

Future of the US Dollar and Monetary & Financial Cooperation in East Asia

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1. Introduction

- Will the US dollar remain as the most dominant international currency?
- If not, what are alternative systems to the current US dollar standard—the SDR standard, multi-polar currency system, or something else?
- What should East Asia do about the regional exchange rate regime?
- How can the region respond to the rising inflows of capital and a weak US dollar?

2. The Role of the US Dollar in the International Monetary System

The US dollar is still the most dominant international currency

- As a vehicle currency, reserve currency, invoice currency, and nominal anchor currency
- The US is largest economy in the world, and has the most sophisticated financial market

But the role of the US dollar will likely decline

- Creation of the euro (1999)
- Persistent current account deficits and a declining international investment position in the US
- Risk of inflation and unsustainable national debt as a result of the global financial crisis (2007-09)
- Rise of China, India and other emerging market economies

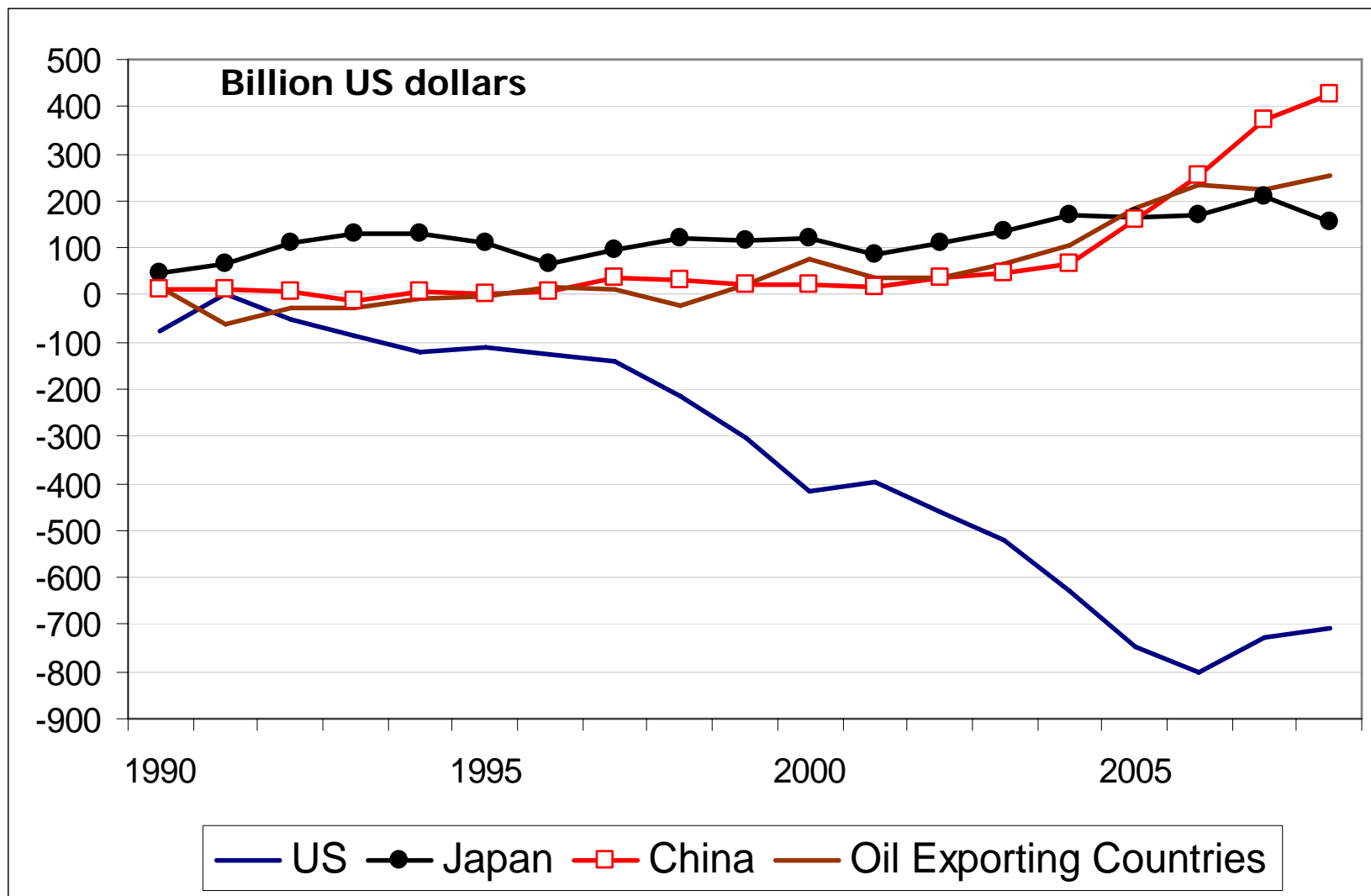
Shares of currencies traded in foreign exchange markets

