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Is Currency Devaluation Overrated?

Currency devaluations can have a significant effect.

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Currency devaluations may affect a nation's real economy not only through their effects on foreign trade but through capital flows. For many emerging economies which are heavily indebted with foreign debt, currency devaluations amid the global economic slump—the Chinese economic slowdown in particular, and the strengthening U.S. dollar—will have stronger negative impacts on their economies through rapid capital outflows and resulting financial instability. This phenomenon has already begun in a number of commodity-exporting countries.

Although individually these economies are not systemically important like China, together they are important for the global economy as a whole. Remember, they contributed a great deal in making up for the global economic slack left by most advanced economies after the 2007–2008 global financial crisis. Therefore, it is important not just for those emerging economies themselves, but for the rest of the world, to appropriately respond in order to avert possible currency crashes leading to another global-scale financial crisis.

First of all, the United States, Japan, and the European Union, which put up massive quantitative easing programs with the primary purpose of stimulating their economies, may want to take the lead to help minimize unintended (perhaps unarticulated) negative impacts on the rest of the world, those vulnerable emerging economies in particular. For example, central banks of those countries might work with their counterparts of emerging economies for bilateral or plurilateral standing currency swap arrangements.

In addition, closer international economic and financial policy cooperation is needed for maintaining global financial stability. Towards this end, the rejuvenated G20 can take the leadership. After all, G20 leaders, G7 included, agreed in Pittsburgh in 2009 to designate the G20 as the premier forum for their international economic cooperation. The G20 already has an agreed mechanism, the Mutual Assessment Process, to be utilized for closer macroeconomic policy cooperation. Of course, the G20 needs to closely collaborate with the International Monetary Fund and other multilateral institutions in exerting the necessary global economic policy leadership.

There is a lot to be done by emerging economies themselves. While they publicly commit themselves to necessary supply-side structural adjustments with well-sequenced implementation schedules, they may need to introduce "macro-prudential measures" for appropriately controlling capital flows. Obviously, measures to stabilize capital inflows in good times are preferable. However, temporary measures on outflows cannot be ruled out as the last resort.