

**COMMENTS ON
MARKETS VS. POLICIES: CAN THE US
DOLLAR'S DOMINANCE IN GLOBAL TRADE
BE DENTED? (GEORGIADIS, LE MEZO, MEHL,
AND TILLE)**



Hiro Ito (Portland State U.)
Conference on
China and World Economy Under the Cloud of Trade Disputes: New Challenges
November 30 - December 1, 2020

AN INTERESTING PAPER!

- This paper explores the two questions
 - Q1:** What factors prevent a larger scale of USD dominance?
 - Q2:** May the renminbi challenge the USD's dominant status?
- It explores interesting issues. Timely and important for policy discussions
- Great dataset! The most comprehensive dataset for the shares of major currencies in trade invoicing
- RMB shares in trade invoicing – first of its kind!!



THIS PAPER FINDS

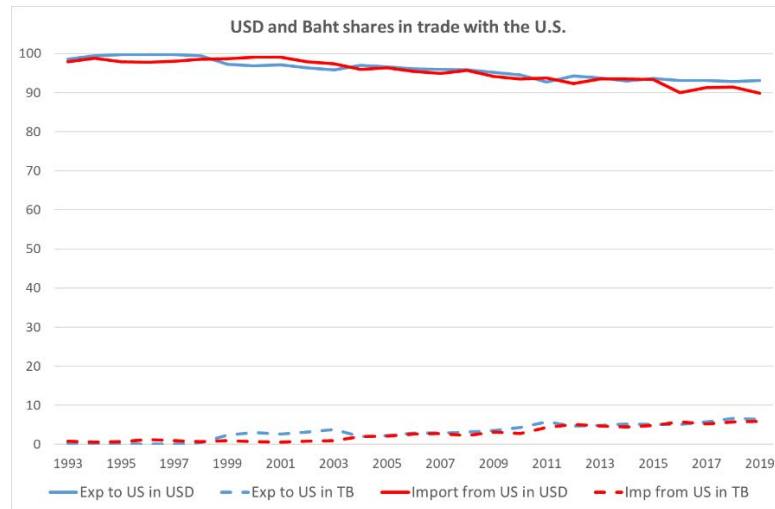
- The US dollar is the dominant vehicle currency used due to strategic complementarities in price setting in export markets.
- The greater exposure to trade with the U.S. (Euro-area), the more USD (EUR) a country tends to invoice its exports in
- Backward GVC integration fosters the use of the US dollar or the euro especially when countries' exports are exposed to trade with the US or the Euro-Area
- The RMB share has increased in the countries that has experienced an increase in their trade exposure to China at the expense of the euro
- The establishment of PBoC swap lines with countries whose trade is particularly exposed to China is associated with increases in RMB invoicing at the expense of USD and EUR



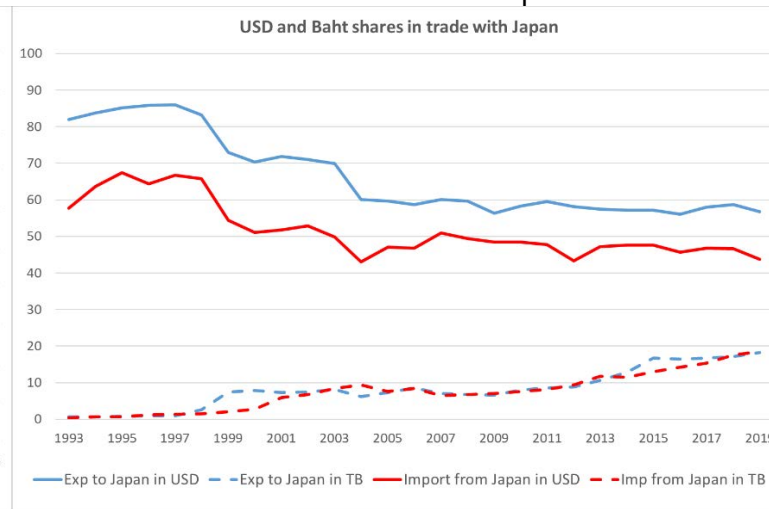
THE FINDINGS ARE CONSISTENT WITH REALITY

USD AND HOME CURRENCY SHARES IN EXPORTS AND IMPORTS FOR THAILAND WITH DIFFERENT DESTINATIONS (ITO AND KAWAI, 2020)

