

ASIA Treasury Markets Summit

Limiting intra-Asian currency volatility: an emerging decentralised approach?

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Agenda

- European approach to regional currency stability
- Approaches to limiting intra-Asian currency volatility
 - McKinnon's Asian dollar standard.
 - Ito/Kuroda's common basket proposal.
 - Implicit coordination through managing currencies against nominal effective exchange rates.
- Evidence from Asian cross-rates
 - McKinnon: RMB and MYR from Sept 1997 to July 2005.
 - Decentralised: RMB, SGD, and MYR since July 2006.

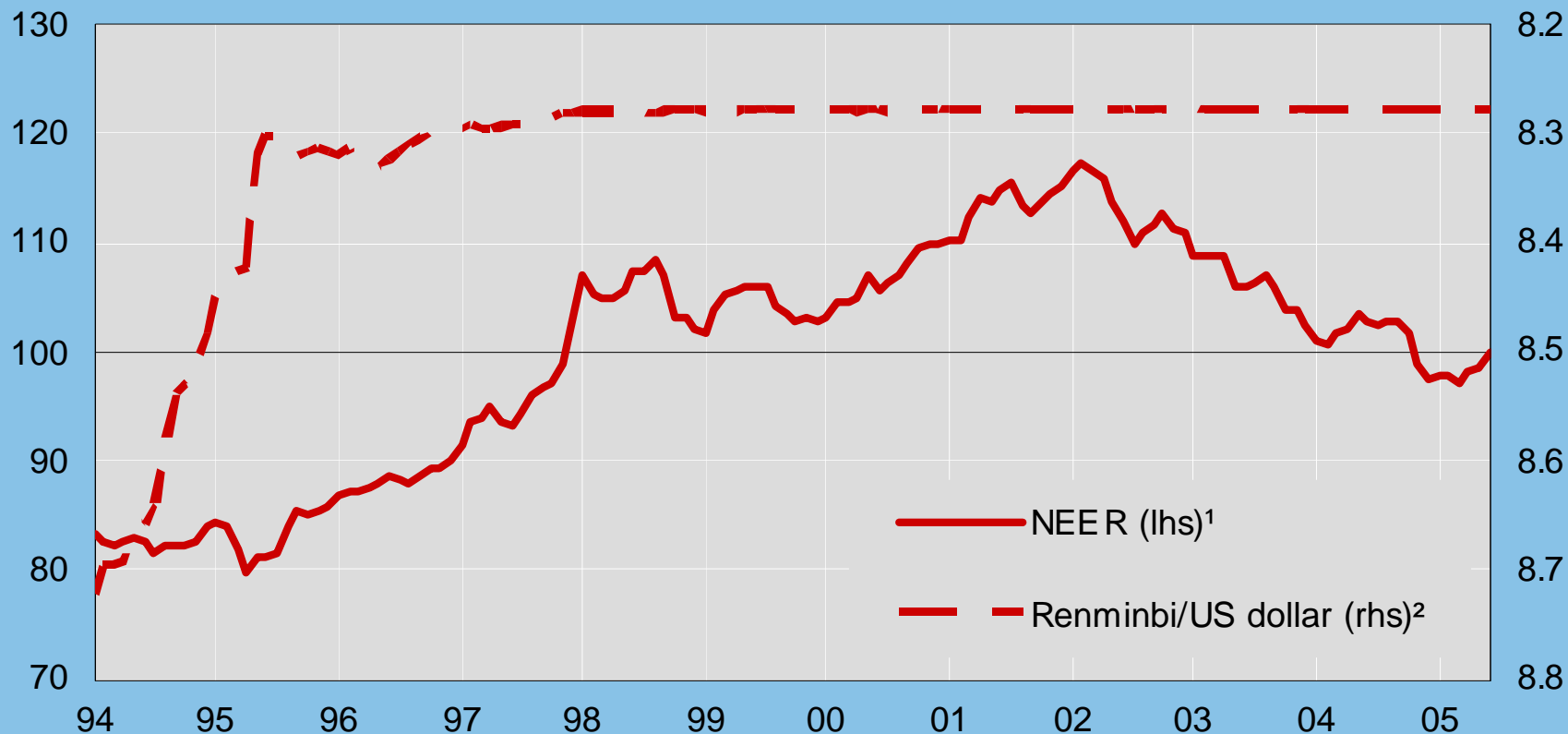
The European approach

- Exchange rate mechanism set agreed grid of bilateral rates, with occasional realignments.
- In principle, symmetric duty to intervene at outer bounds around central rates; in practice, most intervention takes place within bounds by weak currency central bank.
- Swaps available to replenish foreign exchange reserves.
- Ecu as unit of account makes sharing of exchange risk symmetric as between swap creditor and debtor.

