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N.Ireland is on the frontline of the currency war with the Eurozone

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This is an extended version of an article that appears in the Belfast Telegraph Business Month published 2nd March 2015

The Ukraine crisis has just celebrated its first anniversary. With Crimea already annexed and back under Russian control, a surreptitious war in Eastern Ukraine with Russian-backed rebels rumbles on. Western powers have responded to Russian aggression by imposing economic sanctions which include banning exports to, and imports from, Russia. Economic sanctions can be viewed as the most extreme form of a trade war and are often just one step away from outright military action.

The Ukraine conflict represents a new frontline between the East and West with geopolitical tensions on a scale not seen since the Cold War. There are fears that the situation could escalate, with Russia potentially seeking to extend its sphere of influence into the EU via its new members Lithuania, Estonia and Latvia. Such a move would likely trigger a retaliatory response from the US and Western Europe through NATO.

A lesser known conflict has been even more widespread and raging even longer than the Ukraine crisis. These have been the so-called "*currency wars*" that have followed the global financial crisis and the Great Recession. When the global recession troughed in Q1 2009 currency devaluations were at the forefront of US national security concerns. According to the US Director of National Intelligence (February 2009), Dennis C. Blair, *"the primary near-term security concern of the United States is the global economic crisis and its geopolitical implications…Indeed, policies …such as competitive currency devaluations…risk unleashing a wave of destructive protectionism."*[1]

The term "*currency war*" was given prominence four-and-a-half years ago when the Brazilian finance minister, Guido Mantega, aired his concerns about the weakening of the dollar. This followed the Federal Reserve's biggest emergency economic stimulus in history and its $3.5 trillion quantitative easing experiment.

Speaking on 27 September 2010, Mantega stated that "we're in the midst of an international currency war". The Brazilian finance minister's declaration of a currency war surprised the financial elite at the time. Not because they were unaware of it but rather he explicitly mentioned a term that was largely taboo. Less threatening phrases such as "rebalancing" and "adjustment" to re-align exchange rates were frequently used instead.

While the Ukraine crisis has acted as a reminder to Cold War tensions. The new focus on currency wars has revived the memories of the damaging competitive devaluations that occurred during the 1930s and the Great Depression.

John Maynard Keynes famously remarked, "There is no subtler, surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."

According to James Rickards, author of "*Currency Wars: "The Making of the Next Global Crisis"*, a paradox is at the heart of every currency war. *"While currency wars are fought internationally, they are driven by domestic distress."* Devaluating a currency is invariably the economic growth engine of last resort that attempts to steal economic growth from other economies. This is the so-called beggar-thy-neighbour policy. In economics this is a policy whereby the actions of one country to remedy its specific economic difficulties worsen the economic problems for other countries.

[1] Currency Wars: The Making of the Next Global Crisis (p.17) by James Rickards

Deliberately weakening the exchange rate as a policy to boost economic competitiveness, or to fulfil other economic objectives, is not new. Two key sterling exchange rate events stand out. Firstly, on 18th November 1967, Harold Wilson's Labour Government devalued the pound, through a formally announced devaluation, in order to boost UK exports. This was at a time when sterling was in a fixed exchange rate regime. Secondly, some twenty-five years later, Chancellor Norman Lamont, who was at the time being advised by none other than David Cameron, announced the UK's exit from the European Exchange Rate Mechanism (ERM). The latter required the UK to keep the value of sterling within a range linked to the German Deutschmark. This occurred on 16th September 1992 on what became known as *"Black Wednesday"*.

Both of these events were fully transparent and involved public announcements. As such, they were humiliating for their respective governments at the time. The two examples cited above are examples of currency crises, or battles linked to one currency sterling. A currency war is a rolling series of devaluations across a number of economies.

Currency war tactics have advanced since the days of devaluations within a fixed rate currency regime such as in the UK in 1967 and 1992. Within the current floating rate regime, where the exchange rate is largely a function of market forces, the tactics have arguably become more covert.

In a currency war, the central bankers are the generals who call the shots on behalf of their respective economies. The conventional weapon of choice is interest rate policy. More recently, unconventional weapons have been increasingly used, namely, quantitative easing (QE) and the introduction of negative interest rates *(both deposit and lending rates)*. Shots of QE and interest rate cuts have been used in recent years in an attempt to weaken currencies in order to effectively steal economic growth from other economies.

However, the effectiveness of these policies is limited if all economies follow the same strategy. Since January this year, fifteen central banks have cut their interest rates partly in an effort to weaken their currencies. Denmark has recently been frantically cutting its interest rates to keep the value of the Danish krone down. Sweden's central bank has introduced negative interest rates to discourage funds and weaken its currency.

The US and the UK, through the Federal Reserve and the Bank of England respectively, were arguably the most aggressive at the start of the currency war that began in 2010. As far as currency depreciation was concerned they both gained a first mover advantage against the euro. Sterling depreciated by a whopping 25% over the period 2007-2009. This was a period which saw the Bank rate lowered to a record low of 0.5% and the start of a £375bn QE programme.

Sterling and dollar weakness has aided the recoveries of the UK and US. Conversely, the strength of the euro and the Japanese yen during the period 2008-2013 hindered their economic recoveries. Now, however, both the ECB and the Bank of Japan are mobilising their resources to stimulate their economies with massive QE programmes. In turn, this will weaken both the euro and the Japanese yen.

The battlefield of the current currency war has shifted. Sterling and the dollar in particular have been strengthening. Meanwhile the euro and the Japanese yen have been under pressure. In effect, the currency war has gone full circle.

So what do the ongoing currency wars have to do with Northern Ireland? We may see an increasing number of Japanese cars leaving the car showrooms due to the more price competitive Japanese currency. Developments in the latest phase will adversely impact on Northern Ireland's export performance with the Eurozone and the Republic of Ireland in particular. From a sector perspective, our tourism and agri-food sectors benefited hugely from the boost in demand that a weak sterling/euro exchange rate provided. With sterling/euro currently at a 7-year high and set to push higher, those sectors that benefited from a weak sterling are likely to be collateral damage from the latest currency battle.

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2nd March 2015

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