Post-Financial Crisis & Asia's Roles
at
the JEF-NZIIA Symposium

Dr. Mignonne M.J. Chan
2010.10.11

mignonne@mail.tku.edu.tw

Contents

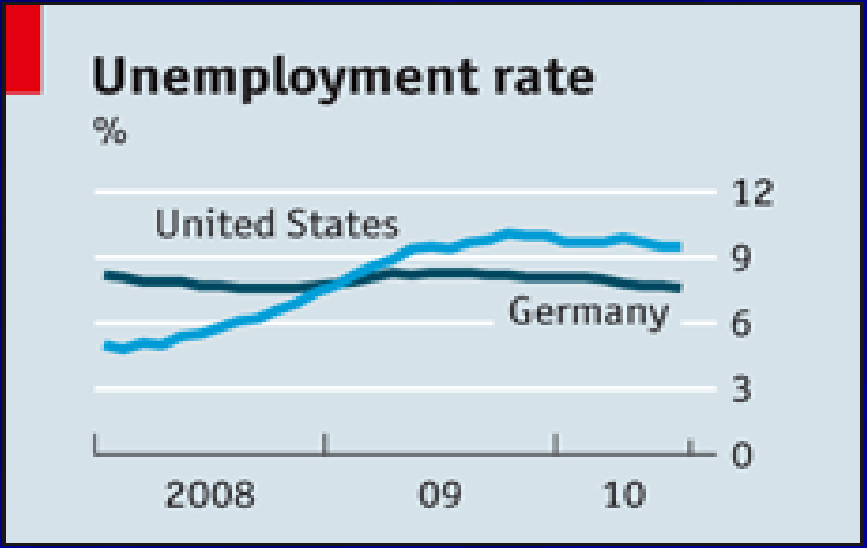
- Post-Crisis Sentiments & Government Interventions
- Struggling for Recovery, Weak Dollar & the Surge of Currency Wars
- RMB Appreciation: Trick or Treat?
- Reincarnation of a “Plaza Accord”?
- Taiwan’s Approach to Capital Flows & Exchange Rates
- Asia’s Roles

General Post-Crisis Sentiments: Steering through Recession

- Nicolas Sarkozy: “laissez-faire is dead.”
- Vince Cable, Britain’s business secretary, “Capitalism kills competition where it can.”
- Corporate America:
  – **a lot to quibble with in the Dodd-Frank Act for financial reform**
  – **accused the government’s prudent policies of creating an “increasingly hostile environment for investment and job creation”, claiming that the administration’s regulatory expansion into “every sector of economic life” is making it “harder to raise capital and create new businesses.”**

Government Interventions & …

- To deal with worst economic recession since the 1930s;
- Stimulus for growth: hope to increase employment, but in danger of increasing over-burdened debt.



- Currency depreciation: export-snatching maneuver instead of increasing domestic demand.
- a lower currency→ higher exports → make excessive debts less onerous;

