

# Adopting single currency in asean region: analysis



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## Question 1

### 1. 1 Introduction

Euro (€) currency was created in 1999 and the single currency provides many benefits to the euro region. For an example, Euro currency eliminated exchange costs and fluctuation risks. It gives stability of economic to the euro region, so it allows government to have better long term planning for future. In addition, economic stability also helps to reduce uncertainty and increase investment, so it gives advantages to the businesses as well. As businesses gain advantages from economic stability, it also give benefits to the citizen as it provides more job and better quality jobs. Furthermore, with a single currency, it is less risky and more cost-effective when doing business within the euro area as there is one large integrated market. Besides that, it promotes cross-border trade and all kind of investments as the price can be compare easily when using the same currency. (N/A, 2014) Thus, the successful of implementing a single currency of euro (€) arise the interest to the topic of whether other region can successfully adopting common approaches. Especially for ASEAN region as ASEAN is one of the region that economic acceleration is much positive. However, there is always a question whether ASEAN can successfully implemented a common currency, as euro currency in European Union. We have to look at the challenges of adopting a single currency for ASEAN economic in order to identify whether ASEAN region is suitable to make such approaches.

### Content

#### 1. 2. 1 Intra-Regional Trade

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First of all, substantial intra-regional trade is one of the key challenges to adopt single currency for Asia. Big volume of inter-transaction within Asia will enhance the currency of countries in Asia. However, countries in Asia done more trading with countries where outside the region, approximately 75% more than countries in Asia. Therefore, Asia countries are worried for their currencies stability against international currencies if they adopt a single currency. Asia countries can import more goods and services from countries outside the region than intra-regional countries only if their total exports is greater than total imports. (Lee, 2009) To sum up, Asean region have to increase their transaction within their regional area before implement a single currency in order to stabilize Asean currency.

### 1. 2. 2 Economic Development

Besides that, Asean countries have different economic development, their GDPs and per capita income levels are different to one another countries. For instance, per capita income of Singapore is approximately 350 times more than poor country like Myanmar's. In addition, countries in the region area like China, India and Indonesia are part of the largest countries in the world, yet they show big income differentials. It is difficult to bear a similar monetary management with such a big income differentials. (Lee, 2009)

### 1. 2. 3 Monetary System & Market Integration

Moreover, monetary integration is another big challenge to adopt single currency for Asean region. Monetary integration refer to central banks and governments of the region countries would have less control over monetary policies and fiscal policies. However, some countries are just not ready for <https://assignbuster.com/adopting-single-currency-in-asean-region-analysis/>

such integration as monetary policy is an important tool to stimulate economy. For instance, countries are not able to use tools such as interest rates to address cyclical needs. (Lee, 2009) For further explanation, every country have different economic objectives, for an example, some countries in the region are suffering recession and some countries are suffering an inflation. Thus, expansionary policies are needed for some countries to address recession, and contractionary policies are needed for some countries to address inflation, but ASEAN central bank can only implement one monetary policy at one time. Therefore, there is a huge problem among the union. In addition, countries like Japan and Korea such developed country have maintain tight restrictions on labor mobility. However, Governments of region countries have to implement policies which allow for greater mobility for labor and capital across within the region borders in order to manage a common currency. However, it is hard to transfers large-scale of resource across national borders as at the union level, governments will have less centralized budget. In addition, Asean is desire to set limits on the fiscal deficits for each country due to experience from European. Hence, country can only respond to country specific shocks by using limited fiscal policies. (Madhur, 2002)

#### 1. 2. 4 Financial System

Other than that, a strong financial systems and markets are required to manage a common currency. It required a strong institutional support as well, but Asean currently does not have such institutions to deal with those threat to the financial sector. (Lee, 2009) Unlike Europe, Europe have established a wide range of institutions such as European Commission,

European Council and the European Central Bank to control regional reserve. Somehow, it is a big challenge to Asean to develop such infrastructure. (Madhur, 2002)

### 1. 2. 5 Macroeconomic Disturbance

Furthermore, the cost of adopting a single currency is domestic central bank have to give up the power to control monetary policy and the currency have to control by ASEAN central bank. However, every countries have different rates of inflation as economic conditions are different. Therefore, it is hard for ASEAN central bank to control all the ASEAN area by implementing a policy and problems may occur if one or two countries failed to adjust interest rates to meet the demands. For an example, the lesson from European debt crisis, European Union is currently discussing whether Greece should return to its own monetary policy that regulated by Greek Central Bank and leave the Euro zone. Meanwhile, there are same situation in the ASEAN as ASEAN nations have two different economic power groups. For instance, the first groups are those nations which are advanced economies such as Brunei, Malaysia, Indonesia, Thailand, Singapore and Philippines. The second groups are those nations which are least developed such as Laos, Vietnam, Myanmar and Cambodia. This two group have big difference in terms of income per capital. For an example, income per capital of Singapore have approximately 350 times more than Myanmar. In addition, Myanmar have high inflation rates and Laos have high unemployment rates. Therefore, it is difficult to address the problems with a same monetary policy as the differentials of inflation rate and unemployment rate between one country and another. (Sidjaja, 2011)

