

Workshop on  
**“Money, Finance and Banking in East Asia”**

Training Centre of the Deutsche Bundesbank, Eltville  
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Discussion of  
**“Currency blocs in the 21<sup>st</sup> century“**

# Comment on “Currency Blocs in the 21<sup>st</sup> Century” by Christoph Fischer

**Ulrich Volz, German Development Institute**

3<sup>rd</sup> Workshop on "Money, Finance and Banking in East Asia"  
Eltville, 5-6 December



- **Paper addresses three questions:**

- What are the characteristics of today's two major currency blocs?
- Which long-term structural variables affect an economy's choice of anchor currency?
- How does a “currency bloc equilibrium” look like?

- **Very good paper**

- It does what it promises
- It is clearly structured and well-written
- Sound methodology



- **Use of IMF's de facto classification of exchange rate arrangements (complemented by Bundesbank's Exchange Rate Statistics)**
  - Classification confined to “pegs” and “float”
  - Intermediate regimes like crawling pegs, crawling bands or regimes of the IMF's residual category “other managed arrangements” classified as “floating”
  
- **Two currency blocs: \$ and € bloc**
  - In 2008, the \$ and € blocs comprised 56 countries each (with the latter including the members of the euro area)
  - Only 26 out of 229 countries and territories chose a peg to a basket or currency other than the \$ or €



- **East Asian exchange rates:**

- “[A]part from China (including Hong Kong and Macao), none of the East and Southeast Asian emerging markets peg their currencies to the US dollar.”

- **Does it make sense to classify most East Asian countries as free floaters despite very strong dollar orientation?**

- “East Asian dollar standard” or “Bretton Woods II system”
- All East Asian countries (except Japan) still maintain strong dollar orientation in exchange rate policy
- USD remains the main invoicing currency for (intraregional) trade



## ■ Explanatory variables, drawing on OCA literature

- High degree of international economic integration in goods and factor markets [log of real GDP in PPP]
- Highly diversified production [log of real per capita GDP in PPP]
- Trade integration within a currency bloc [trade of country  $i$  at time  $t$  with all the (other) countries that belong to the bloc at time  $t$  as a fraction of country  $i$ 's total trade]
- Log of great circle distance between a given country's capital and the location of the central monetary policy authority of each currency bloc
- Percentage of net oil exports in total exports
- Colony dummy



- **Paper “follow[s] Alesina et al (2002) in ignoring variables related to financial markets”**
  - But int’l financial assets and liabilities may be important factors for choice of exchange rate peg since exchange rate swings can bring about significant balance sheet effects
  - Valuation effect of exchange rate movements (Lane & Shambaugh, 2010 AER)
  - “Conflicted virtue” (McKinnon, 2004)

