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# **The Possible Use of Asian Monetary Unit (AMU) - Comment -**

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# I. Summary of the Paper 1

## 1. AMU is different from euro and similar to ECU

- Euro-zone has experienced some troubles and the creation and use of single common currency in East Asia might not be feasible in short run.
- AMU is a composite currency of 13 East Asian currencies

## 2. AMU could be used as a surveillance indicator of misalignment of bilateral exchange rate or nominal bilateral equilibrium exchange rate (Ogawa and Shimizu(2010))

# Summary of the Paper 2

- Causes of misalignment : Fear of appreciation in East Asia and accumulation of foreign reserve by mercantilism and asymmetric intervention
- AMU deviation index (AMUDI) is highly related to trade balance in the region
- Because of the less convergence of fundamentals in East Asia, Asian currencies could not keep narrow margin
- Large margin is needed for the countries which have large trade deficits

# Summary of the Paper 3

## 3. Create AMU-3 for trade settlement currency

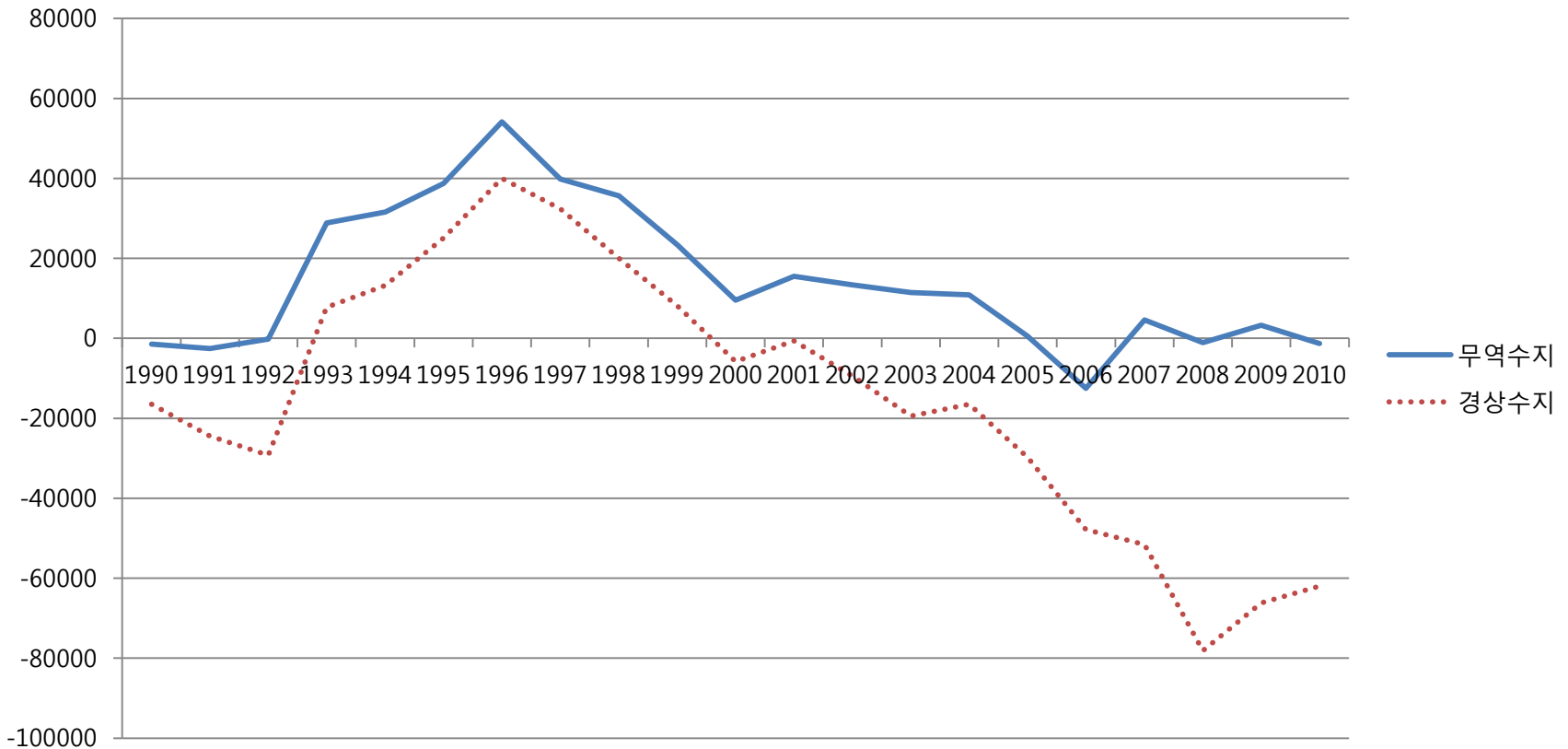
- CMIM's weight : Japan, China, Korea : 32:32:16
- Create CLS bank for AMU-3 trade settlement
- CLS bank could promote local currency settlement or invoicing

