

For the International Joint Research Center  
International Conference  
『Global Crisis and Sustainability of East Asia』  
March 22, 2009, Hitotsubashi University



# Global Crisis and East Asia: Momentum for the Regional Currency Regime

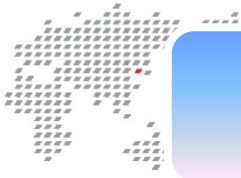
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**KIEP** Korea Institute for International  
Economic Policy



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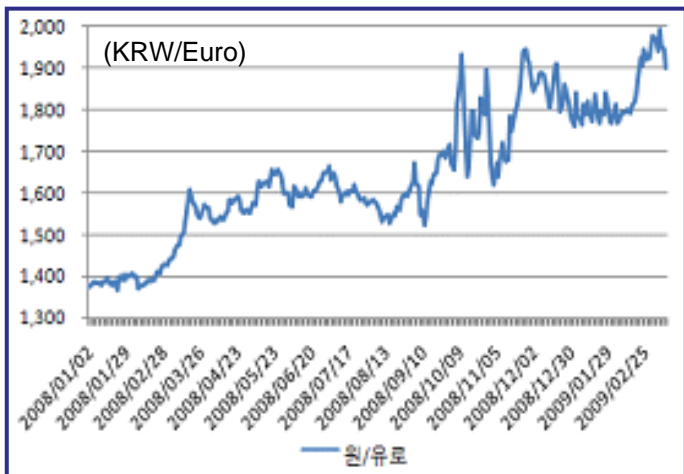
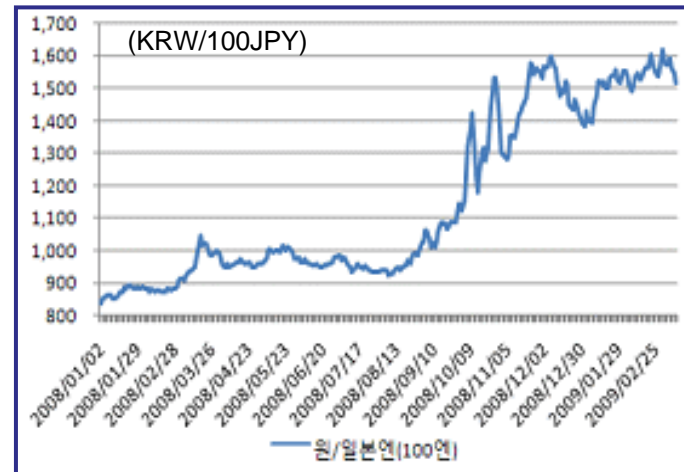
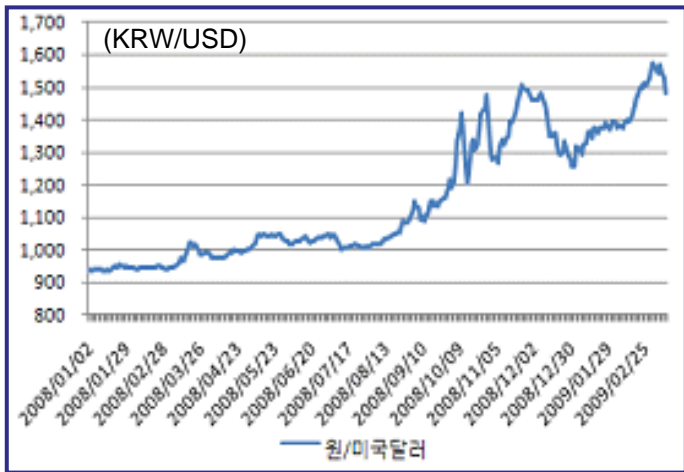