# Structural determinants of anchor currency choice



	share of total assets in domestic currency	share of total assets in foreign currency	share of total assets in USD	share of total assets in GBP	share of total assets in EUR	share of total assets in JPY	share of total assets in CHF	share of total assets in other foreign currencies	share of total liabilities in domestic currency	share of total liabilities in foreign currency	share of total liabilities in USD	share of total liabilities in GBP	share of total liabilities in EUR	share of total liabilities in JPY	share of total liabilities in CHF	share of total liabilities in other foreign currencies
Cambodia	0.0	100.0	56.4	3.0	22.1	2.9	0.8	14.7	37.8	62.2	59.2	0.0	1.4	1.6	0.0	0.0
China, P.R.	0.0	100.0	69.8	2.5	13.1	5.9	0.4	8.3	63.2	36.8	27.5	0.0	2.8	6.4	0.0	0.0
Hong Kong	3.1	96.9	35.7	11.9	10.9	4.0	1.1	33.4	68.7	31.3	19.2	2.2	6.8	2.2	0.9	0.0
Indonesia	0.0	100.0	53.8	7.2	16.3	12.1	0.6	9.9	20.4	79.6	45.6	0.6	8.8	24.1	0.5	0.0
Japan	15.9	84.1	48.7	5.0	23.4	15.9	0.9	6.1	65.4	34.6	22.0	2.1	9.2	65.4	1.1	0.1
Korea	0.0	100.0	70.0	2.7	9.9	5.4	0.5	11.6	59.2	40.8	29.4	1.2	5.2	4.2	0.6	0.2
Malaysia	0.0	100.0	60.6	5.2	11.2	7.5	0.6	14.9	62.1	37.9	26.9	0.2	1.5	9.3	0.0	0.0
Philippines	0.0	100.0	72.1	3.5	10.6	3.9	0.8	9.1	26.3	73.7	35.0	0.1	4.7	33.8	0.1	0.0
Singapore	0.0	100.0	48.6	6.3	11.4	4.7	1.1	27.8	61.0	39.0	24.3	1.1	6.3	5.4	0.5	1.3
Thailand	0.0	100.0	42.3	5.2	21.2	23.0	0.5	7.8	64.7	35.3	11.9	0.0	0.8	22.5	0.0	0.0
Vietnam	0.0	100.0	64.2	4.1	18.8	11.7	0.8	0.4	56.3	43.7	22.6	0.1	4.5	16.5	0.0	0.0

Source: Lane & Shambaugh (2010).



# Structural determinants of anchor currency choice



## Trade of East Asian countries as a percentage of total trade, 2009

	US	EU	China	HK	China+HK	Japan	Korea	ASEAN	ASEAN+3	ASEAN+4
<b>Brunei</b>	1.43	1.16	2.51	0.18	2.69	30.69	11.45	38.16	81.53	81.71
<b>Cambodia</b>	17.84	7.66	9.21	4.81	14.02	2.30	2.68	44.05	58.24	63.05
<b>China</b>	14.48	14.00		11.14	11.14	10.09	6.56	8.57	25.21	36.36
<b>Hong Kong</b>	8.32	7.78	48.67		48.67	6.69	2.83	9.87	68.06	68.06
<b>Indonesia</b>	7.84	8.48	10.07	1.96	12.03	13.09	5.58	29.74	55.67	57.62
<b>Japan</b>	13.75	9.55	20.48	2.91	23.39		6.11	13.97	40.56	43.47
<b>Korea</b>	9.86	9.19	20.24	2.63	22.86	10.38		11.40	42.01	44.64
<b>Lao</b>	1.54	5.81	12.70	0.50	13.20	2.59	2.24	63.30	80.82	81.32
<b>Malaysia</b>	11.06	9.36	11.14	3.57	14.71	9.98	3.96	29.04	54.11	57.68
<b>Myanmar</b>	7.00	2.22	22.04	68.00	22.72	4.46	2.74	50.46	79.70	80.38
<b>Philippines</b>	13.07	8.65	10.70	5.89	16.59	14.81	4.89	21.96	52.36	58.25
<b>Singapore</b>	9.08	9.42	10.12	6.57	16.69	6.01	5.15	27.24	48.52	55.08
<b>Thailand</b>	8.76	8.20	11.59	3.90	15.49	15.24	2.88	19.97	48.70	52.60
<b>Vietnam</b>	11.28	9.60	12.68	3.49	16.17	9.97	5.72	19.11	47.48	50.97
<b>Mean ASEAN</b>	9.57	8.90	10.86	4.46	15.31	10.22	4.62	26.08	51.36	55.82
<b>Mean ASEAN+3</b>	12.39	11.10	9.57	6.60	16.17	8.16	5.13	14.90	37.64	44.24
<b>Mean ASEAN+4</b>	11.97	10.75	13.66	5.91	19.57	8.00	4.89	14.37	40.82	42.8

Source: Own calculations with data from DTS.

