

Introductory Summary

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The Institute for Monetary and Economic Studies (IMES) of the Bank of Japan (BOJ) held its 14th International Conference entitled “Growth, Integration, and Monetary Policy in East Asia,” on May 30 and 31, 2007.²

The conference explored a wide range of economic and financial topics in East Asian economies including financial integration, external balance, growth, and monetary policy. The conference emphasized theoretical, empirical, and policy analysis of these topics, taking into account the integration of world goods markets and financial markets.

The conference began with opening remarks by Governor of the BOJ, Toshihiko Fukui, followed by keynote speeches by the two honorary advisers of IMES, Bennett T. McCallum (Carnegie Mellon University) and Maurice Obstfeld (University of California, Berkeley).

The five subsequent sessions each consisted of a paper presentation and two discussions by designated discussants, followed by floor discussions. Hiroshi Fujiki (BOJ), Michael Devereux (University of British Columbia), Jong-Wha Lee (Asian Development Bank), David Weinstein (Columbia University), and Marvin Goodfriend (Carnegie Mellon University) presented papers.

The conference concluded with a panel discussion session entitled “Growth, Integration, and Monetary Policy in East Asia.” Leonardo Bartolini (Federal Reserve Bank of New York), Hans Genberg (Hong Kong Monetary Authority), and Már Gudmundsson (Bank for International Settlements) served as panelists. The two honorary advisers of IMES and Yu Yongding (Chinese Academy of Social Sciences) served as designated discussants. Akinari Horii (BOJ) served as the moderator.³

In this introductory summary, we begin by summarizing the main theme of the opening remarks and two keynote speeches. We then move on to summarize the main issues related to emerging East Asian economies through the paper sessions, and the main points discussed in the concluding panel discussion. We conclude the introductory summary by touching upon two issues concerning Japan discussed during the conference.

The main themes of the opening remarks and two keynote speeches are as follows.

First, Fukui pointed out East Asia’s growing integration into the global economy through goods and financial markets and proposed that the participants discuss its

1. Director-General of the Institute for Monetary and Economic Studies (IMES), Deputy Director-General of the IMES (currently, Takamatsu Branch), and Director and Senior Economist of the IMES, respectively. As the organizers of this conference, we would like to express our sincere appreciation to our honorary advisers, Bennett T. McCallum and Maurice Obstfeld, and all the other participants at the conference. Our special thanks go to Junko Miyoshi, Takahide Habuchi, and other staff members of IMES who devotedly helped to organize the conference.

2. See Appendix 1 for a list of the participants (the affiliation is as of the time when the conference was held).

3. See Appendix 2 for the program.

implications for the global business cycle and price movements, external imbalances, and appropriate monetary and exchange rate regimes for East Asian emerging economies during the conference.

Second, McCallum analyzed monetary policy in Singapore in his speech entitled "Monetary Policy in East Asia: The Case of Singapore." He showed that a policy rule which adjusted the exchange rate to stabilize the inflation rate and the output gap was appropriate in Singapore, because the economy was extremely open to international trade.

Third, Obstfeld proposed an exit strategy from the essentially fixed renminbi in his speech entitled "The Renminbi's Dollar Peg at the Crossroads." He proposed that China should begin by establishing a limited trading band for the renminbi and then move on to widen the band over time as domestic foreign exchange markets developed.

The main issues related to emerging East Asian economies through the paper presentation sessions were as follows.

First, Fujiki presented a paper entitled "Financial Integration in East Asia." He showed three results for selected East Asian economies: the degree of integration into world financial markets was increasing based on *de facto* quantity measures, the saving-investment correlation was falling while its level was higher than those of in euro area economies, and the degrees of smoothing of idiosyncratic shocks by cross-holding of financial assets were lower than in euro area economies.

Following Fujiki's presentation, regarding the measurement of financial integration, many participants stressed the importance of the price measure and presented their own interpretation on the divergence in *de jure* and *de facto* measures. Regarding the falling saving-investment correlation, one participant emphasized the critical role of current account reversals during the Asian financial crisis. Regarding the analysis of risk sharing, some participants argued that common regional shocks in East Asian economies should be analyzed in addition to idiosyncratic shocks.

Second, Devereux presented a paper entitled "Financial Globalization and Emerging Market Portfolios." He presented a dynamic stochastic general equilibrium model to describe the financing patterns of many emerging economies since the end of the 1990s. The model showed that the optimal risk-sharing financing pattern was to accept inflows of foreign direct investment (FDI) and portfolio investment, while balancing these with outflows of investment in fixed-income, non-contingent assets. A simple calibration to the United States and China led to a close fit between the model and data.

Following Devereux's presentation, regarding the theoretical model presented, some participants wondered whether the assumption of market segmentation employed in the model was realistic. Other participants asked about the role of the precautionary saving motive in the model. Another participant pointed out that the savings and investment net positions were not accounted for by the model. Regarding the fit to the data, one participant mentioned that the model did not explain the timing of the increase in the inflow of FDI and the increase in the outflow of fixed income in China.

