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Tensions over money flows bode poorly for global economy

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By Jason Lange

WASHINGTON (Reuters) - For a bunch of people who just agreed the global economy is doing better, top officials from the world's rich and poor nations sound rather worried.

For poor nations, the easy monetary policies in advanced economies are leading to big swings in capital flows that could destabilize emerging markets. For rich countries, the hoarding of currency by developing nations is blocking progress toward a more stable global economy.

Those tensions, which have been brewing for years, seemed to be rising as finance ministers and central bank chiefs from the Group of 20 economies gathered last week in Washington, as evidenced by harsh words from Washington and Delhi.

Both rich and poor say they are acting in their own self interest, and what makes the conflict so intractable is that both have very rational arguments.

Even though the G20 agreed the global economy was on better footing, the tensions suggested little progress ahead in rebalancing the global economy away from a state where the rich world borrows massively to buy things from the poor world.

"This is not a healthy place," Raghuram Rajan, governor of India's central bank, told a panel ahead of the G20 meeting.

Rajan has become a leading agitator for reforming the global monetary order, and he urged central bankers in advanced nations to avoid experimental monetary policies that might hurt the global economy.

He argued that years of easy money policies in the developed world had pushed emerging markets to hold bigger dollar reserves so they can intervene in currency markets to protect their economies from big swings in capital flows.

The need to hoard is only growing, as it now appears that the United States, Europe and Japan could keep easy money policies in place for several more years.

"You have to consider the feedback or spillover effects on other economies," Brazilian central bank chief Alexandre Tombini said of rich nation policies, speaking alongside Rajan.

Developed countries, led by the United States, argue their stimulus efforts are in the best interest of emerging nations because they lift the global economy. They say the poors' reliance on currency interventions is holding the world back.

Emerging markets often build dollar reserves by keeping their currencies weak to spur more exports, forcing developed economies to borrow to cover their import tab. Many economists feel heavy borrowing by the world's biggest consumer, the United States, fueled the asset bubble that sparked the 2007-09 financial crisis.

"Resistance in many emerging markets to moving more quickly to market-determined exchange rate regimes are hindering the rebalancing needed to ensure a lasting, strong global recovery," a senior U.S. Treasury official told reporters.

Officials in rich countries have largely rejected a call by Rajan call for increased coordination of monetary policy.

Vitor Constancio, the vice president of the European Central Bank, said a more cooperative approach among policymakers would work if emerging markets allowed their currencies to strengthen more, but that this had already failed.

"There was never the acceptance of some degree of appreciation in the emerging economies," he said, speaking on the same panel as Tombini and Rajan.

The root problem could be that central bankers are trying to do too much because their governments are doing too little.

Most economists think politicians around the world could do a lot more to help their economies grow. But rich nations are hesitant to rely on deficit spending and poor countries habitually lag in promoting competition in their markets.

If the governments stepped up, monetary policies wouldn't have to play such an outsized role in spurring economic growth and maintaining financial stability. Eswar Prasad, an economist at the Brookings Institution and Cornell University, said this bodes poorly for future global growth.

"We end up having the central bankers fight proxy battles on behalf of politicians who are feckless and not willing to do the right thing," he said. "I don't see this moving in a productive direction."

(Reporting by Jason Lange; Editing by Tim Ahmann)

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