	1989	1992	1995	1998	2001	2004	2007
US dollar	90.0	82.0	83.3	87.3	90.3	88.7	86.3
Euro	--	--	--	--	37.6	36.9	37.0
Yen	27.0	23.4	24.1	20.2	22.7	20.2	16.5
Pound Sterling	15.0	13.6	9.4	11.0	13.2	16.9	15.0
German mark	27.0	39.6	36.1	30.1	--	--	--
French franc	2.0	3.8	7.9	5.1	--	--	--
ECU & other EMS currencies	4.0	11.8	15.7	17.3	--	--	--
Swiss franc	10.0	8.4	7.3	7.1	6.1	6.0	6.8
Australian dollar	2.0	2.5	2.7	3.1	4.2	5.9	6.7
Chinese yuan	--	--	--	--	0.0	0.1	0.5

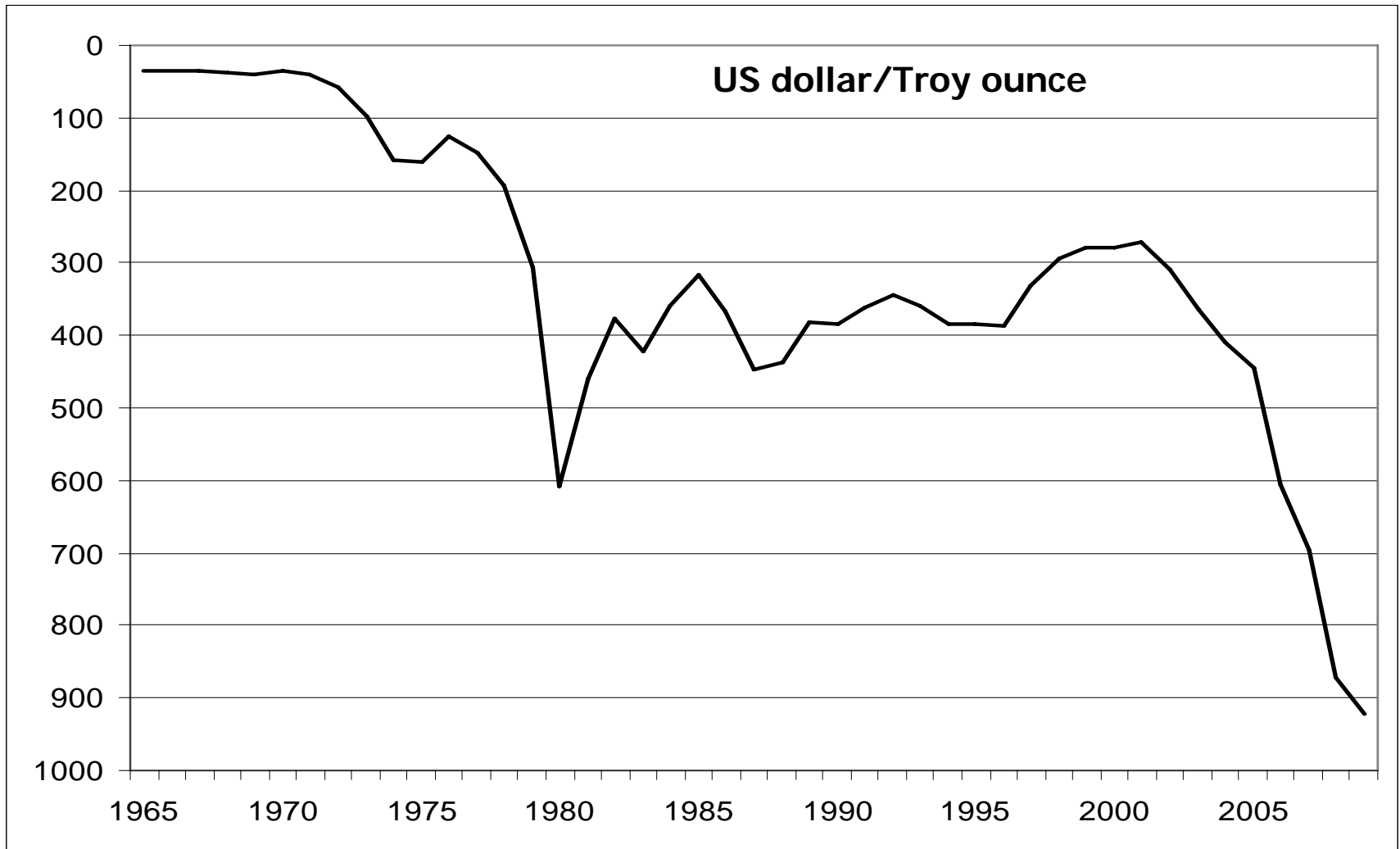
Shares of *de facto* currency areas formed by major currencies (PPP-based GPD)