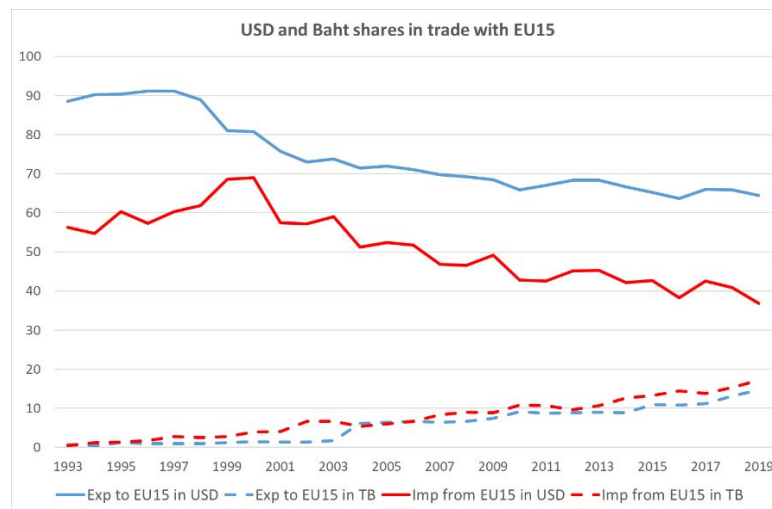
Trade with the US



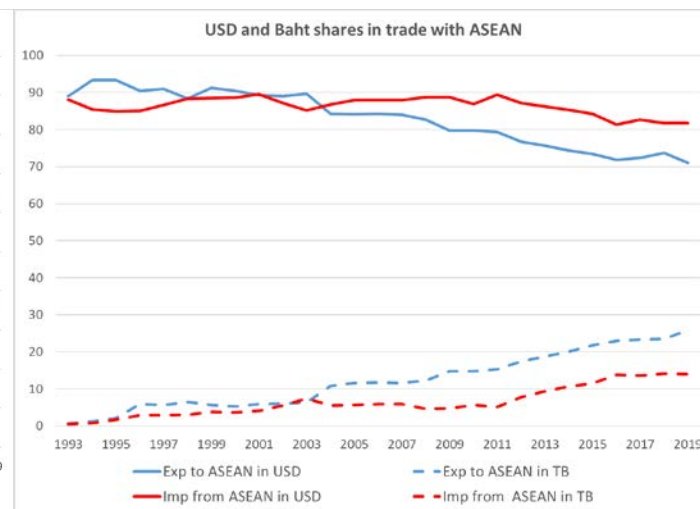
Trade with Japan

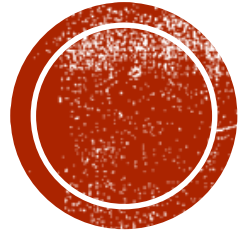


Trade with EU15



Trade with ASEAN





IS TRADE ALL THAT MATTERS FOR CURRENCY CHOICE IN TRADE INVOICING?

The regressions on the determinants of USD/EUR shares in trade invoicing should control for other factors

COMMENT 1:

