



RIETI/ADB Symposium, June 29, 2007

Ten Years After: Learning from the Asian Financial Crisis

Discussion for Session II:

The Effect of Exchange Rate Devaluation on the Domestic Price Inflation and the Feasibility of Regional Monetary Arrangements

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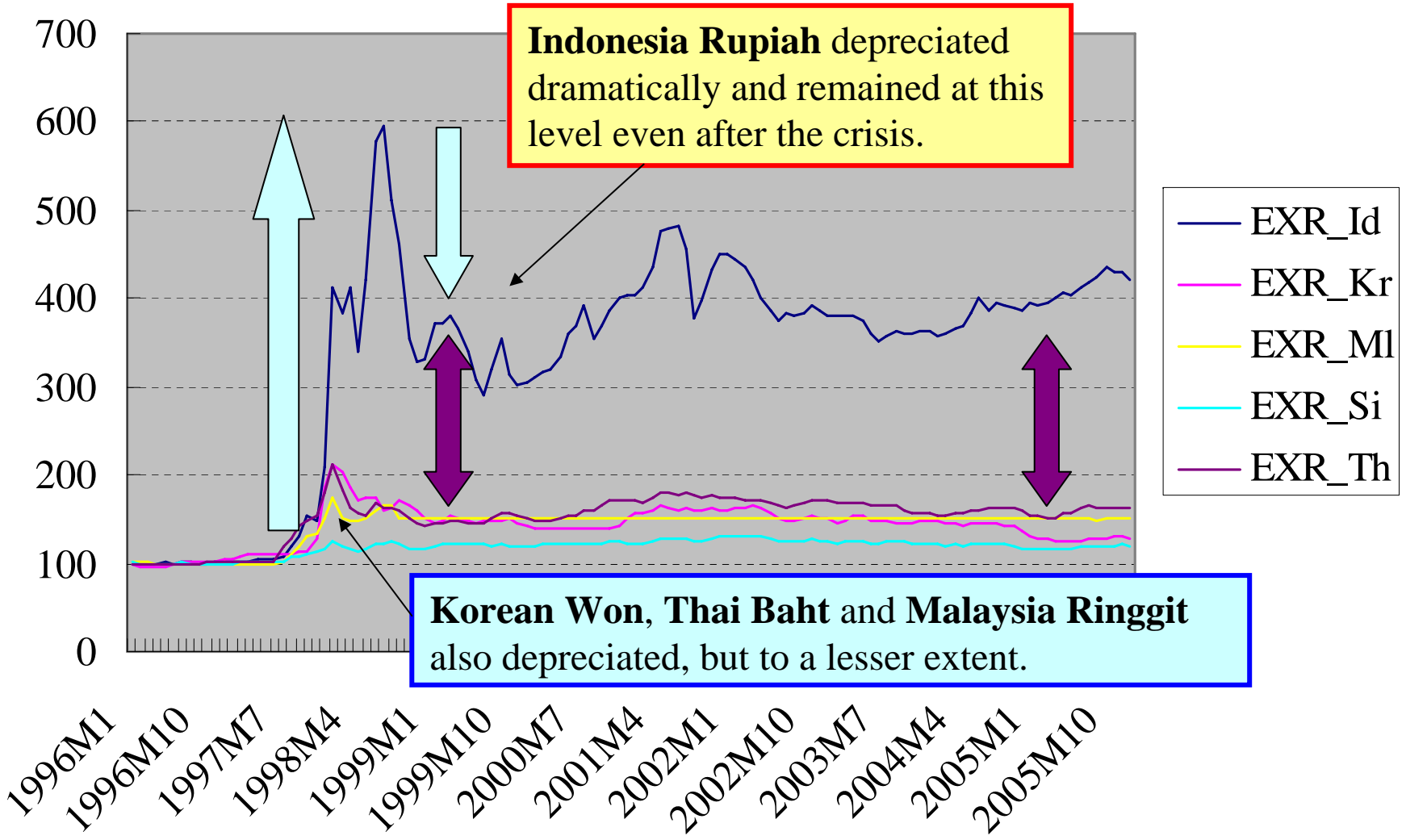
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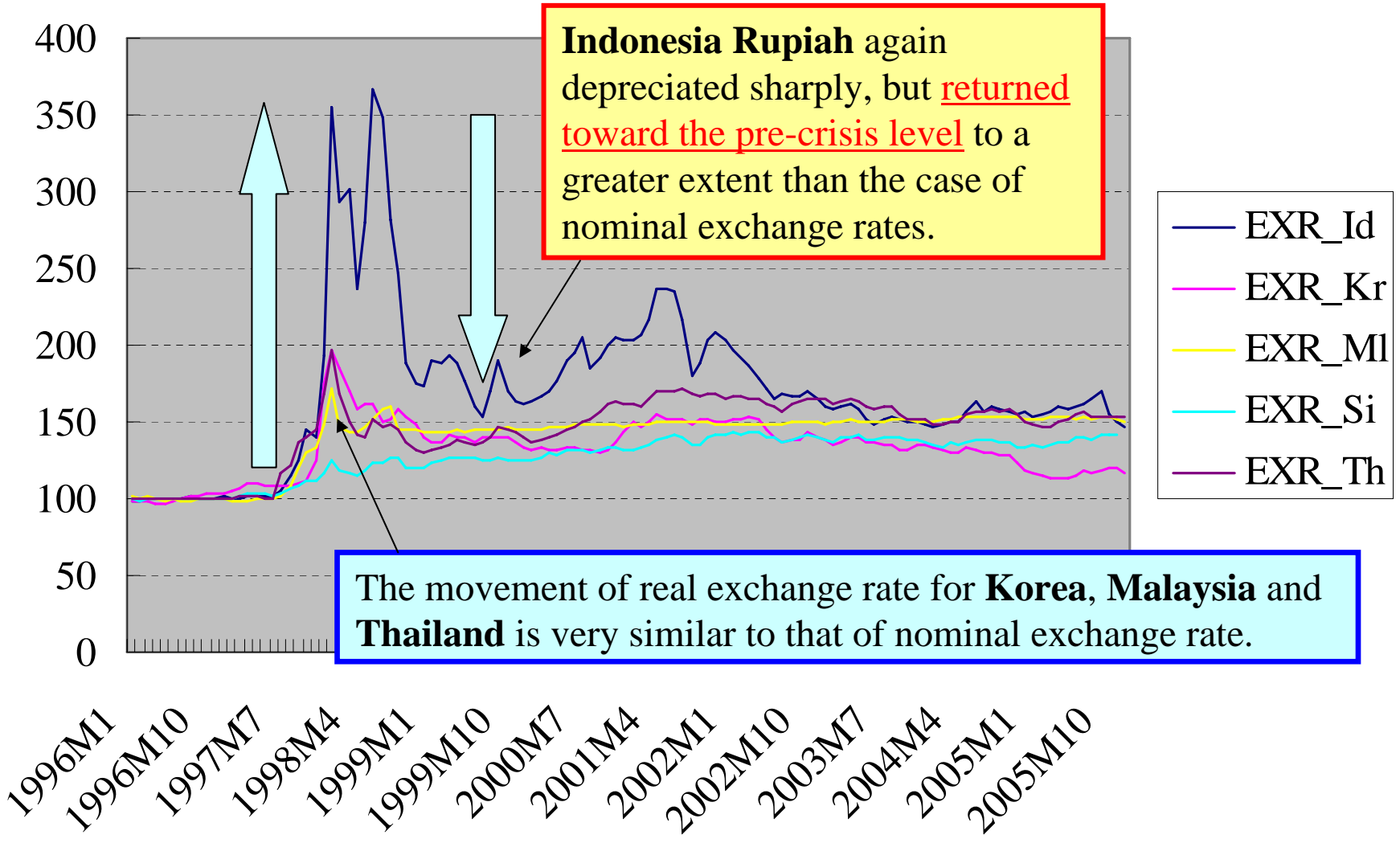
Exchange Rate Movements in the Crisis Period

