〈共通論題〉

Domestic Financial Market Development in Asia and the Role of Sterilization

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Most non-Japan Asian economies have maintained variants of managed exchange rates. The background and reasons for these policy choices are reviewed, and a brief assessment of the different currencies for overvaluation or undervaluation is conducted. The author finds that many Asian economies appear to prefer to operate with significantly undervalued exchange rates. This clearly helps to maintain competitiveness in the traded goods and services sectors of these export-dependent economies, but at the same time it also undermines both the development of domestic financial markets and the growth of the domestic non-traded goods sectors. The mechanism adopted for maintaining exchange rate competitiveness is typically intervention in the foreign exchange market, and the subsequent sterilization of the domestic funds created by means of (1) active use of reserve requirement ratios and/or (2) the issue of additional central bank liabilities that do not form part of the monetary base. These strategies are designed to short-circuit the traditional economic adjustment mechanism (under the Law of One Price). The paper documents the extent of sterilization by Asian central banks.

The main thesis of the paper is that sterilization policies hamper the development of domestic financial markets in two ways: first – quantitatively -- by depriving the domestic financial markets of loanable funds which are locked up on the books of the central bank, and second – on the price axis – by preventing appropriate interest rate adjustments (a form of financial repression). Essentially Asian policy-makers are engaging in a trade-off of the real sector versus the financial sector. They are encouraging the promotion of export-led growth models at the expense of the development of domestic financial markets as well as those domestic sectors that are deprived of funds.

Where sterilization has not been utilised, economic development of the export and domestic sectors has been more balanced, and at the same time domestic financial markets have been less repressed.