EXCHANGE RATES
Recent developments

Real exchange rates in high income countries since mid-2012 have been driven mainly by accommodative monetary policies.

Policy measures in high income countries designed to restore financial market confidence and support economic growth have played a significant role in movements of trade-weighted real effective exchange rates (REER) of both high income and developing countries in recent months. Among the major high income currencies, the Japanese yen depreciated by a steep 21 percent in real effective terms between September 2012 and April 2013 (figure ExR.1). This depreciation came about as markets reacted to initial announcements of macroeconomic policy changes to raise inflationary expectations and support Japan’s growth. These announcements were followed up by the introduction of an explicit 2 percent inflation target in January 2013, and by a commitment in early April to aggressive monetary easing—including near-zero interest rates and an asset purchase program that would double Japan’s monetary base by the end of two years—in pursuit of that target. Although Japan’s expansionary policies were undertaken primarily for domestic goals, they have contributed to the abovementioned sharp depreciation of its currency. Some possible implications of the large yen depreciation are discussed in box ExR.1.

The appreciation of the euro in trade-weighted real effective terms since mid-2012 (discussed in the January 2013 edition of the Global Economic Prospects report) continued into the first half of 2013, partly because of the Japanese depreciation and partly because financial market tensions remained subdued. By February 2013, the euro had appreciated 9 percent in REER terms from its trough in July 2012. Since February, the continued economic weakness in the Euro Area and uncertainties surrounding Italian elections (February) and Cyprus’ banking sector problems (March) tempered the euro’s earlier appreciation, bringing the total rise since July 2012 to 7.1 percent in REER terms by April 2013.

Despite these large fluctuations, the US dollar has remained broadly stable in real-effective terms — holding approximately the same level in April as in July 2012. In between times, it first depreciated during the second half of 2012, and then rebounded in early 2013 as the yen declined. Since January, the US dollar is up by 2.5 percent in real effective terms.

But recent swings in G3 currencies mask important medium term trends

Notwithstanding its steep depreciation since September 2012, the yen was only 2.3 percent lower in REER terms in April compared with its level in mid-2008 prior to the global financial crisis. And despite its strong appreciation since mid-2012, the euro is 12.7 percent lower (REER terms) than its pre-financial crisis level. By contrast, the US dollar has appreciated 3.1 percent in REER terms since mid-2008. In addition to the effect of the recent yen depreciation, the relative strength of the dollar over the longer period partly reflects the status of the US dollar as a “safe haven” during times of market turmoil and heightened risk aversion, when investors sought the safety of US government bonds and other financial assets.
The yen weakened to a four-year low of 103 against the US dollar in May 2013, depreciating 25 percent from its level in September 2012, mainly in response to announcements of expansionary monetary policies. In trade-weighted real effective (REER) terms, the yen depreciated 21 percent between September and April. Together with gradually strengthening global demand, the weaker yen appears to have halted an earlier slide in Japan’s exports (Japanese exports fell by 24 percent in US dollar terms between June 2012 and January 2013 due to weak global growth and a territorial dispute with China, its largest trade partner). Between January and April, Japanese exports rose 9.5 percent in US dollar terms, while imports contracted 5.8 percent. Japanese GDP accelerated to a 4.1 percent annualized pace in Q1 2013, from 1.2 percent in Q4 2012. Sentiment improved among Japanese automobile manufacturers in the first quarter, in part due to improved prospects for exports.

The above trends are broadly consistent with empirical studies which find that large real exchange rate depreciations tend to stimulate exports, and in turn, economic growth (see, for instance, Hausmann, Pritchett and Rodrik (2005) and Freund and Plerola (2012) for cross-country evidence, and Thorbecke and Kato (2012) for evidence from Japanese consumption exports). Conversely, Kappler et al. (2012) using a cross-country dataset find that large exchange rate appreciations result in a reduction in real exports and a deterioration of current account balances.

The implications of the large yen depreciation for Japan’s trade-partner countries need to be considered with some caveats. The unprecedented monetary easing in the current episode together with fiscal stimulus may raise Japan’s aggregate demand substantially. As income elasticities are typically larger than price sensitivities, in this particular instance, developing-country exporters’ gains from increased import demand from Japan might eventually outweigh the losses associated with the Yen’s (real) depreciation. The effect of the yen depreciation on exports of trade partner countries would also vary depending on the extent of their complementarities and competition with Japanese exports in world markets. For instance, using industry-level data, Li, Liu and Song (2010) find that Japan and China’s export structure tends to be complementary, while Japan and South Korea compete in exports of technology-intensive products. The study found that a real depreciation of the yen had a positive impact on China’s (relatively more labor-intensive) exports, but a negative impact on South Korea’s (relatively more high tech and capital intensive) exports.

