Japan's Experience with Promoting the Yen as an International Currency

Lessons for China

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From Reluctance to Approval

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- Reluctance until the Asian financial crisis in the second half of 1990s
  - Fear that capital flow could destabilize the economy and render monetary policy ineffective (major cost for a country promoting the international use of its currency)
- Shift to approval in the second half of 1990s
  - Introduction of euro as a common currency in Europe
  - Recognition of the need for Asian countries to reduce reliance on dollar after the Asian financial crisis
  - Financial Big Bang to transform Tokyo into an international financial center on par with New York and London by 2001

Benefits from the Internationalization of the Yen

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(As emphasized in "Internationalization of the Yen for the 21st Century," Council on Foreign Exchange and Other Transactions, Ministry of Finance, 1999)

- International perspective
  - The dollar, euro, and yen support the world's three major economic regions. As such, the euro representing Europe and the yen as the principal Asian currency are in a position to complement the dollar. Such complementary arrangements can contribute to the establishment of a stable international monetary system supported by the sound economic policies of the United States, Euroland and Japan.
  - Strengthening the international role of the yen will contribute to the stability of foreign exchange markets, particularly those in Asia, and to the stability of Asian economies.

- Domestic perspective
  - The diversification of currencies used in international transactions creates the possibility for developing new financial service businesses and contributes to vitalizing the Tokyo market, the home market for the yen.
  - The growth of yen-based international financial transactions and business will create new business opportunities for Japanese financial institutions and reduce the risks involved in borrowing and lending in foreign currencies. This will also effectively contribute to restoring and improving the competitiveness of Japanese financial institutions.
  - The expansion of yen-invoiced international transactions can reduce foreign exchange risk for Japanese companies.

Little Progress in the Internationalization of the Yen

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- Invoicing
  - Yen's share of Japanese export invoices has remained flat at around 40% since the mid-1990s (Japanese MOF)
  - Yen's share of Japanese import invoices has remained flat at around 25% since the mid-1990s (Japanese MOF)

- FX market turnover
  - Yen's share down from 11.3% in 2001 to 9.5% in 2010 (BIS, Triennial Central Bank Survey)

- Central bank foreign reserves
  - Yen's share down from 6.8% in 1995 to 3.8% now (IMF)

Preconditions for a Currency's Wide Use in International Transactions

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- The issuing country has a substantial international presence in economic and other spheres
- The currency is convenient to use for international transactions
  - deep, liquid, and open capital markets
- The value of the currency is stable
  - Choice of currency for international transactions as a two-stage process:
    - First stage: Government's choice of exchange rate regime based on macroeconomic considerations
    - Second stage: Given the first-stage decision, economic agents' actual choice of currency based on microeconomic considerations, such as the balance between risk and return

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Why has the Internationalization of the Yen Failed?

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- Decline in Japan's economic power over the two "lost decades"
  - Japan's share of world GDP fell from 17.8% in 1994 to 8.4% in 2011 (estimated, according to IMF)
  - Japan's share of world exports fell from 10.3% in 1986 to 5.1% in 2010
  - Asian countries' dependence on Japan as a trading partner has declined
- Financial Big Bang implemented in the late 1990s failed to strengthen Tokyo as an international financial center
  - The number of foreign companies listed on the TSE has fallen from 127 in 1991 to 11 now.
  - Tokyo ranked sixth, behind London, New York, Hong Kong, Singapore and Shanghai, in the latest *Global Financial Centers Index* published by Long Finance.
- Asian currencies have remained more stable against the dollar than against the yen

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Asian Currencies More Stable Vis-à-vis the Dollar than Vis-à-vis the Yen

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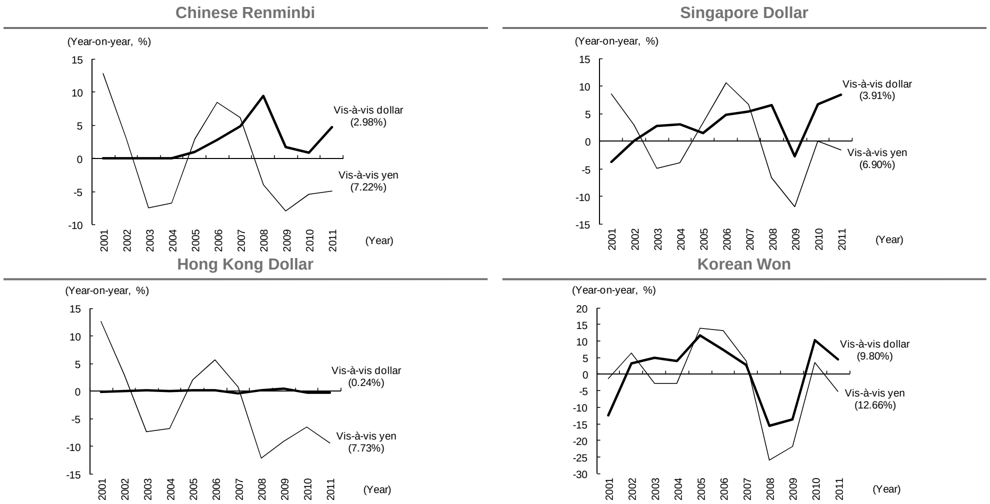

Note: The numbers in parentheses denote the standard deviations of the year-on-year rates of change of the exchange rates concerned for the period 2001-2011.
Source: Based on Bloomberg Database

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Prospects for the Internationalization of the Renminbi

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- Can China make it?
  - China overtaking the US as the world's largest trading nation and may become the world's largest economy in the 2020s
  - May take longer to build deep, liquid, and open capital markets
  - Will Asian currencies shift from pegging loosely to the dollar to pegging closer to the renminbi?
- Capital account opening as the major risk
  - Capital account liberalization must not outpace the strengthening of the domestic financial sector and monitoring capability (the sequencing problem).
  - The Asian financial crisis of 1997-98 clearly showed the consequences if the wrong sequence is adopted
  - Is China following the right sequence?

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