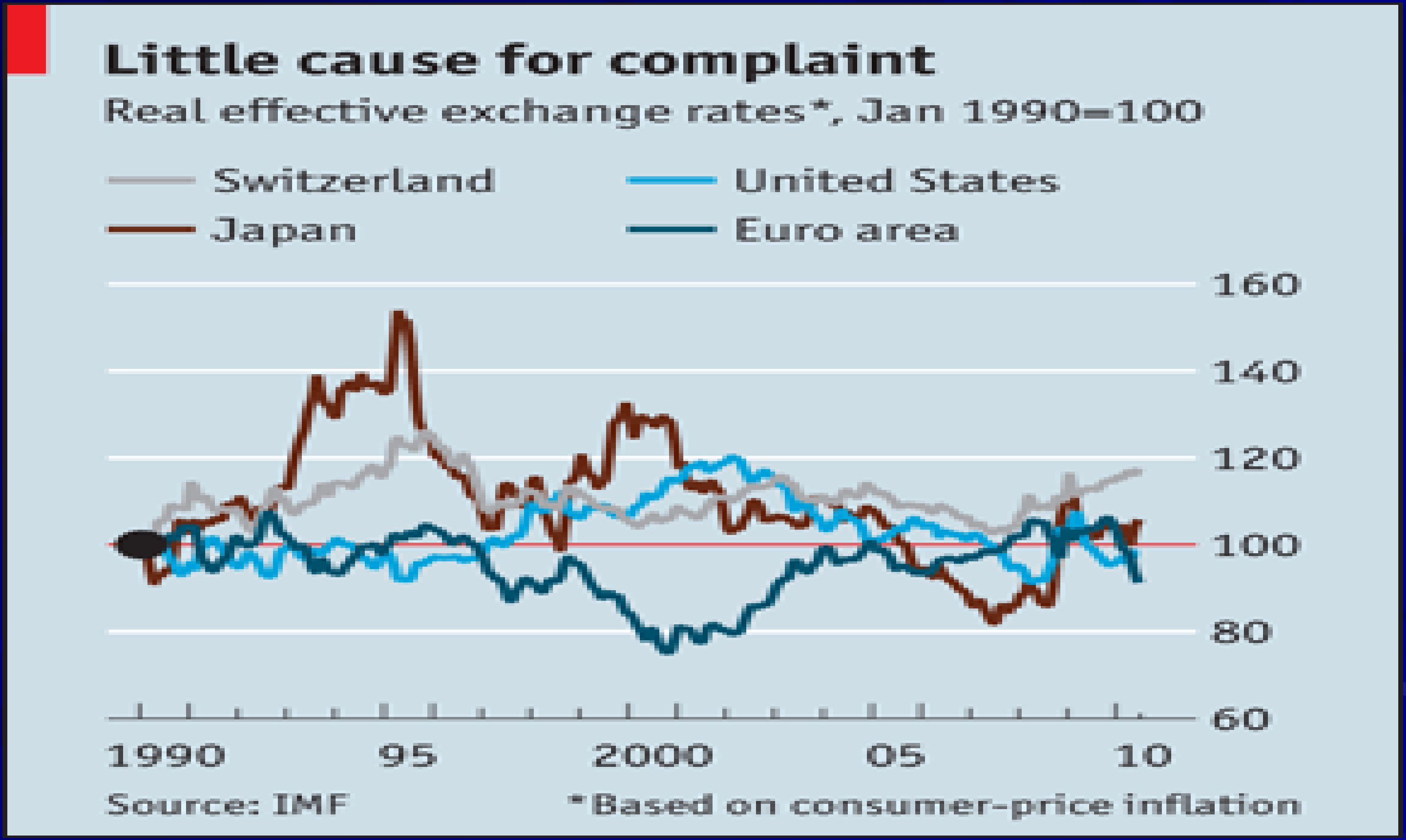
…Negative Impacts

- The aggressive expansionary monetary & fiscal stimulus of the last 2 years has only aggravated one crucial global imbalance, the excess of funds available for cross-border speculation;
- The list of enthusiastic devaluers is long enough to stir up a global fight: Japan, China, the US, the UK and Korea→ sharp & destabilizing movement in currency.

Ripple Effects: Weak $→Stronger Currencies Elsewhere →Stop it!

- **The weak dollar: the Federal Reserve has been striving to help the flagging recovery. The prospect of even looser monetary policy pushed the dollar down sharply: it dipped to its lowest level since March on a trade-weighted basis.**
- **The euro hit a five-month high against the dollar on September 22nd.**
- **In the 15 months to June, Switzerland quadrupled its foreign reserves, to $219 billion, in a bid to stop the franc from rising too fast.**
- **Japan sold about ¥2 trillion ($23.6 billion) on September 15th, its first foray into the currency markets in six years, to stem a surge in the yen that had pushed its nominal rate against the dollar to its highest since 1995.**

Why Not: Not too Lonely in the Bumpy Rides?



Source: Financial Times

So, What Now?

- In North America, the US is pointing its heavy guns at China... The US Congress has proposed a bill naming China as a "currency manipulator."
- In South America, Brazil fires salvoes at Japan, South Korea & Taiwan. "We're in the midst of an international currency war," said Guido Mantega, Brazil's finance minister. What makes the Asian countries a target of Brazil's artillery? They intervened in the currency markets directly, selling their own currencies and buying, among other things, Brazil's real.
- Contentious Issues:
  - China’s outsized current account surplus;
  - U.S. as huge deficit savor

