

The Response and Results of Countries to the Fed's Rate Hike

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Abstract. Many financial institutions including Europe and Japan remained healthy during the global financial crisis, with deposits guaranteed by the federal government. The surge in demand for money did not have any destabilizing effects on the banking system. In fact, bank deposits also increased during this period. However, the rise in demand for money did cause some problems for the paper money distribution business. Traditional models of money demand suggest that interest rate cuts and federal stimulus payments to households have played a role in explaining the increase in money holdings. This study estimates that these factors account for only about 20% of the observed increase in currency holdings. The rest of the rise was likely due to increased precautionary holdings by people worried about the liquidity or solvency of financial institutions and as a contingency measure. It is in line with the disproportionate increase in demand for large-denomination. These results shed light on guiding further exploration of interest rates.

Keywords: Currency; Finance; Fed's rate hike.

1. Introduction

China, Japan and European have the very special situation during the financial crisis time period. Since the first type of contagion channel originates from the actual economic and financial connections between countries or regions, and the contagion of the crisis comes from changes in macroeconomic fundamentals, it is also called "true contact channel" or "fundamental-based contagion", which mainly includes Trade linkages and competitive devaluation, policy adjustments, stochastic aggregate demand liquidity shocks, etc.

In order to get to know more about the situation of currency for each country during the financial crisis time period, this paper discuss the overall and comprehensive information of the effect of financial crisis to the each country's currency. Specifically, China, Japan and the European countries have special change of currency in the financial crisis. The rest part of the paper organized as follows. The Section 2 is about Chinese currency situation in world's financial crisis. The Section 3 will discuss about Japanese situation in world's financial crisis. The last part will discuss about the European countries situation in the world's financial crisis.

2. Respones and Results of China

Under the influence of the financial crisis, the US economic growth was relatively slow, and the loose monetary policy was implemented to deal with the crisis, which would cause the RMB to appreciate. Because the depreciation of RMB against non-dollar currencies has a great impact, the liquidity of exports to various countries is very strong. In this way, non-US dollar currency areas may increase the requirements for the reform of the RMB exchange rate system, and the asymmetric exchange rate structure system will affect the appreciation of the RMB. On the other hand, the renminbi will literally face greater pressure on appreciation. On the whole, the arrangement of the RMB exchange rate system will help the United States to get out of the financial crisis and economic recession. increase, and its trade deficit has turned into a deficit with other countries. The root cause of the financial crisis is that financial development is not good, and it cannot be properly integrated with risk perception, which is not conducive to the stable and healthy development of the financial sector. At the same time, the United States needs Chinese funds. To stabilize its financial system, and China needs a strong U.S. market to achieve employment, once this effective body is broken, it will not benefit both China and the United States. On the other hand, China implements a managed floating

exchange rate system. Besides, China's economy has strongly entered a transition period, but the financial system is still not perfect, which determines that the RMB exchange rate system has its own characteristics. First of all, the implementation of a managed floating exchange rate system and the policy of coexisting exchange rates is conducive to the arrangement of China's exchange rate, improving the flexibility and autonomy of the market, and establishing a unified and standardized foreign exchange market, which is conducive to the connection with countries around the world and promotes the rapid development of the economy brings into play the role of the RMB exchange rate in the market, and the underlying market also plays a role in resource allocation, promoting the rapid development of China's economy [1].

In addition, China's floating exchange rate system is based on the US dollar, which is not only beneficial to the development of China's economy, but also to the development of the US economy. The floating exchange rate system can adapt to the development of China's economy and also acts as a bridge for international development, reflecting the reform results of the RMB exchange rate system. The third is to reform the exchange rate formation mechanism in the direction of marketization and liberalization. In addition, the market-oriented exchange rate system is the core of the RMB exchange rate system. On the other hand, continuously improve the exchange rate formation mechanism and improve the adjustment role of the market. According to the above, it can be seen that the government has a great influence on the exchange rate system, and the formation of the exchange rate is greatly influenced by the government. Such an exchange rate system does not fully reflect the basic role of the market in the formation mechanism, and the market adjustment effect is not very important.