## Impact of single currency to Asean economy

### 1. 3. 1 Positive implications

On the other hand, implement a single currency for Asean economic community would have bring positive effect to the Asean region. Eliminate transaction costs is one of the benefits of implementing a common currency. With a single currency, countries or businesses can save transaction cost when trading within the region as the cost of exchanging currency is no longer needed. For instance, Malaysia citizens can travel or do investment in region area like Singapore, Thailand, Japan and others by using Asean currency. Transaction costs are eliminated as exchange for other currencies are not needed when trading within region area. Therefore, it helps to promote trade within regional area as it is easier to trade by using a single currency. In addition, single currency also allow businesses to have better planning as it eliminated the fluctuation cost. Otherwise, businesses could incur high cost by fluctuation cost. For an example, a company in Malaysia decide to sign a shipping service from company in Singapore with a five year deal which cost 10, 000 SGD per month. At that time, the exchange rate was 1. 00 SGD to 2. 00 MYR, so the company in Malaysia have to pay 20, 000 MYR per month. However, SGD have appreciated against MYR as the exchange rate was 1. 00 SGD to 2. 7 MYR, which result company in Malaysia have to pay 27, 000 MYR because of the fluctuation cost. Hence, investment would increases with using single currency as firms can have a better business planning. Besides that, single currency makes it easier to compare price of products and services across countries in regional area, which

encourage more trading within regional area. As a result, increases in competition, and economic efficiency improved. (Sanno, 2010)

### 1. 3. 2 Cost of adopting Single Currency

The biggest cost of implementing a common currency is countries have to give up their national sovereignty. They are no longer able to implement own monetary policy in their country. This could result some problems to certain countries in the region as monetary policy only can implemented once at one time. As the example of European Union, European central bank cannot address the problems of Greece which suffering of high inflation because if European central bank implement a contractionary policy intend to address high inflation in Greece, it would lead another negative effect to other countries in Europe like Spain where the country currently suffer from recession and having high unemployment rate.

### 1. 4 Conclusion

To sum up, adopting a single currency have pros and cons. A single currency would promotes economic growth of Asean region as transaction costs and fluctuation costs are eliminated which increases trade and investment within the region and attract investors from outside the region. However, countries have to give up for their national sovereignty as monetary policies will be implemented by Asean Central Bank. Despite that, there are several challenges that Asean region have to deal with in order to implement a successful single currency such as intra-regional trade, economic development, monetary systems & market integration, financial system and macroeconomic disturbance. From the view of those challenges, Asean

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region is just not ready yet to implement a single currency as Asean intra-regional trade is not strong enough. In addition, economic development in the region have too big differentials, for instance, Singapore compare to Myanmar. Besides that, some countries like Myanmar and Laos are not ready to give up their national sovereignty yet because Myanmar is currently suffering high inflation rates and Laos is suffering high unemployment rates. Moreover, Asean still need some time to develop a strong financial system to meet the infrastructure like in European Union. Last but not least, Asean is also not ready to deal with macroeconomic disturbance yet as some countries are having high inflation rates, whereas some countries are having high unemployment rates. Thus, it will not be a wised move to adopt a single currency for Asean as member countries in Asean still have a lot in uncommon. As the lessons from Euro crisis, issues in a weak economy country could affect the strong performing country. (Penh, 2012) Asean should adopt a single currency in no rush, otherwise similar consequences would occurred again in Asean region.

## Question 2

### 2. 1 Introduction

The three key macroeconomic factors are inflation, unemployment, and forex. Policymakers always implement many kind of policies to deal with those macroeconomic factors. These three key macroeconomics factors could lead to further global financial crisis if policymakers do not implemented proper policies to address. For instance, when economy reached the peak, high inflation may hit on the economy. Therefore,



policymakers have to implement contractionary policy in order to deal with high inflation. On the other hand, when economy is suffering from recession, high unemployment rate would occur. So that, policymakers have to implement expansionary policy to address high unemployment rate. Moreover, when economy comes to globalization, fluctuation of exchange rates might be too high. Hence, policymakers have to use certain currency reserve to stabilize the exchange rates. However, policymakers sometime just did not see through illusion of business cycle, as a result lead to financial crisis. Stock markets are crucial to financial crisis as when stock markets collapse, countries could suffer from financial crisis. Macroeconomic factors such as inflation, unemployment, and forex would affect the firm value, stock returns and risk assessment.