Moreover, countries that import capital goods or intermediate products from Japan or those that are part of Japanese firms’ regional production chains (e.g., Thailand, Philippines, India) could benefit from a weaker yen through reduced costs of imported inputs. Outward investment flows resulting from Japanese monetary easing may also benefit developing countries (see GEP Finance Annex). Larger and higher productivity firms in trade-partner countries may be able to absorb some of the exchange rate changes in their markups, reducing the sensitivity of their exports to exchange rate movements (see Berman, Martin and Mayer (2012) for evidence from French firm-level data).

Over the longer term, however, the benefits for developing countries are contingent on Japan raising its longer-term potential growth through structural and policy reforms. In the short-term, Japanese quantitative easing could add to the looseness of global monetary condition, through lower global interest rates and potentially strong and disruptive capital flows to developing countries, and could raise overheating pressures, particularly in East Asian countries.

For Japan itself, studies suggest that competitiveness gains from REER depreciation may be temporary and difficult to sustain over time, and may even introduce costly distortions in the real and financial sectors of the economy (Haddad and Pancaro (2010)). Indeed, despite a rise in exports following depreciation episodes in the past, Japan’s share in global trade has declined almost steadily during the last two decades, from over 9 percent in 1991 to 4.6 percent by 2012. Moreover, the eventual adjustment of prices of non-traded goods over time implies that a shift in the monetary policy stance alone cannot be used to sustain a particular real exchange rate that is misaligned with fundamentals (Eichengreen 2008). Overall, the evidence indicates that a real exchange rate depreciation may provide a temporary boost to exports, but structural reforms that bring about sustained improvements in productivity and reduce barriers to trade, investment and labor mobility are likely to play a larger role in a longer-term growth strategy.
Given the protracted debt crisis in the Euro Area during this period and financial market uncertainties, unconventional monetary policies undertaken by the US Federal Reserve in the form of several rounds of quantitative easing may have possibly prevented an even stronger appreciation of the US dollar in REER terms compared with its pre-financial crisis level. FN4

The trend appreciation of developing country currencies has picked up pace since mid-2012

Together with easing of financial market tensions since mid-2012 and the large yen depreciation, the appreciation of developing country currencies picked pace in the second half of 2012 and early 2013. The GDP-weighted average of trade-weighted real effective exchange rates (REER) for developing countries rose by 4.7 percent between September 2012 and April 2013—a significantly faster pace compared with the almost flat trend (0.7 percent annual appreciation) during the previous 24 months (figure ExR.2). The steep appreciation during this recent 7-month period was also faster than the 5.4 percent annual REER appreciation of developing-country currencies observed prior to the financial crisis, between January 2005 and August 2008. The earlier strong appreciation had occurred during a boom in international commodity prices, sustained inflows of foreign capital into developing countries, and a faster pace of growth and higher rate of productivity increases in developing countries compared with high income countries (see Global Economic Prospects July 2012 edition). And prior to that, the average REER for developing-country currencies was broadly unchanged in 2004 compared with its level in 1995.

Notwithstanding the overall REER appreciation in the group of developing countries since the second half of 2012, there was significant variation in the magnitude of, and factors contributing to, currency movements in individual countries. The internationally-traded currencies of typically middle-income emerging market economies were influenced by: movements in high income currencies (in particular, the large yen depreciation); a rebound in private capital inflows to developing countries; elevated international commodity prices; strengthening economic activity and exports in the group of developing countries; and country-specific differences in policies and performance.

The 21 percent REER depreciation of the yen since September 2012 appears to have resulted in significant appreciation pressures in Japan’s trade partners, particularly among countries in the East Asia region. Simulations suggest that in the absence of the steep yen depreciation, on average trade-weighted real effective exchange rates in the East Asia and Pacific region would have appreciated 3.7 percentage points less quickly during this seven-month period (compared to the actual 6.1 percent appreciation), and the average REER for the group of developing-countries would have appreciated 1.7 percentage points less than that observed.

