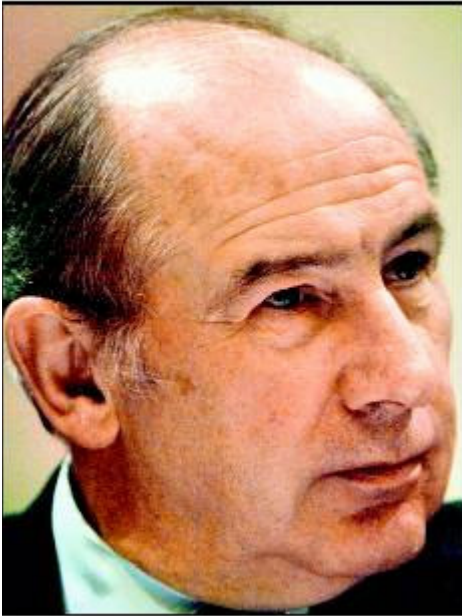


Yen carry trade could worsen global imbalances

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DISORDERLY global imbalances could be worsened by the increased usage of the “yen carry trade”, where investors take advantage of low Japanese interest rates and borrow in yen to purchase other securities, said International Monetary Fund managing director Rodrigo de Rato.

The yen’s depreciation led to an increase in Japan’s current account surplus to almost 4% of gross domestic product in 2006, de Rato said. Countries and financial markets are at risk if there is a reversal in financial flows, he said.

“It could lead to more entrenched exchange rate misalignments that worsen global imbalances,” according to de Rato’s prepared remarks last night before Harvard Business School alumni in Washington. Disorderly global imbalances are “not sustainable” and could lead to disruptions in the market and an “economic downturn” if they are not addressed, de Rato said.

Japan’s yen is the worst performer of the 16 most-active currencies in the past three months as investors borrowed yen to buy higher-yielding assets. The Bank of Japan raised its key interest rate last week to 0.5%, 4.75 percentage points lower than the Federal Reserve’s rate and 3 percentage points less than the European Central Bank’s benchmark.

De Rato acknowledged there is no simple solution, though still urged the government to address the concerns. The Bank of Japan needs to be cautious about raising rates following years of deflation, he said. De Rato encouraged government regulators and central banks to gather information to be able to assess the risks and share them with investors and countries that are unaware of the drawbacks.

The effects of the carry trade are being seen in capital flows into countries such as Brazil and

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Turkey, he said. "Those countries into which funds are flowing should look carefully at their own macroeconomic and prudential frameworks, and be prepared for a reversal of flows at some point in the future," de Rato said.

The global economy is enjoying the strongest five-year expansion since the late 1960s, with growth projected to be about 5% as economic risks diminish.

The slowdown from the US housing market has been limited and high energy prices have subsided, de Rato said. The global economy has also avoided sharp inflationary increases, he said.

De Rato called on the US to work for a breakthrough in the Doha round of world trade talks, which stalled last summer as other nations balked at US demands to lower tariffs in exchange for cuts in farm subsidies.

Negotiating authority for the Bush administration is set to expire in July. The US wants India, the European Union and Japan to agree to steep cuts in their farm duties. De Rato urged Congress to take necessary steps to allow the Bush administration fast-track negotiation authority in the Doha round.

"The terms of such an extension are a matter for the US Congress, the results of their decision are important not only for the United States but also for the rest of the world." — Bloomberg