

# The Possible Use of Asian Monetary Unit - Differences between euro and AMU-

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# Objectives

- The current crisis in Eurozone show us the difficulties to introduce a common currency in the region.
- Then, will we continue to use US \$ as a key currency in Asia?
  - A common currency basket in Asia (AMU, ACU) still have some roll in future Asian economy, since Asian economy is closely integrated.
  - In order to find a new roll of AMU, we need to investigate the differences between the euro and AMU.
- From the lesson of the euro crisis, surveillance over intra-regional exchange rates by using AMU and AMU Deviation Indicators is important.
  - At first, the coordination of exchange rate policy among A3 countries are needed.
  - In addition, another possible usage of AMU might be recommended .

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2. AMU as a Surveillance Indicator
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# 1. Global Financial Crisis and AMU DI

# Differences between the euro and AMU

- The euro is “One currency for one Europe”.
  - On 1st January 1999, the euro became the new official currency of 11 Member States, replacing the old national currencies.
  - Without a monetary autonomy, Euro economy is facing a severe sovereign crisis.
  - The euro has no ability to adjust trade imbalance in the region.
- The AMU is just an artificial “basket” currency composed of 13 East Asian currencies.
  - The AMU is similar to the ECU, which was used as the unit of account of the EC before being replaced by the euro.
  - Ogawa and Shimizu (2010) propose the AMU as a surveillance indicator of AMRO.

# Impossible Trinity

Many Asian countries including China still keep capital controls, which become an obstacle of high transaction costs of Asian currencies.

**Capital Controls**

Asian countries

Increased  
Capital  
Mobility

Fixed exchange rates means no ability to adjust trade imbalance in the region.

**Pure Floating**

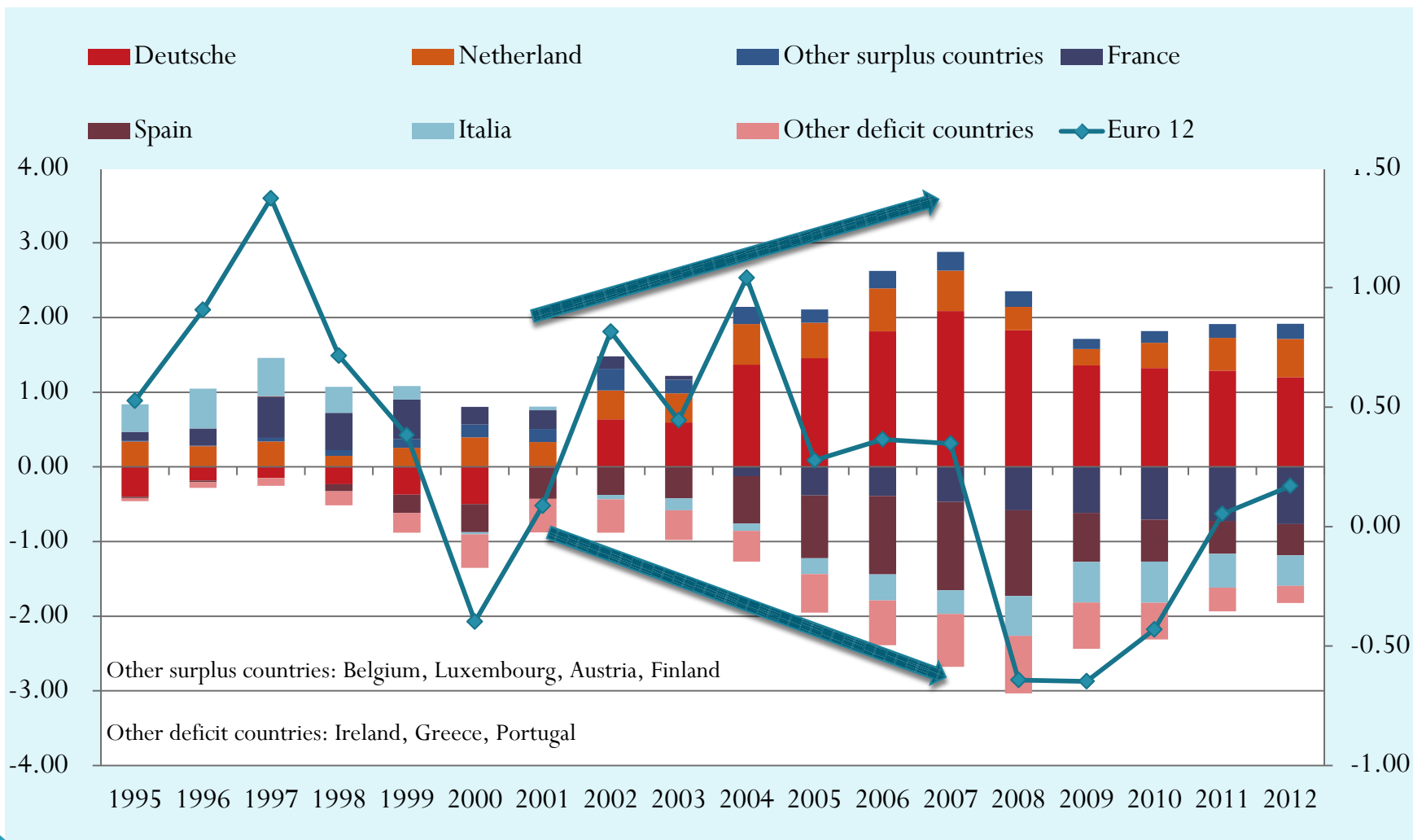
Without an exchange rate stability, Japanese economy is straggling with a strong yen.

**Monetary Union**

Without a monetary autonomy, Euro economy is facing a severe sovereign crisis.

Introducing a common currency in Asia might be a far-distance future objective!

# Euro Countries Current Account (as a percentage of GDP, %)



# Currency regimes in Asia

- After RMB's regime change, most Asian countries started to adopt managed or free float.
  - Since 3<sup>rd</sup> Q of 2010, Asian currencies except HK\$ have been more flexible vis-à-vis the US \$.
- However, related researches indicate that coordinated exchange rate policies are not executed in Asia so far;
  - Levy-Yeyati and Sturzenegger (2007) conjectured that exchange rate policies have evolved towards an apparent “fear of floating in reverse” or “fear of appreciation.”
  - Rajan (2011) confirmed the existence of an asymmetry in central bank foreign exchange intervention responses to currency appreciations.