## II. Lessons from Euro-Zone Crisis

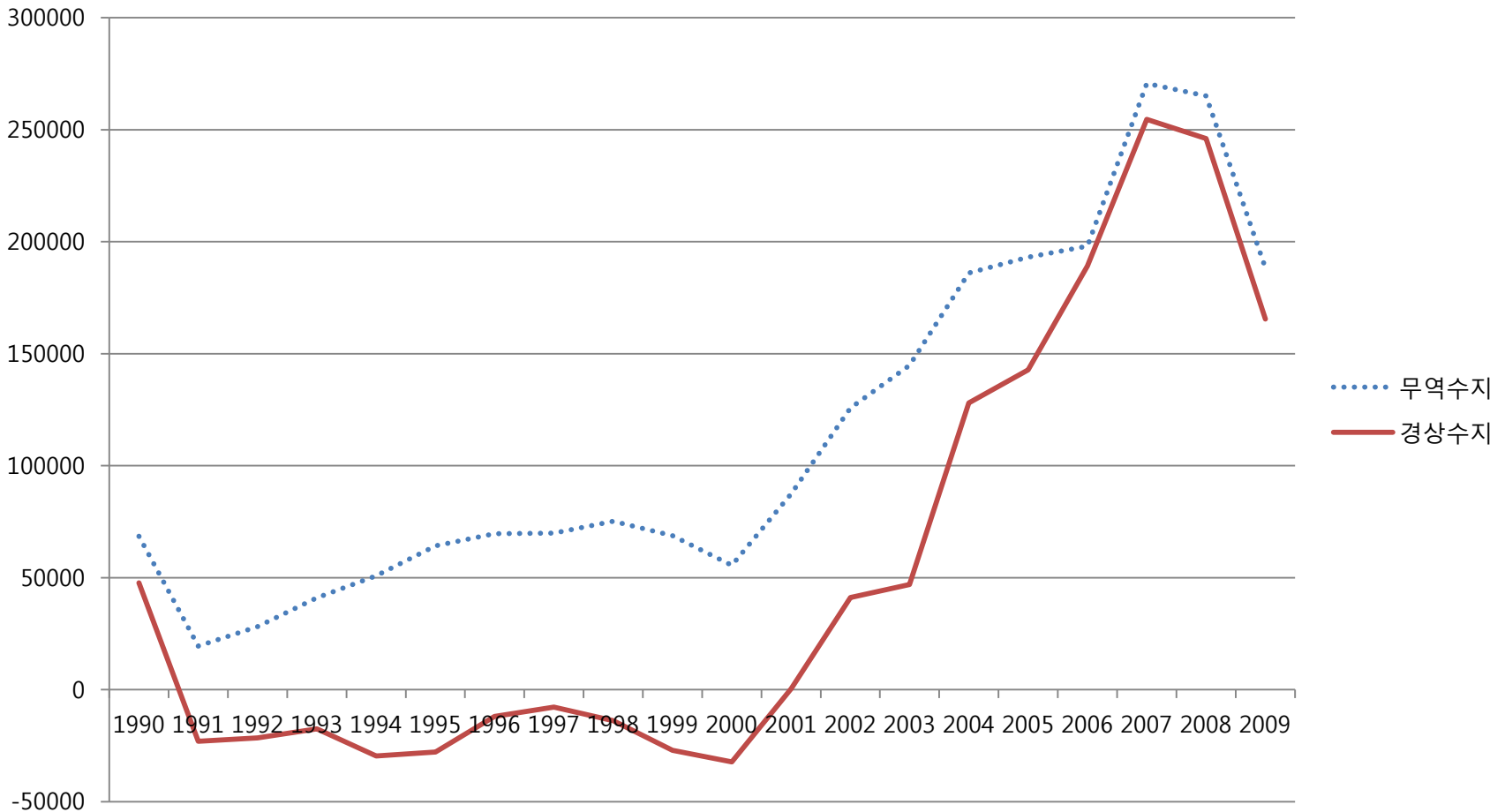
- OCA criteria (fiscal transfer or factor movement etc.) does not work when there is asymmetric Shock
- Difficult to make agreement for fiscal deficit criteria
- Without monetary and exchange rate policies, countries in the region could experience fiscal deficit or national debt crisis
- OCA is not sustainable and exchange rate policy is an important tool for the improvement of trade balance