	US Dollar Area			Euro Area			Yen Area			Pound Sterling Area			Other
	US	Other	Total	Euro Zone	Other	Total	JPN	Other	Total	UK	Other	Total	
1970-74	26.7	27.2	54.0	12.5	12.8	25.2	9.3	0.0	9.3	5.4	3.5	8.9	2.7
1975-79	25.8	27.8	53.6	11.9	15.4	27.3	9.3	1.6	10.9	4.9	1.6	6.4	1.8
1980-84	25.0	26.7	51.8	11.4	13.9	25.3	9.5	2.2	11.7	4.4	2.3	6.7	4.4
1985-89	25.5	27.3	52.8	10.7	9.4	20.0	9.6	0.5	10.2	4.4	1.8	6.2	10.8
1990-94	22.7	32.7	55.4	9.7	13.5	23.2	9.1	0.5	9.6	3.7	1.3	5.1	6.7
1995-99	23.5	36.4	59.9	11.3	10.8	22.1	8.5	2.4	10.9	3.7	0.9	4.6	2.5
2000-04	22.9	31.6	54.5	17.7	11.1	28.8	7.4	3.1	10.5	3.6	0.5	4.1	2.2
2005-07	21.7	32.8	54.6	16.1	14.3	30.5	6.7	1.0	7.7	3.4	1.5	4.9	2.3

Current accounts of the US, Japan, China and oil exporting countries



Rising price of gold = Declining value of the US dollar in terms of gold



Source: IMF, *International Financial Statistics*

3. Ideas for International Monetary System Reform

- **World single currency system** (Cooper 1987)
 - most ideal in the long run
- **SDR standard** (Zhou 2009)
 - private use of SDR yet to be promoted
- **Multi-polar key currency system** (Bergsten 2009)
 - Asia has yet to create an own currency
- **Improvement of the US dollar standard**
 - disciplined macroeconomic policy, and a sustainable current account in the US
 - US liquidity financing (IMF, US Fed)
 - internationally concerted efforts, a la Louvre (1987), to support a rapidly declining dollar

4. Financial Cooperation in East Asia

Three pillars of financial cooperation

- Economic & financial surveillance mechanism (ASEAN+3 ERPDP) for information exchange, policy dialogue, and peer pressure
- Liquidity support facility (CMI) to contain currency speculation, contagion, and crises
- Asian bond market development (ABMI and ABF) to mobilize Asian savings for investment
- East Asia may also create an Asian Financial Stability Board (AFSB) to promote financial system stability
- *Exchange rate policy coordination has yet to be developed*