# De-jure Foreign Exchange regime in Asia

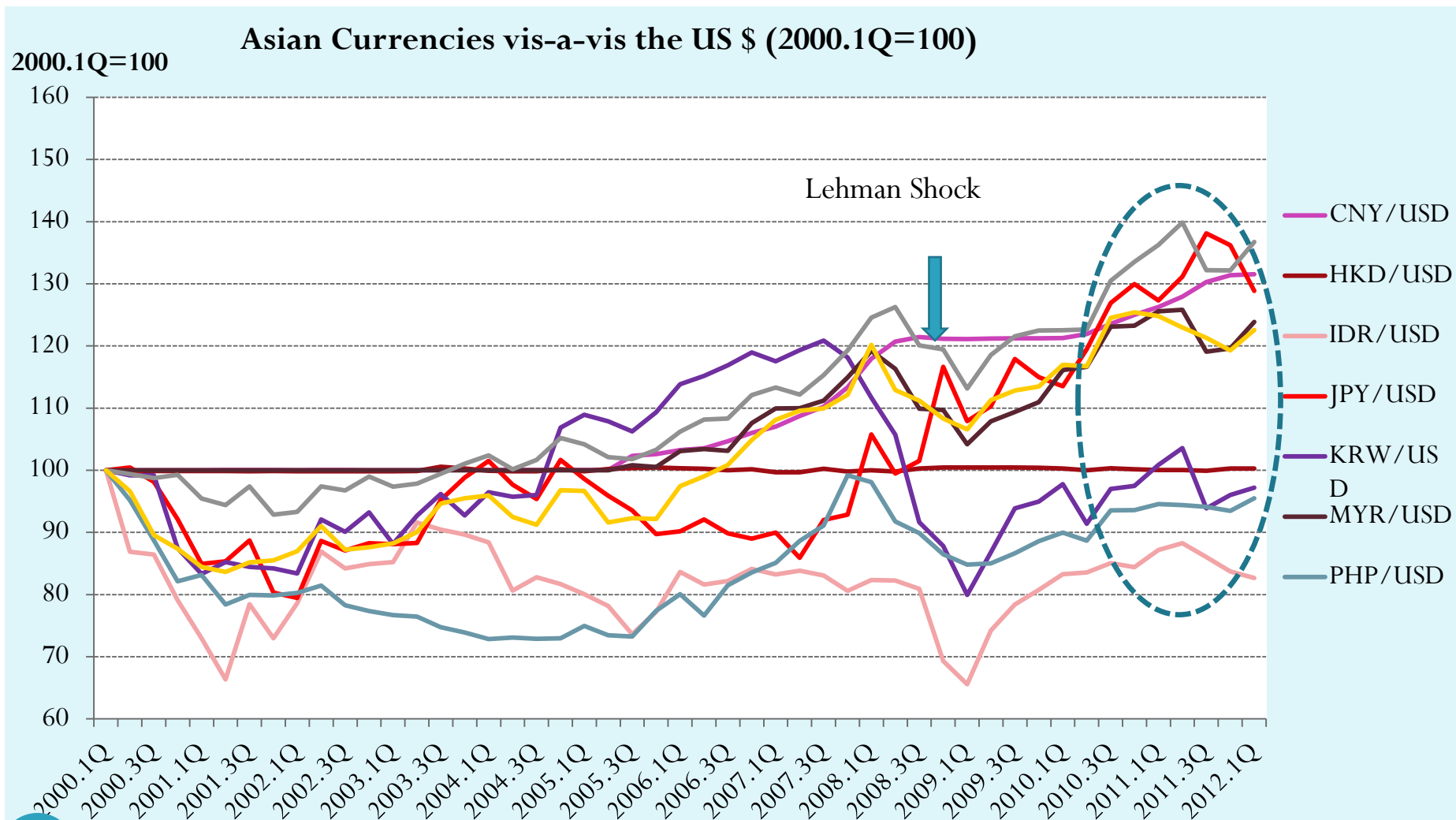
De-jure Exchange Arrangement of Asian Countries

Country	Arrangement in the 2010 AREAER
China	Stabilized arrangement <sup>1)</sup>
Hong Kong	Currency Board
Indonesia	Floating
Japan	Free floating
Korea	Floating
Malaysia	Other managed arrangement <sup>2)</sup>
Philippines	Floating
Singapore	Other managed arrangement <sup>2)</sup>
Thailand	Floating

