



## Yuan as an International Reserve Currency - A Small-and-Open-Economy Perspective

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## Dilemma of Small & Open Economies in Asia

- Original Sin: the domestic currencies of Asian S&OEs cannot be used to borrow abroad
- Asian Financial Crisis (1997) -> Accumulation of FX Reserves

Country	FX Reserve(2000, \$ billion)	FX Reserve(2011, \$ billion)
China	159.6	3,181.1
Indonesia	28.5	110.1
Korea	77.0	306.4
Malaysia	28.3	133.6
Philippines	13.1	75.3

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## Sketch of the S&OEs' Problem: Scenes from 2008-2011

- Global Crisis (2008) & Eurozone Fiscal Crisis (2010-2011)
- Finance Channel: Deleveraging in a Global Scale
- Trade Channel: Export Dependency to US & Europe
- Depreciation of Currencies of S&OE Countries
- Decrease in FX Reserves of S&OE Countries
- Asian S&OE Countries under scrutiny: Repeat of 1997 in Asia?

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## The Problems in Terms of Functions of Reserve Currency

- Means of Payment  
→ Lack of Foreign Exchange Liquidity in S&OEs
- Unit of Account  
→ Volatility in Exchange Rate of S&OEs
- Store of Value  
→ Potential Loss in Dollar-Denominated Assets

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## Immediate Responses (Korea's Case)

- Government Guarantee to Banks' External Debt up to \$100 billion
- Provision of Dollar Liquidity to Banks by Government and Central Bank
- Provision of Korean Won Liquidity to Banks by Central Bank
- Smoothing Operation by FX Authorities to maintain volatility in the Foreign Exchange Market
- Bilateral Currency Swaps between Korea and US / China / Japan

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## **Long-Term Problems in Global Reserve Currency**

- Characteristics of Small and Open Economies in Asia

- Highly Globalized, Trade(Export)-Oriented Economies
- Developed-Country-Dependent Financial Markets
  - Trade Finance, High Growth Rate, High Level of Investment
- Cautious to Potential Financial Crisis
  - Legacy from Asian Financial Crisis of 1997

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## **Long-Term Problems in Global Reserve Currency (cont'd)**

- Means of Payment: Lack of Foreign Exchange Liquidity in S&OEs
  - Unit of Account: Volatility in Exchange Rate of S&OEs
  - Store of Value: Potential Loss in Dollar-Denominated Assets
- Benefits of a New International Reserve Currency?

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## A Quick Check Sheet for Potential Benefits of Yuan's Internationalization for S&OEs

	Potential Benefits (+/-)	Areas of Need for Further Developments / Reforms
International Liquidity Provision	+	<ul style="list-style-type: none"> <li>- Capital Account Liberalization</li> <li>- Developments to Global Banks</li> <li>- Extending FX Swap Arrangements</li> </ul>
Stability of FX Rate	+/-	<ul style="list-style-type: none"> <li>- FX System Developments</li> <li>- FX Policy Readjustments</li> </ul>

## Implications for Yuan's Internationalization

- We may have to think about not only the supply side, but also demand side of Yuan's internationalization.
- Under certain circumstances, internationalized Yuan may provide S&OEs with more international liquidity and options for investments in FX assets.
- The effect of internationalized Yuan on stability of foreign exchange market in S&OEs in Asia may need more research.
- Areas of Further Work include capital account, foreign exchange market policy and system, bond market and banking sector.

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