
World Economic Forum on East Asia

Summary

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Currency Volatility: Balancing Flexibility and Stability 

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How can Asia manage currency volatility to maintain regional competitiveness in global markets?

The following dimensions will be addressed:

- Future of the US dollar
- Internationalization of the yuan
- Macroeconomic policy coordination
- Control of capital inflows
- Market reaction to the Japanese earthquake and aftermath

Key Points

- Chinese policy towards the yuan is at the centre of many regional currency issues.
- The current limited internationalization of the yuan is an unprecedented experiment. The rate and method by which China will internationalize its economy will deeply affect the future of the US dollar and the global economy.
- The decline of the importance of the US dollar will be gradual but inevitable.
- Some monetary policy coordination is occurring in South-East Asian nations.
- Market reaction to Japan following the tsunami and earthquake is not reflective of the country's strong economic fundamentals.

Synopsis

China has long caused concern abroad – particularly for its key trade partner, the United States – by maintaining tight control over the yuan. China's experiment with the limited internationalization of the renminbi in Hong Kong has sparked much interest as countries look to a possible future where China's currency takes on a global role and potentially undermines the US dollar. The fact that China has made these moves – while still preventing the yuan from being convertible – is unprecedented. China has not pursued a weak yuan to hurt the US but has instead focused on its own internal policy objectives, including social stability.

As the weight of the world economy shifts east, it appears inevitable that the US dollar will gradually decline in importance, instead ceding to a multipolar order where the yuan will likely play a greater role. But managing the rise in international significance of the yuan relative to the dollar will be a slow process. The current lack of liberalization of the yuan creates bubbles and distortions. The goal of Asian economies – including China – 35 years in the future should not be to achieve competitiveness through cheap currencies, but instead through fostering home-grown innovations.

While many assume that the liberalization of the renminbi would cause the currency to appreciate, a too-rapid appreciation could cause the opposite effect. If liberalization is not gradual and households were to transfer their savings abroad, pressure on the renminbi could cause it to depreciate. If China wants to liberalize capital controls, one panellist argued, they would have to liberalize financial markets at the same time, but the process would have to be gradual.

In South-East Asia, it appears cooperation is emerging between some nations in coordinating monetary policy. South-East Asian central bankers are communicating and meeting regularly to respond to developments.

Regarding the impact of the earthquake and tsunami on Japan's economy, markets have failed to recognize that the Japanese economy is fundamentally strong, despite the country's high debt to

GDP ratio. One area of economic weakness is in Japan's small and medium-sized enterprises, which have been hit by weak demand. Panellists noted that it is difficult to predict the effect on the strength of the yen as Japan deals with the results of the disaster.

Panellists

Jaspal S. Bindra, Group Executive Director and Chief Executive Officer, Asia, Standard Chartered Bank, Hong Kong SAR

Alessandro Magnoli Bocchi, Chief Economist, KCIC, Kuwait

Cesar V. Purisima, Secretary of Finance of the Philippines; Regional Agenda Council on South-East Asia

Naoyuki Shinohara, Deputy Managing Director, International Monetary Fund (IMF), Washington DC

Noakazu Takamoto, Secretary-General of Davos Diet Members' Caucus, National Diet of Japan

Moderated by

Alex Frangos, Staff Reporter, Wall Street Journal Asia, Hong Kong SAR

Disclosures

This summary was prepared by Aubrey Belford. The views expressed are those of certain participants in the discussion and do not necessarily reflect the views of all participants or of the World Economic Forum.

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