McKinnon's Asian dollar standard

- If each currency pegged or closely managed against dollar, then intra-Asian currency volatility reduced.
- A *sufficient*, but not necessary, condition for intra-Asian currency stability
- Ogawa and Ito (2002) argue this a bad equilibrium: trade competitiveness varies over the dollar's cycle vs the yen and euro.

Effective RMB & the USD cycle, 1994-2004



¹ Sample average = 100. ² Inverted scale; a rise indicates an appreciation of the Chinese renminbi against the US dollar.

Source: BIS.

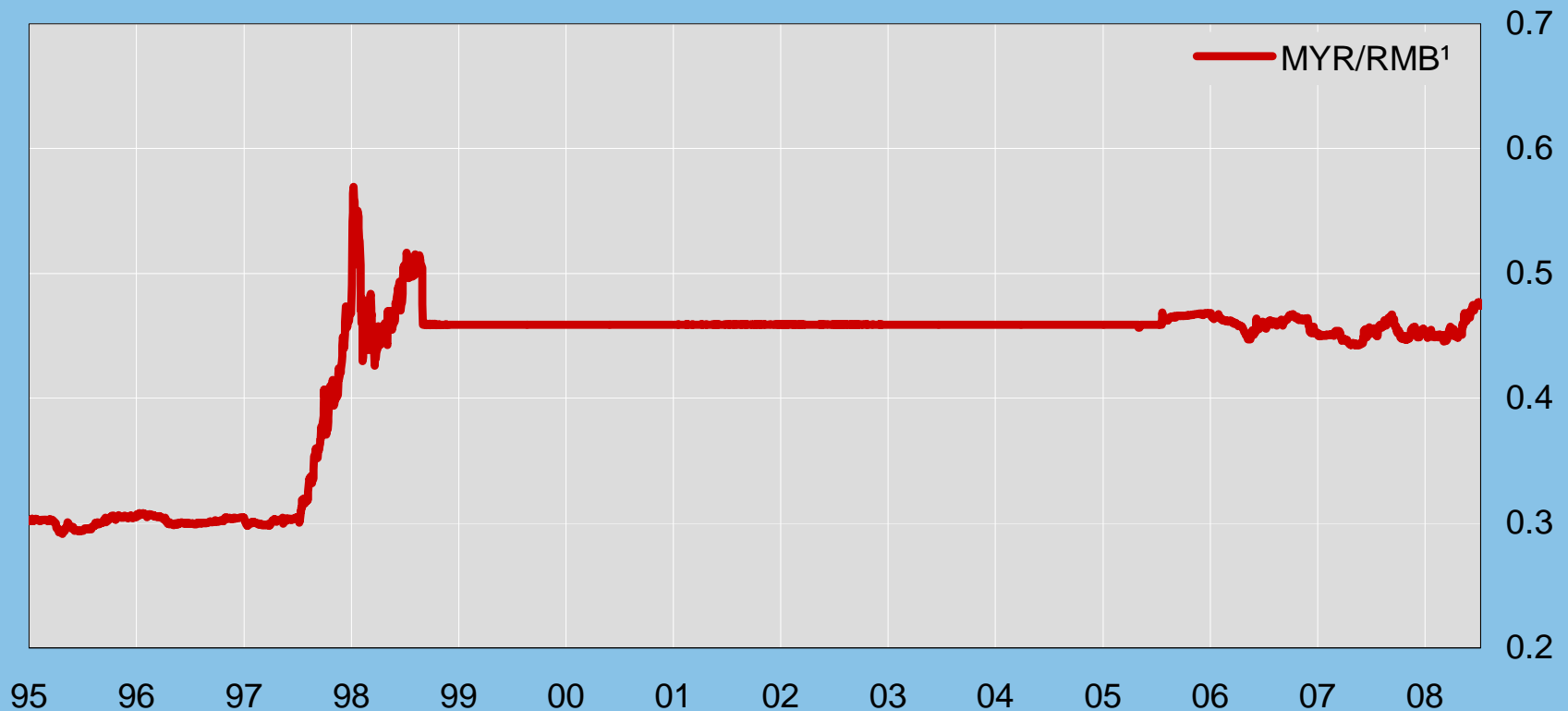
Ito/Kuroda proposal for common basket

- If Asian currencies managed against a common basket with average trade weights, then intra-Asian exchange rates stable.
- *A sufficient, but not necessary, condition.*
- An external basket (eg \$, €, ¥) or an internal basket (ACU—Asian currency unit) or combination?
- How determine common weights?

Intra-Asian currency stability as a by-product of managing currencies vs trade baskets

- If two currencies both managed against their respective trade-weighted baskets *and* if these are similar, then cross-rate will be stabilised.
- This evolutionary approach works without explicit coordination.