# Trend of Italian Trade Balance (1990-2010)

Trade balance/Current Account



# Trend of Germany's Trade Balance (1990-2010)



# III. AMU as the Misalignment Indicator

- Misalignment will be increased under liberalized capital market and competitive depreciation for mercantilism
- Misalignment (overvaluation) could result currency crisis by deteriorating trade balance
- Need to establish regional surveillance system to control misalignment
- AMU DI could be an feasible cooperation and pre-step of single currency creation in the region



# Issues on AMU DI

- Convergence of fundamentals
- Country weight
- Band
- Organization
- How about to make AMU-3 DI

# IV. AMU-3 Trade Invoicing

- Reduce exchange rate risk in regional trade and promote regional trade and investment
- Apply to the AMU-3 Bond market
- Internationalization of non-convertible currencies in the region
- Pre-step of yuan internationalization : can reduce the side-effect of yuan internationalization
- Reduce the dependence of U.S dollar

# Issues on AMU-3 Invoicing

- AMU-3 : Composite currency : Difficult to use private transaction
- AMU-3 : Composite currency (Synthetic currency) : Difficult to forecast the value or exchange rate : Will not be used much
- Controversial issues : Country weight and benchmark year etc.
- Misalignment issues : Asymmetric capital market liberalization

## **V. Alternatives :**

**Local Currency Trade Invoicing**

# 1. Backgrounds and Objectives of the Research

- Increased regional trade volume in ASEAN+3 : \$2,138 billion(2009)
- 38.5% of total trade volume in ASEAN+3 : \$5,556 billion(2009)
- High share of U.S. dollar invoicing in regional trade of Asia
- Exposed by high exchange rate risk as the unstable US dollar value
- To promote regional trade, need alternative trade invoicing or trade settlement system
- For regional FTA, need to reduce trade settlement risk and establish alternative invoicing system

## 2. Determinants of Trade Invoicing : Theoretical Backgrounds

- To be an international currency ( convertible currency) : (1) role of medium exchange, (2) unit of account and (3) store of value
- To be a trade invoicing currency : (1) medium of exchange and (2) unit of account
- Determinants of trade invoicing currency : Transaction cost approach and cost & benefit(profit) approach

# Export Invoicing Determinants

- Currency exchange cost : fee etc.
- Low exchange rate volatility : Low exchange rate risk
- Appreciation of the currency
- Low growth rate of money and low inflation
- Differentiated good or homogenous good : Export invoicing :
  - In the case of differentiated good, the exporter has oligopolistic power and use home currency as trade invoicing currency
  - In the case of homogenous good (Crude oil etc.), trade partner countries' currency or US dollar are used to increase trade competitiveness and market share