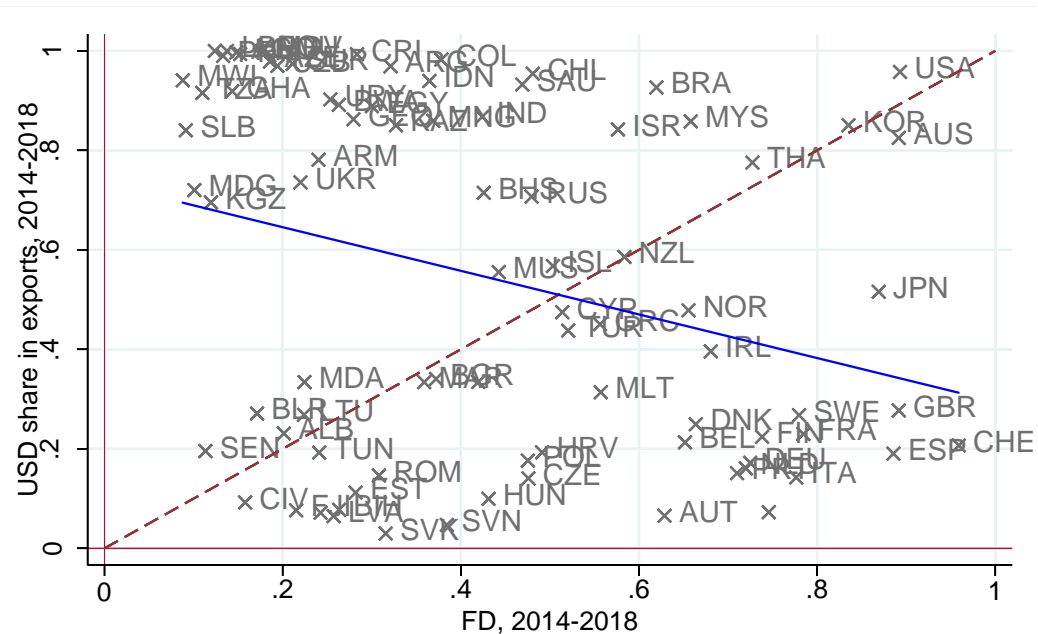
Financial-related variables may matter

- Vast, liquid, and deep financial markets help reduce the transaction costs of the USD and increase its liquidity and usability
 - Financial development and financial openness matter (e.g., JPY and RMB lacking both FD and FO)
 - A country with more developed or open financial markets tends to invoice its trade *more* in its home currency and *less* in the major currencies
- **Why not compare the importance of financial-related variables with that of trade-related ones?**



FINANCIAL DEVELOPMENT AND OPENNESS MAY MATTER – AT LEAST, POLICY MAKERS AND MARKET PARTICIPANTS CARE ABOUT THEM

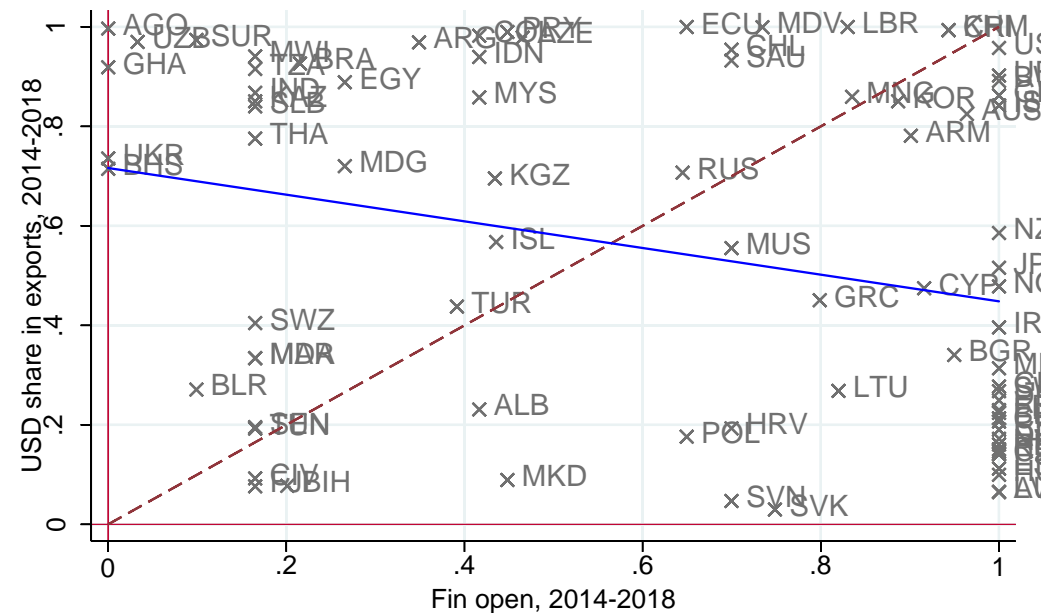
USD in Exp vs. FinDev. (left), USD in Exp vs. FinOpen. (right)



m_exp_usd
 y

 Fitted values

$$y = .733*** - .438***x \quad n = 86$$



m_exp_usd
 y

 Fitted values

$$y = .716*** - .268***x \quad n = 84$$



COMMENT 2:

Which currency zone and to what extent a country belongs may matter

- If a country tries to stabilize its exchange rate movements to the USD, it should tend to invoice its trade in the USD to minimize exchange rate risk

→ The extent of belonging to the USD zone matters for USD invoicing

- It is not just be the volume of trade with the key currency issuer that matters, but also the volume of trade with countries in a particular currency zone
- The size of trade with the USD zone is much bigger than that with the U.S.