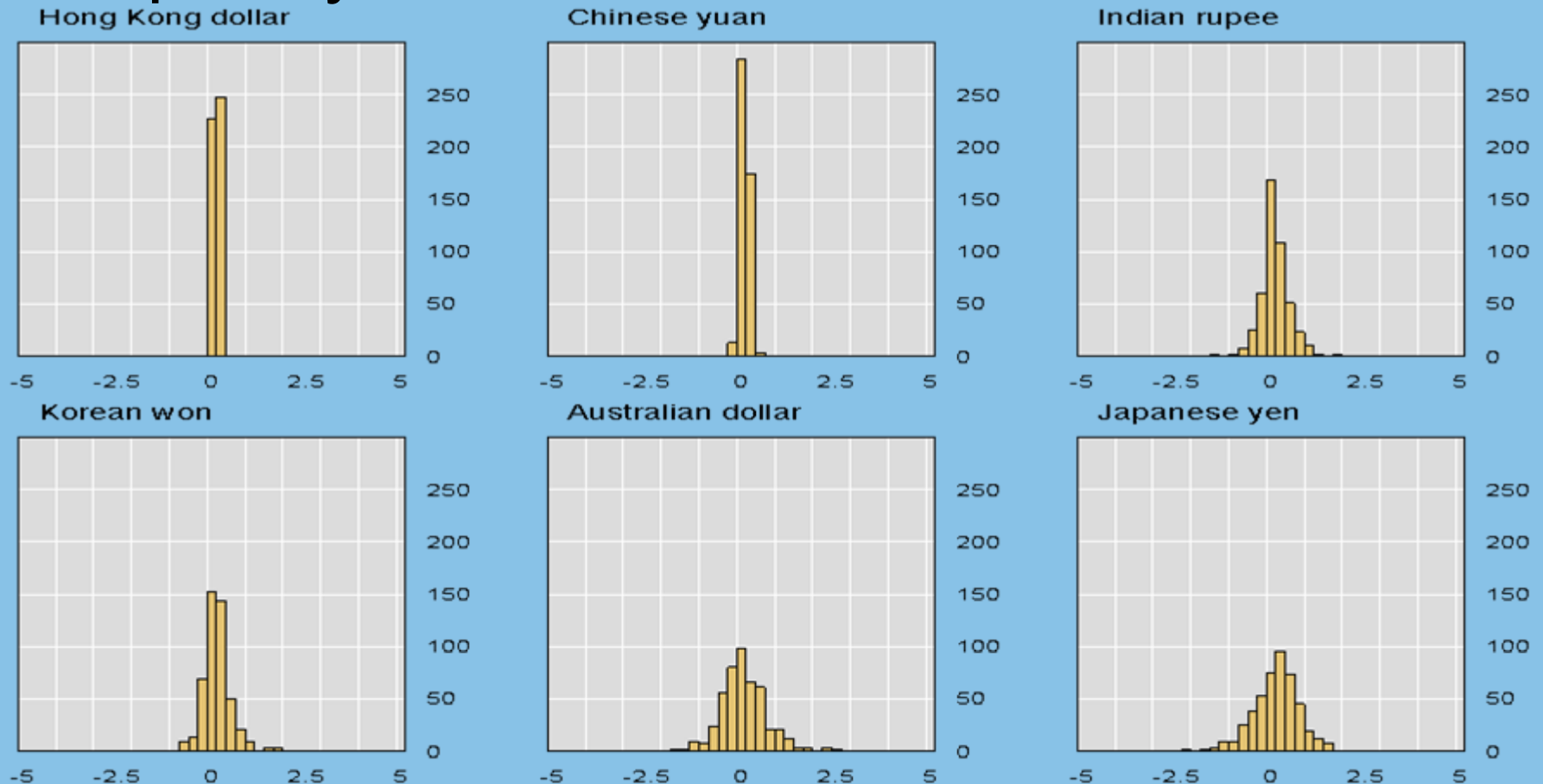
Evidence for McKinnon view: MYR/RMB January 1995 – June 2008



¹ Malaysian ringgit per Chinese renminbi.

Source: Bloomberg.