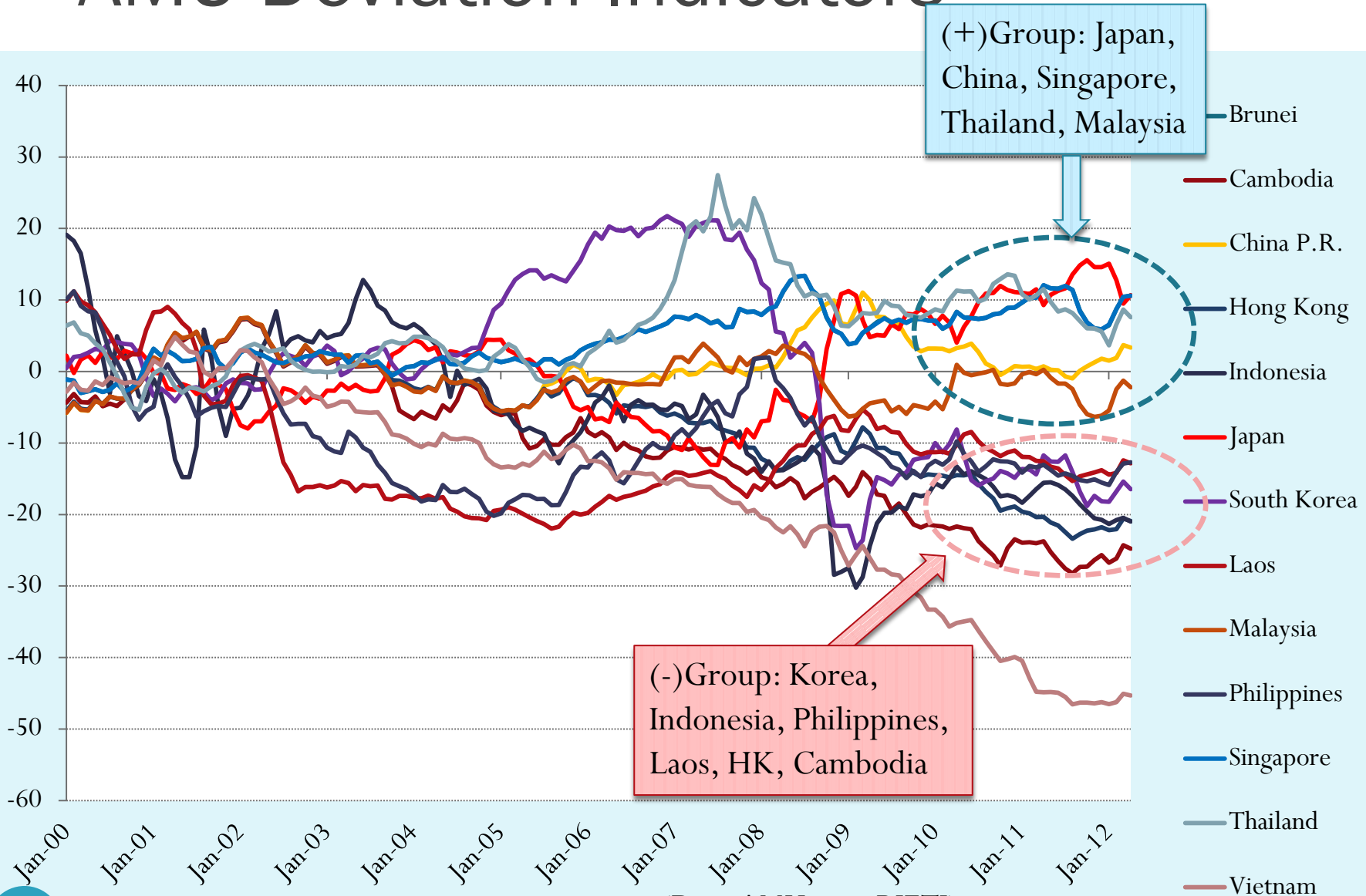
Source : IMF, AREAER 2010

- 1) Stabilized Arrangement is supported by official market intervention.
- 2) 3) Targeted policy band managed against a basket of currencies of the country's major trading partners.

# Asian currencies vis-à-vis the US\$



# AMU Deviation Indicators

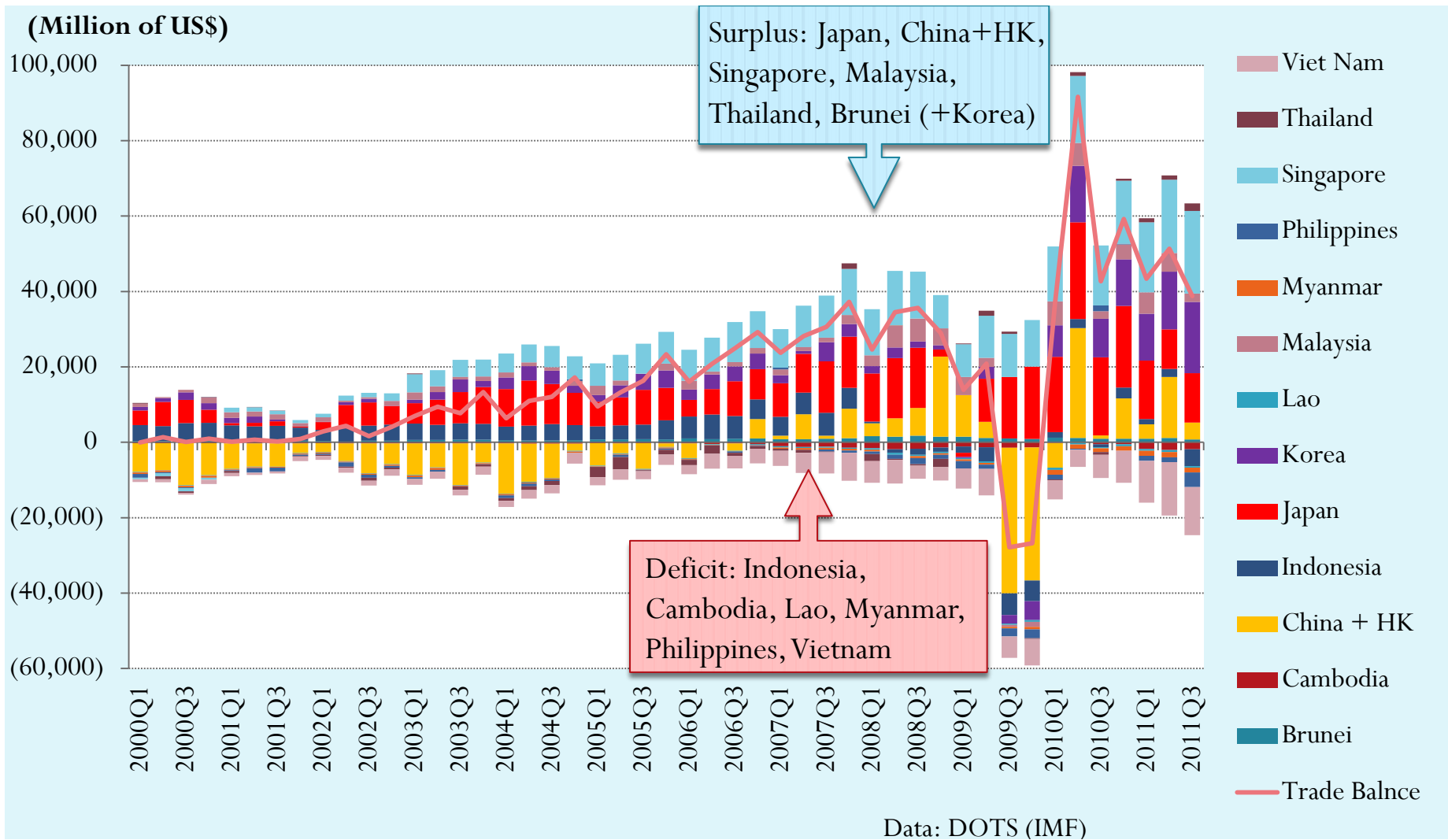


(-) Group: Korea, Indonesia, Philippines, Laos, HK, Cambodia

(+) Group: Japan, China, Singapore, Thailand, Malaysia

(Data: AMU-cmi, RIETI)

# Trade Balance within the region



# AMU DI and Global Financial Crisis

- Global financial crisis asymmetrically affected the Asian currencies.
  - Plus: China, Singapore, Thailand, Brunei
  - Minus: Indonesia, Philippines, Laos, HK, Cambodia, Vietnam
  - Position Change: Japan (minus to plus), Korea (plus to minus)
- AMU DIs are strongly related with the trade balance in the region.
  - Plus countries have surplus and minus countries have deficit in the region.
  - Korea's trade balance turned to large surplus after Korea's AMU DI turned to minus.
- Watching the relationship between trade balance and AMU DI is important!

