Bernanke defends Fed monetary policy, blames China for currency tensions

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In a major speech delivered November 19, Federal Reserve Board Chairman Ben Bernanke defended the American central bank's decision to print dollars in order to purchase $600 billion in Treasury securities. The second round of so-called "quantitative easing," launched on November 3, is designed to lower long-term US interest rates.

Speaking at a conference of the European Central Bank in Frankfurt, Germany, Bernanke ignored accusations by America's international trade competitors and many developing countries that the Obama administration and the Fed are deliberately driving down the dollar's exchange rate in order to gain a competitive trade advantage against Washington's economic rivals. US officials have solemnly averred that they would never pursue a cheap dollar policy, but that is precisely what they are doing.

Bernanke was also responding to denunciations of the Fed by Republican congressional leaders and a number of American economists, who argue that the central bank's loose monetary policy threatens to unleash inflation and create new asset bubbles, increasing the danger of another financial crash.

Although the tone of the speech was scholarly, its substance was confrontational. Without naming any countries, Bernanke clearly put the onus on China for widening imbalances between surplus and deficit economies and increasing currency and trade conflicts. He echoed the demand of the Obama administration that China allow its currency to appreciate more rapidly—a development that would make Chinese exports more expensive and US exports cheaper.

Bernanke diplomatically focused his attack on what he calls "emerging market economies" with trade and current account surpluses, and said virtually nothing about advanced surplus countries such as Japan and Germany. The Fed's cheap dollar policy is also directed against them, and both Germany and Japan have denounced it.

The most ferocious public attack on the Fed's launching of "QE2"—the second round of quantitative easing—came from Germany, whose finance minister, Wolfgang Schäuble, earlier this month said the move was "undermining the credibility of US financial policy." Speaking on the eve of this month's G20 summit of leading economies, held in Seoul, Schäuble went on to say the US "growth model," based on "borrowed money" and an inflated financial sector, was in "deep crisis." He charged Washington with hypocrisy for accusing the Chinese of manipulating their exchange rate and then "artificially [depressing] the dollar exchange rate by printing money."

Washington's policy has also come under attack from a host of emerging economies, including Brazil, Thailand, South Africa, Taiwan and South Korea, whose currencies and asset prices are being driven up by waves of hot money stoked by the Fed's printing presses.

At the G20 summit on November 11-12, the US failed to gain support from Europe, Japan and other Asian nations for a coordinated attack on China's monetary policy, and was unable to push through a policy limiting current account imbalances to 4 percent of gross domestic product. (Under the US proposal, the only country that would be immediately targeted is China, whose surplus is above 4 percent of GDP).

The summit ended with a face-saving and vague communique that avows agreement on the need to rebalance the world economy, but commits no nation to do anything concrete about it. Bernanke's speech in Frankfurt confirms that the failure of the G20 summit has set the stage for an intensification of trade and currency conflicts.

In his remarks, the Fed chairman began with an acknowledgment that global cooperation between the major economies is breaking down. He noted that in recent months "tensions among nations over economic policies have emerged and intensified." He attributed this largely to the "bifurcated nature of the global economic recovery."

Referring later to a "two-speed recovery," he focused on the contrast between stagnant growth in the advanced economies and far more rapid growth in the "emerging market economies." He noted that the US economy has suffered a net loss of 7.5 million jobs since the official start of the recession in December 2007, and that its current annual rate of growth—2 percent—is insufficient to bring down the jobless rate.

He claimed that the main motive in the Fed's decision to launch a second round of Treasury purchases was a desire to reduce the US unemployment rate. However, the Fed's monetary policy will do little to bring down the jobless rate. It will, however, tend to drive up stock prices and corporate profits and increase US exports at the expense of America's trade rivals.

Bernanke argued that the sharp decline of the dollar over the summer was due to a growing appetite among investors for riskier and higher-yielding investments and a weakening of dollar-denominated "safe haven" investments that accompanied last spring's sovereign debt crisis in Europe. By implication, US monetary policy played no role.

From there, he asserted that the continuation and widening of imbalances between surplus countries (China, Japan, Germany) and deficit countries (above all, the United States) was due to a "strategy of currency undervaluation" on the part of emerging market economies that rely heavily on exports. He criticized the policy of China and other countries of intervening in the currency markets to hold down their exchange rates by buying dollar-denominated assets, such as Treasury notes. He singled out China, which currently holds over $2.6 trillion in such assets. But a chart accompanying his speech also pinpointed Taiwan, Singapore and Thailand for aggressively intervening to hold down their currencies.

Somewhat counter-intuitively, Bernanke blamed the waves of hot money flowing into these economies on their "incomplete adjustment of exchange rates." (Logically, if the countries allowed their currencies to appreciate more rapidly, speculative capital would tend to flow there, seeking the higher returns provided by more elevated interest rates).

The Fed chairman simply ignored the immense and destabilizing impact of a falling dollar on global capital flows. Similarly, he criticized countries such as China for rejecting "flexible" and "market-determined" exchange rates, without addressing the highly artificial and manipulative essence of the Fed's own dollar-printing monetary policy.

Summing up, he said: "The current international monetary system is not working as well as it should. Currency undervaluation by surplus countries is inhibiting needed international adjustment and creating spillover effects that would not exist if exchange rates better reflected market fundamentals."

His proposed solution was for surplus countries to voluntarily allow their exchange rates to rise and accept a reduction in exports, so that deficit countries—e.g., the US—could grab a bigger share of stagnating global markets. He even suggested some mechanism to punish surplus nations that refuse to go along with the US recipe for global economic "rebalancing."

No voluntary and peaceful agreement between capitalist nations to redivide the world economy is possible, especially under conditions of a global crisis that precludes a return any time soon to previous growth rates. Bernanke speaks for American capitalism, which is seeking to exploit the privileged position of its currency as the primary reserve currency to offload its own decline and crisis onto the rest of the world.