Chiang Mai Initiative (CMI) and multilateralization

- Bilateral swap agreements (BSA) among ASEAN+3 countries (16 BSAs signed for a total US\$90 billion)
- IMF link: 20% can be disbursed immediately for short-term financial assistance without an IMF program, but if more than 20% is to be disbursed an IMF program is required
- CMI multilateralization (CMIM)
 - \$120 billion, a “surveillance unit,” an “advisory panel of experts” (leading to a *de facto* AMF)
 - ability to formulate independent conditionality

Progress on BSAs under the CMI (as of April 2009)

To:	China	Japan	Korea	Indonesia	Malaysia	Philippines	Singapore	Thailand	Total
From:									
China	--	3.0 ^(a)	4.0 ^(a)	4.0	1.5	2.0 ^(a)		2.0	16.5
Japan	3.0 ^(a)	--	13.0 ^(b)	12.0	1.0 ^(c)	6.0	3.0	6.0	44.0
Korea	4.0 ^(a)	8.0 ^(b)	--	2.0	1.5	2.0		1.0	18.5
Indonesia			2.0	--					2.0
Malaysia			1.5		--				1.5
Philippines		0.5	2.0			--			2.5
Singapore		1.0					--		1.0
Thailand		3.0	1.0					--	4.0
Total	7.0	15.5	23.5	18.0	4.0	10.0	3.0	9.0	90.0

Notes:

(a) The agreements are in local currencies, and the amounts are US dollar equivalents.

(b) Japan-Korea BSA includes both US dollar swaps (US\$10 billion from Japan to Korea and \$5 billion from Korea to Japan) and local currency swaps (US\$3 billion equivalent each from Japan to Korea and from Korea to Japan). The yen-won BSA was raised from US\$3 billion to US\$20 billion equivalent in December 2008 until end-April 2009, which was later extended to end-October 2009.

(c) There is also a US\$2.5 billion commitment (made on August 18, 1999) under the New Miyazawa Initiative.

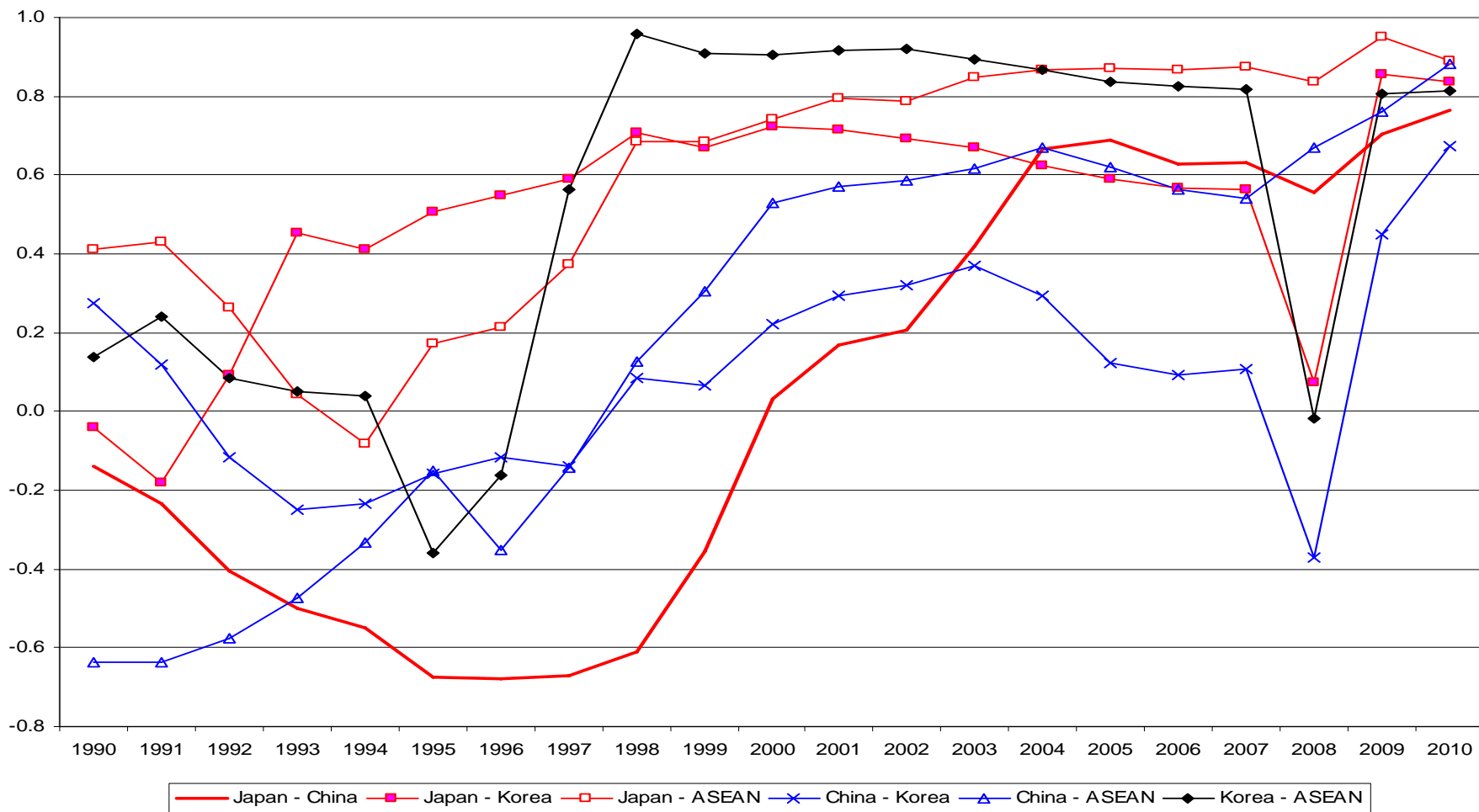
(d) The table does not include the ASEAN Swap Arrangement (ASA), which totals US\$2 billion.