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## 2. AMU as a Surveillance Indicator

# Differences between Euro countries and Asian countries

- Even now, the differences among Asian countries are still larger than those of euro countries.
- For example, we investigate the euro convergence criteria in the case of Asian countries ;
  - Interest rate: Japan (0.9%) to Vietnam (10.4%) (10year bond, May 2012)
  - CPI: Japan (-1.0%, 2010) to Vietnam (9.2%, 2010)
  - Public debt (% of GDP): Brunei (0%, 2011) to Japan (229.8%, 2011)
  - Budget deficit (% of GDP): Korea (+2.2%, 2011) to Japan (-8.5%, 2011)

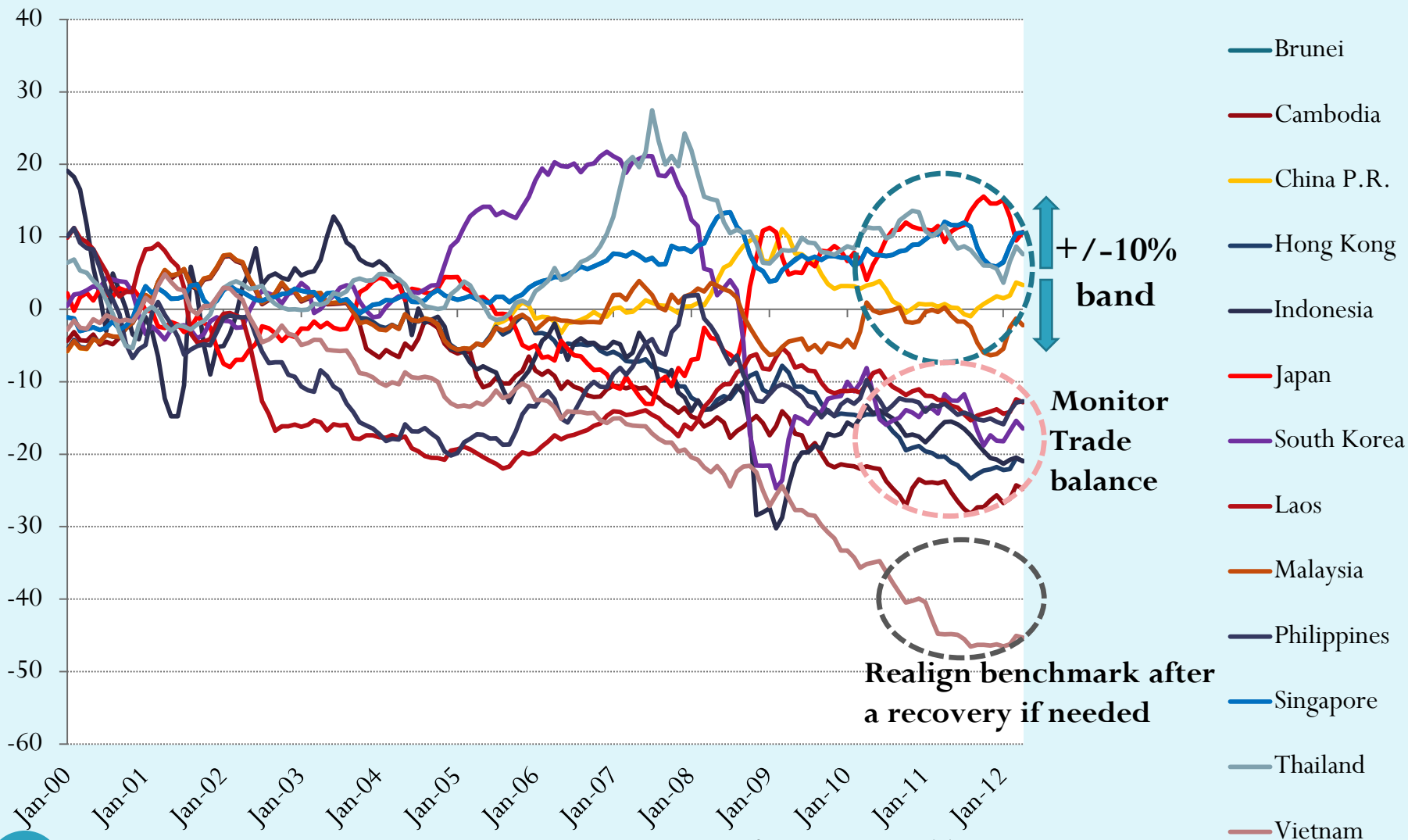
(Data: The World Fact Book, CIA)
- Above conditions suggest us that we do not keep all Asian currencies within a narrow band.
  - The euro crisis teach us that fixed regime is not suit for countries with the great differences.

# AMU as a Surveillance Indicator

- We need to decide some rules to use AMU DI as a surveillance indicator to stabilize the intra-exchange rates.
  - At first, only main currencies, such as Japan, China, Korea + Singapore, Thailand, Malaysia to keep within a band (The total basket share of these currencies is almost 90 %).
  - The previous AMU DI figure shows that the above currencies except Korean won have been within +/- 10% band since Jan 2009.
  - For other deficit currencies, they may stay large minus until their trade balance is improved.
  - Or, we set their benchmark exchange rate realign.