Evidence for McKinnon view: at daily frequency, not much movement of RMB/USD



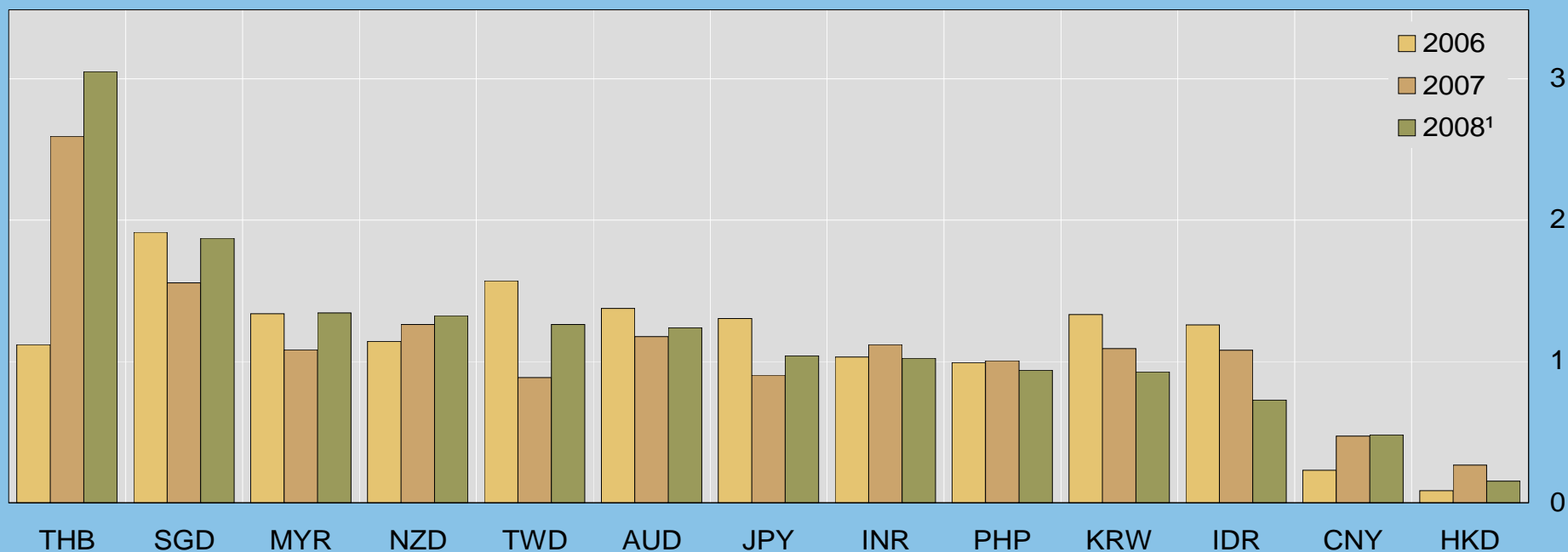
Sample period starts on 21 July 2006. A positive number indicates an appreciation of the US dollar against the corresponding Asian currency.

Sources: BIS; author's estimations.

Evidence against McKinnon view: Asian currencies not generally on dollar standard

Ratio of dollar exchange volatility to effective rate volatility

Annual standard deviation on weekly change in exchange rate



¹ Up to June 4.

