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Currency War the Reasons and Repercussions

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Abstract:
The term "currency war" refers to a situation in which countries devalue their currencies competitively, mainly to increase their export competitiveness. This tactic seeks to lower the price of a nation's goods on the international market in order to increase exports and spur economic growth at home. Resolving trade imbalances, controlling national debt, or pursuing a competitive advantage in global commerce are common motivations.
But such acts might set off a series of counterattack devaluations, which can have serious consequences. These include heightened trade volatility, financial market instability, and inflationary pressures brought on by rising import prices. Furthermore, because countries perceive one another's acts as aggressive economic manoeuvres, currency wars can intensify geopolitical tensions.
Cooperation between nations is necessary to address these problems. Strengthening global frameworks, like those offered by the IMF, is one way to prevent competitive devaluation and encourage exchange rate stability. To reduce the dangers and unfavourable effects of currency wars, major economies must coordinate their monetary policies, prioritise sustainable economic growth, and uphold fair trade principles.

Currency war Is the war of the current hour, the war that is fought with no weapon but with valuation of currency. A currency war is an escalation of currency devaluation polices among two or more nations.
Each of which is trying to simulate an economy. Currency prices fluctuate constantly in the foreign exchange market, but a currency war is marked by a number of nations simultaneously engaged in policy decisions aimed at devaluing their own currencies. In a currency war, nations divide their currencies in order to make their own exports more attractive in markets abroad. By lowering the cost of their exports, countries' products become more appealing. This is known as competitive devaluation. At the same time, such devaluation makes imports more expensive to the nation's own consumers, forcing them to choose homegrown substitutes. This combination of export-led growth and increased domestic demand creates more employment and economic growth. Theoretical Economics In terms of theoretical economics, currency wars are harmful to the global economy because these back-and-forth actions by nations seeking a competitive advantage could have foreseen adverse consequences, such as increased protectionism and trade barriers. Though these mere opinions of these economists are normative in nature, the current currency field proves that these opinions are to be positive statements in the books of economics. Role of the International Monetary Fund and World Trade Organization It is important to note that currency wars are controversial and often lead to retaliation, which can escalate to border trade disputes and economic instability. International organizations such as IMF and WTO closely monitor currency policies to prevent currency wars, currency devaluation, and its examples. Globally, China increases its currency and domestically decreases it. They have a fixed exchange rate because they want to intentionally lower their currency value to have a competitive edge in the global trade. Currency wars may have a wide-ranging

effect on the global economy, while individual countries may benefit in a short period. The overall period can have an overall impact which can lead to economic instability.

Such examples are the United States of America in 2008 and United Kingdom in 1967. Because of the Great Depression of 1930, the United Kingdom's finance administrative had to lower the value of their currency, sterling, in 1967. And in 2008, the US housing bubble burst and triggered the Great Recession. Economies were affected around the world. Currency war, also known as competitive devaluations, is a condition in international affairs where countries seek to gain a trade advantage over other competitive nations, and imports into the country become more and more expensive. Both effects benefit the domestic industry and the employment industry, which receives a boost in demand from both domestic and foreign markets. However, the price increases for imported goods, inclusive of logistics costs, and are unpopular because they harm the citizens' purchasing power. When all countries adopt this strategy, it can lead to a general decline in international trade. Historically, competitive devaluations have been rare as countries have generally preferred to maintain a high value for their currency. Currencies have generally allowed market forces to work or have participated in systems of exchange rates. An exception occurred when a currency war broke out in the 1930s when countries abandoned the gold stand and the great depression was used as a currency devaluation as an attempt to stimulate their economy. Since this effectively pushes unemployment overseas, trading partners quickly retaliated with their own devaluations. The period is considered to have more of an adverse situation for all concerned as unpredictable changes in exchange rates reduced overall international trade. A currency war is more of a political than an economic condition. Governments frequently intervene in their currency markets, increasing the money supplied to combat inflation. The problem is that in an interlinked global economy, currencies don't rise or fall in a vacuum. For example, when China keeps the Yuan artificially low versus the dollar, it keeps the cost of Chinese goods low in the United States, contributing to a trade imbalance. This provides a steep incentive to the US to retaliate by lowering its currency as well. Of course, because two countries can have only one exchange rate, this race will never benefit anyone. Other countries, such as Brazil, are compelled to weaken their currencies in order to prevent from their own appreciating when other currencies do so at the same time in order to boost the feasibility of their exports. Naturally, there are occasions when currency disputes have unforeseen political repercussions. When nations disagree on money, they are less likely to agree to bilateral trade, and universal currency depreciation can have a positive outcome on investments. According to the former Brazilian Minister of Finance, Guido Manteiga, a global currency war broke out in 2010. This view was echoed by numerous other government officials and financial journalists from around the world. Other senior policymakers and journalists suggest the phrase currency war overstated the extent of hostility. With a few experiences such as Manteiga, the war was at 2010 and ended at 2011. Since 2010, states consider there is a potential competitive devaluation, have employed a variety of policy instruments such as direct employment involvement, the application of capital controls and quantitative easing in an indirect manner. The most prominent aspect of the 2010-11 event was the verbal battle between the US and China. This was over the yuan. In 2013, to escalate the issue, Japan deflated its currency value. This raised the fear of the geopolitical world for its second-ever currency war. This time, it was Japan against the Eurozone. After the involvement of the G20 and G70, all fears were removed after declarations to stop.