## I. Global crisis and currency regime

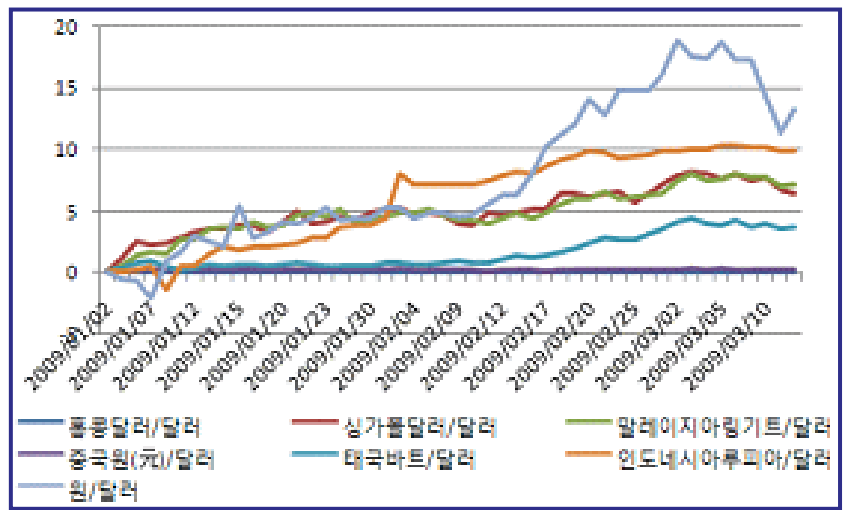
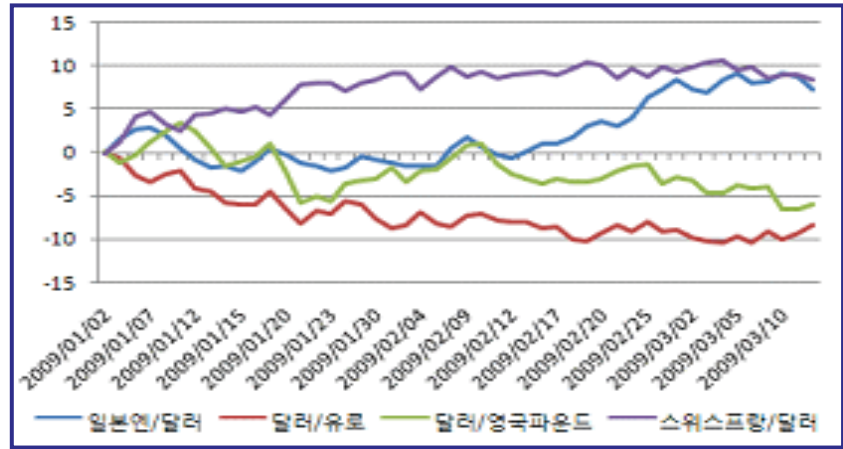
- ◆ **External shocks brought by crisis via exchange rate fluctuation affect both real and financial performance of national economies.**
- A small open economy like Korea suffers from huge devaluations, prone to inflation pressure and reduction in the relative gains from exports.
- A large open economy with moderate openness in trade and finance like Japan observes strong yen, but at a cost of corporate competitiveness at the international stage. Exports and investments fall.
- A large economy with a fixed exchange rate regime like China experiences large drop in its exports and in growth. Keeping the value of the Yuan high is getting more difficult.
- ◆ **On the real side economies like these suffer from lower growth and thus loss of employment. On the monetary side they face undesirable situation regarding the values of their currencies.**

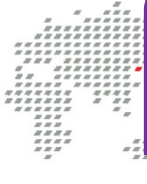


# Korean Won fluctuation: a case with a small, very open economy with flexible exchange rates and performing industries



# Currency instability increases elsewhere as well.





## Internationalization of currencies gains interests of policy makers

- ◆ Internationalization of a currency endogenizes external economic shocks to the degree of internationalization. (e.g. seignorage) Therefore it helps to reduce the impact of external shocks on domestic economy. It could be an interesting and plausible policy choice.
- ◆ But there are possibilities of hazardous effects. This means that markets are more liberalized. For instance the economy could be more prone to speculative attacks.
- ◆ Policy dilemma: in current crisis currency instability increases, which induces attempts to increase financial market protection and internalization of currency by way of exchange market intervention or protective measures.



## Currency competition likely to occur

- ◆ USD will fall eventually as the US debts are not sustainable, especially with economic stimulus packages.
- Currency competition will occur at the anchor currency level (USD, EURO, JPY, CHY, etc.).
- Currencies of smaller economies will try to become more internationalized to minimize the impacts of external shocks to domestic economy.
- ◆ Movement toward East Asian single currency will gain momentum.
- Single currency in East Asia is likely to have similar benefits as internationalization of East Asian currencies possibly at lower cost.

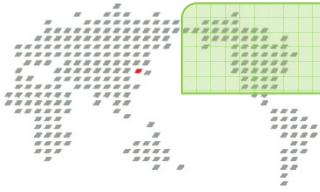


## II. Conditions for international currency

### ◆ Conditions for international currency (Joint work with Seung-gwan Baek)

- Factors to affect whether or not a currency would become an international currency include the size of economy, exchange rate stability, financial market development – foreign exchange market, financial markets, capital markets -, and political stability.
- Literature identifies some of these relevant. (Iwami and Sato, 1996 IJSE; Chinn and Frankel, 2008 NBER WP; Tavlas, 1997 IE)
- More apt to become an international currency, the larger the economy (gdp, trade and financial markets), the more stable the value of the currency, the more developed and open the financial markets, the higher the export relative to the world exports, the more differentiated the manufacturing goods exports, the more exports headed to less developed economies, hysteresis and network externalities, the less the political risks....

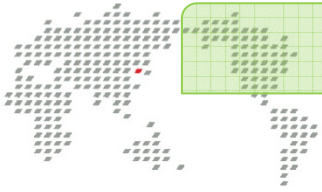




## International currency (by reserves)

Reserve currency in  
the world reserve (%)

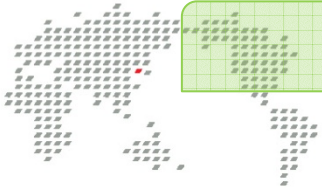
Year	USD	UKP	FRF	DEM	NDG	SWF	JPY	EURO
1976	79.7	2	0.9	7	0.5	1.4	0.8	
1980	55.9	2.5	1.1	11.9	0.8	2.6	3.3	
1985	55.3	2.7	0.8	13.9	0.9	2.1	7.3	
1990	50.6	3	2.4	16.8	1.1	1.2	8	
1991	51.3	3.3	3	15.4	1.1	1.2	8.5	
1992	55.3	3.1	2.7	13.3	0.7	1	7.6	
1993	56.6	3	2.3	13.7	0.7	1.1	7.7	
1994	53.1	2.8	2.5	15.3	0.7	0.6	7.8	
1995	59	2.1	2.4	15.8	0.3	0.3	6.8	
1996	62.1	2.7	1.8	14.7	0.2	0.3	6.7	
1997	65.2	2.6	1.4	14.5	0.4	1.3	5.8	
1998	69.4	2.7	1.6	13.8	1.3	0.3	6.2	
1999	71	2.9				0.2	6.4	17.9
2000	71	2.8				0.3	6.1	18.4
2001	71.4	2.7				0.3	5.1	19.3
2002	67	2.8				0.4	4.4	23.9
2003	65.9	2.8				0.2	3.9	25.3
2004	65.8	3.4				0.2	3.8	25
2005	66.5	3.7				0.1	3.6	24.4
2006	66.1	6.3				0.2	3.1	24.7
2007	64.5	7.2				0.2	2.8	25.9