# 3. Regional Trade Invoicing in ASEAN+3 (Thailand, China)

- Export between Thailand- Japan(2008) : dollar 59.6%, yen 33.1%, baht 6.7%
- Import between Thailand- Japan : dollar 49.5%, yen 43.1%, baht 6.8%
- Export between Thailand- other ASEAN : dollar 82.6%, yen 1.5%, baht 12.2%, SGD 2.2%, MYR 0.6%, others 0.9%)
- Import between Thailand- other ASEAN : dollar 88.7%, yen 1.6%, baht 4.6%, SGD 1.9%, MYR 2.0%, others 1.2%)
- Export invoicing between China-Japan : dollar 78.5%, yen 18.0%, others 3.5% (2009)



# 4. Alternative Trade Invoicing and Trade Settlement System

- Local Currency Trade Settlement(LCTS) System
- Yen or Yuan Anchor Currency Trade Settlement(ACTS) System
- Regional Common Currency Trade Settlement(CCTS) System

# (1) Local Currency Trade Settlement System(LCTS)

- Contract by home currency in export and contract by foreign currency in import
- Settlement by local currency through central bank
- Reduce the exchange rate risk
- Increase regional trade volume
- Improve the regional financial cooperation
- Incentives for small-medium firms regional trade

# Argentina–Brazil Experience

- Local currency settlement system(SML) : Argentina–Brazil in 2006(Research)
- In 2007, bilateral agreement between Argentina and Brazil
- In 2007, attempt to expand to MERCOSUR ( Brazil, Argentina, Uruguay, Paraguay)
- In 2008, launch the local currency settlement system between Argentina and Brazil
- 20% of total volume of Argentina and Brazil's bilateral trade
- Each trade volume is less than \$0.13 million

## (2) Yuan or Yen Anchor Currency Trade Settlement(ACTS) System

- Conditions for regional vehicle currency
  - Economic size and trade volume for the network externality
  - Liberalized and developed financial market
  - Sound economic fundamentals and stable currency value
  - Role of lender of last resort
- Yen and yuan : not feasible in the short term

## <table 34> Japanese Yen and Chinese Yuan on ACTS

	Yen	Yuan
Convertibility	O	X
Stability and credibility	O	O
Liquidity	O	X
Financial market development and opening	O	X
Capacity and stance of regional LLR	Δ	Δ
No concerns on a possible currency block	X	X

Note: Completely authors' subjective judgment

# (3) Regional Common Currency Trade Settlement(CCTS) System

- ACU (Asian Currency Unit)
- Sustainability is important
- For the sustainable regional single currency, economic convergence criteria should be satisfied like EMU(Economic Monetary Union of euro zone)
- Regional fiscal transfer system should be established
- Not feasible in the short term, however feasible in the long term

# 5. Lessons from the Failure of Yen and Euro Invoicing

- Why do Japanese companies not invoice in their home currency ? Why do Japanese companies invoice their exports in the dollar ?
- Ito, Koibuchi, Sato and Shimizu(2010) find the reason from intra-company trade.
  - Japanese exporters have their oversea affiliates in Asia. By invoicing importer country's currency, oversea affiliates can minimize exchange rate risk.
  - Japanese affiliates in Asia export to developed countries like U.S. and Japanese head office use U.S. dollar as invoicing currency.
- Less developed financial market and not well established regional fiscal transfer system are the constraints of the euro as a vehicle currency.

# 6. Future Plan of the Study

- Examine the merits and demerits of local currency settlement system.
- Analyze the feasibility and problems of the alternative settlement systems.
- Investigate the experiences of local currency settlement system etc. and find the lessons for Asia
- Provide feasible cooperation methods in the short term and long term.



# VI. Conclusion 1

- Lesson of euro crisis suggests that the creation and use of the single common currency in East Asia is not feasible in the short run
- AMU DI could be a feasible cooperation in East Asia to realign the bilateral exchange rate
- However convergence cooperation is essential to stabilize the margin of AMU DI

# Conclusion 2

- AMU-3 trade invoicing is a good idea for the cooperation in A3 region
- AMU-3 is a composite currency and invoicing is not convenient to the private trade settlement
- Composite currency is difficult to forecast the value.
- SDR and ECU are composite currencies and they are not used in private trade invoicing
- Local currency trade invoicing is more feasible cooperation for regional trade invoicing
- Local currency trade invoicing is pre-step of AMU-3 invoicing to reduce exchange rate risk in East Asia

**Thank you !**