The currency war of 2009-11 was an episode of competitive devaluation which became prominent in the financial press on September 2010. It involved states competing with each other in order to achieve a relatively low variation for their currency. So, as to assist their domestic industry, with the financial crisis of 2008, the export sectors of many emerging economies experienced declining orders. And from 2009, several states began their levels of currency intervention. There had to be more policies to mitigate the currency war that had fizzled in mid-2011. Both the private and public sector analysts and politicians suggested that the world currency war overstated the extent of hostility between the states, which were engaged in competitive devaluation. But the term was widely used since Brazil's finance minister, Guido Mantega, in September 2010 announced a currency war had broken out. In the middle of October 2010, all finance ministers gathered in Washington DC for discussions for solutions to the currency war, prior to that, meeting IIF-proposed solutions to this economic issue. Boosting exports to other countries while simultaneously discouraging the import of foreign goods and services can have a dramatic effect on a country's terms of trade, this being a very important reason of a currency war. Exporting more and importing less will mean a country's trade deficit, when it imports more than its exports, will reduce. Similarly, if a country is already in a trade surplus, when it expects more than it imports, then this will Increasing a country's exports can help them ignite an economic growth which can lead to competitive devaluation.

Shrinking Trade Deficits Exports will increase, imports will decrease due to exports becoming cheaper and imports becoming expensive. This favours an improved balance of payments, BOP, as exports increase and imports decrease. Shrinking trade deficits, persistent deficits are not uncommon today. With the USA and many other countries running persistent imbalances year after year, long-term shrinking deficits are unstable and unsustainable and can result in dangerously high debt levels that have the potential to destroy our economy or any economy. Reducing these deficits and adjusting the balance of payments, BOP, can be achieved through devaluing the domestic currency, but there could be a drawback to this. When prices in the local currency devaluation also rise, the debt load of loans denominated by foreign currencies can impact the developing nations such as India and Argentina that have a significant amount of dollars and euros. This will become a problem for their valuation. Currency Devaluation As you probably know, a devaluation of currency is not uncommon today and here are some examples of currency devaluation or currency war being a reason for the inflation in multiple nations. For example, in the 1980s, the Chinese government decided to devalue their currency to make their goods and services cheaper to compete with countries such as Germany, Japan and South Korea which kept cheaper products despite the inflated economy. In the 2010s and 2000s, Turkey was facing a serious economic problem. They couldn't control the inflation of their currency. This led to widespread protests and distress in the country. Therefore, the government decided to devalue the currency by making it cheaper by 30% to make the products competitive. In the 1990s, while South Africa faced a lot of problems in their government and economic arenas, they were suffering from a serious budget deficit. Therefore, the government decided to devalue the currency to make exports less expensive and more competitive in the global market. Some of the controllable factors that became a reason of currency war. Cheaper Goods When a currency weakens, the price of a country export falls in foreign markets. Imagine a $10 US toy with a weaker dollar, it becomes cheaper for a European buyer which makes the US toy more attractive. Another example is a costlier good. The flip side of cheaper exports is that the imports now become more expensive. Same 8 euros might not buy as much as US made goods due to the weaker dollar. This discourages domestic consumers from buying imports and encourages to buy domestic goods. Another example. Increased Demand Lower prices due to a weaker currency can lead to a surge in demand for the expected countries who are exporting. Foreign buyers purchase more because they get a better deal. This leads to controlled devaluation as countries might aim for a specific level of inflation to achieve for currency war to occur. A little bit of inflation can make the exports more competitive without causing any excessive hardship domestically.

