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U.S. NEWS

U.S. Chides Europe, Japan for Overreliance on Monetary Policy

U.S. officials increasingly worried authorities will not take politically tough, economically necessary steps



The U.S. Treasury Department on Thursday released its semiannual currency report to Congress and, in it, chided Japan and Europe for their excessive reliance on monetary policy. *PHOTO: JACQUELYN*

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By **IAN TALLEY** and **JEFFREY SPARSHOTT**

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The Obama administration chastised Europe and Japan for excessive reliance on

monetary policy to revive stagnant growth, worried that a failure to deploy other policy tools could further undermine an already gloomy global economic outlook.

In its semiannual currency report, the U.S. Treasury Department also took China and South Korea to task over currency policies that it says hurt other trading partners including the U.S. But the report doesn't name any country as a currency manipulator, a designation it last used in 1994 to call out China.

The report's main finding, published ahead of a meeting of top finance officials next week in Washington, makes for potentially awkward criticism.

The U.S., after a broad economic-stimulus package passed during the recession, relied heavily on monetary policy during the recovery amid discord between the White House and Congress for broader underlying policy measures. The U.S. Federal Reserve has yet to begin its exit from ultraloose monetary policy, which has included trillions of dollars of bond purchases and more than six years of near-zero interest rates.

Still, U.S. officials can point to a relatively stronger recovery—making it among the advanced world's better-performing economies—and evidence that other countries aren't doing enough to address deeper underlying economic problems.

Cornell University economist Eswar Prasad said the Treasury has been very cautious in chiding other nations, “not criticizing monetary policy per se, but saying it should be aided and abetted by other policies.”

“There is certainly a concern that Japan and Germany trying boost their economies through an increase in exports rather than an increase in domestic demand will lead to an increasingly unbalanced recovery, and could lead to trade tensions as well,” said Mr. Prasad, a former International Monetary Fund official. “There is also a concern that if Japan and the eurozone are trying to rise on the coattails of the U.S., that will drag down the U.S. economy as well.”

The Treasury Department's report to Congress on the exchange-rate policies of major trading partners called on policy makers “to use the full set of policy tools at their disposal.”

“Not only has global growth failed to accelerate, but there is worry that the composition of global output is increasingly unbalanced,” it said. “The global

economy should not again rely on the U.S. to be the only engine of demand.”

In the last year, the dollar surged to its highest level in a decade against the euro, with many economists predicting it could hit parity within months. Against a basket of major currencies, the dollar is up roughly 20% since last July. Many economists expect the rise will continue as the Fed considers raising rates for the first time in nearly a decade, central banks in Europe and Japan continue injecting cheap cash into their economies and emerging-market economies slow.

Treasury Secretary Jacob Lew in February joined the world’s other top finance leaders in effectively backing currency depreciation as a tool for promoting growth. The Group of 20 largest economies gave strong support to the aggressive easy-money policies of Europe and Japan as essential for boosting fragile global economic growth.

Back at home, however, the strong dollar has complicated the administration’s efforts to get congressional backing for the Trans-Pacific Partnership trade agreement, a deal that would span a dozen countries representing roughly 40% of the global economy. Some lawmakers are trying to include in trade legislation measures that would penalize trade partners for currency manipulation, even though the administration fears it could disrupt negotiations.

The sharp rhetoric in the currency report could help take some of the political heat off the administration amid lawmaker’s efforts. Still, U.S. officials are increasingly worried that authorities will rely too much on devalued currencies and not take the politically tough, but economically necessary, steps to boost demand and fuel growth through government spending and economic overhauls.

Treasury’s calls for authorities to use all available policy levers were echoed by IMF Managing Director Christine Lagarde in a speech earlier in the day. The IMF chief said the global economy was increasingly at risk of a prolonged era of low-growth, heavy debt and high unemployment without stronger action by officials in the world’s largest economies.

“We can do better,” she said. “We must do better.”

In Europe, Treasury took Germany to task in particular. It noted that the European powerhouse has a trade surplus at nearly 8% of gross domestic product. Germany has been called out by the IMF as surpassing China in having

the world's largest trade surplus.

Fred Bergsten, a former senior U.S. Treasury official and the founding director of the Peterson Institute for International Economics, said the administration is right to criticize Europe and Japan.

“Monetary easing largely drives down their currencies and simply redistributes global growth in their direction, from the U.S. and other countries, instead of adding to total world output,” he said.

U.S. officials say Berlin, by relying so much on exports, undermines the recovery of weaker parts of the eurozone and slowing the currency union's overall expansion. Washington has been urging Berlin to use its ample budget to spur demand through more spending, including on infrastructure.

Markus Knauf, a spokesman for the German embassy in Washington, said that exports from Germany also fuel global growth. Roughly 40 cents of every euro's worth of German exports is comprised of imported parts, he said. Wages are rising, which will spur domestic demand, he said.

Mr. Knauf also said Berlin had boosted infrastructure investment but prudence was still in order. “We need to make sure, especially when spending taxpayer money, that we achieve lasting results and not just a simple flash in the pan.”

“In contrast to debt-financed short-term investment programs, this balanced approach helps to maintain long-term confidence in the stability and reliability of our fiscal stance,” he said.

Treasury's report warned Japan that overreliance on monetary policy without appropriate budget support and policies that make the country more competitive will put Japan's recovery at risk and “and could generate negative spillovers.”

An official at Japan's embassy in Washington declined to comment on the report.

The administration said, while China had appreciated its currency over the last decade, the yuan was still “significantly undervalued,” and urged Beijing to move faster to ensure the currency is market-determined.

Mr. Lew and his top lieutenants have been making the case that the administration's diplomatic efforts are a reason why China, long seen by the U.S.

as the worst currency-offender, has appreciated its currency over the past decade. They have also trumpeted an agreement last year by Beijing to boost transparency of its foreign-exchange operations, the tool it uses to keep a lid on the yuan's value.

Meanwhile, China's economy is slowing, a development that tempts Beijing to slow its plans to widen market access for international investors and firms. Some economists say China may intervene in currency markets again to devalue the yuan if growth stalls further.

The report also targeted South Korea, warning against further interventions in currency markets to keep the won undervalued. An official at the Korean embassy in Washington declined to comment.

Officials at the embassies of the European Union, Germany, China and Japan weren't immediately able to comment.

Although the strong dollar gives Americans more buying power, it also weighs on the economy as U.S. goods and services become more expensive for overseas consumers. That erodes demand for U.S. exports. It is one reason Federal Reserve officials are watching the dollar's impact on growth and inflation as they consider when to raise rates.

Still, both Fed officials and the Obama administration see the weaker euro and yen as important to long-term U.S. growth prospects as the lower-valued currencies boost growth in two of the U.S.'s biggest trading partners.

Write to Ian Talley at ian.talley@wsj.com and Jeffrey Sparshott at jeffrey.sparshott@wsj.com

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