# AMU Deviation Indicators



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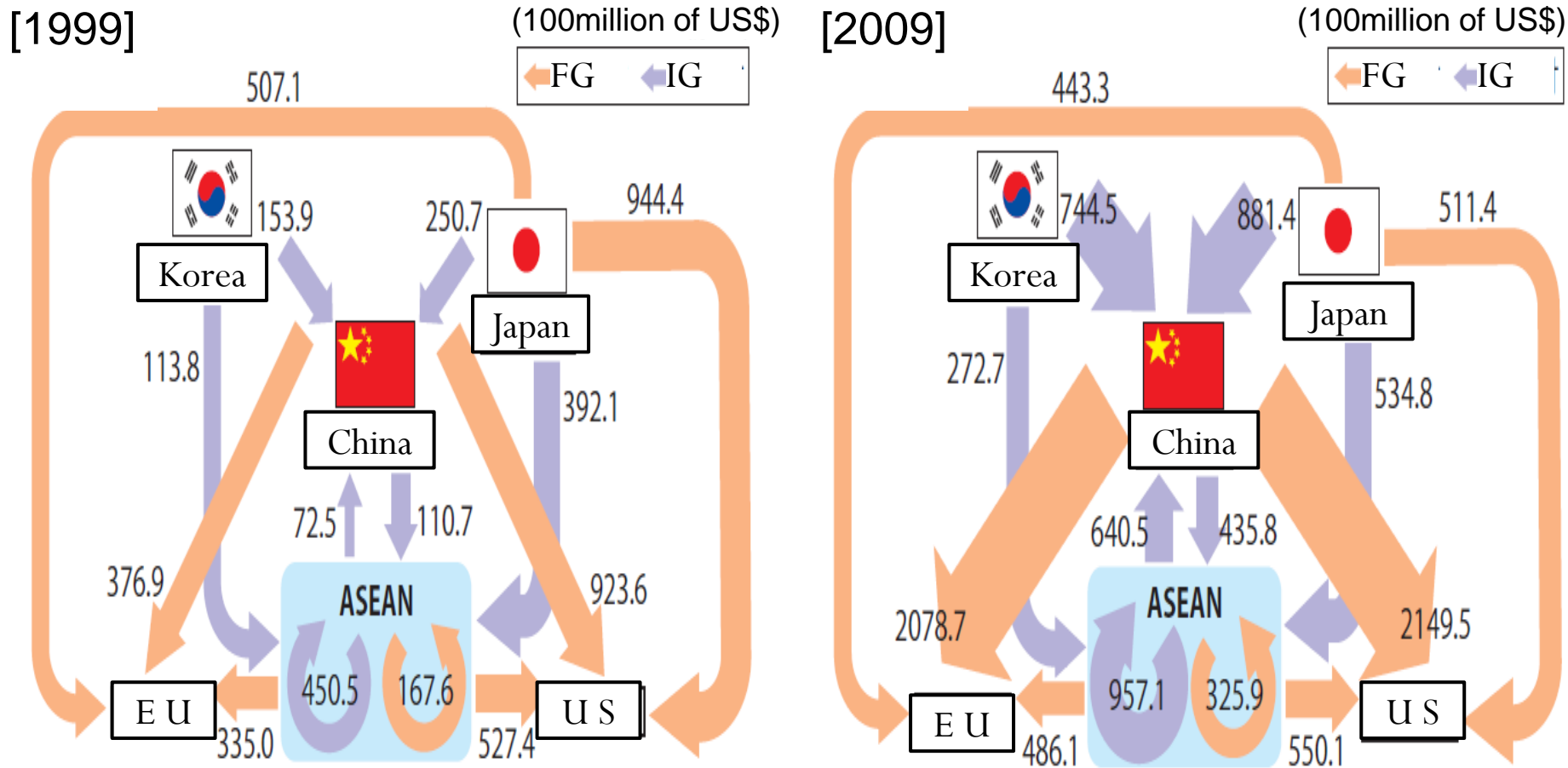
# 3. Internationalization of Asian Currencies

# Differences between Euro trade and Asian trade

- Both region's intra-trade share are high.
  - In euro-area, the euro is a vehicle currency in the region.
- Changes in the global and East Asia trading structures over the past decade are confirmed:
  - East Asia production network has been expanding its supply and demand of intermediate goods in the region.
  - China's increasing presence as an assembly and export base.
  - ASEAN has started to play a role expanding the supply of intermediate goods to China.
- The possibility of the East Asia network to be a “world production and demand network” is to be confirmed.
  - However, these transactions are mainly invoiced in US\$!

# Trade of intermediate and final goods in East Asian countries/regions

(FG: Final Goods, IG: Intermediate Goods)



(Source: White Paper on International Economy and Trade 2010 (METI), RIETI-TID 2011)

# Internationalization of the Japanese yen

- The share of the Japanese yen in Japan's trade rose significantly in 1970s and 1980s at the backgrounds of the following factors.
  - Collapse of Bretton Woods regime: From fixed exchange rate system to floating exchange rate system
  - The Japanese yen achieved full convertibility through liberalization of foreign exchange and capital controls.
  - Expansion of Japan's economy and financial markets
- The rise of the share came to a halt since 1990s.
  - Long stagnation of the Japanese economy
  - Dominant presence of US dollar in East Asian region

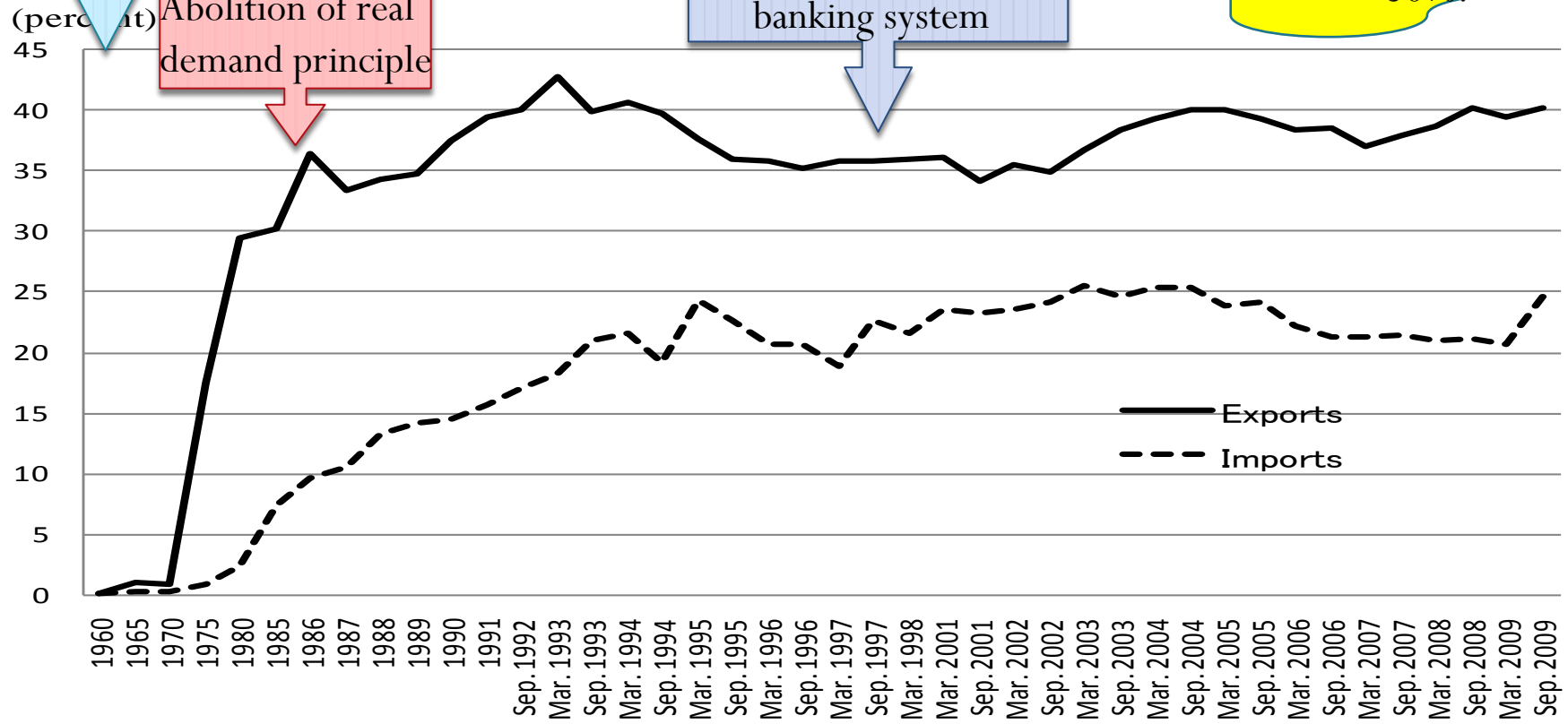
# Yen invoicing share of Japan's trade and Road to the full convertibility of the Japanese Yen

Establishment of free yen account for non-residents

Abolition of real demand principle

Abolition of authorized foreign exchange banking system

However, Yen invoicing share is still below 50%!