Currency weights (i.e., the extent to which a country stabilizes its currency against a major currency) may matter

Frankel and Wei (1996) estimation

(Ito and Kawai, 2016, 2020; Ito and McCauley, 2020)

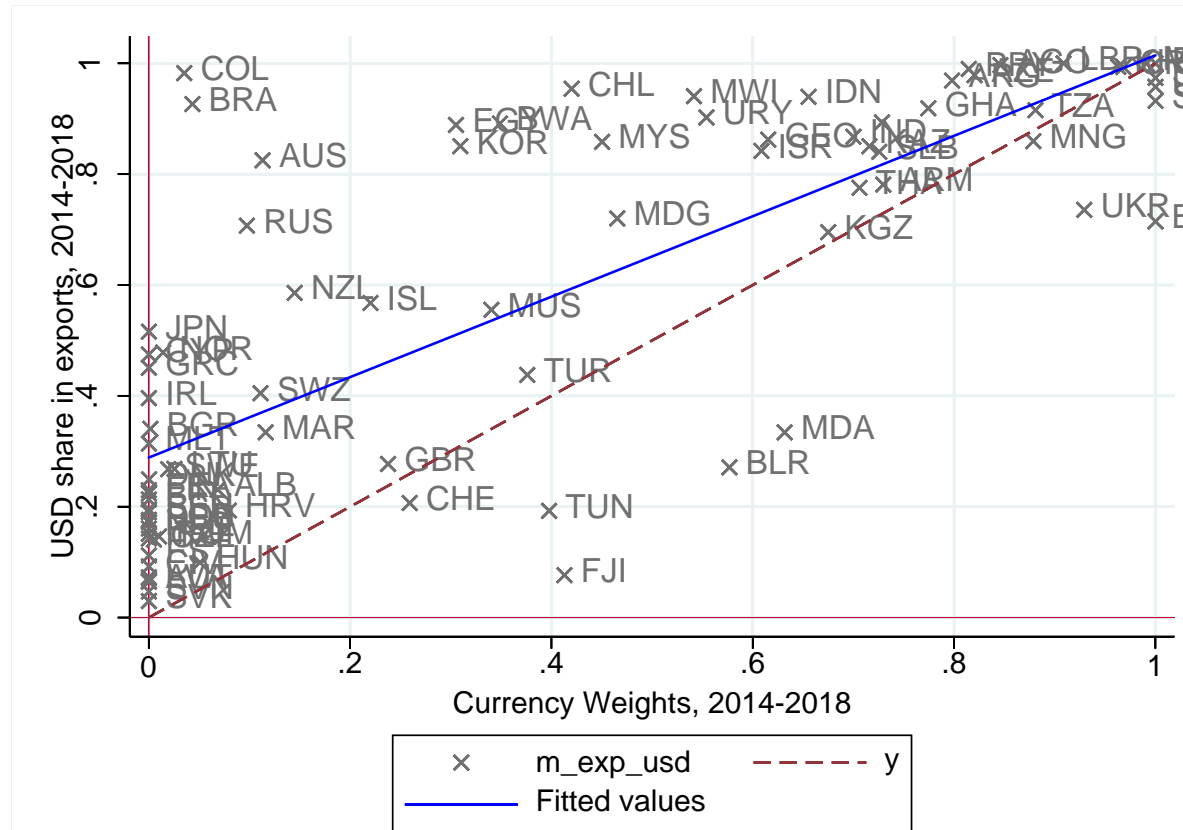
$$\Delta e_t^{i/\$} = \alpha_i + \beta_{i\text{€}t} \Delta e_t^{\text{€}/\$} + \beta_{i\text{¥}t} \Delta e_t^{\text{¥}/\$} + \varepsilon_{it}$$

$$\hat{\beta}_{i\$t} = 1 - (\hat{\beta}_{i\text{€}t} + \hat{\beta}_{i\text{¥}t})$$

- ❑ Assume an implicit currency basket composed of G3-currencies (USD, EURO, JPY).
- ❑ Estimated betas represent currency weights
- ❑ Applying the estimation model to each sample economy over rolling windows of 36 months gives the time-varying betas (i.e., currency weights)
- ❑ Their currency weights are set at the value of one.
- ❑ Each of the issuer countries of the major currencies constitutes its