Third, Lee presented a paper entitled "Integration and Growth in East Asia." He showed a positive relationship between international integration and long-term growth

using both aggregate and micro data sets. He first showed that trade openness and FDI inflows had a significantly positive impact on income growth using cross-country panel data from 1970 to 2005 from 81 economies. He then showed that global integration through inbound FDI, outbound FDI, and trade contributes to the plant-level labor productivity growth and the total factor productivity (TFP) growth using Korean firm-level data.

Following Lee's presentation, many participants warned that the cross-country regression might not identify the causality from integration to growth because of endogeneity. Some participants pointed out that the size of the positive effect of trade openness to growth estimated from the cross-country regression seemed to be too small.

Fourth, Goodfriend presented a paper entitled "Monetary Policy in East Asia: Common Concerns." He identified five common features of East Asian development, evaluated their consequences for monetary policy, and recommended inflation targeting and flexible exchange rates as an appropriate monetary policy framework for East Asian economies based on the New Neoclassical Synthesis (NNS) model. He suggested to begin by strengthening the financial sector to implement the framework, and also suggested the benefit of financial cooperation among the governments of East Asian economies appears to be limited based on the analogy with a credit union.

Following Goodfriend's presentation, some participants wondered whether the NNS model was suitable to evaluate an appropriate monetary policy framework in emerging East Asian economies. One participant argued that the starting point should be credible monetary and exchange rate policies, rather than financial sector reform. Regarding the financial cooperation among the governments of East Asian economies, some participants argued that the current degrees of capital market imperfections and the nature of risk in the region, which were not considered in the NNS model, might justify financial cooperation.

The concluding panel focused on three topics: monetary policy, exchange rate coordination, and monetary cooperation in emerging East Asia. The main points related to emerging East Asian economies are as follows.

First, regarding the monetary policy in emerging East Asia, a participant pointed out that monetary policy strategies in the region were increasingly focused on domestic price stability, rather than exchange rate stability. Several participants indicated that the East Asian economies should continue developing and integrating financial markets and increase the flexibility of exchange rates to pursue domestic price stability. A participant pointed out that the duration of China's policy mix of independent monetary policy, exchange rate stability, and capital controls hinged on the sustainability of the sterilization operation.

Second, regarding the exchange rate coordination and the future possibility of currency union in the region, many participants pointed out that increasing financial integration and the emphasis on domestic price stability made the exchange rate coordination and currency union in the region not credible. However, one participant argued that the case for exchange rate coordination is reasonable, since the Chinese exchange rate regime was under some transition and other Asian economies' regimes were becoming more flexible.

Third, regarding the monetary cooperation in the region, one participant suggested that progressive harmonization of financial market regulations in the region would help to promote the integration of capital markets. The participant also suggested that multilateralization of the current regional bilateral reserve sharing under multilateral surveillance was a good example. Another participant cast doubt on the desirability of reserve pooling solely based on the evidence of a high correlation of shocks among East Asian countries.

We now touch upon the two issues related to the Japanese economy, the yen carry trade, and the measurement of upward bias in the Japanese consumer price index (CPI), discussed during the conference.

First, in the concluding panel discussion, one participant focused on the yen carry trade. The participant pointed out the difficulty of explaining the success of the carry trade using economic theory, measuring carry positions, and estimating the implications of a possible unwinding of carry trades. In response to these points, one participant related the success of the carry trade to the failure of the expectations theory of the term structure in domestic bond markets, while another participant regarded it as the correction of a traditional home bias. Another participant suggested that the impact on the foreign exchange market of unwinding, if it ever occurred, would be smaller than the impact in 1998.

Second, Weinstein focused on upward bias in the Japanese CPI in his paper entitled "Defining Price Stability in Japan: A View from America." He suggested that if the U.S. methodology of calculating price indexes were used, the Japanese CPI was around 1 percentage point higher relative to the U.S. CPI. He argued that the correction of this bias would reduce government spending significantly. Following Weinstein's presentation, a participant argued that one should not take the estimates of the bias at face value, because they were based on a casual application of U.S. results to the Japanese CPI which neglected many important differences between the two economies, such as the compilation method for consumer prices or economic conditions. Another participant pointed out that during the deflationary period, under the current Japanese legal framework on indexation, a better measurement of the CPI led to an increase in government spending, rather than a decrease.