Sources: Bloomberg; BIS; author's calculations

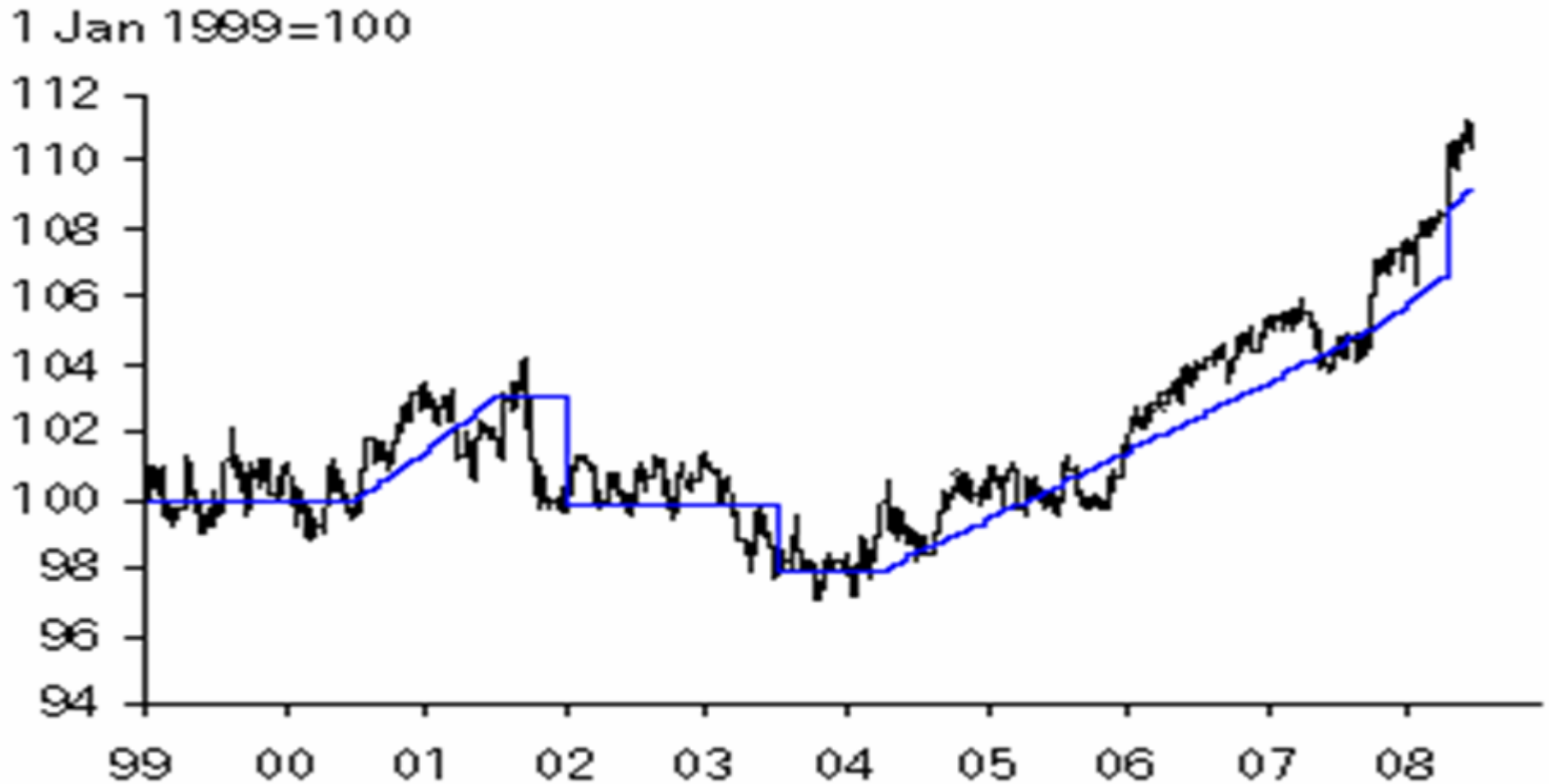
Evidence on management vs NEERs

- First, present evidence of management of Singapore dollar, RMB and MYR against trade-weighted baskets.
- Second, show that the weights in trade baskets are fairly similar using BIS weights.
- Third, show that cross-rates are relatively stable.

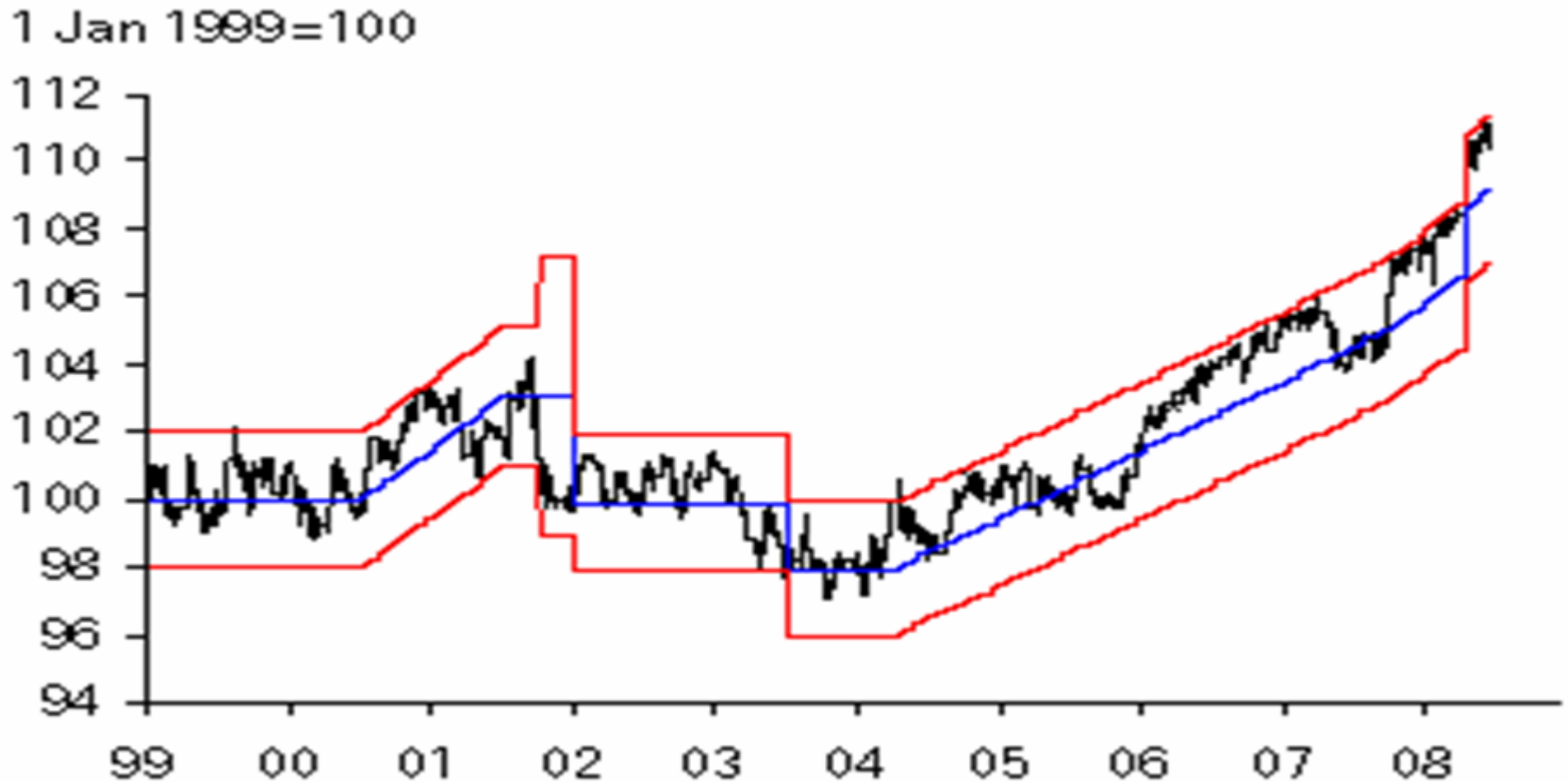
Nominal effective exchange rate of the S\$