In addition to the yen depreciation, a rebound in private capital flows since the third quarter of 2012 and elevated commodity prices appear to have contributed to

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**Fig ExR.2** A faster appreciation of developing-country real effective exchange rates (REERs) since mid-2012

Real effective exchange rates (January 2005=100)

- Developing Countries
- Europe & Central Asia
- Latin America & Caribbean
- South Asia
- East Asia excl. China

Note: The four developing regions shown in the chart account for close to 90 percent of GDP of developing countries. Sub-Saharan Africa (SSA) and the Middle East and North Africa (ME&NA) regions are not shown in the chart, but are included in the overall Developing Country aggregate.

appreciation pressures in several emerging market countries. Private capital flows to countries in Europe and Central Asia, East Asia and Pacific, and South Asia have risen robustly since mid-2012 (see GEP Finance Annex). Some studies suggest that surges in capital inflows are likely to be associated with appreciation of real effective exchange rates of recipient countries (see Magud and Sosa (2010) for developing countries, and Jongwanich and Kohpaiboon (2013) for emerging Asia). The average REER appreciation of large emerging economies appears to be positively related with a decline in their sovereign credit default swap (CDS) rates, an indicator of financial risk (figure ExR.3).

International commodity prices strengthened in early 2013 on an improving global outlook, but have eased in more recent months following an improvement in supply conditions (see GEP Commodity Annex). Notwithstanding these shorter-term movements, industrial commodity prices in 2012 and early 2013 were elevated compared to both the immediate post-financial crisis period and the period prior to 2007. Real effective exchange rates of commodity exporters have typically moved together with international commodity prices (figure ExR.4). But they have diverged in the most recent period, with real effective exchange rates appreciating despite the recent easing of commodity prices, suggesting that other factors may be playing a role in buoying these currencies in recent months.

Strengthening global trade since the third quarter of 2012 and a recovery in developing-country exports have also contributed to increased foreign currency revenues in developing countries. However, in a few countries, country-specific factors seem to have been more significant contributors to movements in real effective exchange rates. The factors relevant for different developing countries and regions are discussed below.

Both yen devaluation and robust capital inflows contributed to appreciation pressures in East Asia

East Asian currencies faced significant appreciation pressures from both the large depreciation of the yen as well as from a surge in private capital inflows since the second half of 2012. In inflation-adjusted terms, between September 2012 and April 2013, bilateral real exchange rates of several countries in East Asia appreciated 25-30 percent relative to the Japanese yen, while Thailand’s currency appreciated a larger 34 percent (figure ExR.5). FN5

Because of the relatively large weight (compared with other developing regions) of Japan in their trade, the average GDP-
weighted REER for developing countries in the East Asia & Pacific region has appreciated strongly by 6.1 percent since September 2012, versus 3.7 percent for other developing regions. The Thai baht appreciated 12.5 percent in REER terms in this period—as strong capital inflows added to upward pressures from the yen depreciation—while currencies of China and Indonesia appreciated 5.9 and 5.4 percent, respectively. By contrast, the South Korean won appreciated a smaller 3.9 percent in REER terms, in part due to political tensions.

Currencies in Latin America & Caribbean and Eastern Europe & Central Asia were influenced by capital inflows and international commodity prices

In the Latin America & Caribbean region, despite an easing of commodity prices in recent months (although prices remain elevated relative to recent years—see GEP Commodity Annex), several Latin American currencies have appreciated in REER terms since early or mid-2012 (figure ExR.6). The Mexican peso rose 8.3 percent since September 2012 together with an upturn in the United States (Mexico’s largest trading partner) and rising demand for Mexican exports, and strong portfolio inflows into government bonds.

Chile’s currency has risen 6 percent in REER terms since early 2012 as a result of robust commodity revenues and private capital inflows. The Brazilian real rose 7.4 percent in real effective terms since September 2012—after depreciating 12 percent during the previous 1½ years following imposition of capital control measures. The financial transactions tax (IOF) on foreign currency inflows into Brazil’s domestic debt markets was reduced to zero in early June 2013. The challenges that developing-country policymakers face when confronted with surges in capital inflows that result in appreciation of real effective exchange rates, and some of the measures that have been used to alleviate their impacts are discussed in box ExR.2.
The shifts in monetary policy stances in high income countries since the global financial crisis—although designed primarily to support their domestic goals of reviving domestic growth and raising inflationary expectations, rather than facilitate depreciation of their currencies or engage in “competitive devaluation”—have still raised concerns among developing country policymakers about their unintended consequences in the form of surges in private capital flows, real exchange rate appreciation and possible loss of export competitiveness (Eichengreen (2013) and Kappler et al. (2012)). Recent research finds that the direct contribution of quantitative easing measures in the United States on capital flows into emerging market economies was relatively modest (see Fratzscher, Lo Duca, and Straub (2012) and Morgan (2011)). However, other studies suggest that the indirect impact of the extended period of unconventional monetary policies in high income countries in terms of reducing global risk aversion and lowering the cost of capital, together with stronger economic performance of emerging economies, may have been important factors behind surges in capital flows into developing countries in recent years (see, for instance, Ghosh et al. (2012) and Forbes and Warnock (2012)). Cross-country and country-specific studies indicate that these inflows have often been associated with appreciation of real effective exchange rates in recipient countries (see, for instance, Magud and Sosa (2010), Combes, Kinda and Plane (2011), Jongwanich and Kohpaiboon (2013), and Ibarra (2011)).