## Size of economy (GDP)

Nat'l GDP relative to  
the world GDP (%)

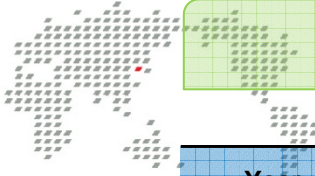
Year	USA	GBR	JPN	FRA	DEU	NLD	SWI	EURO
1980~1989	28.0	4.0	11.5	4.9	5.9	1.2	0.9	-
1990~1999	26.8	4.3	15.3	5.2	7.7	1.3	1.0	23.7
2000~2006	29.6	4.9	11.6	4.6	6.2	1.4	0.8	21.6
2001	32.1	4.6	13.0	4.2	6.0	1.3	0.8	20.0
2002	31.9	4.8	11.9	4.5	6.2	1.3	0.9	20.9
2003	29.7	4.9	11.5	4.9	6.6	1.5	0.9	23.0
2004	28.1	5.2	11.1	5.0	6.6	1.5	0.9	23.4
2005	27.7	5.0	10.2	4.8	6.2	1.4	0.8	22.4
2006	27.2	5.0	9.0	4.6	6.0	1.4	0.8	21.9
	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
1980~1989	0.8	2.3	0.1	0.3	0.7	0.2	0.2	0.3
1990~1999	1.5	2.5	0.2	0.5	0.6	0.3	0.2	0.5
2000~2006	1.7	4.6	0.3	0.5	0.6	0.3	0.2	0.4
2001	1.5	4.2	0.3	0.5	0.5	0.3	0.2	0.4
2002	1.7	4.4	0.3	0.5	0.6	0.3	0.2	0.4
2003	1.6	4.4	0.3	0.4	0.6	0.3	0.2	0.4
2004	1.6	4.6	0.3	0.4	0.6	0.3	0.2	0.4
2005	1.8	5.0	0.3	0.4	0.6	0.3	0.2	0.4
2006	1.8	5.5	0.3	0.4	0.8	0.3	0.2	0.4



## Size of economy (Exports)

Nat'l exports relative to the world exports (%)

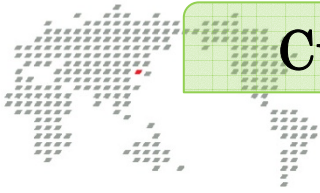
Year	USA	GBR	JPN	FRA	DEU	NLD	SWI	EURO
1980~1989	12.0	5.5	7.8	5.9	9.5	3.5	2.1	33.8
1990~1999	13.1	5.4	7.5	5.9	9.6	3.6	1.9	33.5
2000~2005	11.7	5.0	5.8	4.8	8.8	3.4	1.6	30.5
2001	13.2	5.2	5.9	5.0	8.6	3.3	1.6	30.4
2002	12.2	5.2	5.8	4.9	8.9	3.3	1.7	30.9
2003	10.9	5.0	5.7	5.0	9.3	3.5	1.7	31.9
2004	10.2	4.9	5.6	4.7	9.3	3.5	1.6	31.3
2005	9.9	4.6	5.3	4.3	8.8	3.3	1.5	29.7
	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
1980~1989	1.4	1.2	1.2	n.a.	0.7	0.7	0.3	0.4
1990~1999	2.1	2.3	2.1	3.0 <sup>2)</sup>	0.8	1.2	0.4	1.0
2000~2005	2.5	4.9	2.2	2.9	0.8	1.3	0.4	1.0
2001	2.4	3.9	2.2	3.1	0.8	1.3	0.5	1.0
2002	2.4	4.6	2.1	3.1	0.8	1.4	0.5	1.0
2003	2.5	5.2	2.1	2.9	0.7	1.3	0.4	1.0
2004	2.7	5.8	2.2	2.8	0.7	1.3	0.4	1.0
2005	2.6	6.5	2.2	2.7	0.8	1.3	0.3	1.0



## Currency stability (measured by inflation)

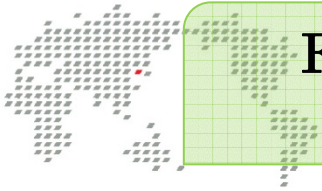
(%)

