



Are World Currencies Becoming More Aligned?

John Williamson says the world is groping toward more realistically aligned currency values, but the US-China and Northern vs. Southern Europe current account imbalances remain worrisome.

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Steve Weisman: Foreign exchange rates and current account imbalances are a crucial part of the stability of the global economy. John Williamson at the Peterson Institute for International Economics has been issuing periodic reports, along with Bill Cline, on these rates and imbalances since 2008. His most recent finding is very startling. He says that the world seems to be approaching a much more realistic alignment of its currency exchange rates. John, what was your overall conclusion about that alignment?

John Williamson: I came to the conclusion the dollar was still overvalued and the Chinese renminbi still undervalued, but the disequity is something like three or four percent now as opposed to much bigger figures in the past.

Steve Weisman: And in the past, it was 20 or 30 percent or even more?

John Williamson: Yes, certainly, against the Chinese renminbi.

Steve Weisman: Right.

John Williamson: It was that order of magnitude, and that's just the effective rate and the dollar rates could even go as much as double that, so it might be 40 percent of added value in the past. But two things have contributed to getting this much better alignment. The one genuine factor is that China has undergone a very gradual but nevertheless very real reevaluation over the years. In recent months, that's been magnified by the excess inflation in China because they have more inflation than the US. The change in the real exchange rate is even greater than the change in the nominal exchange rate.

And secondly, it's also contributed the change in forecasting practices at the IMF, which used to be forecasting a much bigger Chinese surplus in the out-years than it is now. So, that also has reduced the extent to which we still believe that the renminbi is misaligned.

Steve Weisman: The IMF actually changed the way they forecast -- or has their forecast changed?

John Williamson: No, they changed the way that they forecast. They haven't been explicit about what it is, but their forecast is in fact three or four percent smaller than it would have been in the past. They set up a study group to look into the question of forecasting the Chinese surplus, and they came to a conclusion that they tended to forecast too big a figure for the Chinese surplus in the past. And hence in the future, they would forecast lower figures. And not just because of the fact that China had been revaluing. That's part of what went into it, but that's not the whole explanation.

Steve Weisman: Has the economic downturn contributed in some way to this phenomenon?

John Williamson: It certainly contributed to the floor and the Chinese surplus in 2009 which was when the first sign for big reconciliation appeared. There was a big falloff in Western demand for

imports from China and that reduced the Chinese surplus at that time. That's one of the factors that in fact led the IMF to look into whether they had been over-forecasting the Chinese surplus in the future, the fact that the Chinese surplus was coming in smaller than they'd realize—smaller than they had been forecasting.

Steve Weisman: Just to review, you found—I think you worded it very carefully—that exchange rates were becoming more realistically aligned. But some outliers, some countries or sets of countries are still not aligned in the way that might be indicated from their imbalances. Why is that? What countries?

John Williamson: We're talking mainly about the two groups of surplus countries: the countries of east Asia, which are partly reflecting the strong balance of China in the past, but haven't in fact adjusted as fast. That's Hong Kong, Taiwan, Singapore, and Malaysia. And also on the surplus side, Sweden and Switzerland in Europe have big surpluses. So, those are the ones to worry about on the surplus side. On the deficit side are Australia, New Zealand, South Africa, and Turkey. Those are the countries with big current account deficits in the out years, which we worry [about] because they have overvalued currencies.

Steve Weisman: Let's turn to Europe, the euro zone. I think you also said that the imbalances among countries in the eurozone remain worrisome.

John Williamson: That's right. In this publication, we in fact looked at the performance of different currency zones, and if you take the euro as a whole; it's fine. It's close enough to balance. But it's not true of parts of the eurozone, where the North and Germany in particular are in a big surplus, and the South -- Greece, Yugoslavia, Spain, Portugal, Italy -- are in big deficit. It's that imbalance that's the worrying thing. And there, they don't actually have the possibility of adjusting the exchange rate between the two areas to help in facilitating the adjustment process. That's something which they gave up consciously as a matter of policy.

Steve Weisman: Their recourse is what some economists call an "internal devaluation," which is a kind of lovely euphemism. What does it mean?

John Williamson: It means that you try to reduce the costs of some countries (like Italy and Spain and Greece and so on) relative to Germany. That's what an internal devaluation means, that it's happening within one monetary area, but the costs will nevertheless decrease greatly. The two ways of doing it—the old-fashioned way is by austerity, and that's very grim. It goes on for an awful long time, to get an adjustment of costs through that route. One may also look to having a more surgical change, which is what I would favor.

Steve Weisman: Which means lowering prices and costs and wages, but in a way that leaves everybody off relatively the same with each other...

John Williamson: Right. Right. That's the idea. One would try to avoid having sharp changes in the relative wages but the wages of the people in, for example, Greece would have to fall relative to wages elsewhere and the prices elsewhere, and there would be some costs to pay for that.

Steve Weisman: How realistic is that as a proposal? Is it being discussed or even considered?

John Williamson: No, that's not being discussed and I think that's a big problem as I see it in euro area.

Steve Weisman: Thank you very much, John Williamson.

John Williamson: Pleasure.