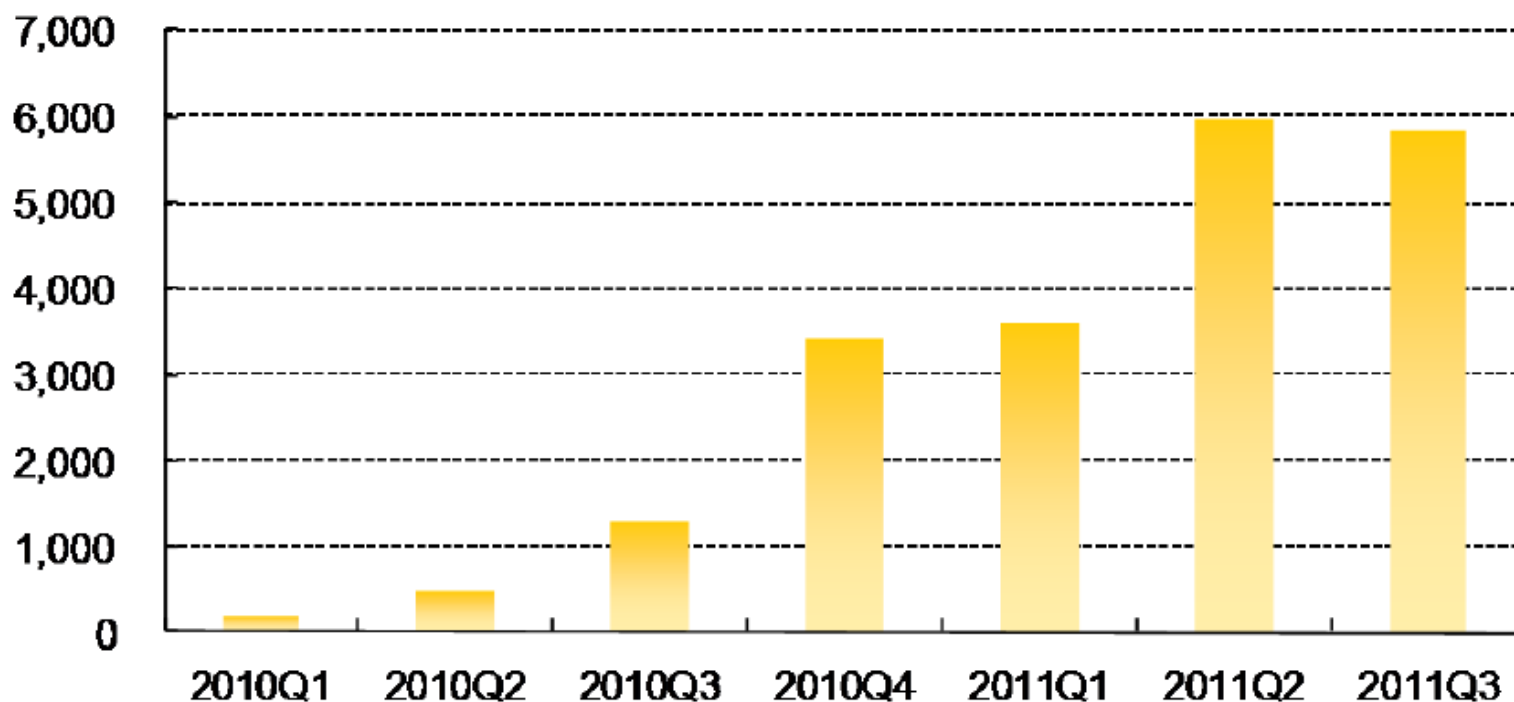
Source: Ministry of Finance, Trade Statistics of Japan; and other sources  
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# The Internationalization of the RMB

- The Standing Committee of the State Council decided in December 24, 2008, to launch RMB settlement trials.
  - Goods traded between the Guangdong-Pearl River Delta area and Hong Kong-Macau, and between the Guangxi-Yunnan region and the ASEAN.
  - China concluded bilateral swap agreements with Republic of Korea, Hong Kong, Malaysia, Belarus, Indonesia, and Argentine to provide RMB liquidity for trade and direct investment.
- As the government expand the pilot program in 2011, RMB invoicing is rapidly increasing, although the ratio is still low because of the followings;
  - Strict foreign exchange and capital controls
  - Domestic financial system needs to be more transparent.

# RMB' Cross-border Settlement Amount

図1 クロスボーダー貿易人民元決済額の推移 (単位：億元)



(出典) 中国人民銀行「2011年第3四半期中国貨幣政策執行報告」



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## 4. Possibility to use the AMU-3 as a trade settlement currency

# Differences between ECU and AMU

	ECU	AMU
Objectives	To maintain stable exchange rate among EEC countries.	To maintain stable exchange rate among East Asian countries.
Anchor	The Deutsche Mark	No anchor currency (Yen, RMB?)
Official use	Yes, by EMS central banks	No (CMIM, AMRO?)
Private use	Yes, mainly as a denominated currency of bond issues and ECU deposit	No (ADB, ABMI?)
Clearing	Yes, the BIS as accounting agent and commercial banks to the clearing system	No

# The Experience of the euro as a regional vehicle currency

- The European Monetary System (EMS) contributed to a substantial reduction in the spreads of cross-foreign exchange rates among European currencies.
  - It helped West German mark to take over the US dollar as a vehicle currency in Europe in 1980s.
- The euro has steadily increased its share in the settlement and invoicing of trade in euro and non-euro area EU countries.
  - The share of local currency invoicing also has increased.
  - The role of the US dollar as a vehicle currency is becoming less important in EU countries.
- This implies that the regional monetary and financial cooperation could be effective in promoting the use of a regional currency.

