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### **One more currency into Fiji's basket!**

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The well known American writer and humorist, Mark Twain once cautioned:

“Put all your eggs in the one basket, and WATCH THAT BASKET.”

The basket of currencies, which central banks under the fixed exchange regime including Reserve Bank of Fiji, have adopted for maintaining the value of their respective currencies, is not a fragile one. The basket of currencies comprises the sturdiest of sturdy currencies of the world. They are of the world's leading economies, which export to the rest of the world goods ranging from machinery and high tech goods and services to manufactured goods of all varieties, covering daily consumption.

The currencies included in the RBF's currency basket are the American dollar, the euro, the Japanese yen and of course, the Australian dollar. Before the birth of euro in 1999, British sterling was one of the currencies included in the basket, which was replaced by the euro.

To the list of these currencies, we now see the possibility of adding the Chinese currency, the renminbi to the basket of currencies. Two weeks ago, Fiji's Minister for Foreign Affairs, Ratu Inoke Kubuabola announced at the end of his visit to China that the renminbi would be included in the basket of currencies.

It signifies the recognition of the growing importance of renminbi in Fiji's trade and investment relations with China.

### **Why basket of currencies?**

Small, island states, whose dependency on external trade is very high for all goods ranging from food and fuel to capital goods, prefer to keep a stable exchange rate so that fluctuations in external value of currencies of the source countries do not affect the value of imports and exports. The stable exchange rate was achieved in the past under a fixed exchange rate regime by linking the country's currency to that of the most important trading partner country.

Before World War II, many countries linked their currencies to the British sterling, as Britain was the then dominant economic power. With the decline of British dominance, and with the emergence of the US dollar as a major currency, soon after the end of the World War II, they switched to linking their currencies with the US dollar.

Currency crises including the Asian currency crisis of 1997-98 exposed the weakness of such a link to one currency, which was the chief reason for the near collapse of the Asian economies. For example, in 1997, the Thai economy was pushed into a deep decline, when its current account balance (which comprises trade and service accounts with income transfers) became adverse and the liabilities in terms of the Thai baht became large. Since the baht was linked to the US dollar, with the continued depreciation of the floating US dollar, the Thai baht liabilities steadily ballooned. As rumours spread that Thailand would not be able to meet its external repayment obligations, there was a run on the Thai economy. As investors began to pull out, Thai currency collapsed.

In the reform years, which followed the 1997-1998 Asian currency crisis, Thailand and Malaysia and others switched on to linking to a basket of currencies rather than one currency. The purpose behind this move is to minimize the impact of violent fluctuations in the currencies of trading partners, since the fluctuations in world currencies are not in the same direction.

By having a basket, the impact of gyration in one currency is offset by the ones in other currencies. Linking to a basket of currencies is a prudent step to minimize the volatility in the currencies of trading partners.

### **Fiji's basket**

The exchange rate, which is calculated on a daily basis, is announced by RBF primarily in terms of the US dollar. For watching the movements in exchange rates of currencies included in its basket over a period, say a month, RBF calculates the monthly average rate by way of a weighted index number. The weights used are the percentages of trade with respective countries, whose currencies are included in the basket.

The index so calculated is known as nominal effective exchange rate (NEER) and movements in NEER would show the variation in exchange over a period of time. For assessing Fiji's

competitiveness, another index number known as real exchange rate (REER), incorporates changes in the relative price levels.

### **Case of renminbi**

Fiji's trade with China has increased substantially over the past years. In terms of percentage to total trade, Fiji's trade with China in 2009 is 4.3%, more than trade with Japan (3.6%) and not very far from trade with USA's (6.9%).

As China has also emerged early this year as the second largest economy in the world, next only to USA, by pushing Japan to third place, its currency renminbi has to be recognized. It is China, which is propelling the Australian economy. But for China's growing appetite for its mineral resources, Australia would have just been any other industrialized country, which is currently in the doldrums.

So, there is every justification for the growing importance of renminbi.

However, there is one essential ingredient missing here.

Capital controls continue to exist in China. The renminbi is not fully convertible. Furthermore, it is not floating and is pegged to the US dollar. It is not determined by market forces of supply and demand.

In fact, that is the bone of contention.

All the advanced countries, including USA, Japan and the European Union, want renminbi to be upvalued, if not floated immediately. It is contended that China has deliberately kept the currency undervalued by 50%.

Thus, currencies already in Fiji's basket and renminbi, which is proposed to be included do not belong to the same category. Inclusion of Chinese currency in the basket would not matter much.

The Seoul meeting of the leaders of twenty governments known as G-20 scheduled in November is expected to discuss the subject. If the G-20 Meeting successfully resolves the ongoing currency conflict, and if China decides to float its currency, thereby joining the elite group of floating currencies, there will be every justification for inclusion of renminbi in currency basket.

It looks improbable?

Nothing is impossible.

China's emergence as the world's second largest economy next only to the USA looked improbable only a few years ago.

Things do change.

Recall the words of Benjamin Disraeli:

“Change is inevitable in a progressive society. Change is constant.”

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