The interrelated goals of maintaining exchange rate stability and open capital accounts in a situation of unconventional monetary policies in high income countries and abundant global liquidity complicates the task of developing country authorities. For instance, lowering interest rates to discourage foreign inflows may exacerbate existing domestic credit and asset price bubbles and cause overheating in certain sectors. But raising interest rates to curb credit growth can risk attracting even more capital inflows and further appreciate the exchange rate (which, in turn, can attract even more short-term speculative inflows)—with potentially destabilizing consequences for sovereign and firm balance sheets if these flows were to reverse suddenly. Moreover, for countries that have relatively less flexible exchange rate regimes, this lack of exchange rate flexibility can create incentives for taking on foreign debt and thereby increase the share of foreign currency credit in overall credit (Magud, Reinhart, and Vesperoni (2012)). The “impossible trinity” of not being able to achieve all three policy objectives of exchange rate stability, free capital mobility, and an independent monetary policy - and a fourth related objective of financial stability - has sometimes been cited as a reason for developing countries to impose some form of controls on capital flows (see Eizenman (2010)).

Emerging economies faced with disruptive short-term foreign capital inflows (“hot money”) have resorted to various measures to correct the resulting temporary deviation of exchange rates from underlying fundamentals, and to alleviate the impact of these flows on credit markets. These include direct foreign exchange interventions, interest rate policies, prudential regulations (e.g., restrictions on banks’ borrowing from abroad, limits on domestic lending to certain sectors), and various forms of capital controls—such as taxes and fees on capital inflows, minimum holding periods for government bonds, withholding taxes on capital gains, and minimum waiting periods to repatriate capital, among others (see Ostry et al. (2012)). Brazil’s earlier financial transactions tax (IOF) on foreign currency inflows into domestic debt markets is a well-known example (This tax was reduced to zero in early June). Earlier, Thailand had imposed withholding taxes on foreign holdings of government bonds in 2010, while Indonesia had imposed a six-month holding period for central bank bonds and limits on short-term foreign borrowing by banks in 2011 (IMF 2012). Peru’s central bank raised reserve requirements on dollar-denominated deposits several times in 2012 and in the first half of 2013, citing the need to moderate inflows of foreign capital and control credit growth; and intervened in foreign exchange markets in the first half of 2013 to stem appreciation of the sol. Turkey has also used prudential measures, including allowing banks to hold part of their required reserves in foreign exchange, which can alleviate pressures from the foreign exchange market when capital inflows are strong. Colombia intervened periodically in foreign exchange markets during 2012 to moderate the rise of its currency against the US dollar.

The evidence on the effectiveness of controls on volumes of capital flows is however mixed (Magud, Reinhart and Rogoff (2011)), although these measures may alter the composition of inflows (Ostry et al. (2012)). Fratzscher (2012) finds that rather than being motivated by capital flows volatility, capital controls have typically been associated with significantly undervalued exchange rates, in addition to concerns about signs of overheating, such as high credit growth and rising inflation. Nevertheless, when faced with a surge of capital inflows that threaten to overwhelm domestic financial markets and result in asset price volatility and bubbles, credit booms, and real exchange rate appreciation, capital flow management (CFM) measures such as temporary controls on foreign capital, domestic prudential measures, and interventions in foreign exchange markets may reduce exchange rate volatility and provide space for the domestic economy to adjust to the changed external circumstances (IMF (2012)). But if these result in real exchange rates that are persistently out of line with underlying macroeconomic fundamentals in the medium-term, capital controls can cause distortions and suboptimal investment and production decisions across tradable and non-tradable sectors, and impose unnecessary economic costs.
Among developing countries in the Europe & Central Asia region, the Russian ruble appreciated 3.8 percent in REER terms since September 2012 on the back of a surge in syndicated bank lending and buoyant crude oil revenues (figure ExR.6). Notwithstanding weakening GDP growth, the Turkish lira rose 7.1 percent in REER terms in the same period, partly reflecting robust capital inflows and an improvement in its export performance, as robust exports to the Middle East offset weakening demand from the Euro Area. The Turkish lira has exhibited one of the largest appreciation among regional currencies, strengthening by 17 percent in REER terms since January 2012, although it still remains 3 percent below its level in early 2008 prior to the global financial crisis. The Romanian leu appreciated by a strong 10.4 percent in REER terms between September 2012 and April 2013, also reflecting robust inflows into local currency bond markets (see GEP Finance Annex).

