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Currency Wars: A Fight to Be Weaker

Tensions Grow in Foreign-Exchange Market as Countries Scramble to Tamp Down Their Money

By TOM LAURICELLA And JOHN LYONS

Tensions are growing in the global currency markets as political rhetoric heats up and countries battle to protect their exporters, raising concerns about potentially damaging trade wars.

At least half a dozen countries are actively trying to push down the value of their currencies, the most high-profile of which is Japan, which is attempting to halt the rise of the yen after a 14% rise since May. In the U.S., Congress is considering a law that targets China for keeping its currency artificially low, and in Brazil, the head of the central bank said the country may impose a tax on some short-term fixed income investments, which have contributed to a rise in the real.

Businesses always want to be more competitive and politicians often talk a big game. But in the current environment, as many economies are still struggling to recover from the global financial crisis, worries are growing that policy makers could be more aggressive in protecting their nation's business interests.

Rising protectionism is "a very big risk," says Erin Browne, a macro stock market strategist at Citigroup. "And it's something that could move more into the spotlight after the [U.S.] election."

Currency-market strains could also be a topic of discussion at next week's IMF/World Bank meeting in Washington where central bank and government finance officials will be gathering.

The Japanese government earlier this month stepped into the currency markets for the first time in years. To counter the yen's rise, Japan sold some $20 billion worth of its currency, which traders said was its biggest-ever effort in a single day.

Japan joined many other Asian emerging-market countries that have fighting rising currencies on a near daily basis, such as Taiwan, South Korea and Thailand. In Latin America, Brazil, Colombia and Peru have also intervened to tamp down their currencies.

In the U.S., protectionist efforts have been on the rise, especially when it comes to China, which is widely seen as keeping its currency, the yuan, at artificially low levels in order to boost its exports and make it more expensive for the Chinese to purchase goods produced abroad.

The House of Representatives is expected to pass legislation on Thursday that would let U.S. companies argue that Chinese currency policy represents an unfair subsidy. Democratic Senator Charles Schumer plans to push similar legislation to punish China for currency manipulation in the lame-duck session following the election. But it is considered unlikely the bill will pass.

Even so, the administration could use the threat of congressional action to press Beijing to make further adjustments in its currency, particularly as a summit of the Group-of-20 leaders in mid November draws closer.

IMF Managing Director Dominique Strauss-Kahn said he wouldn't rule out a currency war and that officials at both the fund and the Group of 20 nations were actively working to prevent such a battle of competitive depreciations.

However, in a press briefing in Washington, Mr. Strauss-Kahn said he didn't believe there was a big risk of such a war.

"There is no good to expect from intervention," he said. "History has shown that the effect of this kind of intervention doesn't last for very long."

Part of the challenge is that the moves in the currency markets that are raising the ire of central banks and politicians are being driven by longer-term investors.

Stronger economies in the emerging markets are attracting capital from the developed world, pumping up demand for local currencies. Talk of additional quantitative easing in the U.S. signals to investors that interest rates there will remain close to zero for a long time.

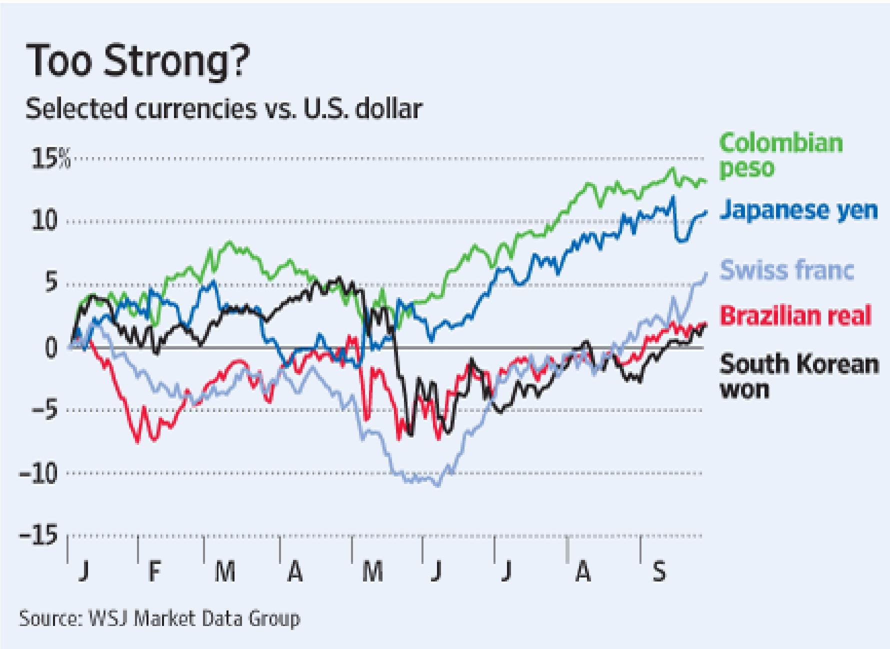
Meanwhile, inflation is building in Asia, forcing interest rates higher. Investors see that mismatch and are shuttling money from west to east, attracted to the higher yields.

"The flows that we're seeing are soundly based," says Richard Yetsenga, global head of emerging-market currency strategy at HSBC.

Some countries intervene more forcefully than others. Technology exporter Taiwan sees little fluctuation in its currency, thanks partly to heavy government intervention. Its currency is up less than 2% against the dollar this year. Malaysia, on the other hand, has allowed a stronger ringgit for the independence a free-floating currency gives its monetary policy makers, and the spur it gives to its exporters to become more efficient.

Government officials outside China for the most part step gingerly when it comes to the region's largest economy and its approach to currency reform, if they say anything at all. Singapore Prime Minister Lee Hsien Loong said last week in an interview with The Wall Street Journal regarding China's appreciation: "I can understand their caution, but on balance they need not go so slow."

The rhetoric was much hotter this week out of Brazil, where its currency has risen more than 30% against the dollar since last year partly because investors flock to its relatively high interest rates.



On Monday, Brazil's Finance Minister Guido Mantega lashed out at the U.S., Japan and other rich nations he says are letting their currencies weaken to spur growth—growth that comes at the expense of other exporters like Brazil.

"We're in the midst of an international currency war," Mr. Mantega said during an event in São Paulo. "This threatens us because it takes away our competitiveness."

The head of Brazil's central bank, which has been intervening in the currency markets to slow the real's rise, was more circumspect on Tuesday.

"There is a very serious currency problem which should be addressed," Henrique de Campos Meirelles said. Mr. Meirelles said that raising taxes on flows into Brazil was a possibility.

Officials say Brazil's 10.75% benchmark interest rate is necessary to squelch inflation and keep the Latin America's biggest economy from overheating. But it attracts a flood of investment from speculators who borrow in the U.S. or Japan where money is cheap, and deposit it in Brazil. The inflows of cash propel the real even higher.

With Brazil's presidential elections scheduled for Sunday, dealing with a strong currency is shaping up as the first major economic issue to face Brazil's next president. Dilma Rousseff, the former Energy Minister and handpicked successor to President Luiz Inácio Lula da Silva leading the polls, is an advocate of Brazil's 11-year-old floating exchange rate. But she is likely to face pressure from economists within her left-wing party, including Mr. Mantega, to intervene more heavily.

—Ian Talley, Bob Davis and Alex Frangos contributed to this article.