- How different the fluctuation of the exchange rate in **nominal** and **real** terms?
- How different **across countries**?

Nominal Exchange Rate vis-à-vis the US Dollar (1996=100)



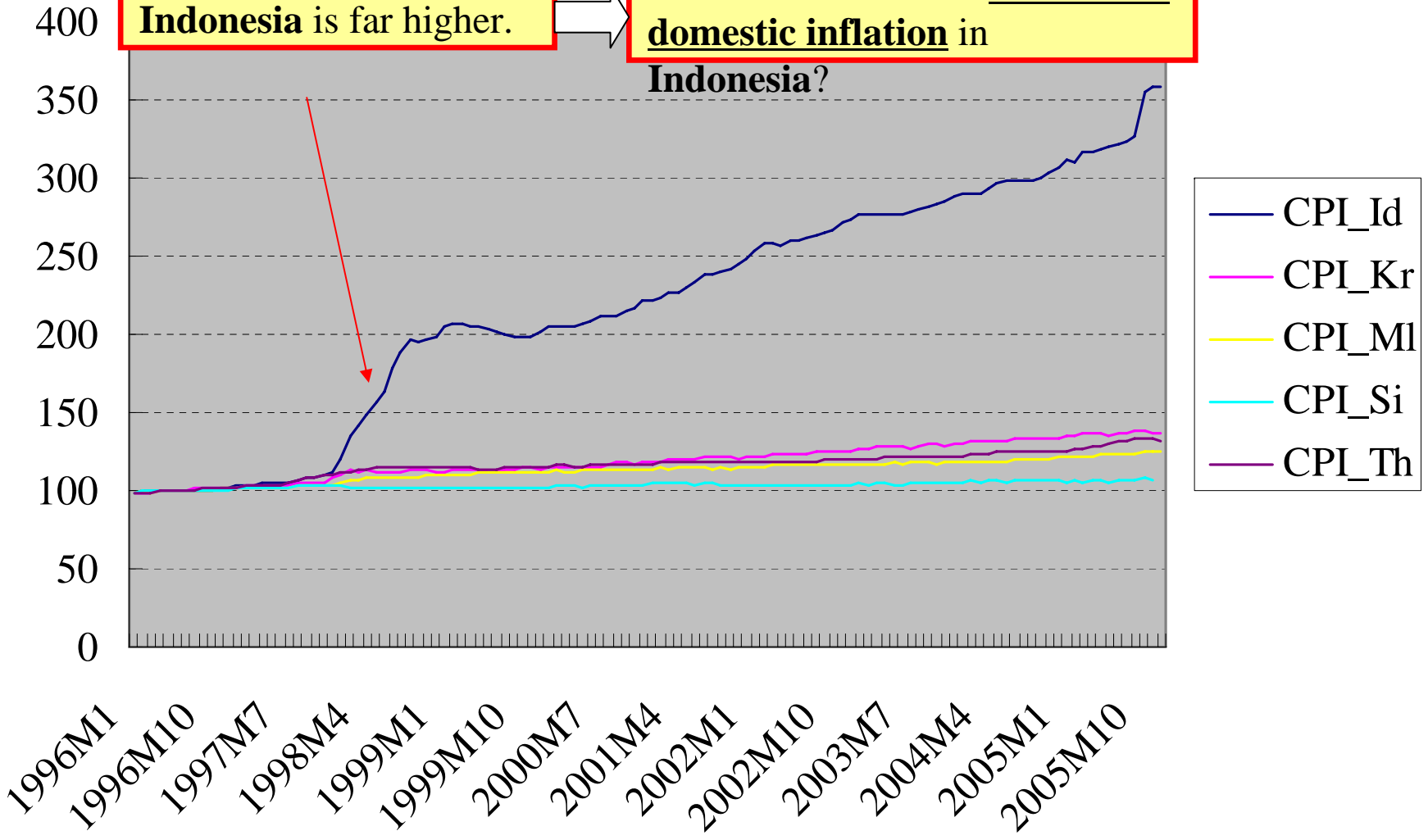
Real Exchange Rate vis-à-vis the US Dollar (1996=100)



CPI (1996=0): East Asian Countries

CPI inflation in Indonesia is far higher.

What caused such an **increase in domestic inflation** in Indonesia?



Why domestic price increased so high in Indonesia?