5. East Asia's Exchange Rate Policy Coordination

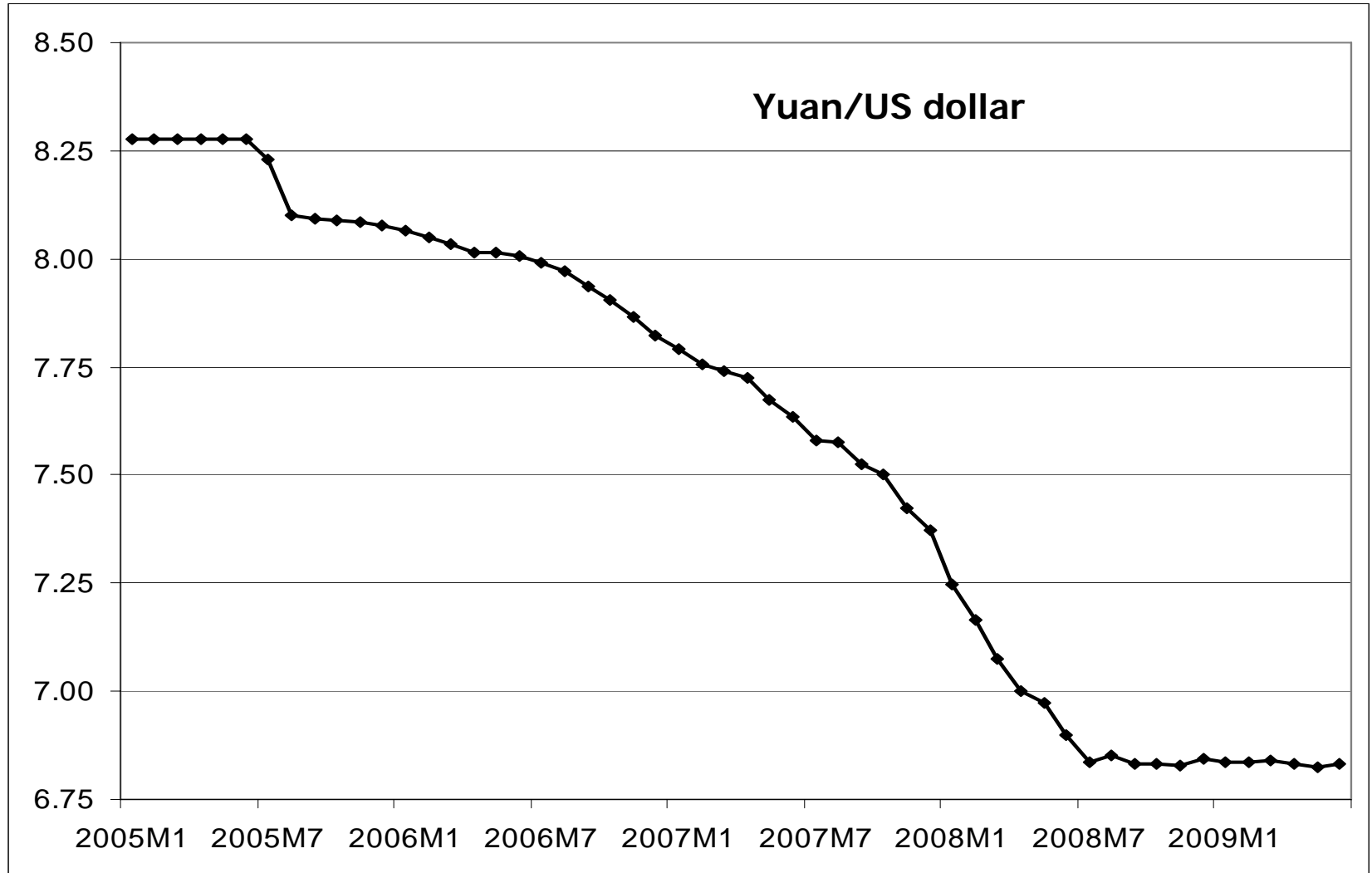
Lack of exchange rate policy coordination in East Asia

