

Bloomberg BRIEF

Economics Asia

NEWS, ANALYSIS AND COMMENTARY

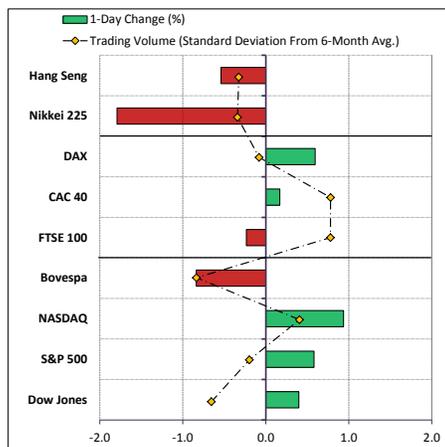
FRIDAY
02.14.14
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QUOTE OF THE DAY

"History shows that the BOJ's stimulus has had no impact on inflation, so additional easing won't make the 2 percent goal more likely. ... Abe's growth strategy is like pie in a sky."

— Jun Ishii, chief fixed-income strategist at Mitsubishi UFJ Morgan Stanley Securities

EQUITY MARKET



CALENDAR (HONG KONG TIME)

	TIME	EVENT	SURVEY	PRIOR
JN	7:50	Japan Buys Foreign Bonds	—	-¥1.8T
JN	7:50	Japan Buys Foreign Stocks	—	-¥107B
JN	7:50	Foreign Buys Japan Bonds	—	¥156B
JN	7:50	Foreign Buys Japan Stocks	—	-¥752B
CH	9:30	CPI YoY	2.4%	2.5%
CH	9:30	PPI YoY	-1.6%	-1.4%
SI	13:00	Retail Sales YoY	-6.8%	-8.7%
SI	13:00	Retail Sales Ex Auto YoY	0.7%	0.4%
SI	13:00	Retail Sales MoM	0.8%	0.1%
IN	14:30	Wholesale Prices YoY	5.60%	6.16%

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ONE ON ONE

Cornell University Professor **Eswar Prasad** talks to **Tom Orlik** about his new book *The Dollar Trap*. (See page 8.)



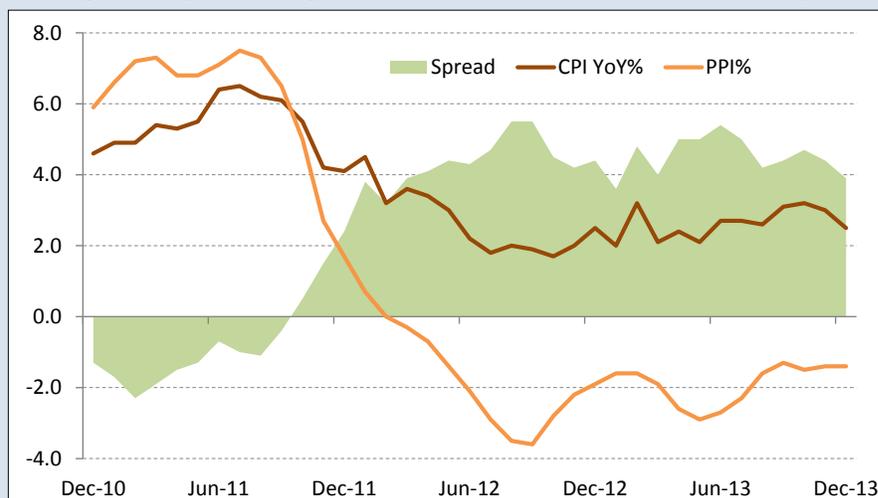
Indian WPI, Chinese Inflation, Singapore Sales

ASIA DAYBOOK:
Anne Riley

■ **WHAT TO WATCH:** India's wholesale inflation may have slowed in January, 2:30 p.m. (See story, page 4.) China's PPI and CPI, 9:30 a.m. Singapore's retail sales, 1 p.m. Indonesia's current account balance.

- **ECONOMICS:** The world needs to adjust to the Federal Reserve's tapering, Australian Treasurer **Joe Hockey** said, calling the policy "methadone." Bank of Korea Governor **Kim Choong Soo** meets investment bankers today to discuss global market conditions. New Zealand's non-resident bond holdings, 10 a.m.
- **GOVERNMENT:** North and South Korea hold another round of high-level talks today after failing to narrow differences in a first meeting on Feb. 12 over issues including military drills. The Obama administration won't engage with North Korea until it moves to give up its nuclear ambitions, U.S. Secretary of State **John Kerry** said in urging China to use its influence. India raised almost \$10 billion from an auction of wireless spectrum.
- **COMPANIES:** BP reportedly dropped plans to invest in a refinery in China and "dismantled" a team assigned to the project. Kirin said it's interested in raising its stake in San Miguel Brewery. Fortress bought back Nomura's 12 percent stake after seven years.
- **MARKETS:** Silver posted its longest rally since March 2008. Russia's ruble weakened the most out its 24 emerging-market peers. (All times are in local time for Hong Kong.)