Perceived policy centre of the S\$ NEER



Perceived policy bands of the S\$ NEER



Nominal effective exchange rate of the RMB

Index, 2000 = 100



Least squares centre of the RMB NEER, July 06 - June 08

Nominal effective exchange rate of the Chinese yuan

Index, 2000 = 100



+/- 2% bands around least squares centre of RMB NEER

Nominal effective exchange rate of the Chinese yuan

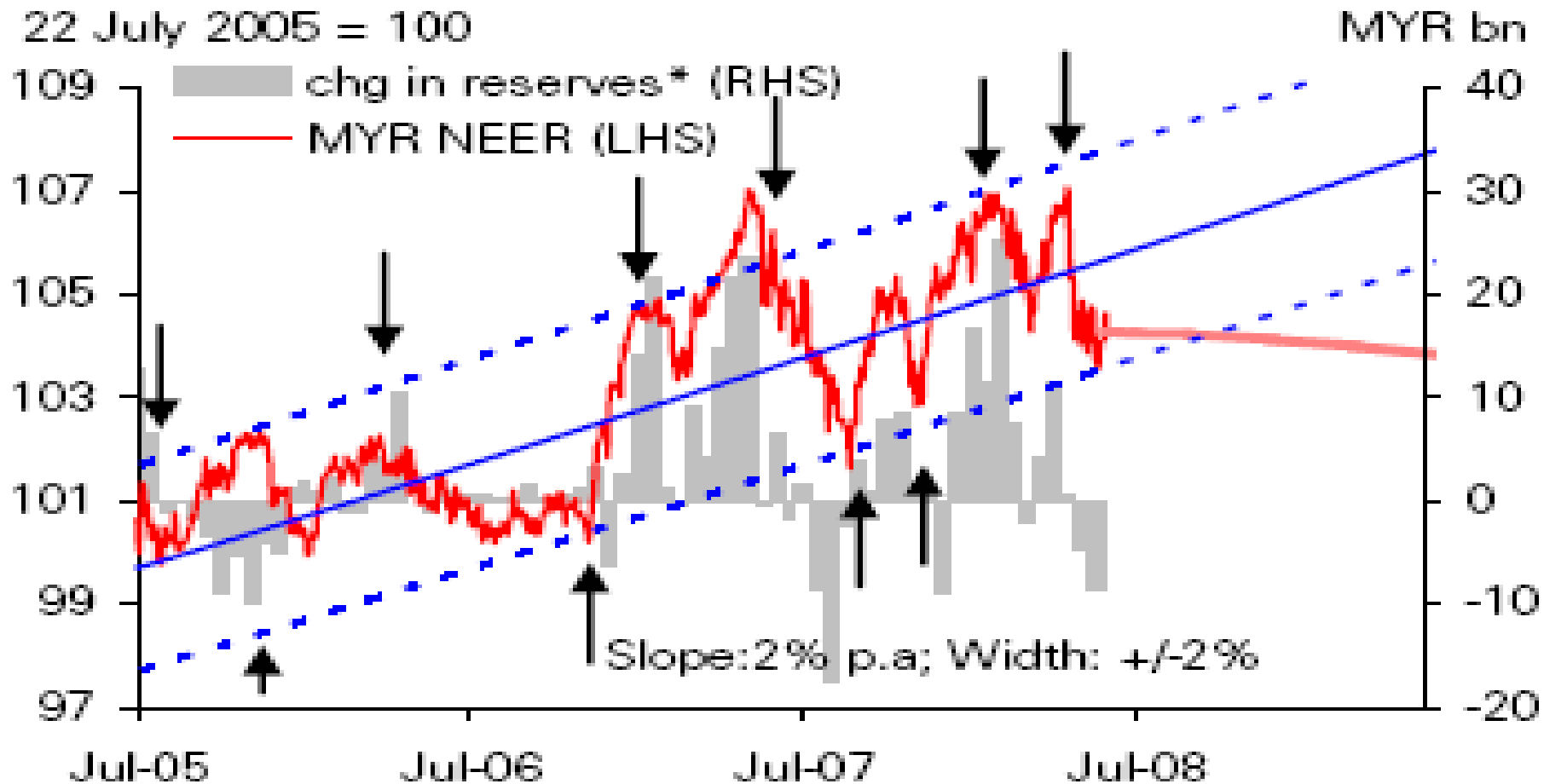
Index, 2000 = 100



Note: The thick dotted lines represent $\pm 2\%$ of the trend line, while the thin dotted lines represent $\pm 1\%$ of the trend line.

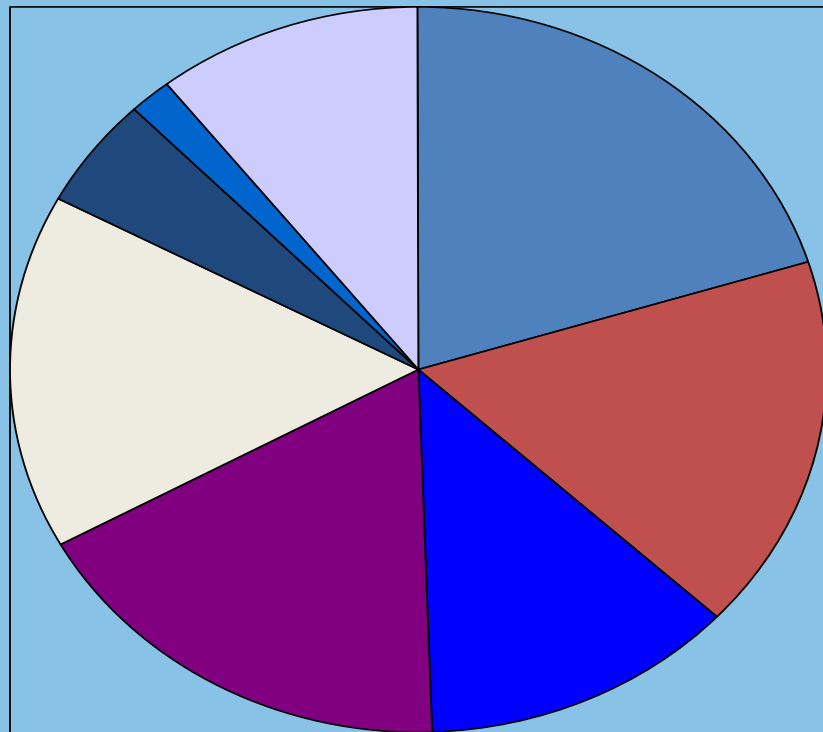
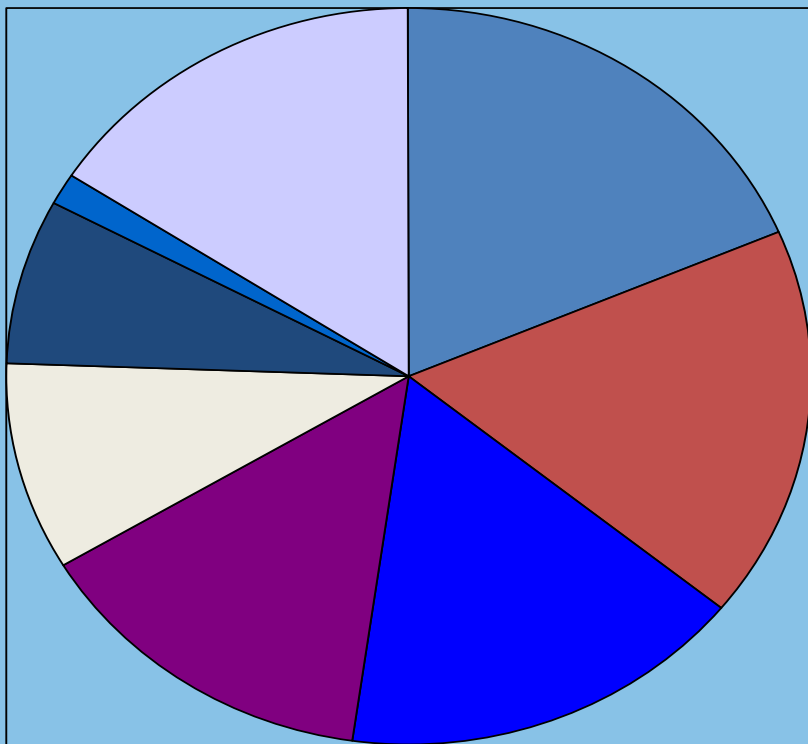
Sources: BIS; author's estimations.