Year	USA	GBR	JPN	FRA	DEU	NLD	SWI		
1980~1989	5.6	7.4	2.5	7.4	n.a.	2.9	3.3		
1990~1999	3.0	3.7	1.2	1.9	2.0	2.4	2.3		
2000~2007	2.8	2.8	-0.3	1.8	1.7	2.2	0.9		
2001	2.8	1.8	-0.8	1.7	2.0	4.2	1.0		
2002	1.6	1.6	-0.9	1.9	1.4	3.3	0.6		
2003	2.3	2.9	-0.3	2.1	1.1	2.1	0.6		
2004	2.7	3.0	0.0	2.1	1.7	1.2	0.8		
2005	3.4	2.8	-0.3	1.8	2.0	1.7	1.2		
2006	3.2	3.2	0.2	1.6	1.7	1.1	1.1		
2007	2.9	4.3	0.1	1.5	2.1	1.6	0.7		
	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA	
1980~1989	8.4	14.8	2.8	7.5	9.6	3.7	14.9	5.8	
1990~1999	5.7	7.8	1.9	6.9	14.5	3.7	9.0	5.0	
2000~2007	3.0	1.6	1.0	-0.8	8.7	2.0	5.0	2.5	
2001	4.1	0.5	1.0	-1.6	11.5	1.4	6.8	1.6	
2002	2.8	-0.8	-0.4	-3.1	11.9	1.8	3.0	0.6	
2003	3.5	1.2	0.5	-2.5	6.6	1.0	3.5	1.8	
2004	3.6	3.9	1.7	-0.4	6.2	1.5	6.0	2.8	
2005	2.8	1.8	0.4	0.9	10.5	3.0	7.6	4.5	
2006	2.2	1.5	1.0	2.1	13.1	3.6	6.2	4.6	
2007	2.5	4.8	2.1	2.0	6.4	2.0	2.8	2.2	



## Currency stability (monthly variation of SDR)

Year	S.D of monthly changes of SDR (%)							
	USA	GBR	JPN	FRA	DEU	NLD	SWI	EUR
1980~1989	1.81	2.27	2.13	1.79	1.81	1.78	2.22	
1990~1998	1.58	1.92	2.47	1.71	1.65	1.65	2.15	
1999~2006	1.23	1.53	1.87				1.57	1.41
2001	1.22	1.18	2.72				1.67	1.54
2002	1.45	1.33	1.26				1.54	1.38
2003	1.64	1.84	1.71				2.03	1.87
2004	1.26	1.50	2.57				1.56	1.40
2005	1.31	1.40	1.28				1.10	0.85
2006	1.06	1.64	1.24				1.29	1.22
2007	0.80	1.45	1.94				1.10	0.71
	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
1980~1989	1.99	2.54	1.36	2.06	3.38	1.35	3.66	1.88
1990~1998	3.39	2.87	1.49	1.52	5.55	2.88	3.31	2.75
1999~2006	1.97	1.20	1.08	1.15	4.08	1.27	1.94	1.61
2001	2.20	1.18	1.11	1.20	7.76	1.22	2.32	1.57
2002	1.54	1.31	1.18	1.30	2.85	1.37	1.28	1.17
2003	2.39	1.57	1.03	1.46	1.51	1.60	1.38	1.24
2004	1.44	1.18	0.83	1.13	2.74	1.20	1.33	1.01
2005	1.24	1.14	1.16	1.09	2.42	1.16	1.64	1.26
2006	1.48	1.16	0.78	1.00	2.67	1.18	2.03	1.59
2007	1.29	0.97	0.89	0.84	2.13	1.45	1.70	1.12



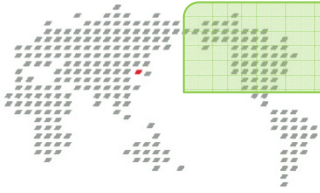
## Financial market restrictions, openness and exchange rate regime

	USA	GBR	JPN	FRA	DEU	NLD	SWI	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
Capital market securities	o	x	o	o	o	x	o	o	o	o	x	o	o	o	o
Money market instruments	o	x	o	o	o	x	o	o	o	x	x	o	o	o	o
Collective investment securities	o	x	o	o	o	x	o	o	o	x	x	o	o	o	o
Derivatives and other instruments	x	x	o	x	o	x	o	o	o	x	o	o	o	o	o
Commercial credits	x	x	x	x	x	x	x	x	o	x	x	o	o	o	x
Financial credits	x	x	o	x	o	x	o	o	o	o	x	o	o	o	o
Guarantees, securities, and financial backup facilities	x	x	x	x	x	x	x	x	o	x	x	o	o	o	o
Direct investment	o	o	o	o	o	o	o	o	o	x	x	o	o	o	o
Liquidation of direct investment	x	x	x	x	x	x	x	x	o	x	x	x	x	x	x
Real estate transactions	x	x	o	x	o	x	o	o	o	o	x	o	o	o	o
Personal capital movements	x	x	x	x	x	x	x	x	o	x	x	x	o	o	o
Financial openness (Gross private capital flows/GDP, %)	14	123	16	33	31	94	84	7	11	96	78	7	24	18	13
Source: AREAER, IMF & World Economic Indicators (WB) Exchange rate regime	float	float	float	float	float	float	peg	float	Crawl ing peg	Mana ged float	Curre ncy board	Mana ged float	Mana ged float	float	Mana ged float

