

Comments

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It is a rather difficult question to answer, given the large number of competing views, the question of whether the U.S. deficit is going to be sustainable or not. But from East Asia's perspective, it is clear that any further accumulation of capital and current account surpluses are not going to be sustainable. Since the bulk of East Asia's surplus comes from its trade with the US, the U.S. deficit is not going to be sustainable.

Another point I would like to make is that it is time to take action. Much has been written on the causes and probable consequences of global imbalances. We have seen many simulation studies showing the amounts of East Asia's currency adjustments that are required. We do not need any more research. The US, EU, and East Asia must agree to and set in motion an adjustment process that could reduce the global imbalance to a manageable proportion. So far, in this workshop four alternative options for the resolution of the imbalance have been proposed. I believe that Fred's suggestion is the most viable and realistic one. What is needed at this stage is an agreement or an accord, among the four important players, that is the United States, Japan, China, and EU, on policy adjustments they are going to make over the next three years.

It is worth emphasizing the need for policy cooperation among the four because East Asian countries individually or as a group will not be able to make any unilateral adjustments, and even if they did, their actions alone would not be effective. I am reluctant to talk about the Japanese policy conundrum without any Japanese-based Japanese economists present at this workshop, but Japan as the largest economy in East Asia has not been able to provide leadership needed for policy coordination in the region. Since 1997 Japan has been at the forefront of promoting financial and monetary integration in East Asia. If you read some of the statements made by ASEAN+3, Japan is very much concerned about the intra-regional exchange rate misalignment and the need to bring about an across the board adjustment of East Asian currencies against the US dollar. Japan has proposed the creation of an Asian currency unit (ACU) similar to

the ECU. According to its advocates, the ACU could facilitate an overall appreciation of the East Asian currencies against the United States.

If Japanese policymakers are really serious about establishing the ACU, the least they can do is to stop the further sliding of the Japanese yen against dollar, Euro, and other East Asian currencies. Since 2005, the yen has continuously depreciated vis-à-vis the US dollar and other currencies, complicating the resolution of global imbalances. Nevertheless, Japan is not likely to take any measures to strengthen the yen in the near future because Japanese policymakers are still unsure about whether they will be able to generate additional domestic demand to sustain economic recovery: they will continue to rely on exports for growth and employment. As long as Japan pursues what appears to be a beggar thy neighbor policy, other East Asian countries including China will find it difficult to let their currencies appreciate against the US dollar. As the Financial Times suggested, perhaps Japan should consider seriously intervening in the foreign exchange markets to reverse the trend.

John Williamson was pondering sometime ago whether there was any possibility of East Asian countries jointly intervening in order to stabilize bilateral exchange rates in the region. Such an intervention requires close policy coordination. For sometime now, the East Asian economies participating ASEAN+3 have been discussing *modus operandi* of effective policy coordination among themselves. Despite the clear need for policy coordination, China and Japan simply have not been able to agree on how it could be done. I fully support Fred's suggestion that Korea, China, Japan, and other countries intervene in the foreign exchange market to buy yen, but at this stage, there is little prospect for such intervention.

There has emerged clear consensus in this workshop that China needs to allow a substantial appreciation of its currency, the renminbi. If Japan lets its currency appreciate, it will be easier for other countries to demand China and on its part China will find it easier to make the necessary currency adjustments. Unfortunately, East Asian countries will not be able to coordinate their exchange rate and demand management policies necessary to bring down the size of the global imbalances to a sustainable level. This inability is one reason why the global economy needs global policy coordination, in particular, among the four major players.

Although the workshop has been presented with different figures, a 20 percent depreciation of the US dollar over the next two years, along with a large appreciation of the Japanese yen will need to be matched by a substantial appreciation of the renminbi and other major East Asian currencies. This across the board appreciation in East Asia

may result in Euro's real depreciation so that it will be effective if it is complemented by Euro's appreciation against the US dollar.

If the four major players reach an agreement on the currency adjustments, it will have to be supported by stimulation of domestic demand in East Asia and Europe to prevent global recession. Many claim that Japan has exhausted its arsenal of policy instruments effective in boosting domestic demand. It would be presumptuous if I offered any policy recommendations. But in my view Japan will not contribute to the adjustment process called for if it does not take measures that could strengthen the yen. A stronger yen could boost domestic demand through the terms of trade effects in the short run. Any policy statement that suggests possible policy changes for a stronger yen is likely to generate expectations for the yen's appreciation. Furthermore it is certain that the appreciation of the yen will put more pressure on Japanese policymakers to do something to revive domestic demand. Similar policy adjustments also apply to China, Taiwan, and possibly Singapore.

As it has been raised several times during the workshop, the global adjustments should not lead to reduction in the global aggregate demand. In this regard East Asia must be prepared to lead expansionary domestic demand policy. There are many things these countries can do, including structural adjustments and institutional reform. However, these reforms are going to take a long period of time to come through. In the meantime, it seems that expansionary fiscal policy can be combined with currency appreciation.

Regarding the Korean situation, the country is no longer an important player in the resolution of global imbalances as it is forecasted to record a current account deficit in coming two years. Nevertheless, the market believes that the Korean won will appreciate further once China starts letting its currency strengthen vis-à-vis the dollar. Korea is no longer capable of continuing with sterilized intervention and as long as it follows an inflation targeting framework it is likely to move to greater flexibility. Since 2005, the Korean won has appreciated by more than 15 percent vis-à-vis the dollar while the yen and renminbi have depreciated both in nominal and real effective terms. I do not think countries like Korea and Thailand can wait any longer, just hoping that China and Japan will send clear signals to the market that they will do something about their currencies. If they do not as likely, what options do countries like Korea and Thailand have? They will most probably go back to market intervention to weaken their currencies again. This is why some sort of policy coordination in East Asia and at the global level is critical.