Commodity exporting developing countries in the Europe & Central Asia region and in Latin America & Caribbean typically have weaker trade linkages with Japan compared to that of East Asian countries, and were therefore less affected by the yen depreciation.

**Domestic developments played a more significant role in South Africa and India**

Some notable exceptions to the general appreciation trend among developing countries include countries with growth concerns, in particular, South Africa and India (figure ExR.7). Until recently, movements of the rand tended to track closely South Africa’s terms of trade, adjusting flexibly to international commodity price movements (see Global Economic Prospects June 2012 edition), and in turn, facilitating internal economic adjustment. This historical link appears to have been broken in the most recent period, as the rand weakened in REER terms in the second half of 2012 despite a rally in international commodity prices. The rand’s performance was adversely affected by mining sector tensions, a downgrade of South Africa’s sovereign rating, and weak growth in 2012; and by further weakening of activity in the first quarter of 2013. The Indian rupee has also been weak due to slower growth and a widening current account deficit, but stabilized somewhat in REER terms in the second half of 2012 and early 2013, mostly due to robust portfolio inflows after announcement of a number of reforms, including raising limits on foreign direct investment in the retail, broadcasting and aviation sectors.

**Current account balances of developing countries deteriorated and international reserves as a share of imports have fallen**

The weak global economy and decline in the pace of expansion in international trade in 2012, together with rebalancing of China towards domestic sources of growth in recent years, have sharply reduced the overall current account balance of developing countries (figure ExR.8). Oil exporters among developing countries gained from...
sustained high international oil prices during 2011-2012 and in early 2013, although a modest 2.5 percent decline in crude prices is projected for the whole year (see GEP Commodity Annex). By contrast, robust domestic demand and high crude oil prices in recent years (up until early 2013) contributed to strains on oil importers’ trade and current accounts balances.

At the same time, developing countries’ holdings of international reserves have declined as a share of imports since 2010 (figure ExR.9). Reserves have fallen the most among oil importers in the Middle East and North Africa region (a decline equivalent to 3.5 months of imports) and in South Asia (decline equivalent to 3.9 months of imports). Reserves in Europe and Central Asia declined to 2.3 months of imports as regional trade and investment was adversely affected by the weakness in Western Europe. The decline in average reserve coverage of imports in other regions is smaller: by 1 month in East Asia and Pacific excluding China, and by 0.3 month in Sub-Saharan Africa. By contrast, international reserves in months of imports remained broadly stable in the Latin America and Caribbean region in this period (rising by 1 month of imports), mainly on the back of strong commodity revenues and robust capital inflows.

Notwithstanding declining import cover across developing regions, reserves still stand well above the critical 3 months of imports in the vast majority of developing countries, with a few exceptions. However, the number of developing countries with reserves equivalent to less than 3 months of imports rose to 17 countries as of April 2013 from 11 in January 2010 (figure ExR.10). For instance, in Egypt and Pakistan, international reserves have fallen below 3 months of imports.

Smaller reserves relative to imports may increase the risk of sudden depreciation of real exchange rates due to shifts in investor sentiment or other external shocks. It should be noted, however, that reserves in months of import cover are a relatively crude measure of reserve adequacy and may need to be complemented with other measures that take into account a country’s overall external financing needs. Moreover, reserve adequacy depends, among other factors, on the exchange rate regime: countries with flexible exchange rates and without the need to defend a particular exchange rate may require a lower reserve coverage of imports.
Conclusions

The weaker current account and reserve position of developing countries can imply increased vulnerability to shifts in investor sentiment. The trade balances and reserve positions of developing countries have started to improve in line with a pickup in exports and easing of international commodity prices. But as discussed, these indicators remain significantly weaker compared with the levels in 2010. Although buoyant private capital flows have helped to finance the larger current account deficits of the group of developing countries excluding China and crude oil exporters, they also render their balance of payments and real exchange rates vulnerable to sudden shifts in investor sentiment and reversal of capital inflows. This can happen, for instance, in response to domestic problems (e.g., weaker than expected growth, recognition of asset price bubbles); increased risk aversion resulting from renewed fiscal and debt tensions in high income countries; or from an unanticipated move towards a tighter monetary policy stance in some high income countries.