# Exports

	USA	GBR	JPN	FRA	DEU	NLD	SWI	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
<b>Exports to less-developed economies (%)</b>															
1980	41.60	27.91	52.30	28.36	23.36	13.75	26.12	31.66	51.71	58.36	36.57	22.27	40.05	24.53	41.84
1990	35.82	18.74	41.14	19.57	19.23	9.87	20.58	24.60	63.18	50.07	46.48	29.52	49.39	20.70	32.09
1998	43.29	20.11	45.54	20.87	24.51	14.00	20.20	51.15	44.37	52.29	51.45	46.36	47.93	29.31	39.49
2002	44.94	18.25	51.53	22.21	25.88	13.26	22.28	52.18	45.14	60.65	56.35	47.20	52.67	39.84	44.89
2006	48.25	20.51	59.04	25.05	29.84	16.80	24.08	61.48	47.99	68.12	63.68	53.28	55.97	45.12	53.45
2007	48.92	22.63	61.38	25.92	30.72	18.49	28.48	65.79	49.86	70.34	67.67	54.52	58.52	62.95	56.21
<b>Exports of machinery and transports equipment (%)</b>															
1980	40.96	34.70	54.91	33.71	n.a.	16.61	33.49	6.22	19.78	n.a.	28.41	19.01	0.50	11.51	2.69
1990	47.16	40.00	65.94	37.14	n.a.	22.17	31.71	20.10	36.92	17.63	48.12	24.35	1.44	33.59	18.14
1998	53.29	48.35	66.18	43.75	50.34	33.30	31.69	39.92	50.79	25.34	66.42	31.45	10.14	56.34	72.37
2002	51.02	42.24	64.85	43.68	51.83	31.20	27.04	41.93	59.80	35.57	64.87	39.49	14.18	58.95	75.97
2006	48.36	42.45	62.82	41.25	49.10	29.72	24.92	44.37	58.74	44.12	60.13	50.17	12.87	52.37	69.99

Source: IMF, Direction of Trade



## Country risks (Dec., 2007)

	USA	GBR	JPN	FRA	DEU	NLD	SWI	KOR	CHN	SGP	HKG	IDN	MYS	PHL	THA
Political risk	77	82	79	79.5	87.5	84.5	89	78	70.5	84.5	83	62	75.5	60.5	56
Corruption	4	4	3	5	5	5	4.5	2.5	2.5	4.5	4	3.5	2.5	2	1.5
Bureaucracy	4	4	4	3	4	4	4	3	2	4	3	2	3	3	2
Government stability	8	6	6.5	9.5	10	7	9.5	6.5	11	11	10.5	7.5	9	5	6.5
Investment	12	12	11.5	12	12	12	12	10	7	12	12	9	9.5	9	7
Internal conflict	10	9.5	10.5	9	11	10	12	10	10.5	10.5	11	9	10	6.5	8
External conflict	7	7	9.5	10	10.5	12	11	9	10	10.5	10.5	10.5	10	11	10
Military in politics	4	6	5	5.5	6	6	6	4	3	5	5	2.5	5	3.5	3.5
Religious tensions	5.5	6	5.5	4	6	2.5	4.5	6	5	4.5	5	1	4	3	2
Law and order	5	5.5	5	5	5	6	5	5	4.5	5	5	3	4	2.5	2.5
Ethnic tensions	5	4	5.5	2.5	4	4.5	4	6	4.5	6	5	2	4	5	2
Democratic accountability	6	6	5	6	6	6	6	6	1.5	2	2.5	5	4.5	5	4.5
Socio	8.5	10	8	8	8	9.5	10.5	10	9	9.5	9.5	7	10	5	6.5
Financial Risk	30.5	40	46.5	38.5	39.5	40.5	44	43	48.5	44.5	41	40.5	43.5	38	41.5
Economic Risk	38.5	39.5	42.5	39.5	44	45	46	43	42	47	48	38.5	43	40	39.5
Composite risk	73	80.7	84	78.7	85.5	85	89.5	82	80.5	88	86	70.5	81	69.2	68.5

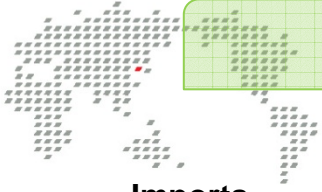
Source: ICRG(the International Country Risk Guide), PRS Group



