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Currency turmoil again!

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Global economic uncertainties, following the Chinese economic slowdown and devaluation of the Chinese currency, are now haunting the currency world.

The Aussie dollar fell on Tuesday to a six year low: US 70 cents. The reason is decline in China's Purchasing Manager's Index to 49.7, the lowest in three years. An index number below 50 indicates economic contraction. Currency markets always react very fast in response to global market sentiments.

A floating currency such as Australian dollar falls immediately once bad economic news goes viral.

The Chinese chill has caused Australia's sneeze.

Chinese economic contraction is expected to reduce demand for Australia's mineral exports. It is estimated every one dollar in Australia's exports is from its key export iron ore.

Australia has indeed been a satellite economy to China.

Once bad news spread, currency traders concluded the Australian dollar should fall. They started selling Aussie dollar.

On Tuesday, Reserve Bank of Australia decided to keep interest rate unchanged at 2%. A day after, on September 2 came an unexpected, yet another bad news: Australian economy did not do well. The economy expanded only by 0.2% from the previous quarter as against the expected quarterly growth of 0.4%.

The currency market reaction was quick: Aussie dollar fell again, to US 69 cents.

The RBA has a problem on hand.

Will it ease the monetary conditions?

Reduce the interest rate or just leave it to the depreciated Aussie dollar to work its way through?

Anyway, Australia has to think in terms of "re-balancing" or turning towards domestic demand rather than depending on mineral export, whether China does it or not:, known as the much heralded , "New-normal" policy.

Fiji dollar

Fluctuations in Fiji dollar, being under a fixed exchange regime, are minimal. The nominal rate is allowed to vary only within margins fixed by Reserve Bank of Fiji. Extreme decision to devalue is taken only under exceptional circumstances, when international reserves are precariously low.

Fiji's currency market is shielded away from gyrations in world markets. Years ago, Australian economists suggested that Fiji should also adopt a flexible exchange rate regime and trade would then balance, with no pressure on foreign exchange reserves.

Fiji's annual foreign exchange earnings are not steady throughout the year unlike Australia's from minerals and manufactured goods. Fiji's tourism and sugar export earnings are seasonal. But Fiji's imports are steady, as food and fuel import expenditures do not vary from season to season. A floating currency would be disastrous. The fixed exchange rate regime, a right step indeed!

It has served Fiji economy well.

US economy

We have good news from America.

The US economy grew in the second quarter at an annualized rate of 3.7%. The US exports to China are less than 1% of US GDP. China's slowdown or a lower growth would not affect the US economy. If US job data continue to be similar to past three months, US will be engine of growth for the world henceforth.

The US Fed has a problem on hand.

Will it soon increase the current near zero interest rate? Or will it postpone the decision to 2016? That is the decision, the Fed has been toying with past 12 months.

Pointing finger at the Fed

Communist China embraced capitalism for reducing poverty three decades ago. It enjoyed prosperity, running export surplus with every country through exports of manufactured goods with foreign domestic investment by using cheap labour; and also at a deliberately kept undervalued exchange rate.

There were other excesses too: investment at 45% of GDP and debt at 282% of GDP.

Having enjoyed the blessings of capitalism, the time has come to suffer the curses: the capitalistic karmic cycle of expansion and recession, much hated by the Guru of communism, Karl Max.

The one-party ruled Chinese government is understandably ,highly sensitive to criticism.

Yao Yudong, chief of China’s central bank's research institute pointed finger at the US Fed.

He said “The global stock market rout of the past week was sparked by concerns over a possible interest rate rise by the US Federal Reserve and not by the devaluation of China's currency”.

The subject of hike in interest by the US Fed is not a recent one. The debate on the pros and cons has been going on for past 12 months and more.

The attempt to put the blame on the US Fed now, as the proximate cause is the feeblest of all attempts in cover-up.

Remember the Aesop fable on lamb and wolf?

“While the Lamb was drinking, the Wolf went and stood by the brook, a little farther up, and cried out:

- *"See here, you Lamb! How do you dare to muddy the water when I am about to drink?"*

- *"How can I muddy it?" said the Lamb. "You are higher up the stream than I am, and the water runs away from you, towards me."*