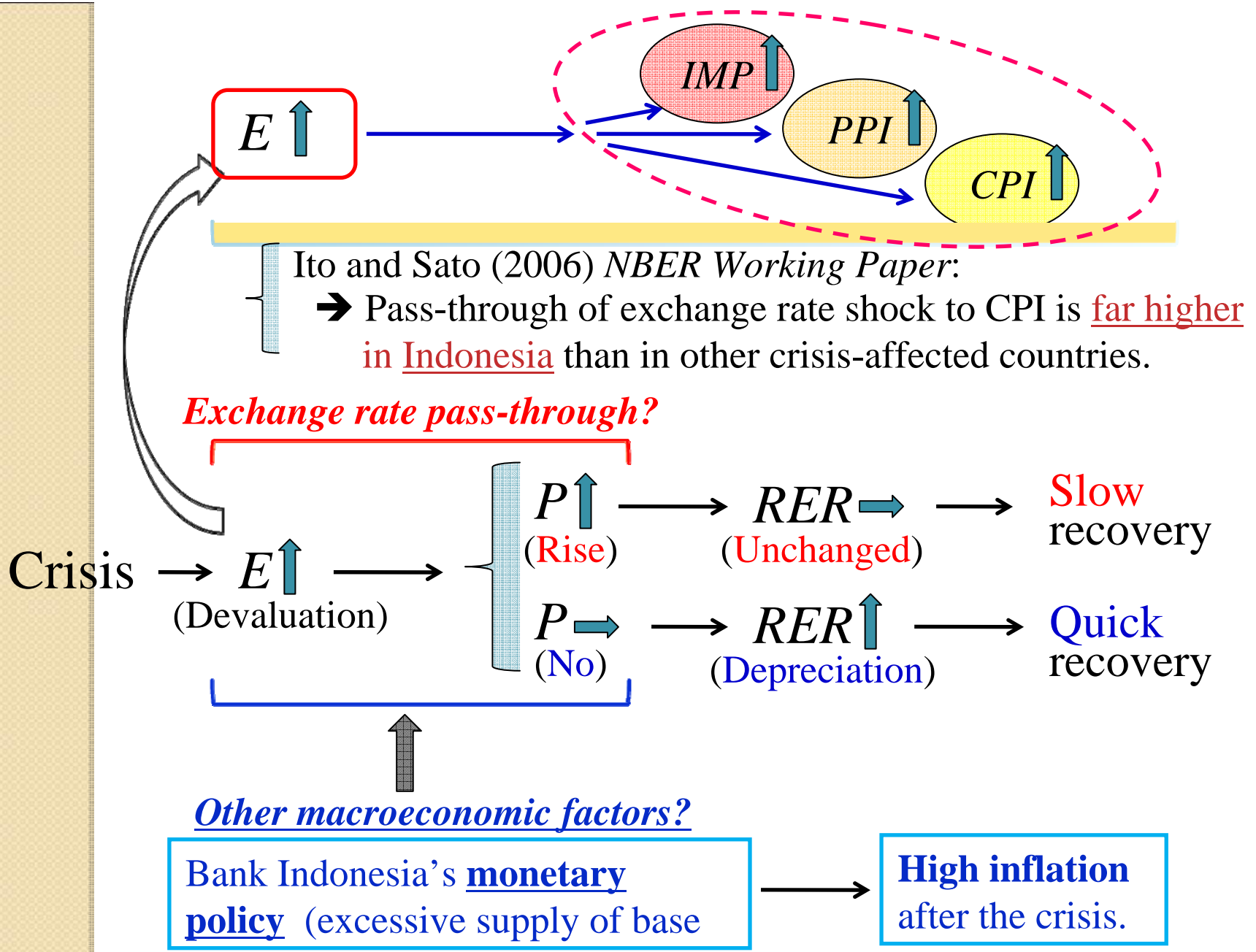
Currency devaluation



Increase in domestic price



Significant impact on
the post-crisis recovery process.



→ See Ito (2007) *AEPR*; Ito and Sato (2006); and Mcleod (2003) *BIES*.



Lessons from the Crisis

- **Appropriate monetary policy** is important.
 - Indonesia expanded the supply of base money excessively.
 - ➔ This likely caused a very high inflation in Indonesia.
- Important to keep the **inflation rate lower**.
 - Domestic price ↑
 - ➔ RER appreciation
 - ➔ Lose the export price competitiveness



Regional Monetary Arrangement?

