Currency Wars

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- Currency wars are said to occur when countries seek to devalue their currency to gain a competitive advantage.
- If one country seeks to become more competitive through devaluation, it means other countries become less competitive. Therefore, they may respond by weakening their currency too. Thus, we may get a situation of competitive devaluation where each country seeks to reduce the value of a currency.

Why do countries want a weaker currency?

- If you devalue your currency, it means your exports are relatively more competitive (cheaper to foreigners). Therefore you will export more.
- Also, imports become more expensive so there should be a rise in Aggregate Demand. This should help boost economic growth and reduce unemployment.

How does an Economy weaken its Currency?

- **3 ways→ using exchange rates + Fiscal policy + monetary policy**
- **deliberate lowering of currency value:**
- Countries with fixed exchange rates typically just make an announcement. However, most countries are on a flexible exchange rate. They must increase the money supply to lower their currency’s value. When supply is more than demand, the value of the currency drops.
- A central bank has many tools to increase the money supply by expanding credit.
- It does this by lowering interest rates for intra-bank loans, which affect loans to consumers.By this Central banks can also add credit to the reserves of the nation’s banks.

- A country's government can influence the currency's value with expansionary fiscal policy. It does this by spending more or cutting taxes. However, expansionary fiscal policies are mostly used for political reasons, not to engage in a currency war.

Problems of Currency Wars

- Instability which discourages investment and trade
- Policies to weaken currency like printing money can cause instability such as potential future inflation.