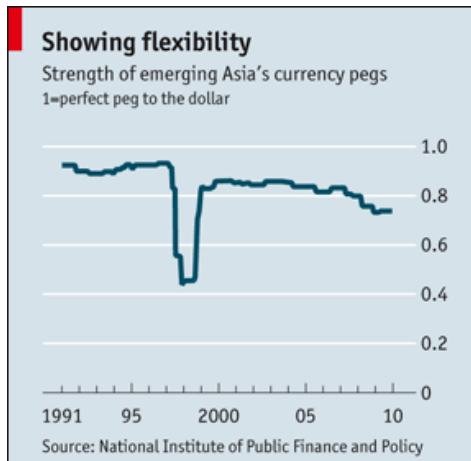


Asian currencies

Chips off the block

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Currencies around Asia are more flexible than you think



AMID all the diplomatic ding-dong over China's yuan, it is easy to lose sight of emerging Asia's other currencies. There is not much din over the dong, for example. While China has kept the yuan pegged to the dollar since July 2008, ignoring complaints that it is artificially cheap, Vietnam's currency, the dong, has depreciated by 13% against the greenback over the same period, unremarked and unprotected. South Korea and Taiwan, the only countries besides China ever to be labelled currency manipulators by America's Treasury, have seen their currencies cheapen by 17% and 6% respectively.

China's critics justify their preoccupation by invoking a "yuan block". China's neighbours and rivals are reluctant to allow their currencies to rise too far against the yuan, for fear of losing China as a customer, or losing out to it as a competitor. Thus although China accounts for only 19% of America's imports, its peg, it is argued, frustrates a broader realignment of currencies in the region.

Does such a yuan block exist? For over a decade before July 2005, it was impossible to say. Since the yuan did not move independently of the dollar, it was hard to know if China's neighbours were in thrall to its currency or America's. But for the following three years, China allowed the yuan to crawl slowly upwards against the dollar. A 2007 study by Chang Shu, Nathan Chow and Jun-Yu Chan at the Hong Kong Monetary Authority took advantage of this interlude to measure the influence of China's yuan on other regional currencies.

Using a method popularised by Jeffrey Frankel of Harvard University and Shang-Jin Wei of Columbia, they looked at the fluctuations of Asian currencies against the Swiss franc. Insofar as the Thai baht and the dollar mirrored each other's moves against the Swiss currency, the authors could conclude that the baht was under the dollar's spell. But if the baht and the yuan strengthened against the franc when the dollar did not, they could identify the separate pull of China's currency.

That pull was strongest on the Korean won, Thai baht, New Taiwan dollar and Singapore dollar. But it also

seemed to reach as far as the Indonesian rupiah and even the Indian rupee. The economists' results suggested that if the yuan were to appreciate by 1%, independently of the greenback, the Singapore dollar, New Taiwan dollar and the Thai baht would rise by 0.58%-0.68% in sympathy. The Korean won would strengthen one for one.

Since July 2008 the yuan has not moved an inch against the dollar. Does that mean that other members of the yuan block have also stood still? Hardly. Malaysia untethered its currency from the dollar one day after China in July 2005. But unlike China it did not retether it during the crisis. The ringgit fell by 15% from April 2008 to March 2009, before regaining much of that ground over the next 14 months. The won's wobbles have been even greater. It lost 40% of its value from February 2008 to March 2009, and remains 25% below its pre-crisis peak.

Most of emerging Asia's currencies strengthened against the dollar this spring. The ringgit rose by 8% from February to May, after Malaysia's independent-minded central bank raised interest rates in March and again on May 10th. In April Singapore's Monetary Authority said it would allow a "gradual and modest" appreciation of its currency. But since the debt crisis in Greece unnerved investors, these currencies have mostly lost value again.

This block isn't scared any more

The flexibility shown by Asia's currencies is noteworthy, even if most of their flexing has been downwards. Economists used to accuse the region of a "fear of floating". In 2003 Michael Dooley of the University of California, Santa Cruz, with David Folkerts-Landau and Peter Garber of Deutsche Bank argued that a de facto dollar standard prevailed in much of the region, akin to the "Bretton Woods" regime of fixed dollar parities that emerged after the second world war. But a paper published on May 19th by Ila Patnaik and her colleagues at the National Institute of Public Finance and Policy in Delhi documents a gradual thinning out of the Bretton Woods II regime.

They use a similar method to Messrs Frankel and Wei to show how closely Asia's currencies track the dollar, euro, yen and pound. They give each country a Bretton Woods II score, based on the rigidity of its currency, especially relative to the dollar. In 2003 the average score in Asia was about 0.85 (a score of one represents a hard peg to the dollar). But the score has since dropped steadily to 0.75.

The new flexibility should stand Asia's economies in good stead. Their ties to the dollar once guaranteed stable prices at home, as well as competitive exports abroad. But America's monetary policy, suited to an economy with flat prices and high unemployment, is too loose for a region now growing so rapidly. As Asia's recovery outstrips America's, the region's central banks will have to raise interest rates, as Malaysia, Vietnam and India have already done. Their currencies will appreciate as a result.

This appreciation will be easier to stomach if the yuan also strengthens. But China's neighbours should not wait for this to happen. Even members of the so-called yuan block should not let the yuan block their progress.