- US dollar peg system:
 - Not appropriate for East Asian countries.
- Regional monetary union or regional monetary unit?
 - Promising idea.
 - **→ Question: Does East Asia now meet the preconditions for a monetary union?**



Analysis of Shock Symmetry

- Econometric technique (structural VAR):
 - Identify the fundamental shock to the country.
 - Correlation analysis of shocks.
- If shock is closely correlated among the countries...
 - It would be less costly for regional countries to react to the shock by using the common monetary policy.



Results

- Correlation Analysis for 3 sub-periods:
 - (1) 1981Q1 – 1988Q4
 - (2) 1989Q1 – 1996Q4
 - (3) 1999Q1 – 2006Q4

Supply Shock Correlation: 1981Q1 – 1988Q4

1. Supply Shock Correlation: 1981Q1-1988Q4

	US	JP	KR	TW	HK	SG	MY	ID	TH	PH	CH
United States	1.00										
Japan	0.08	1.00									
Korea	0.00	-0.06	1.00								
Taiwan	-0.27	-0.14	0.44	1.00							
Hong Kong	-0.06	0.15	0.28	0.32	1.00						
Singapore	0.20	-0.13	-0.10	0.15	0.51	1.00					
Malaysia	-0.14	-0.11	0.07	0.20	-0.01	0.26	1.00				
Indonesia	0.26	-0.12	0.32	0.12	0.04	-0.09	0.33	1.00			
Thailand	-0.10	0.09	-0.03	-0.04	-0.03	0.31	0.28	0.03	1.00		
Philippines	-0.02	0.13	0.04	-0.20	-0.15	-0.27	-0.27	-0.05	0.11	1.00	
China	-	-	-	-	-	-	-	-	-	-	-

Note: Bold figures if they are 0.30 or over. Blue colored figures if they are 0.40 or over.

Supply Shock Correlation: 1989Q1 – 1996Q4

2. Supply Shock Correlation: 1989Q1-1996Q4

	US	JP	KR	TW	HK	SG	MY	ID	TH	PH	CH
United States	1.00										
Japan	-0.17	1.00									
Korea	0.11	0.15	1.00								
Taiwan	-0.27	-0.20	0.04	1.00							
Hong Kong	0.25	-0.21	-0.05	-0.44	1.00						
Singapore	0.02	-0.31	0.13	-0.03	-0.17	1.00					
Malaysia	-0.18	-0.05	0.28	0.09	-0.14	0.10	1.00				
Indonesia	0.10	-0.07	-0.17	0.08	-0.23	0.03	-0.18	1.00			
Thailand	-0.22	0.02	-0.06	0.16	-0.09	-0.08	-0.04	0.07	1.00		
Philippines	0.31	0.27	0.07	0.01	-0.20	0.14	0.13	0.12	-0.04	1.00	
China	-0.13	-0.20	-0.27	0.24	-0.11	0.08	-0.11	0.32	0.02	-0.39	1.00

Note: Bold figures if they are 0.30 or over. Blue colored figures if they are 0.40 or over.

Supply Shock Correlation: 1999Q1 – 2006Q4

3. Supply Shock Correlation: 1999Q1-2006Q4

	US	JP	KR	TW	HK	SG	MY	ID	TH	PH	CH
United States	1.00										
Japan	0.08	1.00									
Korea	0.08	0.33	1.00								
Taiwan	0.24	0.17	0.30	1.00							
Hong Kong	0.29	0.21	0.44	0.60	1.00						
Singapore	0.41	-0.02	0.24	0.48	0.65	1.00					
Malaysia	0.22	0.29	0.46	0.46	0.38	0.26	1.00				
Indonesia	-0.05	0.16	0.07	-0.11	0.21	0.18	0.06	1.00			
Thailand	0.26	0.06	0.02	-0.16	0.01	0.27	0.14	0.15	1.00		
Philippines	0.02	0.27	0.32	0.45	0.42	0.18	0.38	0.13	0.03	1.00	
China	-0.04	0.13	-0.19	0.22	0.26	0.26	0.07	0.15	0.25	0.21	1.00

Note: Bold figures if they are 0.30 or over. Blue colored figures if they are 0.40 or over.