Exchange Rate Regimes and Structural Realignment of Global Economies

Comments from an Asian perspective

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Main points

1. Revaluation of the Chinese renminbi in the future is expected to be limited and slow.

2. The foreign exchange rate policy coordination in East Asia will become more important in the future.

3. Japan is showing a very poor performance in terms of economic growth rate. Japan should do something.

World economy before the global crisis

Current account surplus of emerging economies

Low interest rates
Excessive risk taking behavior in the US
Problems in financial supervision

House price bubble in the US

European financial institutions

Domestic demand growth in developed economies

Increase in exports from emerging economies to developed countries

In this way, the global imbalances expanded and the risk of crisis increased.

The Global Crisis during 2007-2009

Subprime shock

Collapse of house price bubble in the US and other developed economies

Reversal of capital flows

Global financial crisis

Decrease of exports from emerging economies to developed economies

Global recession

Solution for the global crisis prevention

- Improve financial supervision and governance of financial institutions

- Reduce the global imbalances
  - ✓Reduce the current account deficit of the US
  - ✓Reduce the current account surplus of the emerging economies
    - Increase domestic demand
    - Revaluation of the Chinese renminbi

      Price or exchange rate elasticity of the current account surplus

Revaluation of the Chinese renminbi would be beneficial to the Chinese economy as well.

(Demerits)

- Damage the exporting sector in the short run

(Merits)

- Reduce current account surplus
- Correct under-consumption or over-savings
- Switch external demand to domestic demand
- Make it easier to control excess liquidity and price inflation
- Well balanced growth of the Chinese economy

However, the Chinese authority might be slow in raising the value of renminbi.

- Keep crawling peg against the US dollar
- Keep strict foreign exchange control and capital restrictions
- The authority will not be positive toward revaluation of renminbi, as long as inflation risks are low enough.

- China's large current account surplus could be a factor risking the stability of the world economy.

Foreign exchange rate policy coordination in East Asia will be more important. (1)

- The regional monetary and financial cooperation in Asia
  - ✓For crisis prevention : Chiang Mai Initiative

    (Large foreign reserves and more economic integration in Asia)
  - ✓For intra-regional foreign exchange rate stability in the future)

- Exchange rate regimes in East Asian countries
  - ✓China: De facto crawling peg
  - ✓The other countries: More flexible exchange rate regimes
  - ✓Intra-regional exchange rates could be unstable.

Foreign exchange rate policy coordination in East Asia will be more important. (2)

- It is reported that several Asian countries' authorities recently intervened in the foreign exchange markets to mitigate the appreciating pressure on their own currencies.
- Although intra-regional exchange rate stability is important, such interventions could be detrimental to the reduction of the global imbalances.
- It can be a good start for discussing a framework, in which Asian currencies are collectively flexible against the extra-regional currencies like the US dollar, while keeping intra-regional exchange rate stability.

Japan is showing a very poor performance in terms of economic growth rate in East Asia. Japan should do something.

- Establish a region-wide free trade agreement
- Promote exports of finished goods to emerging Asia
- Further deregulation in regulated non-tradable sector (e.g. agricultural sector)

(Kawai and Takagi (2009))