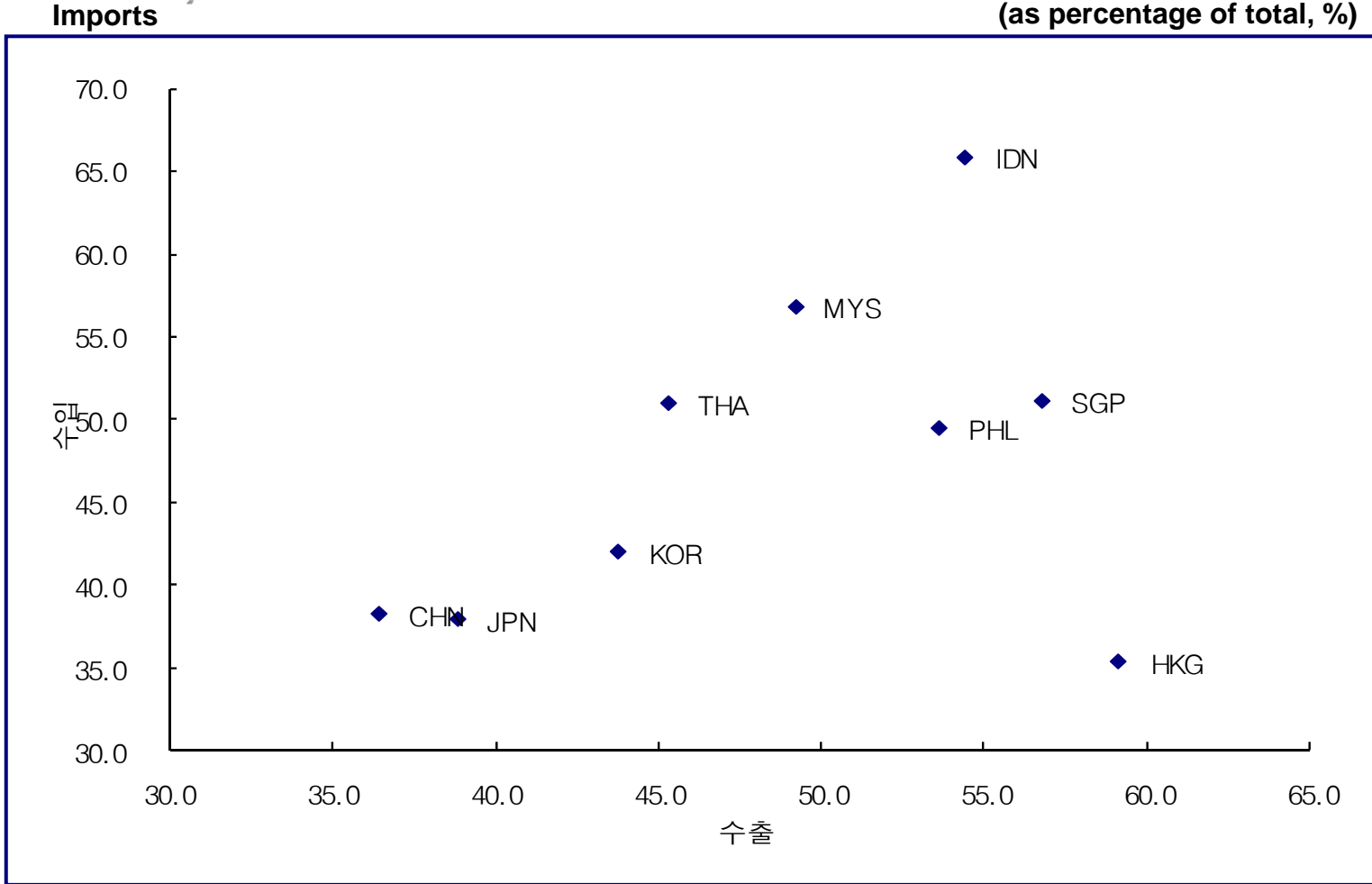


### III. Momentum for a regional currency regime in East Asia

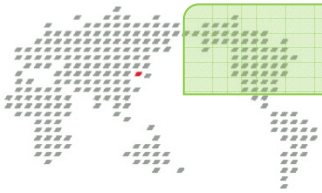
- ◆ **Currency competition in East Asia would happen as EA nations cope with the crisis.**
- East Asia is a combination of large and small economies with differing degrees of openness in financial markets and exchange regimes. But it is a well integrated trade area.
- Large economies as well as smaller economies would be interested in diminishing the impacts of external shocks to their national economies. They would tend to opt policies that favors the use of their own currencies rather than for instance the USD.
- The best place to start with is East Asia. Larger economies and richer net exporters are in the better position to start as they have stronger bargaining power.
- Will importers in EA prefer currencies other than USD to USD?