USD EXPORT INVOICING IS HIGHER FOR COUNTRIES THAT STABILIZE THEIR CURRENCIES AGAINST USD



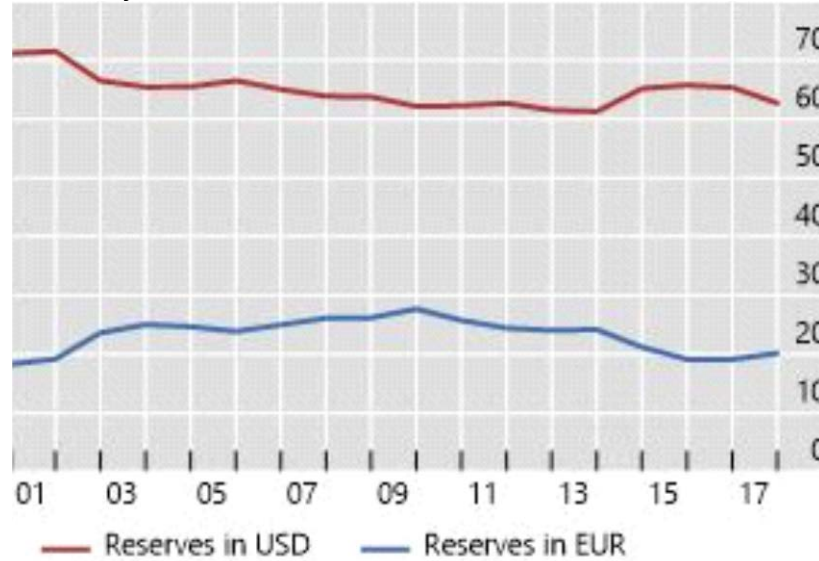
$$y = .289*** + .726***x \quad n = 86$$



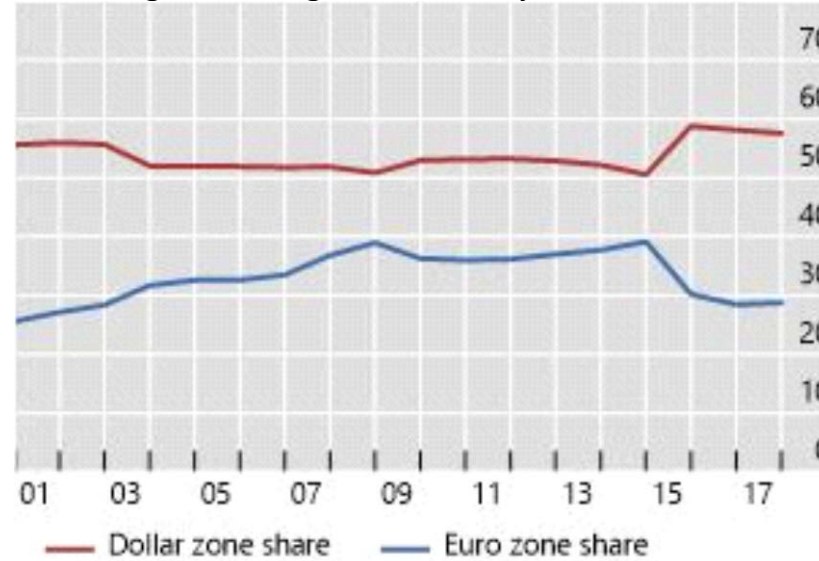
In per cent

Graph 1

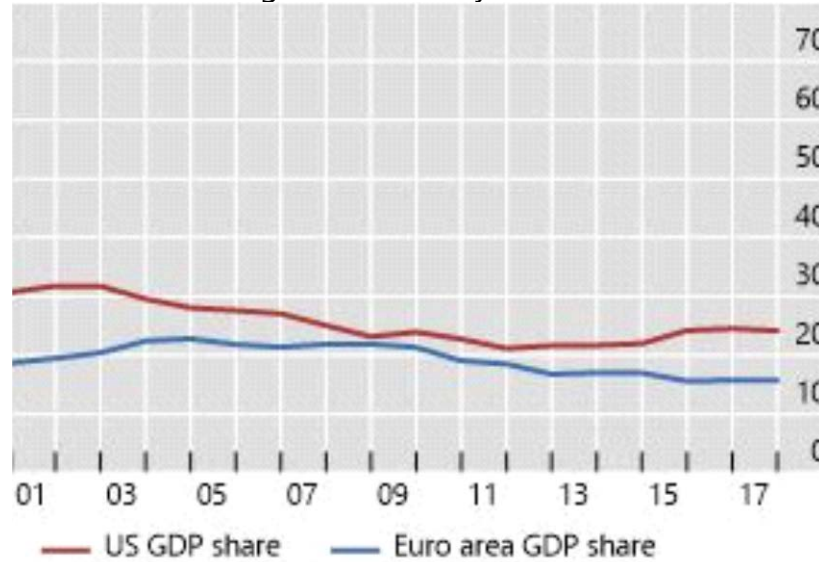
Currency shares in FX reserves



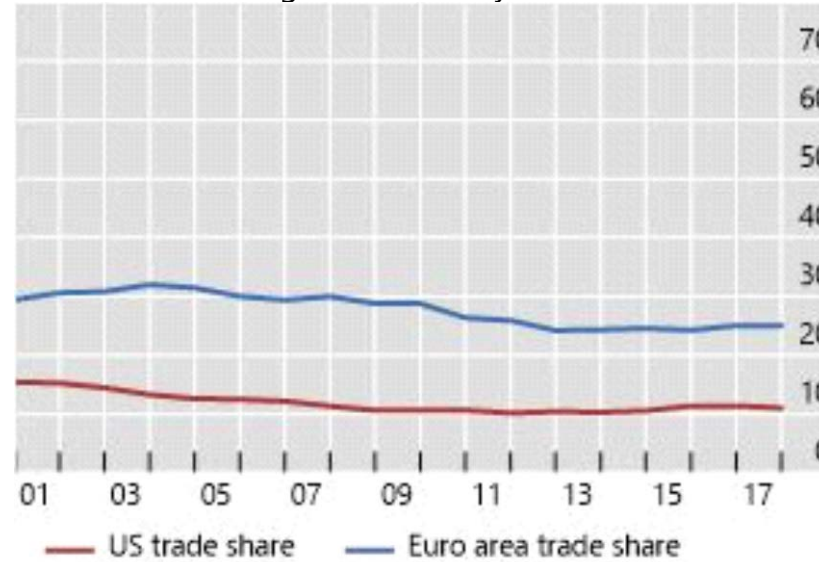
Zone weights in the global economy



GDP share in the global economy



Trade share in the global economy



Sources: IMF, *Currency Composition of Official Foreign Exchange Reserves (COFER)* and *International Financial Statistics*; World Bank, *World Development Indicators*; authors' calculations.



The volume of trade with G3-currency zones matters

- Test the share of trade with major currency zone h (USD, EUR, JPY)

$$SHARE_{hit} = \frac{\sum_j^J \beta_{jht} \cdot TRADE_{ijt}}{TRADE_{it}}$$

- When this exercise was done to the estimations of USD, JPY, and DM shares in trade invoicing in the 1970s and 1980s, a higher share of trade to the USD (DM) zone is positively (negatively) correlated with the USD share in invoicing
- A major currency tends to be used *less* as the



How about the effects of trade with G3-currency zones?

- This exercise can be applied to the RMB estimation as well
- The RMB share in trade invoicing must be high for countries like Brazil, Korea, Malaysia, and Thailand since these countries tend to stabilize their currency movements to those of the RMB. The share of trade in the RMB zone must be high for these economies
