

# Currency conflicts deepen between US and Europe

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Deepening tensions between the Trump administration and the European Central Bank, which surfaced last week over the level of the US dollar in international currency markets, reflects the growing tensions over the administration's "America First" agenda and the danger this could lead to trade and currency wars.

The war of words was sparked by comments by US Treasury Secretary Steven Mnuchin last Wednesday at the Davos summit of the global elites in which he remarked that "a weaker dollar is good for us as it relates to trade and opportunities." Mnuchin later tried to soften his remarks saying he was only noting the short-term "factual" benefit of a lower dollar for US exporters.

But they sparked controversy because of concerns that the US is shifting from the position of previous administrations in favour of a strong dollar in line with the increasingly aggressive trade policies of the US which has imposed a series of new tariffs on solar cells and washing machines and is considering sweeping measures against Chinese and other imports.

At his press conference last Thursday following a meeting of the ECB's governing council, the bank's President Mario Draghi directly addressed the issue of the falling value of the US dollar which is pushing up the euro-dollar exchange rate.

In his prepared remarks, Draghi noted that the "recent volatility in the exchange rate" represented a "source of uncertainty" and downside risks to growth "continue to relate primarily to global factors, including developments in foreign exchange markets."

Further elaboration followed in response to a series of questions from journalists about US exchange rate policy.

In a clear shot at Mnuchin and the Trump

administration, Draghi referred to the "use of language ... in exchange rate developments that doesn't reflect the terms of reference that have been agreed lastly on October 14th, 2017" at the meeting of the International Monetary Fund in Washington.

Draghi was then asked whether comments from "certain members of the US administration" on the benefits of a lower dollar could lead to a "currency war scenario". He insisted that governments and ministers had agreed that "excess volatility or disorderly movements" in exchange rates could have "adverse implications for economic and financial stability" and that "we will refrain from competitive devaluations and will not target our exchange rate for competitive purchases."

While Draghi did not directly name Mnuchin or cite the Trump administration, his remarks were, in terms of the language used in international financial discussions, the equivalent of "gloves off".

They were sparked, at least in part, because of the pressures he is under on the governing council of the ECB. The policies of ultra-low interest rates and quantitative easing—the purchases of billions of dollars of government and corporate bonds by the central bank—initiated under his leadership have been opposed by Germany and its supporters on the governing council. In seeking to push back against this pressure Draghi has insisted that the ECB will move to "normalise" monetary policy but only when the European inflation rate moves back to a sustained level of close to 2 percent.

However, it remains at around 1.5 percent and the effect of a lower US dollar and a higher euro is to lower import prices into Europe, thereby working against a rise in inflation and a return to a "normal" monetary regime.

Under other circumstances, Mnuchin's remarks may have been dismissed as the slip of a tongue and of no great concern. But they attracted wide international attention because they are seen as another manifestation of the breakdown of the international trading and financial order for which the US provided the central pillar of support.

In a comment reported in the *Financial Times*, Matthew Goodman, a former US treasury official, now at the influential Center for Strategic and International Studies, commented: "There has been a lot of thunder, and now a storm is coming. Maybe the world economy can absorb all of this, but these actions on trade and currency have ripple effects around the world and I don't take them lightly."

Stephen Moore, a former economic adviser to the Trump campaign, said there was an "obsession" among some White House advisers about the US trade deficit that could lead to counter-productive measures on currency and trade and disrupt the present increase in economic growth.

"When you look at the kind of things that could disrupt this burst of growth, the movement against international trade would be one of them," he said, adding that it was "fool's gold" to think that a weaker dollar could improve the situation.

However, the view of key figures in the Trump administration is not that its actions will lead to a trade war but that it has been going on for some time and the US has been losing because other countries are using international regulations and agreements to disadvantage it. The difference today is that, according to remarks delivered by US Commerce Secretary Wilbur Ross to the Davos gathering: "US troops are now coming to the ramparts."

The issue of the fall in the dollar's value goes beyond the issue of Mnuchin's remarks. Since the start of 2017 it has fallen against a basket of currencies by about 9 percent, the major portion that decline coming against the euro which has risen from around \$1.07 to as high as \$1.25. This decline has come in the face of higher US economic growth and increases in US interest rates by the Fed, which would normally bring a rise in the dollar's value.

One interpretation of this apparently anomalous situation is that it reflects a longer term decline in the economic position of the US and its role as the linchpin

of the international trading order and a monetary system.

In a note to clients this week, reflecting the rise of global economic tensions, Deutsche Bank wrote: "You can only be entrusted with the management of the reserve currency of the world if you care about the world. The US has unilaterally declared that it doesn't and that comes at a price."

Concern about the global position of the US also appears to be at the centre of criticism by the *Wall Street Journal* of the US administration.

An article on Mnuchin's comments noted that while it might be too much to say a currency war had started, "a skirmish has definitely broken out."

In an editorial it said Mnuchin's comments were "baffling" because with the effect of the corporate tax cuts the administration should be "riding high" adding, in reference to the call for a lower currency value: "Why mess it up by imitating the economic policy of Argentina?"

It returned to the issue following Draghi's criticisms in another editorial in which it said Mnuchin should be assisting the ECB chief in trying to return stability in the world's most important exchange rate.

"Mercantilists in the White House" may think eurozone monetary policy is not their problem, it stated, but if their "greenback gimmicks" pushed the ECB too far away from following the Fed's "modest attempts" at normalisation there could be "unpredictable consequences for exchange rates and the world economy."



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