Note: Mean ASEAN, ASEAN+3, ASEAN+4: unweighted average



- **“From the model’s perspective, [...] the case for a floating renminbi is overwhelming.”**
  - Taking into account China’s int’l financial position and valuation effect of exchange rate movements, it may be rational to limit appreciation against the dollar (although the current situation is clearly sub-optimal and perpetuates dependency on the USD)



- **“[S]ome countries would be able to raise their deterministic utility significantly if they chose to switch their exchange rate regime or currency anchor.”**
  - Useful to consider choice of exchange rate (and hence “currency bloc equilibrium”) as path-dependent (as done in the paper)
  - Change of currency bloc affiliation of one (large) country may lead to changes in utility of other countries and therefore a reconsideration of policy choice
  
- **Sensible predictions resulting from counterfactual analysis**
  - Equilibrium characterised by several Asian and African countries de-pegging from the US dollar and additional European countries adopting a fixed exchange rate vis-à-vis the euro
  - An adoption of the euro by a larger EU country would increase benefit of others joining as well



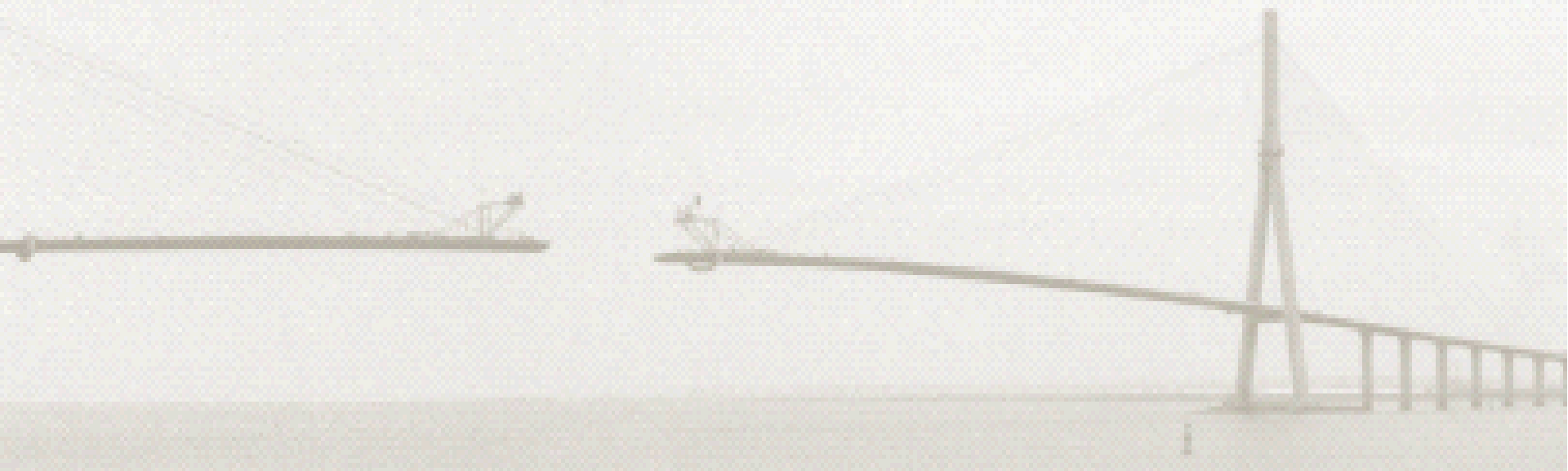
- **Low potential for formation of RMB bloc less convincing to me**
  - “[T]he counterfactuals suggest that, first, the present potential for a renminbi currency bloc is very small, even if convertibility of the renminbi were to be established, and second, that China still has a long way to go before the renminbi obtains the potential to rival the US dollar as an anchor currency.”
  - Many would maintain that already today the choice of most East Asian countries’ exchange rate policy is strongly influenced by Chinese policy (some would already talk of an RMB bloc)
  - One major advantage of the current “East Asian dollar standard” is that it provides relative exchange rate stability across the region

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**Thank you for your attention!**