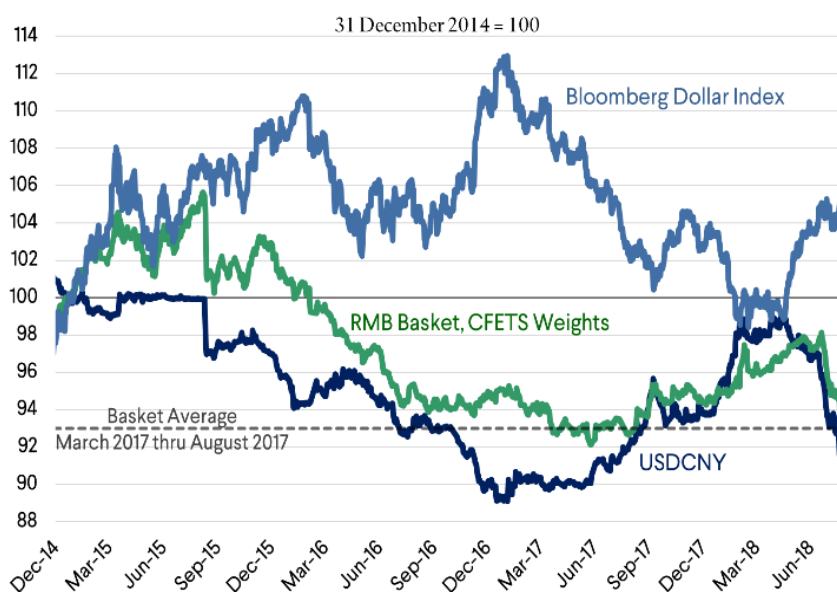


Figure 1. The evolution of Chinese money.

There are still some problems with the current exchange rate system. However, in order to reduce the risk of inflation, central bank bills were issued to hedge part of the newly issued RMB, and the exchange rate was pegged through passive countermeasures. However, the continuous increase of foreign exchange reserves and the cost of pegging the exchange rate also increased. At the same time, the bank's foreign exchange collection and payment behaviors are checked. In terms of foreign exchange management, the crackdown on short-term capital entering China will be intensified, which largely limits the large inflow of speculative capital. On the other hand, further improve and perfect the RMB exchange rate formation mechanism, keep the RMB exchange rate basically stable, and enhance the two-way floating flexibility of the RMB exchange rate. In addition, expanding the volatility of the RMB is the general trend of exchange rate reform. If the dollar continues to rebound in the future, the volatility of the RMB will expand accordingly. More specially, the market-oriented

direction of the RMB exchange rate formation mechanism is that the central bank adjusts the fluctuation range of the RMB exchange rate. In the short term, it is this policy that reduces the pressure on the central bank to intervene in the foreign exchange market, and can activate the foreign exchange market and enhance the flexibility of the RMB exchange rate; It can be seen in Fig. 1 that the convertibility of the RMB has been improved, especially the international recognition has increased, which has promoted the two-way fluctuation of the RMB exchange rate. As this measure gradually takes effect, the decisive role of the RMB exchange rate in the market will be enhanced [2].

After a brief review of the background and reasons for the formation of the financial crisis in the United States, and then from the perspective of the exchange rate system, this paper analyzes and discuss the problems existing in China's exchange rate system. It shows that the best choice for China to prevent currency crisis is to establish a flexible exchange rate system that is in line with the market as depicted in Fig. 2 [3].



Figure 2. The exports and imports data.

3. Responses and Results of Japan

Because on the issue of currency exchange rates, Japan has learned from the past. The exchange rate of the yen has been freely floating with market changes since 1973, when 1 US dollar = 308 yen. In 1985, Japan signed the "Plaza Agreement", and the yen was forced to appreciate. On April 19, 1995, the highest value in history occurred, that is, 1 US dollar = 79.75 yen. Although there have been ups and downs since then, in general, the yen has been in a state of appreciation since the 1970s. Many scholars believe that the appreciation of the yen has led to the long-term depression of the Japanese economy. This paper mainly studies the changes in the nominal and real exchange rates of the yen from 1983 to 2001, and the relationship between exchange rate changes and GDP, import and export trade volume, and consumer price index, explores the law of yen exchange rate changes, analyzes Whether an increase in output necessarily leads to an increase in the real exchange rate. It is hoped that through the analysis of the changes in the yen exchange rate after the marketization, it can be used for reference and enlightenment to the construction of my country's exchange rate system [4]. According to economist Richard Marston's study of U.S. and Japanese industry data from 1973 to 1983, U.S. tradable productivity gains were 13.2 percent greater than non-tradables productivity gains, and Japan's tradables productivity gains were non-tradables productivity gains U.S. relative prices of non-tradable goods rose 12.4%, while Japan rose 56.9%. After 1983, this situation continued. Compared with U.S. tradable goods, the prices of Japanese tradable goods have fallen a lot, but the decline in the prices of tradable goods was not enough to offset the impact of the sharp rise in the prices of Japanese non-tradable goods on the exchange rate. In conclusion, the rapid rise in the prices of non-tradable goods in Japan is the basic reason for the appreciation of the real exchange rate [5].

