Summary of Summaries

on

“Possible Use of Regional Monetary Units – Identification of Issues for Practical Use”

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Institute for International Monetary Affairs

The three research institutions, Institute for International Monetary Affairs (IIMA) in Japan, Nanyang Technological University (NTU) in Singapore, and University of Indonesia (UI) in Indonesia, collaborated on the above-mentioned topic. The following is a summary of the summaries of the three institutes’ reports which are attached to this summary.

Introduction

An RMU (Regional Monetary Unit) can serve as a monitoring device for regional macroeconomic surveillance and contribute to the stability and growth of the regional economy in East Asia. It can also be used for official and private transactions. The RMU can contribute to the development of financial and capital markets in the region. Its use for official and, subsequently, for private transactions as well is expected to become more feasible as economic and financial integration deepens.

The three research institutions build on the outcomes of the Research Group Study on RMUs from 2006/2007 and 2007/2008. They conducted detailed studies on how the RMU can be used for regional surveillance and for transactions as well as a perception survey on the opinions of government officials, researchers, experts, and practitioners in the financial sector regarding the RMU.

RMU for Macroeconomic Surveillance

IIMA proposes the practical use of the RMU for macroeconomic surveillance at AMRO. The use of the RMU for surveillance is strongly supported among the respondents in the NTU survey.

Monitoring the RMU and RMU deviation indicators (RMU DIs) plays an important role in the regional surveillance process, a role which cannot be played by bilateral exchange rates. This is because the RMU DIs represent the degree of deviation from the benchmark rates of regional currencies against the currency basket, whereby the RMU represents the value of the currency basket against the US dollar or the euro. The RMU and RMU DIs could play an early warning role in surveillance due to the following characteristics.

It has been observed that there is a high correlation between the effective exchange rates in the region and the RMU DIs and also that the effective exchange rates were more stable under the hypothetical peg system against the RMU than they actually were. Although the effective exchange rates are affected by changes in the value of the RMU against currencies outside the region, stabilizing the RMU DIs leads to more stable effective exchange rates.

The respondents to the NTU survey felt that the level of economic integration was high and that the introduction of the RMU could further accelerate the integration process. As economic integration deepens further in East Asia, it would be more beneficial to East Asian countries to adopt an exchange rate regime that collectively floats against the US dollar and the euro while maintaining a stable intra-regional exchange rate. Consequently, an exchange rate regime referring to the RMU would be more beneficial to these countries.

The RMU DIs are useful indicators for measuring dispersion within the region. The development of the RMU DIs of all the member countries showed intra-regional exchange rate movements becoming more divergent during the global financial crisis in 2007-2009. Divergent intra-regional exchange rate movements can cause trade and current account imbalances among countries in the region. When the RMU DIs exceed the upper or lower limit of the fluctuation band tentatively set, it may signal erratic capital flows or reversals of such flows.

The RMU DIs could be more useful than bilateral exchange rates in detecting the mean reversion movements of exchange rates. This means that excessive appreciation or depreciation of exchange rates can be corrected by a sharp reversal.

Measuring the correlations between the RMU and individual currencies such as the US dollar, euro, and major regional currencies can provide information on how exchange rate regimes and exchange rate policies in the region as a whole have developed.

IIMA’s study is based on the CMIM contribution-weighted RMU. There are various kinds of weighting schemes for the RMU, using various combinations of GDP, trade volume, financial and capital market size, and contributions of member countries to the CMIM. The differences among the weighting schemes, however, do not significantly affect the trajectories of the RMU and the RMU DIs, as long as these differences are limited.

According to the NTU survey and the UI survey, political and technical issues for introducing the

RMU such as the weighting scheme and the base year are considered to present a challenge. IIMA suggests that it should be important to begin using an RMU tentatively based on a certain weighting scheme for macroeconomic regional surveillance, aside from discussions among member countries on the appropriate weighting scheme to be selected.

RMU for Official Use

IIMA proposes that AMRO and the ASEAN Secretariat use the RMU as a unit of account for financial reports and budgets. The Asian economic database in AMRO could be published in terms of RMU. These uses of RMU would be beneficial to get more stable figures since intra-regional exchange rates are stable even though regional currencies as a whole are fluctuating widely against the US dollar. The official use of the RMU as a means of payment among member governments, for credit transactions among member authorities, and as a reserve asset presents challenges for the long term.

RMU for Private Use

The RMU-denominated transactions will enable the diversification of foreign exchange risks. They will give individuals, businesses, and financial institutions in high-interest countries in the region a means to raise funds at lower rates, while those in low-interest countries will have chances to invest the funds at higher rates. If these characteristics can be effectively utilized, it will help promote "channeling intra-regional savings into intra-regional investment" that has been advocated since the Asian currency crisis in 1997.

The three institutions agree that official use is a key to promoting private use. Official commitment would strengthen the private sector's confidence in using the RMU. Market liquidity, transparency and simplicity, and the attractive risk-return profile of financial instruments denominated in RMU would facilitate its private use. Official support for private use of the RMU would be also important. This could take the form of, for example, issuance of RMU-denominated bonds by governments or multilateral institutions, preferential treatment of RMU-related operations in foreign exchange regulations, *de jure* or *de facto* acknowledgment of the RMU for private use as a "foreign currency," harmonization of accounting and tax treatment for RMU-related products, and support for the establishment of an RMU fund settlement system.

Roadmap

With respect to its use for surveillance, IIMA proposes that AMRO define an RMU, publish RMU values on a daily basis, and continuously monitor the RMU and RMU DIs for regional surveillance. This could begin immediately.

The respondents to the NTU survey felt that greater publicity needs to be given to the work of the ASEAN+3 Research Group and newer institutions such as the CMIM and AMRO, so that there will be greater awareness and appreciation of their work and their contribution to the economic integration process.

With respect to official and subsequent private use of the RMU for transactions, there will be medium- and long-term challenges. Use of the RMU should be initiated for surveillance, then for official transactions, and subsequently for private transactions, with consideration for the divergent performance of the member countries in terms of real economy and foreign exchange, financial, and capital markets.

UI concludes that the necessary steps for introducing the RMU would include conducting an in-depth study of the RMU, confirming its benefits, and raising public awareness of the RMU. UI lists the problems identified by the survey and proposes a gradual approach in which several countries would begin to use the RMU and then other countries would follow later.

Steps that will help deepen economic and financial integration and increase the benefit of using the RMU for surveillance and transaction purposes include facilitation of financial cooperation and intra-regional exchange rate stability, member countries' moves toward currency convertibility taking sequencing of capital account liberalization into consideration, and promotion of FTAs/EPAs within the region.

International financial architecture is being discussed by the G20. The EFSF (European Financial Stability Facility) and EFSM (European Financial Stabilization Mechanism) have been established in Europe. The euro area Ministers of Finance agreed to establish the ESM (European Stability Mechanism) which will provide assistance to member countries in financial distress. It would be a high time to discuss the regional financial architecture in East Asia, including the future course of CMIM and AMRO, the possibility of AMF, and the feasibility of the RMU. These regional efforts could bring a global financial stability by supplementing IMF functions.