- Despite close interdependence of East Asian economies, there has been no exchange rate coordination yet
- Asian exchange rate regimes are very diverse and in serious disarray, with Japan adopting a pure float and China a tightly managed regime targeted at the US dollar
- Japan has not been able to play an anchor currency role for Asia's monetary policymaking
- China's return to the US dollar-peg in July 2008 suggests the difficulty of such coordination

GDP growth rate correlations among ASEAN+3 have generally risen over time (10-year moving windows)



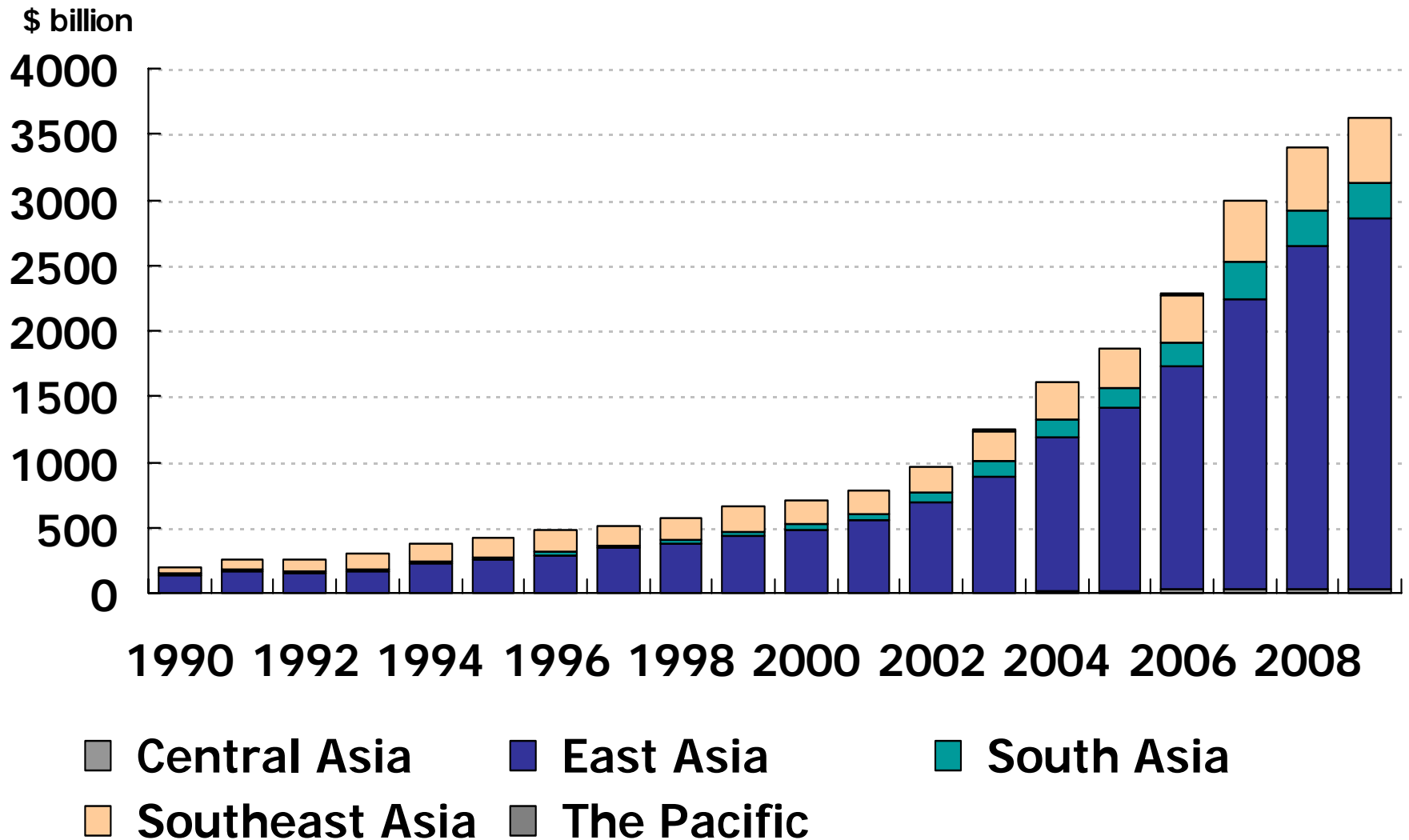
Return of the yuan to the dollar peg



A case for collective currency appreciation to manage capital inflows

- Facing persistent capital inflows, many Asian emerging economies used to intervene to prevent currency appreciation for fear of loss of price competitiveness, thereby accumulating large reserves and injecting domestic liquidity
- But this intervention policy is often costly from macroeconomic and financial sector stability (overheating, inflation, and asset price bubbles)
- A collective currency appreciation vs. the US dollar is recommended as it keeps relative currency stability within the region and promotes financial and macroeconomic stability while minimizing loss of price competitiveness

Developing/emerging Asia has built sizable foreign exchange reserves



Yen, yuan or a basket?

Which currency as anchor for East Asia?

- The yen (failed internationalization, declining size) or the yuan (inconvertible, weak prudential supervision, non-independent central bank) alone cannot assume a nominal anchor currency role
- The yen, yuan, won, ringgit & other regional currencies can share the nominal anchor role for East Asia; so create an Asian currency unit (ACU)

Currency basket system

- SDR-plus currency basket (dollar, euro, pound, and ACU): Singaporean model
- ACU system: complex and hard to establish internal anchor for now, but using it as a currency basket index is a useful starting point

Informal policy coordination (regime choice)

- Greater exchange rate flexibility vis-à-vis the dollar, based on a basket of SDR or SDR-plus currencies (dollar, euro, pound, and ACU [= yen plus emerging Asian currencies])
- Stabilization of exchange rates against SDR or SDR-plus does not require rigorous macroeconomic policy coordination
- Use ACU for the purpose of exchange rate policy dialogue and coordination
- Developing ACU-denominated bonds will be useful

6. Conclusion

- In the short run, East Asia should work with the global community to improve the functioning of the US dollar system, while at the same time increasing exchange rate flexibility vs. the dollar
- In the medium- to long-run, East Asia should establish its own exchange rate arrangement (or even a common currency)
- Exchange rate policy coordination will be key to the management of capital inflows for macroeconomic and financial system stability
- Stronger regional financial cooperation (from CMIM to AMF, bond markets, AFSB, and creation of ACU) can contribute to this process

Thank you

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