# Currency Breakdown of Exports and Imports of Goods (outside the euro area)

## Euro countries

Euro area countries	Export		Import		
	Euro	USD	Euro	USD	
Belgium	2002	53.6	32.5	53.7	34.5
	2006	58.5	31.9	58.3	35.0
France	2001	50.8	41.0	42.6	45.7
	2007	51.3	36.8	44.2	46.2
Germany	2002	50.1	30.5	48.4	35.3
	2007	65.2	21.3	56.9	37.2
Greece	2001	23.5	67.7	29.3	61.5
	2007	39.2	57.2	34.9	62.5
Italy	2001	52.7	34.6	40.8	50.8
	2007	64.5	30.2	44.6	51.9
Luxembourg	2002	44.0	38.3	31.9	47.5
	2007	59.2	30.3	37.9	49.6
Netherlands	2001	47.8	39.2	41.1	48.5
	2002	52.0	35.2	48.0	43.8
Portugal	2001	40.3	41.3	50.3	40.5
	2007	61.4	31.5	51.3	44.7
Spain	2001	52.0	38.4	49.7	43.7
	2007	65.2	28.6	56.7	40.9
Average change from 2001 to 2007	11.3	▲ 6.7	5.0	0.4	

Source: European Central Bank, "The Review of the International Role of the Euro" July 2009.

## Non-euro Countries

New euro area & Non-euro area EU countries	Export			Import			
	Euro	USD	Local currency	Euro	USD	Local currency	
Bulgaria	2001	48.1	49.0	...	55.5	41.8	...
	2006	57.7	40.2	...	58.9	39.0	...
Czech	2001	68.7	14.1	10.3	66.6	19.7	7.7
	2007	72.0	15.9	...	68.0	22.6	...
Denmark	2001	32.8	25.3	22.3	36.3	23.1	27.9
	2007	34.3	19.3	28.0	32.7	18.1	38.9
Estonia	2001	53.8	14.0	21.2	53.9	25.7	5.2
	2007	57.8	17.7	18.6	58.5	19.4	17.0
Hungary	2001	79.4	15.7	...	70.5	21.7	...
	2004	84.8	9.6	...	70.8	18.8	...
Latvia	2001	34.1	41.4	...	44.5	37.3	...
	2007	59.5	28.9	3.5	67.2	22.1	5.5
Lithuania	2001	27.8	58.8	8.0	38.3	52.9	1.2
	2007	56.5	36.0	5.0	55.4	37.6	0.6
Poland	2001	57.2	33.8	4.1	57.7	32.9	4.6
	2007	69.8	17.2	9.0	59.1	26.9	11.2
Romania	2001	55.7	39.5	...	60.6	35.1	...
	2007	67.7	29.5	...	71.5	26.7	...
Slovakia	2001	71.0	15.0	5.9	58.0	24.0	5.1
	2007	95.8	3.1	0.4	82.4	15.9	0.4
Slovenia	2001	85.0	10.3	...	79.0	15.7	...
	2007	89.2	8.0	...	84.0	14.6	...
Average change from 2001 to 2007	12.0	▲ 8.3		8.0	▲ 6.2		

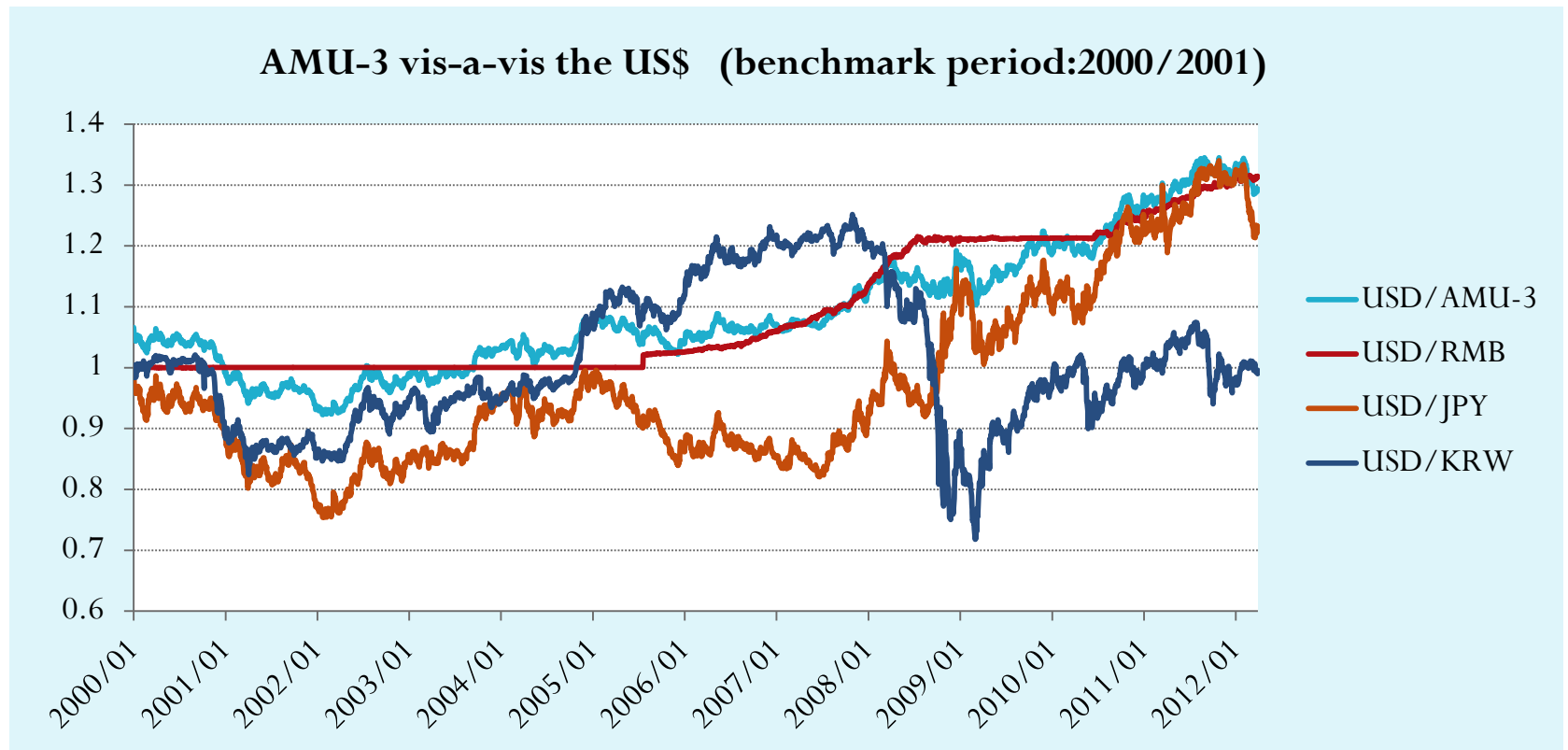
Source: European Central Bank, "The Review of the International Role of the Euro" July 2009.