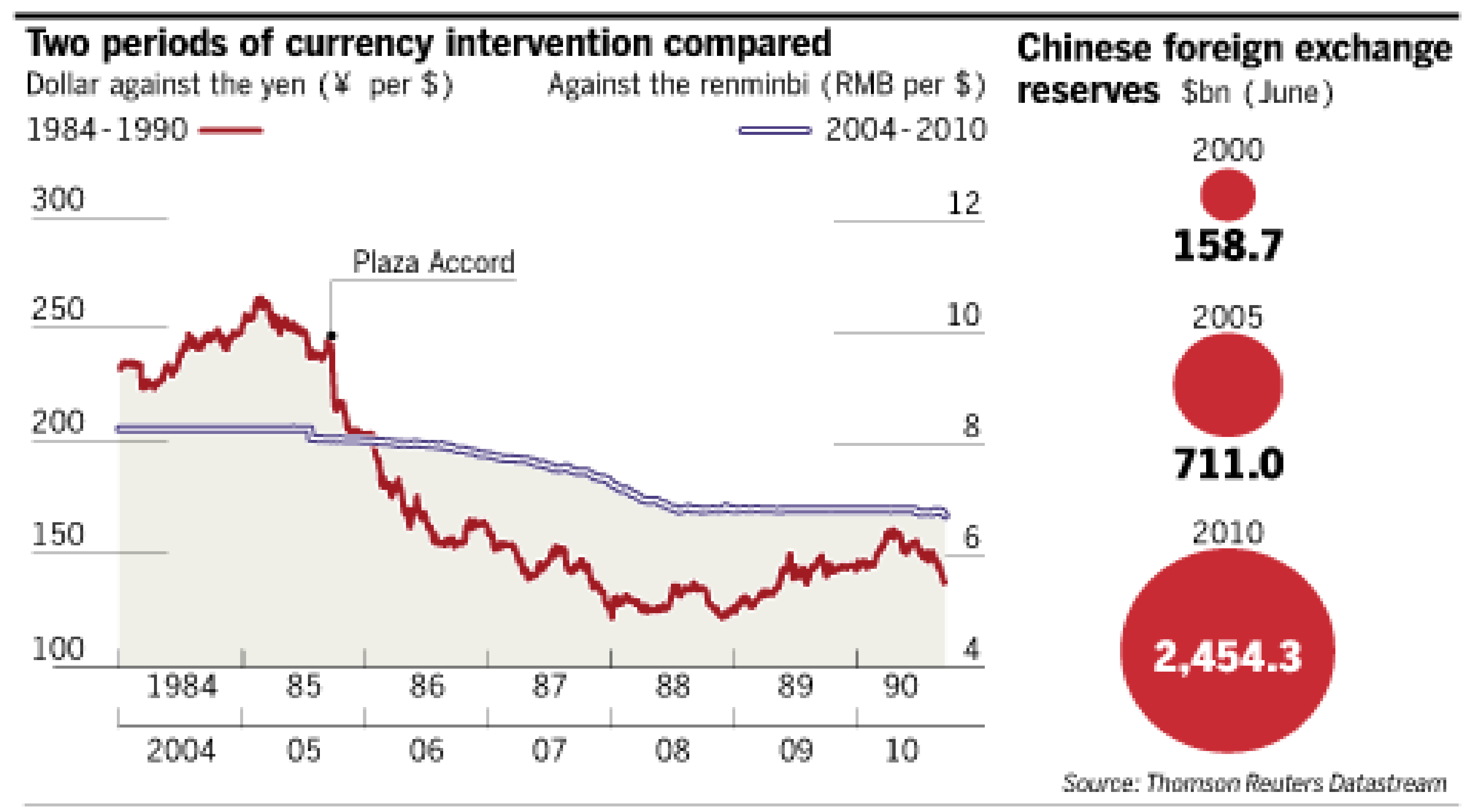
Rebirth of another Plaza Accord?

- Plaza Accord (1985): Big 5 Governments comgined to weaken the dollar and rebalance the world economy, stands as perhaps the high-water mark of international economic co-operation over the past 40 years.
- Plaza and the Louvre Accord (a subsequent deal in 1987 to stabilise the dollar) allowed the White House more freedom to reduce the US's large fiscal deficit.
- Today, as deep fissures have opened between the governments of the world's leading economies over exchange rates, imbalances in the global economy and deficit reduction, a reawakening of the Plaza Accord spirit could be invaluable.

