

Risk tolerance of Asian economies is high as a whole, despite lingering wariness of capital outflow

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The US dollar has appreciated further against emerging market (EM) currencies since November, and triggered sizable depreciation in currencies in other parts of the world as well, including Asian economies. Comparing the declining value of currencies in major Asian economies after the US presidential election with the currency depreciation in those economies in the past, their currencies dropped to about the same degree as seen in the wake of Bernanke shock of May 2013, notably in Malaysia, during the beginning of the transition period after the presidential election. However, the strengthened dollar against EM currencies that started in November is mainly due to capital inflows back to the US on hopes of a fiscal expansion by the new US administration boosting the economy and increasing interest rates in the US, as a consequence of the November presidential election results. The current depreciation of EM currencies against the dollar is essentially different from the currency crisis in the past where the EM currencies experienced a sharp selloff due to the deep structural problems faced by emerging countries. Asian economies are highly likely to avoid the tail risk of a currency crisis because of overall improvement in their fundamentals and risk tolerance, a shift to a floating exchange rate system in many of the region's economies as well as expansion of currency swap agreements as a safety net. In fact, when comparing the foreign exchange reserves of Asian economies, an important indicator of a country's ability to tolerate a crisis, with the IMF's "Assessing Reserve Adequacy (ARA)" metric, most of the economies in the region, except for Malaysia, hold the appropriate level of reserves proposed by the IMF (see table 1).

Looking at the real economies in Asia, countries in the region sustain strong domestic demand, underpinned by the stable employment and income environment as well as fiscal policies. Furthermore, the recovery of exports in those economies becomes apparent and a moderate pickup in exports is expected to gradually push up the economy. On the monetary policy side, central banks in India and Indonesia decided to keep interest rates unchanged in December in defiance of market expectations for additional rate cuts. This reflects the fact that an accommodative monetary policy in some Asian economies is constrained by their wariness over capital outflows. Meanwhile, interest rates in the US, which influence the monetary policy stance in Asian economies, are anticipated to increase at a more moderate pace than in the past amid continuously low and stable inflation in the region, and therefore central banks in the region will continue to implement their monetary policies taking into account the economic conditions while closely watching financial market trends. The real exports in Asian economies move in the opposite direction of exchange rates (see chart 1) and a moderate depreciation of Asian currencies is expected to support export expansion, through improved price competitiveness, especially in export-driven countries such as Newly Industrializing Economies (NIEs), Malaysia and Thailand.

Table 1: Foreign Exchange Reserves of Asian Economies and Currency Volatility

	①Foreign exchange reserves (in billions of USD as of end-2015)	②Appropriate level of reserves (in billions of USD)	Level of reserve adequacy (①÷②、%)	Currency volatility (% during the period from the US presidential election until now)
China	3,406	2,845	120	▲ 2.3
Korea	368	297	124	▲ 5.2
Indonesia	106	87	122	▲ 2.9
Malaysia	95	115	83	▲ 6.6
Thailand	163	76	216	▲ 3.0
Philippines	81	35	229	▲ 2.6
Vietnam	37	-	-	▲ 1.9
India	356	230	154	▲ 1.9

Note: The IMF's ARA (assessment of reserve adequacy) index is calculated as below.

Foreign exchange reserves above 100 to 150% of the IMF's index are regarded as an appropriate level of reserves.

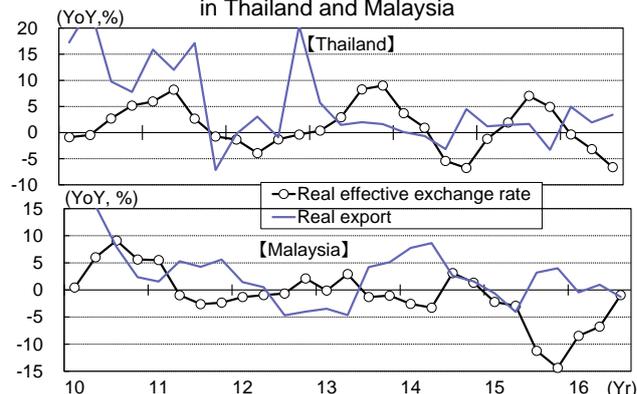
ARA = 5% × export amount + 5% × broad money

+ 30% × short-term foreign debt outstanding

+ 15% × other foreign debt outstanding (such as mid-to-long term foreign debts)

Source: IMF, Bloomberg and BTMU Economic Research Office

Chart 1: Real Effective Exchange Rates and Real Exports in Thailand and Malaysia



Note: Real effective exchange rate of Thailand is two-quarter lead.

Source: BIS, NESDB, Statistics Bureau of Malaysia and BTMU Economic Research Office

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