## Content

### 2. 2. 1 Inflation

Inflation means that overall price levels increase sustainably. Inflation does affect firms' performance as inflation incur costs on firms. With the inflation, firms have to spend more money on raw materials. For an example, Air Asia have to pay more money for the jet fuel if the price of jet fuel goes up. In addition, employee demand more wages as inflation lower down their standard of living. Jet fuel and wages are two major costs for Air Asia. Increases in price of jet fuel and wages also mean that cost of Air Asia increased. Therefore, Air Asia would increase price of airline tickets as well to sustain their profitability. In this situation, cost of the services increased and price of the services also increased. However, demand for airline tickets

decrease due to the theory of demand, as price goes up, demand comes down. Hence, revenue of Air Asia decreases. In addition, the risk goes up because revenue of Air Asia might not be able to afford to pay loans and costs. As risk goes up, default risk goes up as well. Besides that, provision of doubtful debt increases because debtors might also not be able to settle the debt as revenue of debtors are also decreasing. As the result, share price comes down. As the share price comes down, firm value also decreases. Moreover, inflation could also affect stock returns. Stock returns are the dividend paid by issuer to the stockholders. Most probably rise of inflation would reduce the stock returns as drop in revenue of company. Company can afford to pay same amount of dividends while suffering inflation only if company is able to ensure their earnings are keeping pace with the growth rate of inflation. However, it is unlikely as most of the revenue of companies would decrease. (n/a, 2012) Furthermore, inflation also affects the risk assessment of a company as inflation brings different degrees of risks. First of all, when the economy is having high inflation rates, central bank would implement contractionary policy to address inflation. Therefore, quantity of money supply in economy would decrease and thus, low purchasing power in economy. Hence, companies should focus on market in abroad rather than domestic country. For example, Air Asia should offer more of their flight services to other strong purchasing power countries like China, Singapore, Korea and others. As economy is suffering from high inflation, revenue of companies are expected to reduce. Therefore, company should have cut down their cost. For an example, Air Asia would have to cut numbers of staff and closed certain area in airport. In addition, companies should not only focus on offering a single product or service in order to

diversify the risk. For instance, Air Asia not only offer flight services but also selling tax free chocolate, alcohol, and others product. Therefore, when the inflation hit on the input price of jet fuel, Air Asia is still able to gain some revenue. Share price of companies are expected to drop when hit by inflation. Hence, the possibility of shareholders sell all of his shares are high, so companies should have prepared funds to buy back those share to maintain the share price as much as possible; otherwise the company would panic.

## 2. 2. 2 Unemployment

Unemployment refers to people who currently do not have a job, but willing to work. Unemployment bring many impacts on firms. First of all, high unemployment mean there is less disposal income in economy. People don't get income when they do not have a job. Hence, the spending power in the economy is weak. On the other hand, cost of wages would decrease as there are too much surplus of labor supply in the economy when there is high unemployment. Reason decline of wages is because of the competition for a job. People is willing to accept lower wages to get a job. Decreases in cost of wages is one of the element to get better profits, but in high unemployment situation, revenue and profits of company would fall as the purchasing power is low. Therefore the risk of company increases as company might not able to settle down the liability because revenue of company is not enough to cover. Hence, default risk of company increases as rises of risk of company. In addition, provision of doubtful debt might increases as other companies might also face similar difficulties which they can't afford to pay their debt. At the end, the share price of company would falls because of the poor

business performance of company. Share price of company falls lead to firm value falls. Besides that, unemployment also affect stock returns, when suffering from depression, most of the companies would not pay a single sen to their shareholders as they need to gather up their capital to deal with uncertainty or set to make expansion. So that, stock returns are zero at this situation. Other than that, unemployment also affect the risk assessment of a country. High unemployment have some specific risks. First, central bank would implemented expansionary policy to deal with high unemployment. At the same time, government is eager to address unemployment problem as soon as possible because taxes receive by government falls and national economic is weak. At this stage, central bank may reduce the interest rates which intend to lend out money to firms for expansion and thus, deploy labor. In addition, wages of labor is cheap. Therefore, the risk to expand the businesses of firms are low as firms can enjoy cheap interest rates and cheap labor wages. Moreover, it is risky to offer normal or luxury goods and services since most of the people can't afford to enjoy such goods and services. Instead, firms should offer more inferior goods which most of people can afford. Besides that, firms should hire security guards in the working area in order to eliminate risk of crime. Such social problems happened frequently, especially when depression. For example, every Rolex retail shop have deploy at least two security guards to keep their shop safe and avoid robbery. (Riley, 2009)