Increased coordination on policies affecting currencies can help to mitigate the spillovers of domestic policies across borders. Given that domestic policies of large countries aimed at boosting their own growth can have significant unintended spillovers on currencies of other countries, greater international coordination on policies that affect currencies may prove mutually beneficial (Eichengreen (2013), IMF (2012), Ostry, Ghosh and Korinek (2012), Hoekman (2013); see also the G-7 Statement (2013) and G-20 Communiqué (2013)). For instance, coordination in monetary policies across large economies can ensure that spillovers of domestic policies on other countries and effects on exchange rates are minimized (Basu (2013)).

Developing countries should try to adjust to persistent foreign currency inflows and maintain real exchange rates that are consistent with macroeconomic fundamentals. Maintaining flexible market-determined exchange rates can facilitate adjustment of the domestic economy to changes in capital inflows, commodity revenues, and other external shocks. However, in the shorter term, as discussed earlier, developing countries (including those with sound macroeconomic fundamentals) may face destabilizing currency pressures resulting from surges in capital inflows. In specific circumstances, temporary controls on capital flows and macro-prudential measures may help in reducing exchange rate volatility caused by external events (IMF 2012). But over the longer term, such controls can cause unnecessary distortions and suboptimal investment and production decisions, especially if they result in real exchange rates that are persistently out of line with underlying macroeconomic fundamentals. Therefore, exchange rate policies and related capital flow management measures should not be seen as a substitute for structural and labor market reforms, and investments in infrastructure and human capital that are necessary to raise productivity and growth over the longer term.
Notes

1. Since the global financial crisis of 2008-09, central banks in the G3 economies (United States, Euro Area, and Japan) have maintained a highly accommodative policy stance—reducing short-term policy interest rates to below 1 percent and implementing unconventional monetary policies, including large-scale financial asset purchases—in order to restore financial market confidence and support economic growth (see GEP Finance and Inflation Annexes).

2. In late July 2012, the head of the European Central Bank Mario Draghi promised to stand behind the currency union after financial market tensions intensified during mid-year. Subsequent measures taken by Euro Area authorities to restore financial market confidence—including, among others, the Outright Monetary Transactions bond purchase program announced in September 2012 and extension of Greek debt in November 2012—resulted in an easing of financial market tensions and reduced the tail risk of exit of periphery countries from the Eurozone. Despite fiscal contraction, accommodative monetary policies in general appear to have contributed to increased market confidence in the ability of the Euro Area currency union to weather negative shocks (see GEP Finance Annex for more details).

3. The extent of complementarity, however, may have declined since the 1997-2004 period covered by the study as China has moved towards production of higher value-added products in recent years. See also Auboin and Ruta (2013) on other studies on the relationship between exchange rates and trade.

4. The US Federal Reserve has undertaken three rounds of quantitative easing (QE) since November 2008. Recent research finds that the dollar weakened significantly in real trade-weighted terms following QE announcements (Glick and Leduc 2013). An unanticipated QE announcement equivalent to a 1 percentage point reduction in federal funds interest rate futures resulted in a 0.5 percentage point depreciation of the dollar in REER terms following the announcement. F ratzscher, Lo Duca, and Straub (2012), however, find that QE1 and QE2 had opposite effects on the US dollar. QE1 measures undertaken in the immediate aftermath of the global financial crisis in late 2008 were associated with inflows into US financial assets, which, in turn, appreciated the US dollar. But QE2 measures implemented from August 2010 onwards triggered a portfolio rebalancing from US financial assets toward emerging market equities, resulting in a marked depreciation of the US dollar.

5. South Korea, Singapore, and Hong Kong SAR, China which are part of geographic East Asia, are considered high income countries according to the World Bank’s income classification, and are therefore not included in the East Asia and Pacific (EAP) regional aggregates.

6. The evidence suggests that the effect of capital flows and commodity revenues on real effective exchange rates of commodity-exporters tends to be larger in countries that are relatively more integrated with international financial markets (see January 2013 edition of the Global Economic Prospects).

References


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