# Create AMU-3 for trade settlement

- Creating a common currency in Asia will be a useful method to free Asian countries from the US dollar over-dependence.
  - As the previous figure shows, the trade linkage among Japan , Korea and China are strong.
- Why don't we create a trade settlement currency composed with Yen, Won and RMB, so-called "AMU-3"?
  - In order to change the US dollar standard in Asia, not a single Asian currency's internationalization, but a Japan-China-Korea coordinated internationalization would be better.
  - At the same time, create the CLS banks in Asia to handle clearing of AMU-3 settlement, which will promote the local currency invoicing in the region.

# AMU-3

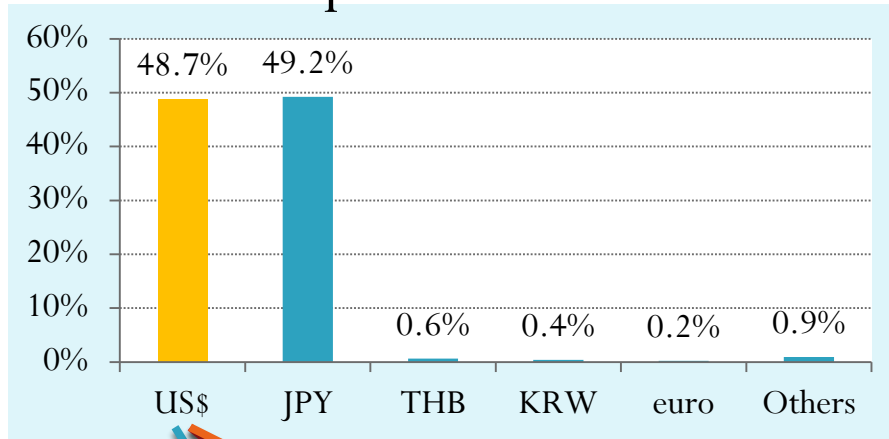
- The basket share of AMU-3 is based on each country's contribution proportion of CMIM.
  - JPY:RMB:KRW=32:32:16



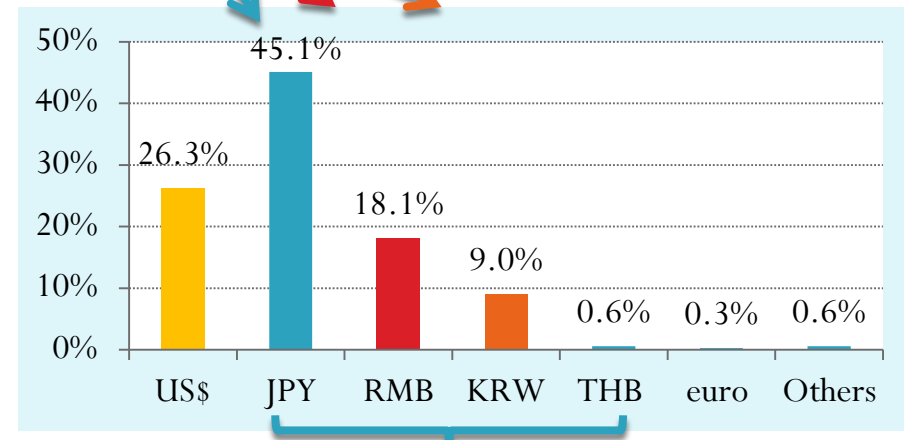
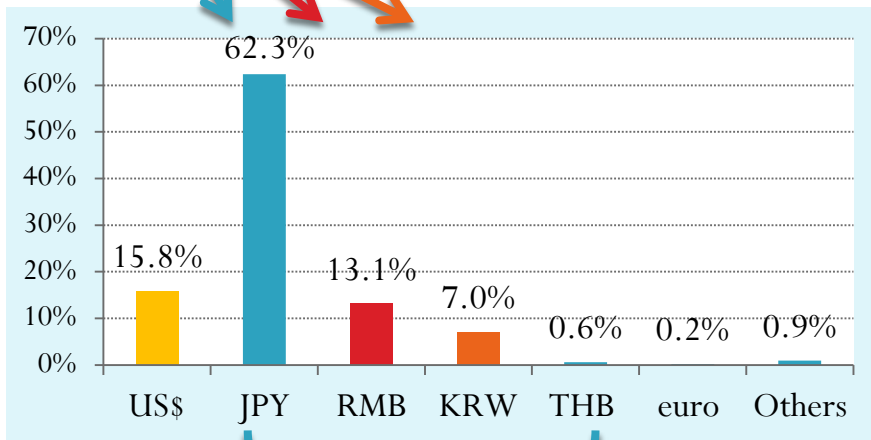
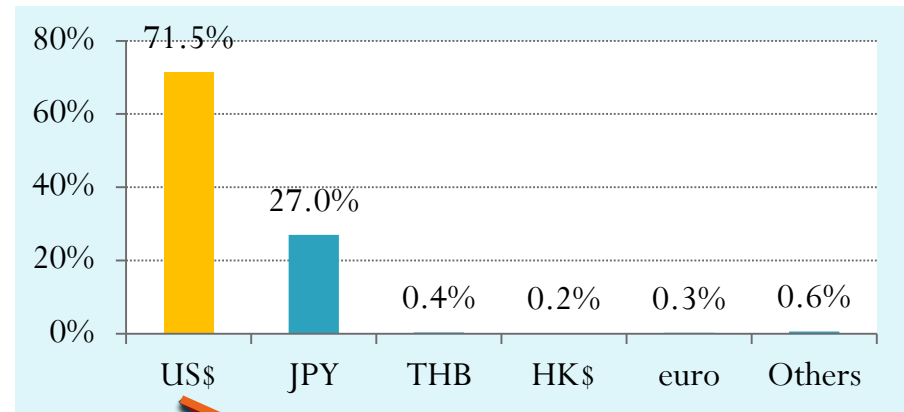
# In the case of Japanese trade

If Japanese firms use AMU-3 invoicing for export/import with China and Korea;

<Export>



<Import>



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# 5. Policy Recommendation



# Policy Recommendations

## **AMU for surveillance:**

Define AMU and AMU DI for surveillance purpose.

- We recommend the AMU based on CMIM weights.
- Set the narrow fluctuation band (+/-10%) for trade surplus countries at first.
- For deficit countries, monitor the AMU DI and their deficit carefully, and realign the benchmark exchange rate if needed.

## **AMU for trade settlement:**

Create AMU-3 (Japan, China, and Korea) and AMU-3 CLS banks.

- Japan, China and Korea corporate each other to free their firms from the US dollar over-dependence.

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