The GDP evolution of Japan is illustrated in Fig. 3. During the period from 1984 to 1986, the exchange rate of the yen fluctuated violently, and the value of the currency appreciated substantially, and then it rose and fell relatively smoothly. The yen appreciated again between 1989 and 1994, reaching its highest value in 1995, after which the yen depreciated. From 1997 to 1999, the Japanese yen rebounded, and then there was an appreciation of about 20 yen. After 1999, affected by the Southeast Asian financial crisis, the yen depreciated slightly. In general, the nominal and real exchange rates move in roughly the same way. The purchasing power parity theory is completely ineffective in explaining the short-term behavior of the nominal exchange rate, but a large number of empirical evidences show that the real exchange rate of industrial countries tends to return to the long-term historical average, which indicates that the purchasing power parity theory has certain validity in the long run. There are a number of important corrections and improvements to the long-term trend of exchange rates away from purchasing power parity.

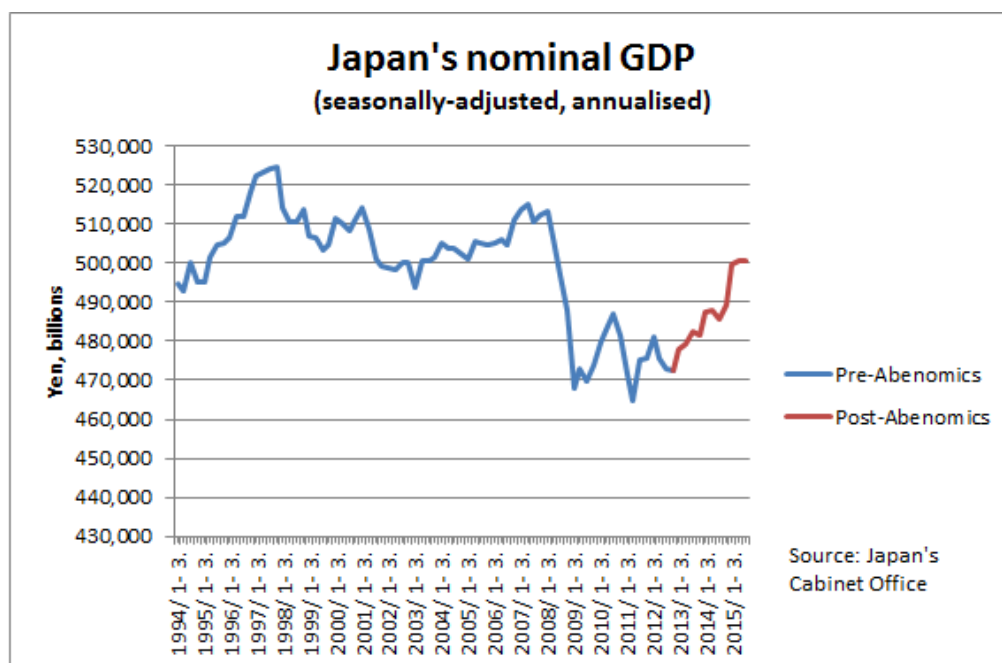


Figure 3. GDP evolution of Japan.