Malaysian ringgit NEER



Source: DB Global Markets Research, *includes forward book

Trade basket weights similar: China Malaysia



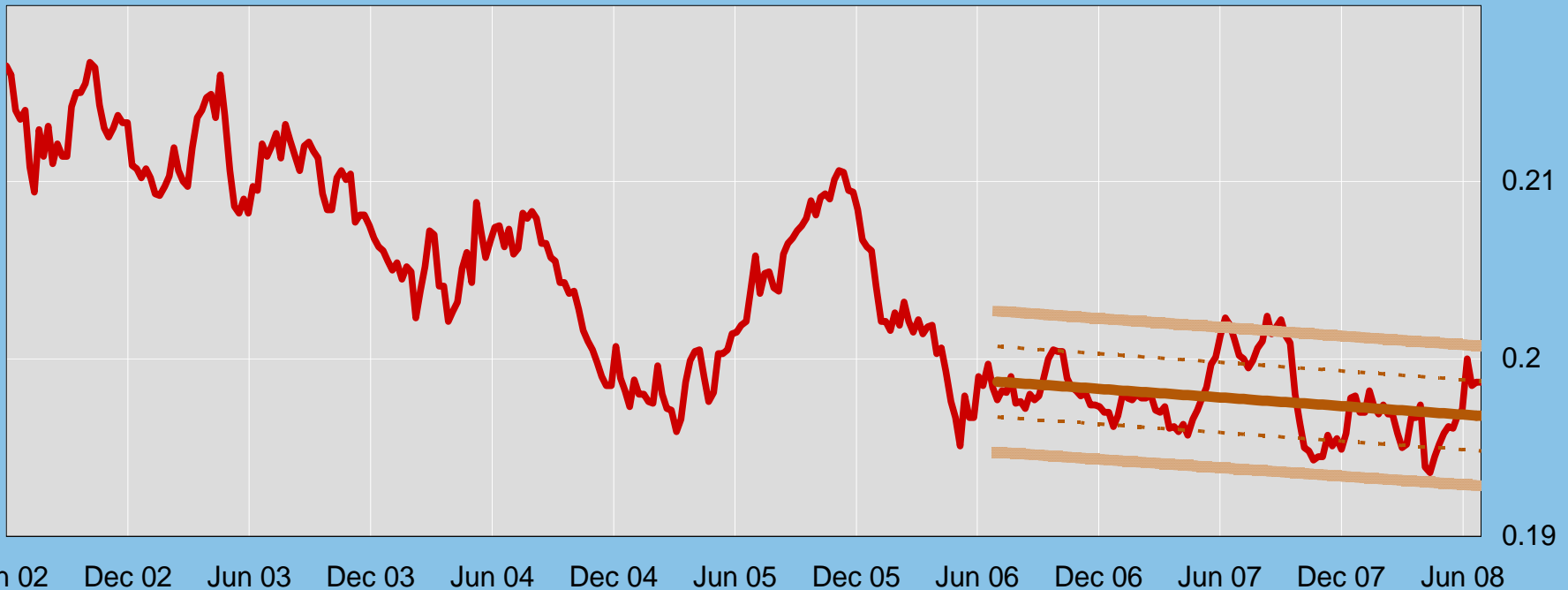
Source: BIS.



SGD/RMB in a 1¢ range

Bilateral exchange rate between the Chinese yuan and the Singaporean dollar

SGD per RMB



Note: weekly data.

Source: Bloomberg

MYR/RMB in a 2¢ range

Bilateral exchange rate between the Chinese yuan and the Malaysian ringgit

MYR per RMB



Note: weekly data.

Source: Bloomberg

Conclusions

- An East Asian dollar standard once provided intra-Asian exchange rate stability, but many currencies in the region are now more stable against their trade-weighted baskets than in US dollar terms.
- Explicit coordination and common basket not necessary for substantial stability of intra-Asian exchange rates.
- Instead, each currency managed against its own trade-weighted basket provides a large measure of stability, given similarity in trading patterns.

References

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