However, too much inflation can erode the purchasing power of the citizens and negotiate and negate the benefits of cheaper exports. It's a balancing act for policy makers. Therefore, high inflation can lead to domestic and social unrest and economic instability which can lead to discouraging foreign investment. Therefore, direct intervention is made by central banks and they directly intervene into the foreign exchange market, buying foreign currencies and selling their own to weaken their currency. This is also helped with the help of lowering interest rates can make a country's currency less attractive to hold leading devaluation. However, this can also have unintended consequences. Capital outflows is another important reason of why a currency war occurs. While advanced economies' monetary policies indeed have substantial spillover effects on an emerging market economy, there was and still is room for market coordination. It then argues that restrictions on capital flows were and are a more natural instrument for advancing objectives as both macro and financial stability. Capital control represents any measure taken by a government, central bank or any other regulatory body to limit the flow of foreign capital in and out of the country, including the domestic economy. These controls include taxes, tariffs, legislations, volume restrictions and market-based forces. Capital controls can affect many asset classes such as equities, bonds and foreign exchange trades and capital markets into and out of the country in account to the government monetary policy. This can also enact the capital control, restricting the ability of possession of foreign assets referred to as capital outflows. Simply imposing greater restrictions on trade across the border can affect the price of a currency by limiting the movement of capital in and out of the country. The currency can begin to appreciate in the value in turn. Lifting restrictions on the movement of capital in and out of the economy can cause a depreciation in the country itself. Now, because of devaluation, it creates trade war.

Devaluation causes a shift in international trade, changing the trade in favour of devaluing the country's currency. Revising how much one currency is worth relative to another means the relative cost of goods from each country also changes. Increasing the price of imports protects the domestic countries but they may become less efficient without the pressure of competition. Higher exports relative to imports can also increase aggregate demand relative to imports leading to inflation. This would become a situation for manufacturing leading to an increase in the price of goods and services. For example, the Omnibus Trade and Competitiveness Act of 1988 requires the USA Secretary of the Treasury to analyse the exchange rate policies of other countries and determine if they are manipulating the exchange rate between their currency and the US dollar. In 2019, Secretary Mnuchin found that China devalued its currency to gain an unfair competitive advantage. However, in 2023, following the several years of trade wars caused by the COVID-19 pandemic, China's central bank hopes to keep the Chinese Yuan from weakening too quickly against the US dollar as imports are becoming more expensive to its imports. To explain how currency war affects the political world and creates an imbalance, we can use the Great Depression as an example. Before the Great Depression, many countries tried to increase the value of their currency by increasing the value of the gold as per the gold standard. This limited a government's ability to control its money supply. The stock market crashed in 1929, triggering a global economic shutdown. Unable to freely print money due to gold standards, countries started to abandon this policy and then started to devalue their respective currencies, making them cheaper compared to other countries. This aimed for boosting exports and increased domestic production. This strategy is often called as beggar-thy-neighbour. This is a policy that many European countries used that created an economic disparity in currencies. This created a major problem in trade and high rates of unemployment.