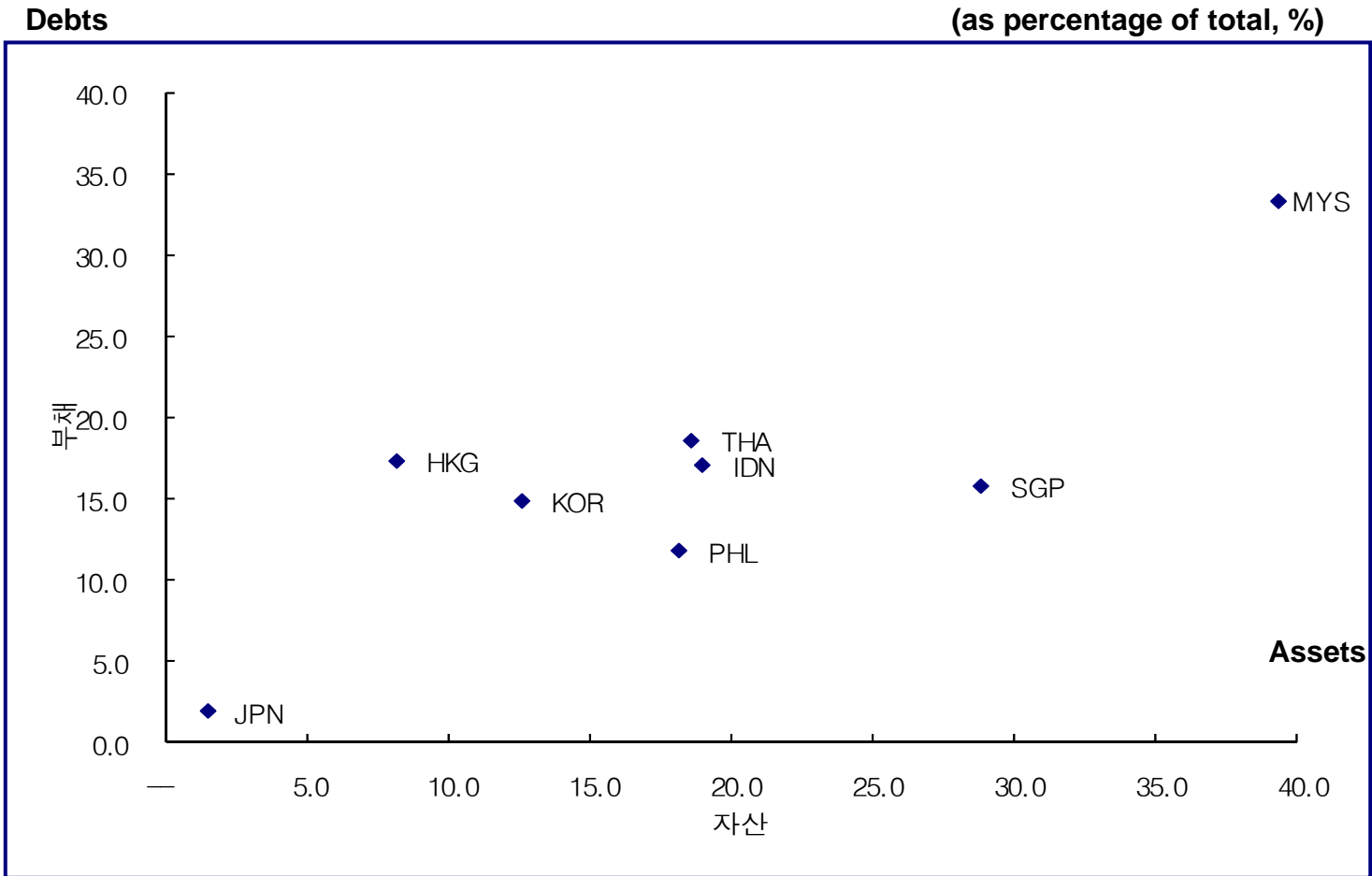
# Bilateral trade within East Asia



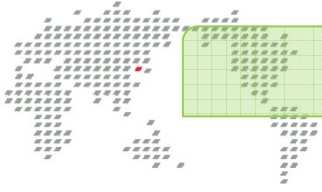
Source: Direction of Trade, IMF



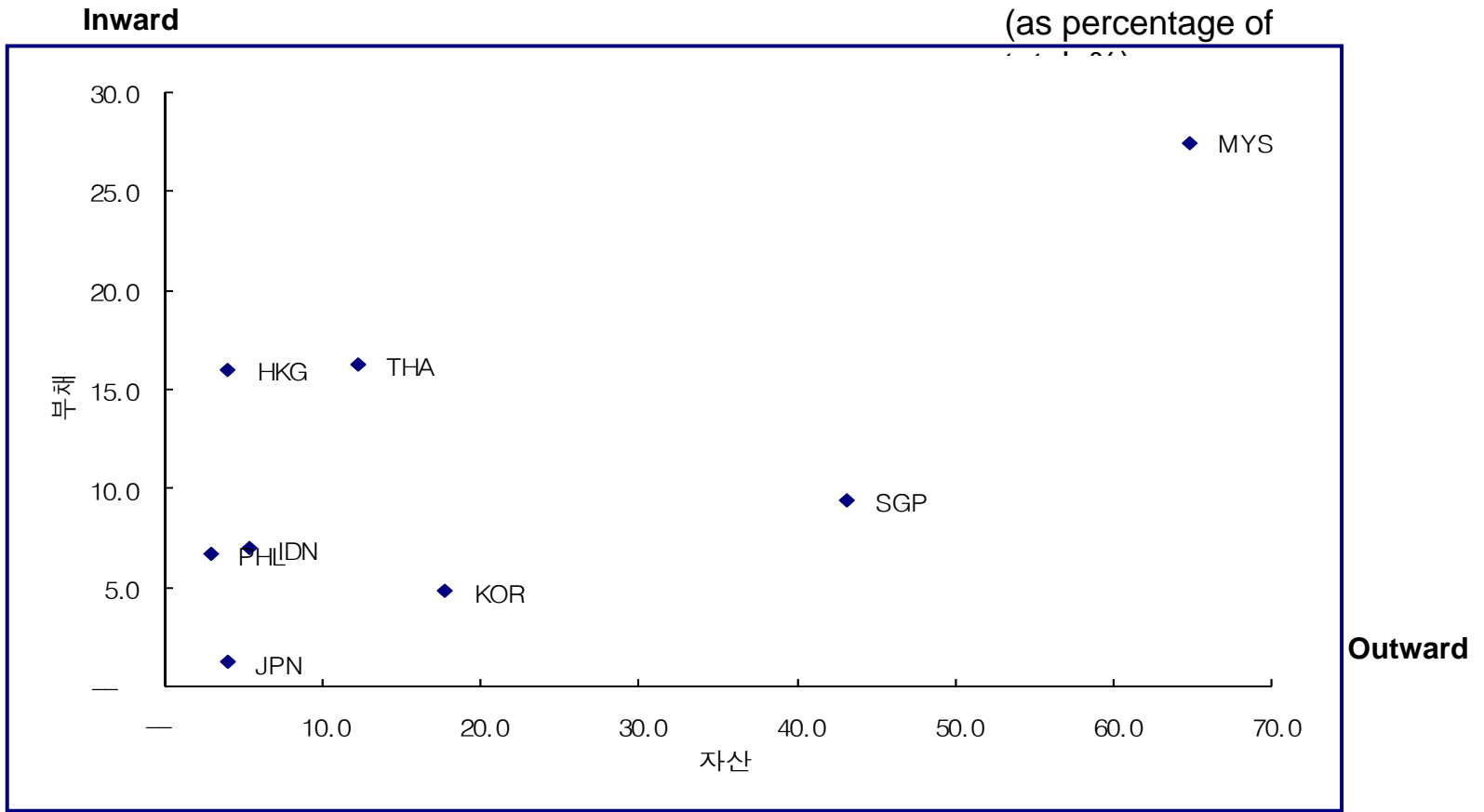
# Portfolio positions within East Asia



Source: Coordinated Investment Portfolio Survey, IMF



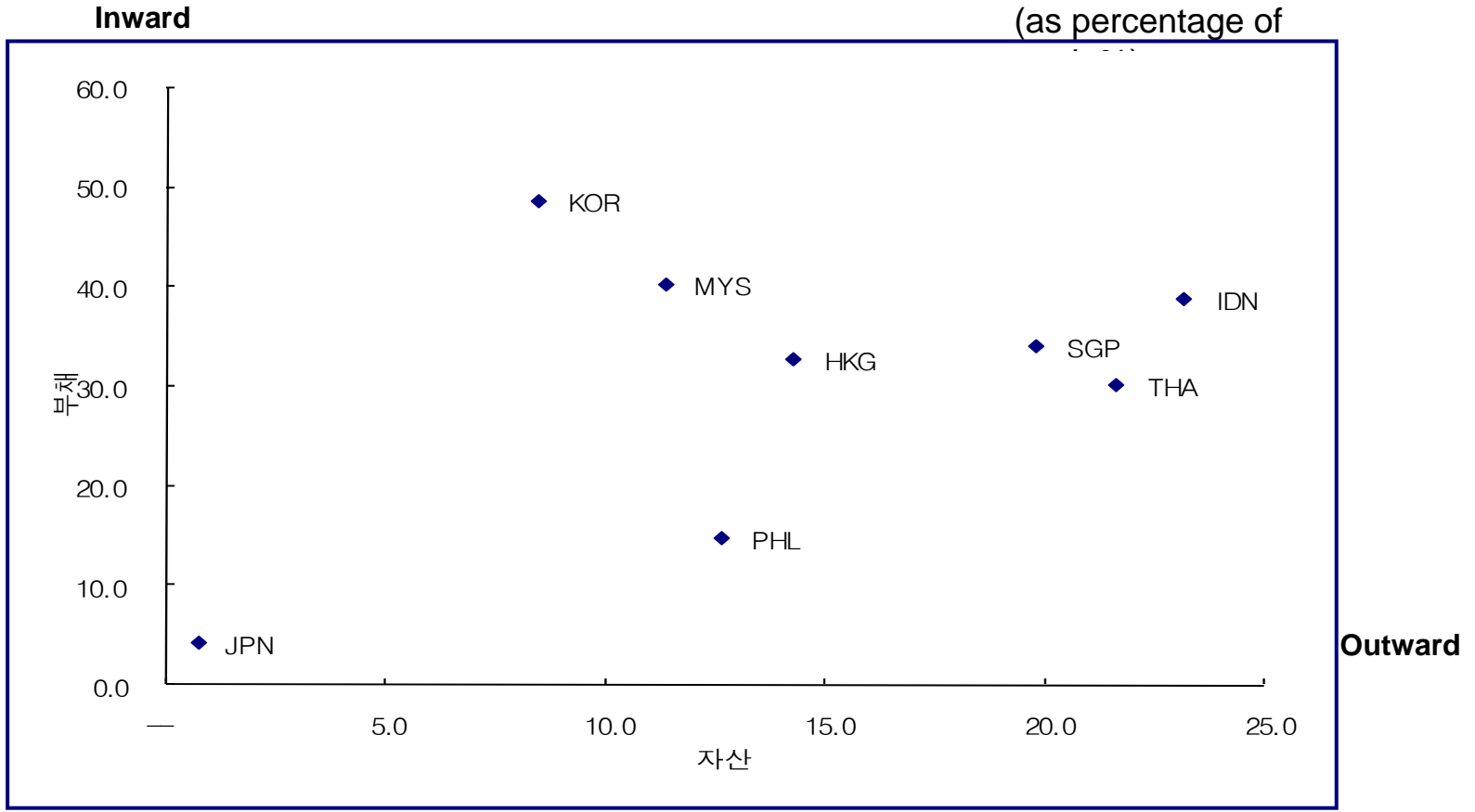
# Equity positions within East Asia



Source: Coordinated Investment Portfolio Survey, IMF



# Fixed income securities positions within East Asia



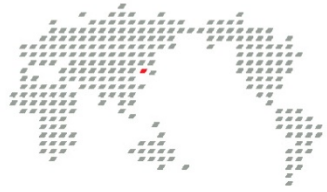
Source: Coordinated Investment Portfolio Survey, IMF



## Concluding remarks

### ◆ Currency competition or currency coordination for EA?

- The current crisis provides enough incentive for EA economies to pursue internationalization of their currencies. But the lack of financial and foreign exchange market competitiveness hinders the progress.
- Some EA economies would be ready to accept other EA currency for, say, clearing their trade, if it is less costly than using USD. The shortage of USD liquidity is a favorable factor for those EA countries with liquidity problem to opt more easily for the former.
- This in turn opens the possibility to take the road for the single currency in East Asia. If they have to choose other EA currency, why not an Asian currency?
- What about those who do not have to consider choosing other EA currency?



Thank You !