In the economic crisis, the appreciation of the yen has objective inevitability, it is the inevitable result of Japan's economic development. It has played an indelible role for the yen to become an international currency, for Japan to become an international economic power, and even for the soundness of Japan's financial market. At the same time, it also gave birth to Japan's economic bubble. Economic bubbles are not necessarily a bad thing, as long as they are dealt with reasonably, they can absorb part of the excess liquidity, and they can contribute to economic development. However, due to Japan's excessive and rapid credit crunch, the overheated Japanese economy lost the opportunity of a "soft landing" and also caused the current situation of the Japanese economy. Therefore, the mistakes of the government's policies are the main reason for the cooling of the Japanese economy. The appreciation of the exchange rate makes Japanese companies relocate and increase unemployment, which deteriorates Japan's foreign trade environment and affects Japan's exports and economic growth. At the same time, it also provides a strong impetus for the technological innovation of Japanese enterprises, promotes the upgrading of Japan's industries, and also promotes the emergence of a large number of advantageous enterprises with high cost performance and low energy consumption, laying the foundation for Japan to gain an advantageous position in the international division of labor. Meanwhile, it also improved the financial market in Japan, and also formed a push for the Japanese currency to become an international currency [6].

4. Responses and Results of European

Although currency crises and financial crises often occur at the same time, currency crises are different from financial crises. Since the 1990s, financial crises and currency crises have occurred in both emerging economies and developed countries. There is no necessary connection between them. The outbreak of a currency crisis is closely related to the exchange rate system implemented by a country, and most of the countries in which the currency crisis occurs are in deficit. During the Japanese financial crisis in the early 1990s, due to the free floating of the Japanese yen, the exchange rate has greater flexibility, which restrained the excessive outflow of international capital to a certain extent, and the financial crisis did not cause a currency crisis.

The currency crisis in Britain and Italy in 1992 shows that, in the case of free capital flow, the fixed exchange rate system cannot resist the impact of international capital outflow. The deep-seated reason of the currency crisis in Mexico in 1994 lies in the fixed exchange rate system and international capital flow that Mexico has implemented all the year round. With the help of the United States and the International Monetary Fund, Mexico has successfully overcome the currency crisis. The currency crisis in Russia in 1998 was triggered by the financial crisis. In the case of a relatively fixed exchange rate, due to the rapid withdrawal of international capital when the financial market collapsed, the ruble exchange rate depreciated significantly [7].

The currency crisis in Brazil in 1998 was related to its relatively fixed exchange rate system. Because Brazil has a good banking system and foreign exchange reserves, the Brazilian financial system has been effectively protected, and the currency crisis did not cause a financial crisis. Argentina's currency crisis in 1999 caused the financial crisis. In order to ensure the independence of the central bank in regulating the economy, the currency board system had to be abandoned and a floating exchange rate system was implemented instead. There are 12 Central and Eastern European countries that joined the EU after the fifth and sixth rounds of EU enlargement. Currently, these 12 Central and Eastern European countries have been deeply affected by the financial crisis. Considering that the capital projects of these 12 countries have been opened, the choice of exchange rate system has become an important factor in preventing and preventing currency crises. If one evaluates the 12 new EU member states based on the actual situation of the exchange rate system of each country, it is feasible to find that although the financial crisis continues to spread in Central and Eastern Europe, foreign capital withdraws and the exchange rate depreciates in all countries, but the possibility of currency crisis in these countries is not the same. Slovenia, Cyprus, Malta, Slovakia have joined the euro zone.