Another such repercussion of currency war is resource misallocation. During a currency war, countries prioritized making their exports cheaper to win the market share. This can lead to businesses focusing on short-term cost-cutting measures instead of long-term investments in productivity improvements. This neglect of innovation and efficiency can hinder future economic growth. Currency fluctuations can create uncertainty for businesses as well. When the value of the currency is unstable, it becomes difficult to predict the future costs and returns on investments. This uncertainty can discourage businesses from investing in productive activities, leading to misallocation of resources. As the currency weakens, imports become more expensive. This leads to a push for domestic production. Even if the domestic alternatives are less efficient or lower quality, this shift can lead to misallocation of resources away from higher quality options. Stated above are the multiple philosophies, reasons, and repercussions.

But mentioned below are the actual currency wars that is about to unleash soon. For example, the US dollar's involvement in the currency market. It is one of the most critical aspects of the US dollar's global trader role in its function of a reserve currency. A reserve currency is a currency held by central banks in significant quantities. It is widely used to conduct international trade, financial transactions, eliminating the cost of setting transactions involving different currencies. Today, central banks hold about 60% of the foreign exchange reserves in US dollars. Even though the dollar's share of central banks' foreign exchange reserves has gone down over the years, it's almost twice as much as the Euro, Yen, Pound, Yuan combined, which it was a decade ago. The dollar's stability and widespread acceptance makes it the popular choice. The Indian rupee's involvement in the currency market. The internationalism of the rupee is inevitable as the Indian economy is continuously growing. But currency internationalism cannot be decided on one day, pursued the next. It comes about for a long evolutionary process when all building blocks are in place, which financial stability is a paramount block of the INR. Because in 2024, there had been a sharp decrease of INR when the increase of USD had occurred in 2024 April. This has resulted in purchasing power of the INR in the international market diminishing and increased imports significantly. Which is heavily dependent on oil imports suffers severely due to devaluation of the Indian rupees. India has not experienced any currency wars so far, but they came very close in September 2015 when China purposefully devalued the Yuan due to competitive high disparity the Indian rupee had to also fall. How the Dirham or the AED plays an involvement in the currency market? It's an official currency of UAE and it's actively traded in the forex market. It is often involved in currency pairs such as dollars and dirhams, dollars and euros, dollars and GBP. Traders can take advantage of the fluctuation in the exchange rates due to the volatility between the dirhams and US dollars, euros and GBP. This is to mainly create profits. While trading the dirham, we should be more aware of its fluctuations as it is subject to market volatility. Additionally, liquidity can also vary from different currency pairs. Some pairs may have a lower trading volume whereas some high. So traders should take this into consideration for its impact of its liquidity overall. Based on how three currencies have played its major roles in the currency market or the trade market, we can see that they three are somehow interlinked into the awakening of a second currency war, which is the USD versus the INR versus the AED. India has signed a pact with the UAE to pay an oil import in Indian rupees. India has also executed trade with Russia in Indian rupees. For Russian oil imports, currently they are seeking the dethroning of US dollar and awakening of a new international currency, rupees. With the aid of the UAE, the Indian rupees is becoming a kingpin of the currency market globally in the UAE. The UAE government has also agreed for trade deals to be done in Indian rupees. The competition between the USD and INR can be seen through the deal done with the UAE.

To sum up completely the reasons and repercussions of a currency war, there are mainly only four points on how a country or an international organization can find a solution to currency war. Multilateral frameworks and agreements can be a very important solution. These agreements can include commitments to avoid competitive devaluations and new exchange rates possible. Transparency and reporting requirements. Increased transparency can report and promote more informed decision making by the participants of the market and to reduce uncertainty in financial markets. Exchange rate coordination and communication. Encouraging greater coordination and communication between the central banks of multiple countries. This can help mitigate currency wars. Countries to engage in dialogue to promote exchange rate stability and avoid sudden and disputed currency movements. This could involve regular meetings, information sharing, commitments, refrains from using exchange rates for competitive purposes. Macroprudential policies. These policies will help us mitigate any chance of a currency war. Moreover, it will mitigate the repercussions of a currency war stated above. For instance, policy makers can use these macroprudential tools to manage capital flows, limited excessive borrowings in foreign currencies. These policies aim to manage a systematic risk function in the financial system. Implementing such policies can help address potential vulnerabilities.