APPENDIX 1: LIST OF CONFERENCE PARTICIPANTS

Shaghil Ahmed	Board of Governors of the Federal Reserve System
Sanghoon Ahn	Korea Development Institute
Enrique Alberola Ila	Banco de España
Masayoshi Amamiya	Bank of Japan
Akira Ariyoshi	International Monetary Fund
Leonardo Bartolini	Federal Reserve Bank of New York
Paul Bloxham	Reserve Bank of Australia
Anton Braun	University of Tokyo
Alberto Cogliati	Bank of Italy
Michael Devereux	University of British Columbia
Hiroshi Fujiki	Bank of Japan
Ippei Fujiwara	Bank of Japan
Toshihiko Fukui	Bank of Japan
Hans Genberg	Hong Kong Monetary Authority
Marvin Goodfriend	Carnegie Mellon University
Már Gudmundsson	Bank for International Settlements
Hideo Hayakawa	Bank of Japan
Robert Hetzel	Federal Reserve Bank of Richmond
Akinari Horii	Bank of Japan
Cheng Hsiao	University of Southern California
Chris Hunt	Reserve Bank of New Zealand
Toshio Idesawa	Bank of Japan
Kiyoto Ido	Bank of Japan
Nobuo Inaba	Bank of Japan
Takatoshi Ito	University of Tokyo
Kazumasa Iwata	Bank of Japan
Masahiro Kawai	Asian Development Bank Institute
Yang Woo Kim	The Bank of Korea
Jong-Wha Lee	Asian Development Bank
Samuel Lelarge	French Embassy in Japan

Zubir Maatan	Bank Negara Malaysia
Bennett T. McCallum	Carnegie Mellon University
Shamsuddin Mohd Mahayiddin	Bank Negara Malaysia
Michael Moskow	Federal Reserve Bank of Chicago
Toshiro Muto	Bank of Japan
Hiroshi Nakaso	Bank of Japan
Uwe Nebgen	Deutsche Bundesbank
Ng Bok Eng	Monetary Authority of Singapore
Svante Öberg	Sveriges Riksbank
Maurice Obstfeld	University of California at Berkeley
Ong Jia Wern	Monetary Authority of Singapore
Georges Pineau	European Central Bank
Robert Rasche	Federal Reserve Bank of St. Louis
Lawrence Schembri	Bank of Canada
Manfred Scheuer	Deutsche Bundesbank
Mototsugu Shintani	Vanderbilt University
Shigenori Shiratsuka	Bank of Japan
Mark Spiegel	Federal Reserve Bank of San Francisco
Miyako Suda	Bank of Japan
Made Sukada	Bank Indonesia
Wataru Takahashi	Bank of Japan
Masaru Tanaka	Bank of Japan
Akiko Terada-Hagiwara	Bank of Japan
Ma. Almasara Cyd Tuaño-Amador	Bangko Sentral Ng Pilipinas
Wang Hongbo	People's Bank of China
Kenichiro Watanabe	Bank of Japan
David Weinstein	Columbia University
Robert Wood	Bank of England
Tao Wu	Federal Reserve Bank of Dallas
Yu Yongding	Chinese Academy of Social Sciences

APPENDIX 2: PROGRAM

Wednesday, May 30, 2007

Morning Opening Session

Chairperson: **Kazumasa Iwata**, Bank of Japan
Opening Remarks: **Toshihiko Fukui**, Bank of Japan
Keynote Speeches: **Bennett T. McCallum**, Carnegie Mellon University
 Maurice Obstfeld, University of California at
 Berkeley

Session 1 on “Financial Integration in East Asia”

Chairperson: **Robert Rasche**, Federal Reserve Bank of St. Louis
Paper Presenters: **Hiroshi Fujiki** and **Akiko Terada-Hagiwara**,
 Bank of Japan
Discussants: **Shaghil Ahmed**, Board of Governors of the Federal
 Reserve System
 Masahiro Kawai, Asian Development Bank Institute

Afternoon Session 2 on “Financial Globalization and Emerging Market Portfolios”

Chairperson: **Wataru Takahashi**, Bank of Japan
Paper Presenter: **Michael Devereux**, University of British Columbia
Discussants: **Georges Pineau**, European Central Bank
 Mark Spiegel, Federal Reserve Bank of San Francisco

Session 3 on “Integration and Growth in East Asia”

Chairperson: **Michael Moskow**, Federal Reserve Bank of Chicago
Paper Presenters: **Jong-Wha Lee**, Asian Development Bank, and
 Sanghoon Ahn, Korea Development Institute
Discussants: **Paul Bloxham**, Reserve Bank of Australia
 Cheng Hsiao, University of Southern California

Session 4 on “Defining Price Stability in Japan: A View from America”

Chairperson: **Svante Öberg**, Sveriges Riksbank
Paper Presenter: **David Weinstein**, Columbia University
Discussants: **Anton Braun**, University of Tokyo
 Shigenori Shiratsuka, Bank of Japan

Thursday, May 31, 2007

Morning Session 5 on “Monetary Policy in East Asia: Common Concerns”

Chairperson: **Nobuo Inaba**, Bank of Japan
Paper Presenter: **Marvin Goodfriend**, Carnegie Mellon University
Discussants: **Enrique Alberola Ila**, Banco de España
Lawrence Schembri, Bank of Canada

Concluding Panel on “Growth, Integration, and Monetary Policy in East Asia”

Moderator: **Akinari Horii**, Bank of Japan
Panelists: **Leonardo Bartolini**, Federal Reserve Bank of New York
Hans Genberg, Hong Kong Monetary Authority
Már Gudmundsson, Bank for International Settlements
Discussants: **Bennett T. McCallum**, Carnegie Mellon University
Maurice Obstfeld, University of California at Berkeley
Yu Yongding, Chinese Academy of Social Sciences