was of first priority. After the decision, Indian Rupee revalued 0.2% against dollar separated from the other four countries in the positive sense (www.dunya.com)

Another country that increased interest rates to avoid devaluation its national currency Rand against dollar was South Africa. In 2013, devaluation of the South African Rand against dollar tested 21.2%. In the meeting held on 29 January, the Central Bank of South Africa increased its interest rate from 5% to 5.5% willing to avoid the sharp falls in Rand (Derby & Strauss, 2014)

Both FED's announcement that it was going to adopt a recession in bond buying as of 2013 and Turkey's own domestic disturbances in June and December caused signification devaluation in Turkish Lira. Central Bank of Turkey, which tried to balance the Exchange rates interfering with the interest rate corridor rather than the policy interest rate in the period from May to late January, interfered with the policy interest rate immediately upon dollar's breaking a record reaching a level of 2.9 on 29 January. Announcing the decision at midnight, the Central Bank made a shocking increase in the interest rate taking policy interest rate from a level of 4.5% to 10%. Following 17.2% devaluation of TL against dollar, it was recorded that dollar regressed to the level of 2.17 again with the interest rate increase carried out by the central bank and that TL experienced a revaluation of 9% against dollar since 28 January when the decision was made. With such move by the Central Bank, Turkey became the second country – after Brazil- with the highest interest rate among the fragile five(www.aa.com.tr)

In this context, when January 2014 is examined, interest rate increases made by developing countries due to FED's reduction of its monetary expansion policy became a current issue. Although the increases in the interest rates are attributed to the reduction in bond buying, it was emphasized in the latest report published by FED that the present situations of the economies of these countries resulted from the internal dynamics thereof and from the wrong policies adopted by their central banks in the index created among 15 countries with fragile economies (www.finansgundem.com)

As a matter of fact, taking over the portfolio of FED Presidency from Bernanke on 3 February, Yellen published a report in his first official speech made at the House of Representatives on 11 February and stated that the country with the most fragile economy was Turkey (www.cnnturk.com.)

The report, which handles the economies of 15 developing countries, analyzes the fragilities of these countries developing an index taking six factors such as current account balances and ratio of foreign Exchange reserves to economic production. In the analysis, Turkey, which was selected as the most fragile country, was followed by Brazil and India respectively, whereas China was reported as the country with the least fragility. While fragile countries were defined as countries with the highest devaluations in their currencies and higher interest rates in public borrowing; the reasons why Turkey was determined as the most fragile country were its negative separation of other developing countries with a current account deficit/national income ratio of 8%, as well as its displaying a very weak performance against external shocks –which was the most important reason. The report indicates that Turkey, which was going through a year with intensive political unrest, could not avoid the devaluation in Turkish Lira (www.milliyet.com.tr)Up until the day, on which the Central Bank decided to increase the interest rate; TL's devaluation against dollar rose up to 21.3 %. Dollar, which adopted a tendency to devaluate, was recorded to have recessed to 2.18 (www.teramenkul.com).

In the report, which touches upon the fragile five in general, the New President Yellen – although accepting the fact that FED might have caused a sales wave in the financial markets in developing countries in the report- emphasized the responsibilities of the developing countries stating that such volatile progress of their national currencies against dollar was not related to FED's reduction of bond buying as a whole. While evaluating the reason why the markets of these countries suffered so much, he indicated that they left their currencies defenseless against the domestic problems they were experiencing rather than the reduction in bond buying. Stating that the increases in the interests rates were temporary solutions, Yellen warned the developing market economies on finding more structural solutions. (Harding, 2014).Touching especially upon the Asian Crisis, Yellen determined that countries which took lessons from the crisis and reduced their fragilities were the smiling side now, whereas Turkey did not do its homework decently.

Turkish economy, which-no doubt- has points of fragility, fell under the influence of political risk upon the 17th December investigation of corruption, thus, the mood of optimism relating to its economy started disappearing completely. However, these developments must not be seen as a reason for FED's, which is the tower of capitalism

an done of the leading institutions in guiding world economy, refusing its responsibility for the situation the countries are in. What FED is doing today is the same as what many previous international platforms did. Just as IMF and the European Central Bank emphasized in the G-20 Summit held in February 2013 that the foreign Exchange rate movements created were mostly movements with no specifically set targets and evaluated these tendencies as macroeconomic policies implemented by countries aimed at empowering their economies to get out of the recession; the USA displays a point of view denying the currency war today and its responsibility relating to

4. Conclusion

Upon sweeping of the problems arising in the US housing market and transformation thereof into a crisis, a difficult period began and the USA chose to inject liquidity to the market to save its economy from recession. First criticism relating to the imposition of competitive Exchange rate by the USA by way of monetary expansion came from Brazil. Criticisms directed at the USA relating to the fact that it would start currency wars were directed at Japan last year. Just like the USA, Japan chose monetary expansion in early 2013 to save its economy from the recession it had been suffering for 20 years and decrease the effects of the crisis that arose in 2008 on its economy and Japan became the party triggering a new currency war with such movement.

In this context, believing that an increasing trade volume is the only way out of the recession, countries chose to interfere with Exchange rates and the tragic end was experienced again in the under developed and developing countries. While developing countries having injected excessive amounts of money in to the market implemented this policy to take their economies out of recession; hot money flowing into the developing countries rendered the economies of these countries fragile and rendered them dependent on hot money and put them into a difficult situation. National currencies of especially the developing countries made a volatile progres before the FOMC meeting held by FED regularly every month. Developing countries were stayed focused on FED’s decisions upon FED’s announcement that it would reduce monetary expansion – provided that such macroeconomic data as employment and inflation are at the desired level- in its meeting in May. Announcement of the fragile five companies that will be affected by FED’s reduction in quantitative expansion in Morgan Stanley’s economy report of August attracted the attention to these countries The news that FED would make a reduction of 10 billion dollars as of January 2014 was shared with the public opinion in FED’s last FOMC meeting of year 2013. After that date, although central banks of countries –like Turkey- that increase interest rated and has fragile economies reduced the fever of dollar for short periods in order to protect the value of their national currencies against dollar, they are face to face with rising costs due to rising Exchange rate. Moreover, these countries trying to oppress inflation are in a difficult process due to the political unrest they are going through. Developing market economies trying to finance their current account deficit feeding with hot money for years cannot find dollars in the market at a discount any more upon reduction of bond buying and this creates a mood of panic in these countries. While countries damaged by the quantitative expansion implemented by the USA and Japan in an aggressive manner are developing economies, it was again the same economies that were affected the most upon FED’s reduction of its bond buying. Despite all these, claiming that the reduction in bond buying was not the reason why developing countries were going through a difficult period, new President of FED Yellen stated that it was a situation that had to with the fragility of developing countries including Turkey. Stating that reduction in bond buying was signaled months in advance, Yellen pointed out that countries had to taken precautions during this period. This statement by Yellen can –no doubt- be evaluated as global capitalism’s turning its back on developing countries. However, this statement is significant especially in the context of reminding Turkey that it had to implement the structural reforms, the results that would reduce the fragility of Turkey of which would be seen in the long term. On the other hand, it is observed in country reports published by IMF in October 2013 and OECD in November 2013 that they are pessimistic about Turkey, too. Especially in the report published by WB recently in January 2014, it is observed that WB is more pessimistic compared to the other two institutions. Therefore, creation of labor force with a high level education to be able to change the import–dependent production structure of Turkey, thus increasing the added value of exported products, encouragement of participation of women in the labor force and enhancement of rate of savings can be listed as main important steps to be taken.

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