- The presence of large U.S. dollar zone countries (in Asia and other major trading partners) is an impediment to RMB internationalization



COMMENT 3:

The characteristics of policy initiatives for RMB internationalization have changed lately

- Focusing on RMB swaps *may* not capture PBOC's policy initiatives
- It is unknown how much of swap lines has been used. Very likely that it has not so much
- Geopolitics, trade war, economic sanctions, global financial instability, etc.



SINCE 2016 TILL RECENTLY, CHINESE AUTHORITIES STOPPED PUSHING FOR YUAN INTERNATIONALIZATION

- Mainly because of the market crash in 2016. Through large capital outflow, RMB depreciation, and Shanghai stock market crash, China lost \$700 B of FOREX reserves in 2016-17
- Chinese authorities imposed capital controls to stop bleeding
- The Trump protectionism and economic sanctions imposed by the U.S. due to China's handling of HK and Uighur issues rekindled the interest in RMB internationalization
- The govt of China is now interested in increasing the use of RMB outside China through introducing digital RMB and promoting The Belt and Road Initiative (BRI)
- The authors may need to try some other variables that capture policy changes (not just in China but also in ROW)



LAST REMARKS: AGAIN, IT IS NOT JUST ABOUT TRADE

- It would be better to incorporate the impact of financial-related factors
- It is unknown how much of Swap lines has been used. Very likely that it has not so much
- Estimate the determinants of the home currency share in invoicing. Then analyze what kind of implications you can get for the RMB