Today's Report May Show Chinese Prices Slowing



Source: Bloomberg; CNCPIYOY, CHEFTYOY Index

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China's inflation probably slowed in January for a third consecutive month, with CPI rising 2.4 percent from a year earlier, according to a Bloomberg survey. PPI, a measure of the cost of goods as they leave the factory, may have dropped 1.6 percent, a 23rd straight monthly decline, adding to evidence that the world's second-largest economy weakened last month. — Nipa Piboonantasawat, Bloomberg Brief

ONE ON ONE TOM ORLIK, BLOOMBERG ECONOMIST

Prasad of Cornell University Sees Dollar Remaining as Main Reserve Currency

Cornell University Professor **Eswar Prasad** explains in his new book *The Dollar Trap* why the dollar's status as the world's principal reserve currency has strengthened.

Q: How has the financial crisis bolstered the dollar's role in the international financial system?

A: It comes down to shifts in the demand for and supply of financial safe assets. The demand for such assets has risen since the financial crisis even as supply has shrunk. Emerging market economies have a strong incentive to accumulate more foreign exchange reserves to insulate themselves from volatile capital flows. Regulatory reforms that require financial institutions to hold larger buffers of safe and liquid assets are adding to this demand. Meanwhile, government bonds of many major economies look shakier in the aftermath of the financial crisis, as they contend with weak growth prospects and sharply rising debt burdens. Few private sector securities are regarded as safe assets. With its deep financial markets and rising public debt, the U.S. government has thus become the primary global provider of safe assets.

Q: China wants a greater global role for the yuan. Is it ready for prime time?

A: China is actively promoting the renminbi's use in international financial and trade transactions. These steps are fast gaining traction given the economy's sheer size and prowess in international trade. As the currency becomes freely convertible, it will become a viable reserve currency. However, the limited financial market development and structure of political and legal institutions in China make it unlikely that the renminbi will become a major reserve asset that foreign investors, including other central banks, turn to for safekeeping of more than a small portion of their funds. At best, the renminbi will erode but not significantly challenge the dollar's preeminent status.

Q: Emerging markets are once again being roiled by unstable capital flows.

Is that inevitable as the Fed tapers?

A: The Fed's taper has led to a pullback of capital from emerging markets. This is after a prolonged period when the Fed's quantitative easing policies led to capital flowing into those economies, stoking asset price booms, inflation, and sharply appreciating currencies. Despite the turmoil they are experiencing, few emerging markets are on the verge of classic currency crises. Most of these countries learned their lessons from past crises — they now have flexible exchange rates that act as shock absorbers, large stocks of foreign exchange reserves and low levels of foreign currency debt. Nevertheless, the turmoil has exposed the vulnerabilities of countries with large current account and budget deficits, with political instability in some worsening the situation. The crux of the problem is that in both advanced and emerging market economies, monetary policy is taking on the brunt of the burden of supporting growth, and keeping inflation low and currency values stable. This is not a sustainable situation unless other policies, both fiscal and structural, shoulder more of the burden.

Q: If the financial crisis strengthened the dollar's role in the global system, what does the end of the crisis mean?

A: The dollar's continued prominence as a reserve currency does not necessarily mean that the dollar will remain strong in value relative to other major currencies. In the decade before the financial crisis, it was depreciating at a rate of about 1 percent a year against a trade-weighted basket of currencies of its major trading partners. This trend is likely to resume as financial markets stabilize and the safe-haven demand for U.S. financial assets weakens. The dollar needs to depreciate further to bring down the U.S. trade deficit. This means that foreign investors are paying a high price for ostensible safety — getting low yields on Treasuries and accepting a gradual decline in the foreign currency value of their dollar holdings.

Q: Any tipping points that could precipitate an erosion of the dollar's role as the main reserve currency?

A: China could try to aggressively diversify its new foreign exchange reserves away from dollars. However, there is no other financial market, other than the one for Treasury securities, that can absorb a large amount of inflows. Inflationary expectations in the U.S., which have so far remained tame, could become untethered and cause a spike in interest rates. While a few such scenarios are plausible, they all lead back to the dollar trap. There is no easy escape route, as financial turmoil even in the U.S. will simply drive investors back to the clutches of the dollar. There is no other viable safe haven for large investors, including foreign central banks.

This interview was edited and condensed.

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