Tracing the Footprint of the Plaza Accord?

- 1985: The “Plaza Accord” laid out a package of coordinated policies. The dollar duly fell, by more than 50% against the D-mark and yen by 1987. The deal is still seen as a high-water mark of international monetary co-operation.
- Now: unilateral, uncoordinated and in one direction→ in danger of protectionist backlash!
- Can we pick up some “Plaza Accord” of sort?

Contention: Too Little to Slow?



Source: Financial Times

RMB: Slow & Steady Realignment

- avoid sudden inflow of speculative capital;
- 19 June 2010: unpegged from $
- In real terms: the trade-weighted RMB is up 7.5% over the past six months and fully 20% over the past five years.
- to use a basket of currencies of China's main trading partners to guide the RMB. [implication: potentially depreciated against the dollar if the euro were to weaken.]

Source: Financial Times

Pressures for RMB Appreciation & Proposals against Currency War

- Direct Pressure: by the U.S.
- Multilateral Approach: including attempts in WTO, and most likely in IMF and G20;
- Countervailing Currency Intervention: (Fred Bergsten); and
- Capital Account Reciprocity: (Daniel Gros of the Centre for European Policy Studies in Brussels): Affected countries could prevent other countries from purchasing their financial instruments, unless the latter offered reciprocal access to their financial markets.

China's Concerns: a deja vous of a "Lost-Decade" Japan?

- Chinese officials often argue: the Plaza Accord was disastrous for Japan. The agreement encouraged the Bank of Japan to cut interest rates to offset the strengthening yen.
- Many in both Japan and China: That shift encouraged Japan's massive property and financial bubble at the end of the 1980s, followed by the "lost decade" of economic stagnation.

China’s Resistance against Rapid Currency Appreciation

- Mei Xinyu, a researcher affiliated with the Chinese ministry of commerce:
  - rapid appreciation would have an even bigger impact on China than on Japan since China was <u>at a much earlier stage of development.</u>
  - China’s “labour-intensive industries cannot stand the pressure from a substantial appreciation because of their very slim profit margins”.
- damage export industry;
- Would risk a “lost decade” similar to that of Japan in the 1990s.

International Financial Architecture: Indispensable Tool

- FDI: creates a win-win situation for the recipient country and the investing country.
- Short-term capital: Large and sudden inflows of foreign capital → exchange rate overshooting, loss of trade competitiveness, domestic credit booms and asset price bubbles, → elevate systemic risks and create financial fragility.
- Prudential regulations that target specific segments of the economy can play a useful role in dampening the demand for speculative capital.
- Hong Kong, Singapore, South Korea & Taiwan, have all introduced targeted prudential measures to curb real estate speculation as international capital inflows continue to put upward pressure on asset prices.

Taiwan’s Approach to Managing Foreign Capital Flows

- Foreign ownership accounts for 30% of Taiwan's stock market capitalization. Taiwan has more than 10,000 registered foreign institutional investors (FINIs), roughly 20 are responsible for more than 40% of all FINI foreign-exchange transactions. The volume of FINI foreign-exchange trading tends to fluctuate wildly, frequently disrupting Taiwan's foreign-exchange market.
- To prevent Taiwan's foreign exchange market from being disrupted by international capital flows; and to ensure that exchange rates are determined by economic fundamentals rather than short-term capital movements;

Asia’s Roles: Taiwan’s Central Bank Perspectives (1)

- Financial Stability by Monitoring Capital Flows: Some Asian Ns have join the framework of regional economic surveillance to monitor short-term capital flows, but seldom moved beyond information sharing.
- Financial Support Facilities: the Chiang Mai Initiatives Multilateralization (CMIM) [a currency swap arrangement among 13 countries] came into effect on March 24, 2010 with a reserve pool of $120bn. However, the CMIM should evolve into a comprehensive multilateral swap mechanism across Asia with a credible regional institution at the centre to serve as the primary intermediary.

Asia’s Roles: Taiwan’s Central Bank Perspectives (2)

- Regional exchange-rate stability: When exchange rates are stable, lower transaction costs and reduced uncertainty will boost growth in intra-regional trade and investment. Asian countries should set up a formal regional exchange-rate coordination mechanism through which stable currency relationships can be established.

Thank you!

Comments are welcome.