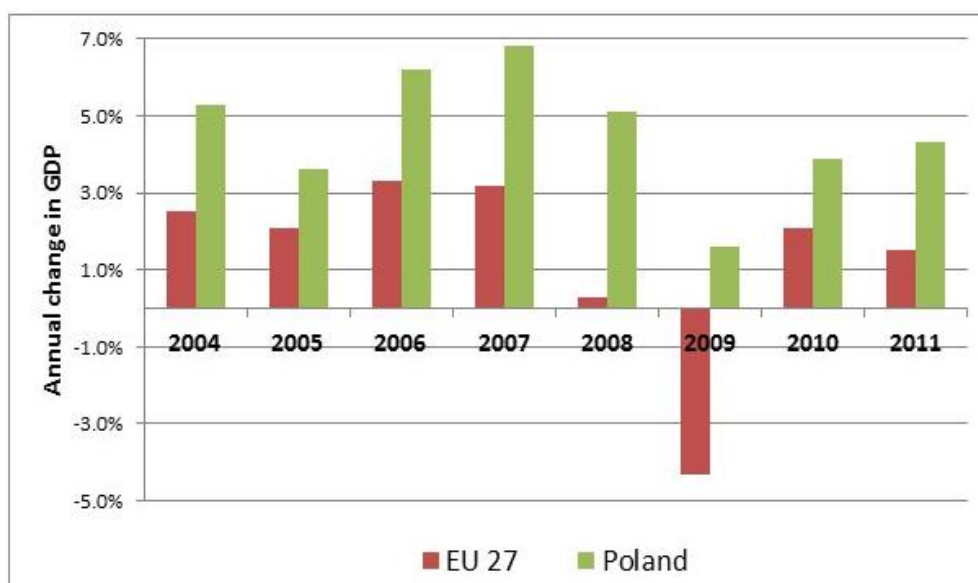


Figure 4. The annual change in GDP for EU and Poland.

In the current world financial crisis, although the euro area has been greatly affected and the exchange rate of the euro against the dollar has also depreciated to a certain extent, as the world's second largest currency, the euro area is obviously not going to have a currency crisis. Therefore, Slovenia, Cyprus, Malta and Slovakia, which have joined the euro zone, will not have a currency crisis. The exchange rate regimes of the three Central European countries, Poland, the Czech Republic, and Romania, are relatively liberal. Poland started to implement a separate floating exchange rate system in 2000 [8]. The Czech exchange rate system itself was changed to prevent the currency crisis. After the currency crisis occurred in May 1997, in order to reduce the space for international capital arbitrage, the Czech Republic began to implement a managed floating exchange rate system. Romania implements a managed floating exchange rate system that does not prescribe the exchange rate trajectory, and its exchange rate elasticity is relatively close to the single floating exchange rate system. Judging from the exchange rate systems of these three countries, although the currencies of various countries have depreciated greatly against the US dollar, there is a factor of depreciation of the euro against the US dollar, and the currencies of these countries have not depreciated significantly against the euro. Since the fluctuation of the exchange rate itself can restrain the continuous withdrawal of foreign capital, the flexibility of the exchange rate is also conducive to improving foreign capital's confidence in the currencies of these countries, and the currencies of these countries will not depreciate significantly against the euro. Considering that foreign capital mainly comes from EU countries, and foreign trade partners are mainly concentrated in Europe, as long as the currencies of various countries can keep stable relative to the euro, there will be no currency crisis [9].

The GDP change of European countries are presented in Fig. 4. From the perspective of exchange rate system, among the 12 new EU member states, the exchange rate systems of most countries can effectively prevent currency crises, and some countries have the possibility of currency crises. As for the current account, it can be found from the Southeast Asian financial crisis that the long-term deficit of the current account has laid a hidden danger for the currency crisis. This is despite the fact that 12 EU member states in Central and Eastern Europe are in deficit. However, the trade deficit of the 12 Central and Eastern European countries is mainly concentrated within the EU member states, and the scale of the trade deficit with other countries in the world is not large. From the exchange rate system and current account, it can be found that these 12 Central and Eastern European countries need assistance from the European Union. If the European Union can provide sufficient support, the possibility of currency crisis in these 12 countries is very small. However, for these 12 EU member states, there are also some unfavorable external factors. The currency crisis in Southeast Asian countries in 1997 was triggered by Thailand. The currency crisis in Thailand affected the currency crisis in South Korea, Malaysia, Indonesia, the Philippines and other countries. Therefore, the transmission of currency crisis in a certain area is also worthy of attention. In Central and Eastern Europe, in addition to the 12 new EU member states, Russia, Ukraine, Moldova, Belarus and other countries are also deeply affected by the world financial crisis. Unlike EU countries, the currencies of these non-EU countries are more closely related to the US dollar. This means that under the background of the world financial crisis, the non-EU countries in Central and Eastern Europe are more likely to break out of currency crisis. If a currency crisis breaks out in these countries, it may also trigger a currency crisis in the entire Central and Eastern Europe region [10].

5. Conclusion

In summary this paper discusses the currency situation in financial crisis in China, Japan and European countries. To be specific, financial crisis have big impact toward many countries' currency situation. According to the analysis, China, Japan and European countries' currency situation had highly affected by world's financial crisis and the implementations of federal. Nevertheless, all the data is retrieved from second-hand sources. For further exploration, first-hand information ought to be collected in order to enhance the accuracy of the results. Overall, these results offer a guideline for analysis the governments performance under certain issues.

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