Economic downturn intensifies global currency conflict

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Amid a torrent of disastrous news for the world economy, the Swiss National Bank on Tuesday took the drastic step of setting a ceiling for the Swiss franc, a move that harkens back to the competitive devaluations and currency wars of the 1930s.

The Swiss National Bank announced that it would adopt a minimum exchange rate of SFr1.20 to the euro, and that it is prepared to purchase foreign currency in "unlimited quantities" in order to defend the franc.

The move triggered a massive sell-off of the currency, which almost immediately lost nearly ten percent of its value against the euro.

The Swiss franc has risen 25 percent against the euro in the past two years, as the currency became a safe haven for investors amidst an intensifying debt crisis in the eurozone.

In its press release announcing the measure, the Swiss National Bank said that the "overvaluation of the Swiss franc poses an acute threat to the Swiss economy," and that the central bank is "aiming for a substantial and sustained weakening of the Swiss franc."

The bank will enforce the new minimum rate with "the utmost determination," the statement added.

The Swiss economy is highly export-driven, and a continued increase in the value of the franc would significantly increase the price of exports, hitting Swiss manufacturers' sales to its main trading partners in the European Union. Swedish economic forecaster BAK Base on Tuesday cut its estimated growth rate for Switzerland next year to 0.8 per cent, compared to the rate of 1.9 percent estimated for this year.

The Swiss franc increased sharply during the past week in response to the exacerbation of the European debt crisis and fears of an even sharper downturn of the world economy. Since August 30, the Swiss franc has risen eight percent against the euro, offsetting all previous efforts by the country's central bank to control its appreciation.

Meanwhile dire economic news that led investors to seek the safety of the franc has continued to pour in. This includes a report in the US showing zero jobs growth last month and multiple indices indicating a new economic slump three years after the crash of 2008.

The world economy grew at its slowest pace in two years, according to the JPMorgan Global Manufacturing & Services Purchasing Managers' Index figures released Tuesday morning. The index fell from 52.5 in July to 51.5 in August, only marginally points above the figure of 50 taken to divide growth from contraction. These figures have fallen drastically since the start of the year.

Output hit a two-year low in the eurozone and a 27-month low for India. "Although manufacturing was the main drag, the service sector fared only moderately better," said David Hensley, Director of Global Economics Coordination at JPMorgan.

The Markit combined Purchasing Managers' Index reading for the eurozone, meanwhile, fell from 51.1 in July to 50.7 in August, the lowest level since 2009. Even more disastrously, the manufacturing figure for the eurozone fell to 49.0 in August, the first contraction in two years.

The government debt crisis, meanwhile, has called into question the solvency of several European banks. "It is obvious, not to say a truism that many European banks would not cope with writing down government bonds held in the banking book to market value," Josef Ackermann, chief executive of Deutsche Bank, noted on Monday.

The continuing economic slowdown has deepened divisions within Europe, while redoubling the

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dedication of the dominant sections of the European ruling class, particularly in Germany, to austerity.

Wolfgang Schäuble, the German Finance Minster, reaffirmed his support for even further austerity measures in Greece, Portugal, Spain a and Italy, amid renewed evidence of the disastrous impact of these measures on the world economy. In a column published in the *Financial Times* Tuesday, "Why austerity is only cure for the eurozone," Schäuble argued against any let-up in slashing public spending. He rejected out of hand any increase in spending in the stronger eurozone economies to compensate for spending cuts to the weaker ones.

Yet these austerity measures are only intensifying the global economic downturn, which is in turn putting renewed stress on countries to pursue unilateral exchange rate policies.

The Swiss National Bank's announcement of a currency ceiling for the franc is only the latest sign of growing international tensions over exchange rate policy. It follows the announcement earlier this year by Japan that it would seek to lower the valuation of the yen, coupled with the cheap-dollar policy pursued by the United States over the course of years.

While the United States has not openly claimed a weak dollar as a policy goal, its near-zero interest rates and two rounds of "quantitative easing" asset purchases by the Federal Reserve have had the effect of weakening the dollar 15 percent against the euro since June 2010.

Brazil's finance minister Guido Mantega said Friday that this cheap dollar policy was partly to blame for the fact Brazil's growth rate slowed from 1.2 percent in the first quarter to 0.8 percent in the second.

"Part of Brazil's growth is leaking overseas," he said, blaming the devaluation of the dollar for putting Brazilian exporters at a disadvantage. Mantega said that a third round of quantitative easing, currently being debated in Washington, would mean a "devaluation of the dollar and too much internal liquidity, which will probably lead to appreciation of the real and a continuation of the currency war."

He added, "Unfortunately, monetary policy seems to be the only weapon the US chooses to use to solve its problems and this leads to problems for the world economy."

US policy since the crisis of 2008 has been dictated by the determination to bail out the financial system through the endless provision of cheap credit. This has inflated the markets, aided US exports, and placed immense pressures on the global currency system.

The world currency crisis is rooted fundamentally in the long-term decline of American capitalism and the US dollar, the foundation of the post-war currency regime. This is now leading to a general breakdown of the international exchange rate system and a turn to protectionism, as any defensive currency move by one country puts pressure on others to follow suit.

As the events of this summer make clear, the measures taken by the ruling class in response to the crisis of 2008 have resolved nothing. The ruling class has no way out of the disaster it has created.

Switzerland's explicit announcement that it seeks to protect its currency by acquiring "unlimited" amounts of foreign cash will inevitably put pressure on other countries to respond with even more radical and unilateral measures.

The continuing downturn of the world economy, mixed with a global financial and fiscal crisis, sets the stage for the return to the beggar-thy-neighbor protectionism of the 1930s, which dramatically intensified the Great Depression and set the stage for world war.

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