Summary of the Report on "Toward Greater Financial Stability in the Asian Region: Measures for Possible Use of Regional Monetary Units for Surveillance and Transaction"

by the Institute for International Monetary Affairs
27 February 2008

This study focuses on the definition of RMU for surveillance, the way to utilize RMU in regional surveillance, and how to promote RMU denominated transactions.

(The definition of RMU for surveillance)
RMU and RMU deviation Indicators (DIs) as a monitoring device would be effective in avoiding misalignment and excess volatility of intra-regional exchange rates, thereby contributing to the economic and financial stability and the growth in the region. If and when the RMU is to be used for ASEAN+3 surveillance process, it should consist of the thirteen currencies. However, there is no consensus on what is the best weighting scheme. Here we calculate the weights based on the shares of two variables, GDP, and intra-regional trade. Regarding GDP, GDP measured in PPP-exchange rate and GDP measured in market-exchange rate are applied. In addition, capital market size is included as a third variable for calculating the weights. Thus, four types of RMU are constructed. The best one should most powerfully explain variables such as effective exchange rates, exports, and imports of regional countries. However, statistical analysis finds out that the levels of statistical significance and the estimated coefficients do not differ so much depending on the types of RMUs. Therefore, it would be recommended that we try to reach an agreement on selecting a certain experimental RMU and monitoring that RMU and RMU DIs for ASEAN+3 regional surveillance process.

The choice of benchmark year of RMU DI affects the present degree of deviation. The benchmark year should be selected when exchange rates are close to the equilibrium levels. However, estimated levels of equilibrium exchange rates will differ significantly depending on the estimating approaches. The IIMA propose 2000/2001 as a benchmark year citing the relatively small size in the current account balances in the year.

(Regional surveillance)
In parallel with the IMF surveillance, ERPD, an independent regional surveillance in East Asia, is expected to play an important role. Regional surveillance is expected to do: monitoring contagion, spill-over, or transmission of macro-economic conditions and risks in the region; solving coordination failure of exchange rate policy; or dealing with problems arising from the access limit to the IMF

lending.   Therefore, monitoring RMU and RMU DIs, in addition to the main economic and financial indicators and those used for early warning system such as the ratio of short-term external debt to foreign reserves, will make regional surveillance more effective.   Also, European experience of regional surveillance could be learned, which shows the importance of the existence of regional institutions and the personal trust among high ranking officials.

(RMU for transaction)

RMUs for transaction, which can be composed of selective convertible currencies, offer instruments for diversification of foreign exchange risk with the weighted average interest rates of their component currencies.   They will work as a bridge between savings and investment within the region, leading to further deepening of the regional economic and financial integration.

It is effective to enhance the use of RMUs through expanding network externalities where people use the RMU because others are doing so.   Network externalities can be better enhanced with official supports to the use of any RMU, such as in preferential treatment in foreign exchange laws and taxation, issuing RMU-denominated public debt securities, or defining and creating an official RMU in the region.

The increase in the use of RMUs will be supported by facilitating regional economic and financial integration, increasing the number of convertible currencies in the region, and dealing with technical issues on designing RMU-denominated financial instruments.   Particularly, facilitating financial integration is an important challenge, as financial integration lags far behind economic integration in this region.

Stable value of the RMUs is also essential for enhancing the use of the RMUs.   RMU-denominated transaction should be promoted, if such measures as monitoring the RMU for regional surveillance are taken to stabilize intra-regional exchange rates.

(Roadmap to RMU)

The roadmap to introduce RMUs has two paths.   One path is for surveillance, which is different from the one for transaction.   These two paths can converge into one, with sufficient economic and financial intra-regional integration in the longer-term.

An RMU for surveillance on exchange rate policy can be started immediately.   It is recommended that the authorities would reach an agreement to define a certain kind of RMU for surveillance, announce the RMU value every day, and monitor RMU DIs in ASEAN+3 ERPD.   As for enhancing the use of RMUs for transactions, official support would be effective, in addition to exploring the needs of RMUs for transactions in the private sector.   In order to steadily take the actions mentioned above, it should be emphasized that establishing a permanent secretariat is indispensable.